



Financial Reporting Council

**Deloitte LLP**

**Audit Quality Inspection and Supervision**

July 2023

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# Introduction: FRC's objective of enhancing audit quality

The FRC is the Competent Authority for UK statutory audit, responsible for the regulation of UK statutory auditors and audit firms. We assess, via a fair evidence-based approach, whether firms are enhancing audit quality and are resilient. We adopt a forward-looking supervisory model and hold firms to account for changes needed to improve audit quality.

Auditors' opinions on financial statements play a vital role upholding trust and integrity in business. The FRC's objective is to achieve consistent high quality audits so that users have confidence in financial statements. To support this, we:

- Set ethical, auditing and assurance standards and guidance, as well as influence the development of global standards.
- Inspect the quality of audits performed by, and the systems of quality management of, firms that audit Public Interest Entities (PIEs<sup>1</sup>) and register auditors who carry out PIE audit work.
- Set eligibility criteria for auditors and oversee delegated regulatory tasks carried out by professional bodies such as qualification and the monitoring of non-PIE audits.
- Bring enforcement action against auditors for breaches of relevant requirements.

Since our July 2022 report we have delivered on a reform programme ahead of the Government response to restoring trust in audit and corporate governance, including:

- Taking responsibility for PIE auditor registration allowing us to impose conditions, suspensions and, in the most serious cases, remove registration of PIE auditors.
- Agreeing a memorandum of understanding with the Department for Levelling Up, Housing and Communities (DLUHC) setting out our responsibilities as shadow system leader for local audit.
- Updating [Our Approach to Audit Supervision](#), outlining the work of our supervision teams.
- Publishing a [Minimum Standard for Audit Committees and the External Audit](#) and consulting on revisions to the UK Corporate Governance Code.

Our 2023/24 transformation programme will demonstrate our continued commitment to the public interest and restoring trust in the audit profession.

The seven Tier 1 firm<sup>2</sup> reports provide an overview of key messages from our supervision and inspection work during the year ended 31 March 2023 (2022/23) and the firms' responses to our findings.

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<sup>1</sup> Public Interest Entity: in the UK, PIEs are defined in Section 494A of the Companies Act 2006 and in Regulation 2 of The Statutory Auditors and Third Country Auditors Regulations 2016.

<sup>2</sup> The seven Tier 1 firms in 2022/23 were: BDO LLP, Deloitte LLP, Ernst & Young LLP, Grant Thornton UK LLP, KPMG LLP, Mazars LLP, PricewaterhouseCoopers LLP. We have published a separate report for each of these seven firms along with a cross-firm overview report.

## Our supervisory approach

The audit supervisory teams in the FRC's Supervision Division work closely together to develop an overall view of the key issues for each firm to improve audit quality. We also collaborate to develop our plans for future supervision work.



## The supervisory staff producing our reports

The audit supervisory teams comprise 90 experienced professional and support staff assessing the risks to audit quality and resilience at each firm and the actions needed to address those risks.

90



## Deloitte LLP



### Audits within the FRC's inspection scope<sup>4</sup>

Inspection Cycle	FTSE 100 audits	FTSE 250 audits	Total audits in FRC scope
2023-24	23	40	307
2022-23	21	48	348
2021-22	21	50	344



### Corporate audits inspected by the FRC<sup>6</sup>



### Local audits<sup>7</sup>



<sup>3</sup> Source: The ICAEW's 2023 QAD report on the firm.

<sup>4</sup> Source: The FRC's analysis of the firm's PIE audits and other audits included within AQR scope as of 31 December 2022.

<sup>5</sup> Source: The FRC's 2021, 2022 and 2023 editions of Key Facts and Trends in the Accountancy Profession.

<sup>6</sup> Excludes the inspection of local audits.

<sup>7</sup> The FRC's inspections of Major Local Audits are published in a separate annual report. The October 2022 report can be found [here](#).

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This report sets out the FRC's findings on key matters relevant to audit quality at Deloitte LLP (Deloitte or the firm). As part of our 2022/23 inspection and supervision work, we reviewed a sample of individual audits and assessed elements of the firm's quality control systems.

The FRC focuses on the audit of PIEs. Our risk-based selection of audits for inspection focuses, for example, on entities: in a high risk sector; experiencing financial difficulties; or having material account balances with high estimation uncertainty. We also inspect a small number of non-PIE audits on a risk-based selection.

Entity management and those charged with governance can make an important contribution to a robust audit. A well-governed company, transparent reporting and effective internal controls all help underpin a high quality audit. While there is some shared responsibility throughout the ecosystem for the quality of audits we expect firms to achieve high quality audits regardless of any identified risk in relation to management, those charged with governance or the entity's financial reporting systems and controls.

Higher risk audits are inherently more challenging, requiring audit teams to assess and conclude on complex and judgemental issues (for example, future cash flows underpinning impairment and going concern assessments). Professional scepticism and rigorous challenge of management are especially important in such audits. Our increasing focus on higher risk audits means that our findings may not be representative of audit quality across a firm's entire audit portfolio or on a year-by-year basis. Our forward-looking supervision work provides a holistic picture of the firm's approach to audit quality and the development of its audit quality initiatives.

This report also considers other, wider measures of audit quality. The Quality Assurance Department (QAD) of the Institute of Chartered Accountants in England and Wales (ICAEW) inspects a sample of the firm's non-PIE audits. The firm also conducts internal quality reviews. A summary of the firm's internal quality review results is included in the Appendix.

# 1. Overview

## Overall assessment

In the 2021/22 public report, we concluded that the firm had continued to show improvement in relation to its audit execution and firm-wide procedures.

82% of audits inspected were found to require no more than limited improvements. None of the audits we inspected this year were found to require significant improvements and 82% required no more than limited improvements, the same as last year. This was the case for 78% of FTSE 350 audits (91% last year). The firm has maintained its focus on audit quality on individual audits, with consistent FRC inspection results.

The areas of the audit that contributed most to the audits assessed as requiring improvements were revenue and margin recognition, and provisions. There continues to be findings related to the audit of provisions, which was a key finding last year, although in different areas of provisioning. At the same time, we identified a range of good practice in these and other areas.

Following actions by the firm, the extent of themes across FRC inspections has reduced, with improvements in group audits, as well as independence matters and the involvement of the Engagement Quality Control Review (EQCR) reviewer on audits.

The results from other measures of audit quality, covering a broader population and a larger sample of audits, also show consistent improvements. The results from the Quality Assurance Department of the ICAEW set out on pages 23 and 24, which is weighted towards higher risk and complex non-PIE entities within ICAEW scope, assessed 100% of the audits it inspected as good or generally acceptable. Good practices were identified in a number of areas including risk assessment procedures and use of specialists in complex areas. Over a similar period, the firm's internal quality monitoring process (covering both PIE and non-PIE audits) assessed 88% of audits as meeting its highest quality standard (see page 42).

The firm has continued to invest in its resources, culture and in embedding the Continuous Improvement Group.

In response to this year's findings, we will take the following actions:

- Maintain the reduced number of audits inspected at Deloitte in proportion to the number of audits in scope compared with other Tier 1 firms.
- Continue to assess the remit and effectiveness of the Continuous Improvement Group.



# 82%

of audits inspected were found to require no more than limited



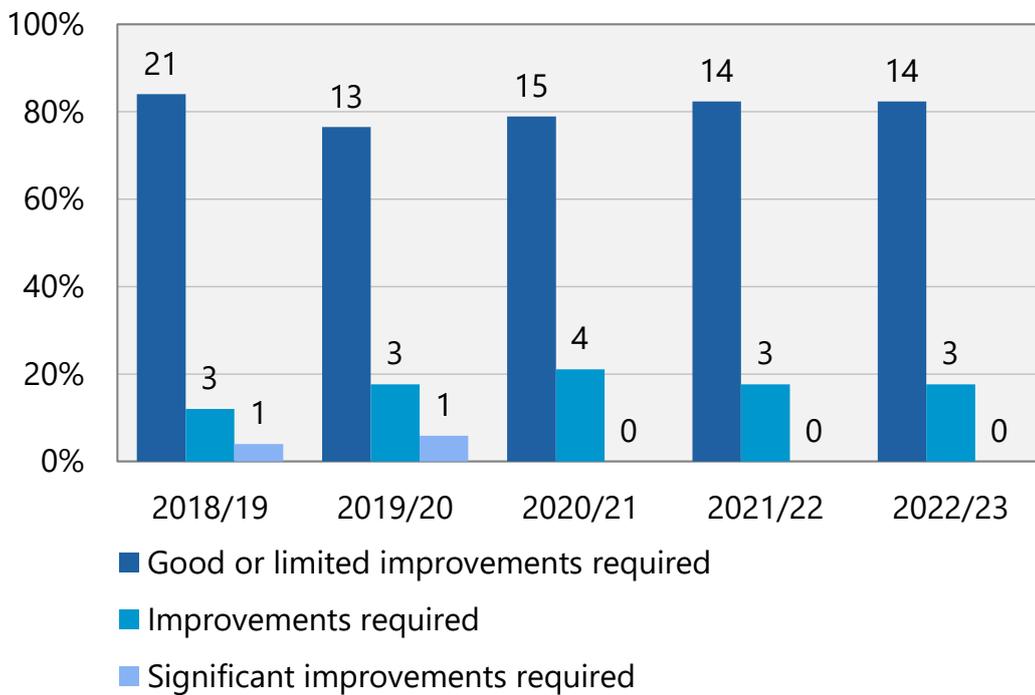
No audits inspected in the current cycle required significant improvements.

- Continue to assess and challenge the firm on its audit culture and the role audit specific behaviours and mindset have in delivering high quality audits.
- Work with the firm to further develop the Single Quality Plan process, subject to formal reporting and regular review by the FRC.

### Inspection results: arising from our review of individual audits

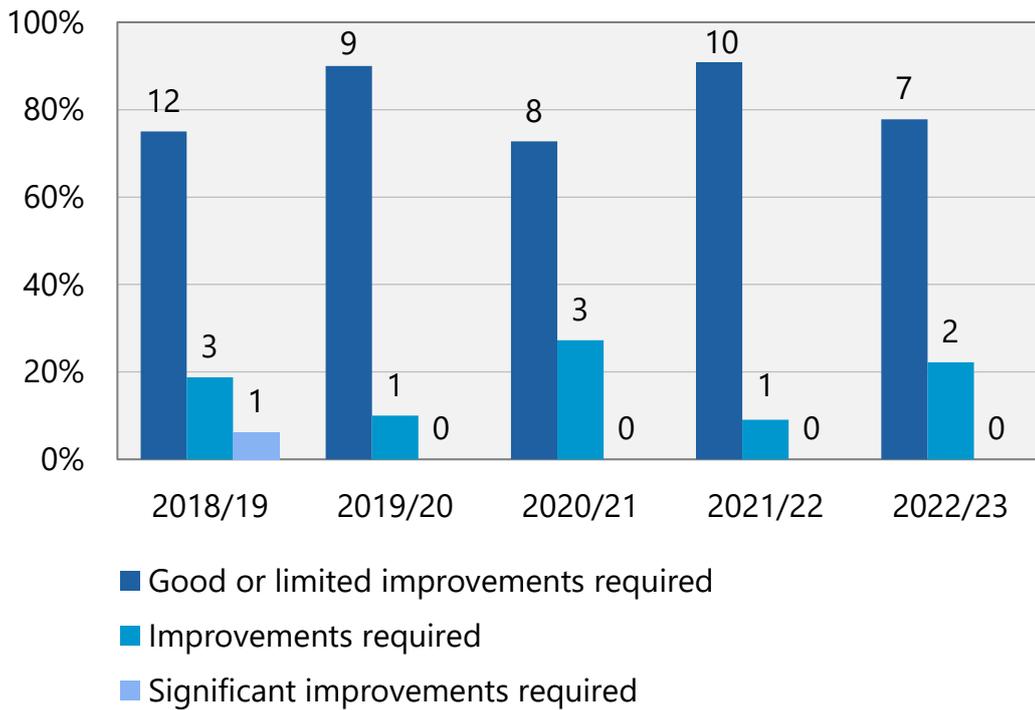
We reviewed 17 individual audits this year and assessed 14 (82%) as requiring no more than limited improvements. Of the nine FTSE 350 audits we reviewed this year, we assessed seven (78%) as achieving this standard.

#### Our assessment of the quality of audits reviewed: Deloitte LLP



**All firms are required to include actions within a Single Quality Plan, subject to formal reporting and regular review by the FRC.**

## FTSE 350: Deloitte LLP



The audits inspected in the 2022/23 cycle included above had year ends ranging from June 2021 to April 2022.

Changes to the proportion of audits falling within each category reflect a wide range of factors, including the size, complexity and risk of the audits selected for inspection and the individual inspection scope. Our inspections are also informed by the priority sectors and areas of focus as set out in the Tier 1 Overview Report. For these reasons, and given the sample sizes involved, changes from one year to the next cannot, on their own, be relied upon to provide a complete picture of a firm's performance and are not necessarily indicative of any overall change in audit quality at the firm.

Any inspection cycle with audits requiring more than limited improvements is a cause for concern and indicates the need for a firm to take action to achieve the necessary improvements.

Our key findings related to the audit of revenue and margin recognition, cash equivalents and cash flow statements, certain provisions and impairment reversals.

We identified a range of good practice related to risk assessment, the execution of the audit and completion and reporting.

Further details are set out in section 2.



**Our key findings on the individual audits included the audit of revenue and margin recognition, cash equivalents and cash flow statements and certain provisions.**

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## Inspection results: arising from our review of the firm's quality control procedures

This year, our firm-wide work focused primarily on evaluating the firm's: actions to implement the FRC's Revised Ethical Standard; partner and staff matters; acceptance, continuance, and resignation procedures; and audit methodology relating to settlement and clearing processes.

Our key findings related to compliance with the FRC's Revised Ethical Standard, timely continuance procedures, and audit methodology relating to settlement and clearing processes.

We identified good practice points in the areas of compliance with the FRC's Revised Ethical Standard, partner and staff matters, and acceptance, continuance and resignation procedures.

Further details are set out in section 3.

### Forward-looking supervision

The firm has continued to communicate the importance of audit quality and continuous improvement and shares emerging issues and good practices on a real time basis. There is consistent sharing of experiences throughout the audit practice, which reinforces audit quality messages. However, there is more to do on embedding audit specific behaviours, that are aligned to the public interest, within the firm's audit culture.

The firm has developed its Single Quality Plan (SQP) process to identify eight priority areas that are central to sustaining high quality audits. The firm must ensure that its SQP priorities are periodically reassessed, continue to improve its SQP analysis, and embed and review effectiveness measures identified for each SQP priority.

The Continuous Improvement Group (CIG), which has the responsibility for identifying and implementing an appropriate response to consistent and recurring findings, is now in place. Whilst functionally CIG has added value through review and challenge, its focus has been on the progress made in respect of non-financial sanctions and on the implementation of the SQP. CIG must continue to broaden its oversight of remedial actions to ensure it has a more holistic view.

Deloitte's Root Cause Analysis (RCA) process and the RCA team is well established. There have been continued refinements in the year, including improvements in the causal factor descriptors in the global taxonomy, which assists in more accurately identifying the underlying root cause, and expanded coverage of types of prior period adjustment.



With respect to quality control procedures, our key findings related to compliance with the FRC's Revised Ethical Standard, timely continuance procedures, and audit methodology relating to settlement and clearing processes.



The firm has continued to invest in quality initiatives and continuous improvement.

The firm reduced its central quality monitoring (Internal Quality Monitoring and In-flight Reviews) activity this year. Going forward, the firm must ensure it maintains the number of these types of reviews it performs.

Further details are set out in section 4.

## Firm's overall response and actions



### Introduction

Audit quality is at the heart of everything we do. Within Audit & Assurance, we are committed to acting with the highest levels of integrity in the public interest to deliver confidence and trust in business. In that context, our inspection results for our audits selected by the FRC as part of the 2022/23 inspection cycle remain consistent year-on-year, with 82% of all inspections in the cycle assessed as good or needing limited improvement. This reflects the ongoing investment we continue to make in audit quality, with a relentless focus on continuous improvement. Our audit culture and the audit quality environment we create are critical to our resilience and reputation as a business and we remain committed to our role in protecting the public interest and creating pride in our profession.

We value the observations raised by both the FRC AQR and Supervision teams, both in identifying areas for improvement and also the increasing focus on sharing good practice to drive further and continuous improvement.

### Our audit and assurance business strategy

Audit quality continues to play a fundamental role in our evolution by shaping our vision of the business we want to be, driving our priorities and defining our successes. Put simply, our strategy is about getting better at how we organise ourselves, how we develop and deploy our talent, how we shape our culture and how we strengthen our resilience to deliver high quality outcomes in the public interest. Our strategy execution framework sets out the measurable steps – our 16 strategic objectives – that we are taking to deliver our strategy across our 4 areas of focus: quality, people, resilience and transformation. Achieving these strategic objectives means we will succeed in our aspirations; to be leaders in quality, to be the number one choice for talent, to continue to strengthen our financial and operational resilience in a ringfenced world, as well as to enhance our business' agility to fulfil our purpose of protecting the public interest and building trust and confidence in business.

Audit quality underpins our entire strategy, and we focus on 8 key areas of improvement across our 16 strategic objectives to drive high quality outcomes: audit culture, the audit quality environment, our talent experience, governance, audit methodology, training, technology and innovation. Together, our strategy execution framework, Audit Quality plan (AQP) and Single Quality Plan (SQP) help us design, prioritise and drive changes in the business to realise strategic benefits and our audit quality ambitions. We determine in-year strategic priorities to speed up seeing the results of our strategy; identifying three to four of our strategic objectives for increased focus and investment to create momentum and acceleration. For FY23, these were focused on our strategic objectives related to building and upholding a purpose-led culture focused on delivering the highest audit quality, assessing emerging issues and risks, winning the race for talent and delivering a resilient audit portfolio. We believe there is real benefit in continuing with the same strategic priorities for another year to enable us to build on our successes and drive even further progress.

The audit culture and the audit quality environment we create is critical to our resilience and reputation as a business. On 1 June 2021, the majority of our Audit & Assurance business was operationally separated from the rest of our UK firm and since then, we have been operating as a fully transparent business, independently governed by the Audit Governance Board (AGB) with an enhanced focus on delivering high quality audits in the public interest. The first two years of our transition period to full operational separation has seen us become an even stronger business: for the first time in our history our business is now over 6,000 people strong, which is a positive reflection of our ability to attract, develop and retain talent. We believe our structure is aligned to better serve our purpose and are committed to the importance and strength of our multi-disciplinary model.

### **Single Quality Plan (SQP)**

The development of our SQP has been a key focus area during the year and seeks to drive measurable improvements in audit quality. Our SQP aims to prioritise and measure progress in specific identified areas that we consider are most critical to achieving our stated audit quality ambition. We have identified a number of priority areas, with each priority area having an A&A Executive sponsor, identified KPIs to measure progress and means of measuring the effectiveness of key actions which we continue to refine. Wider actions are tracked within our Audit Quality plan (AQP) and any high priority actions also reported in the SQP. Our recently developed SQP tool is also now in place and enables effective analysis of the detailed actions contained within the SQP and AQP, which allows for real-time monitoring and provides a holistic overview of audit quality initiatives. Our Independent Non-Executives (INEs) have oversight over the SQP through regular Audit

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Governance Board (AGB) reporting as well as direct access to the SQP tool to aid ongoing oversight. We are committed to continuing to develop the SQP by further strengthening the focus and prioritisation of key initiatives and responding to further feedback from the FRC.

### **Audit culture**

The culture and values of our firm drive the behaviours of our people and are a significant contributor to audit quality and therefore critical at every level, from our leadership through to our newest joiners. We highlighted last year our culture journey and following the review by our Risk Advisory practice we have identified the areas we need to focus on to drive us towards our Cultural Ambition. Professional scepticism and culture of challenge are priority areas in our Single Quality Plan.

In January 2023, we appointed a partner to the Audit & Assurance (A&A) Executive in a newly created role of A&A Culture Lead. This role has brought further focus and momentum as we continue to build and nurture our purpose-led culture. Our Cultural Ambition is that *we include everyone; we challenge and we rise to the challenge; and that we do the right thing, always*. Following engagement with people across the breadth of our A&A practice and wider stakeholders, we have now developed a set of aligned A&A behaviours, which build on our global shared values to bring our Cultural Ambition to life. These behaviours reflect our shared purpose, our inclusive nature, the standards we uphold and the pride in what we do as an Audit & Assurance practice. We want our people to be proud of our role in protecting the public interest and that what we do matters. Our main annual technical training programme this summer is designed around our Cultural Ambition and these A&A behaviours. The behaviours are also incorporated into our performance management process from 1 June 2023 through our balanced scorecards and objective setting process.

As we strive to embed our aligned A&A behaviours into everything that we do, including our learning and development and reward and recognition structures, understanding where we are on our journey to achieving our stated Cultural Ambition is paramount. We are currently designing our approach for culture measurement and monitoring which will be used to assess our progress towards our desired Cultural Ambition and inform decisions we make as a practice to continue to drive consistently high quality audit work.

## Continuous improvement and root cause analysis

We are pleased to see the positive impact of actions taken over the last 12-18 months to address findings raised by the FRC in the prior year relating to EQCR, Independence & Ethics and Group Audits, with none of these areas identified as key findings in this year's engagement inspection cycle. The consistency of our work in evaluating the work of component auditors by the group audit team has been an SQP priority area over the last year. The reduction in findings in this area reflects the ongoing effectiveness of the actions taken, particularly the successful rollout of our group audit coaching programme. Our EQCR transformation programme, which commenced in the second half of 2021, has served to further enhance the effectiveness of our EQCR process and led to improved evidence on our audit files demonstrating the EQCR challenge.

We welcome the breadth and depth of good practice points raised by the FRC, particularly in respect of effective group oversight and effective procedures for impairments, where we have made sustained efforts and investment to drive consistency and high quality execution.

We have performed root cause analysis for all findings across all FRC inspections, including areas of good practice. A wider root cause analysis across external inspection findings and other quality events has also been performed. Pleasingly, the measures we have taken over the last 12 months to improve the effectiveness and efficiency of our resourcing model mean that the workload and capacity challenges evident last year due to resource pressures and extended timetables due to COVID 19 have eased and are no longer a root cause of adverse inspection results.

Our root cause analysis identified the following factors which contributed to findings and inspection outcomes:

1. **Leadership direction, supervision and review:** Engagements where leadership demonstrated early and regular involvement throughout the audit in their review and collaboration with the wider team, including active discussion of approach and issues, led to the execution of higher quality audit work. Conversely, instances where coaching was limited or the senior team members had prioritised their review on other areas considered higher risk, the depth of review of a particular area contributed to lower quality audit work.

2. **Technical skills and knowledge:** There were instances where a lack of understanding of the application of methodology or technical guidance, particularly where staff were new experienced hires or were working on the area for the first time, led to weaker quality execution of testing. Where active discussion of audit approach was identified involving partners and directors, high quality outcomes were more evident.
3. **Mindset and critical thinking, including reliance on prior knowledge:** The mindset to ensure that assumed or previous knowledge of accounting judgements or conclusions, including from prior audits, is captured to evidence the judgements and conclusions reached, including appropriate reconsideration where there may have been changes, is critical to achieving a robust and high quality audit. Instances where teams relied on assumed knowledge from previous audits, information obtained at an interim date or through discussion with management led to poorer quality outcomes. This also led to weaknesses in the evidence of audit challenge. We also observed that where the audit team interact regularly and share relevant knowledge with specialist teams, and vice versa, including the timely follow up on matters raised in specialist reporting we see higher quality audit work. Conversely, where relevant prior knowledge is not shared on a timely basis between the audit team and specialists this led to lower quality outcomes which included insufficient challenge and a lack of critical thinking where specialist conclusions indicated additional follow up or additional procedures may be required.
4. **Audit response to the quality of management information:** On audits where there was strong project management of both the audit process and entity management to ensure the timely provision of good quality information this contributed to a higher quality audit. Where there were weaknesses in the project management and the audit response to poor quality management information or late delivery, there were often lower audit quality outcomes and an overreliance on prior knowledge.

In response to FRC recommendations and in order to address recurring findings and root causes, the firm established its Continuous Improvement Group (CIG) on 1 June 2022 alongside an Actions Development Group (ADG) in the second half of 2022. The ADG, comprising workstream leaders from across the business, has formalised our process for developing actions and facilitated more timely response to emerging areas of focus.

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Since its inception, CIG has focused on reviewing and challenging audit quality actions developed by ADG, reviewing and challenging the Single Quality Plan and reviewing progress made in respect of actions taken in respect to the FRC's Annual Supervisor Letter and actions associated with non-financial sanctions.

During 2023 CIG has established a schedule of regular meetings with: members of the AGB; the UK Managing Partner Quality Risk and Security; the Managing Partner, Audit & Assurance; the NSE Monitoring and Remediation Partner; and the NAA Risk & Regulation team to ensure they have a holistic view. CIG also now receive all the monthly management information used by the UK Audit & Assurance Executive.

CIG has also been heavily involved in reviewing and challenging responses to the 2022/2023 inspection cycle, including detailed review of RCAs, meeting with inspection support teams and ensuring that actions developed (which are summarised below) are clearly responsive to the findings and root cause analysis. CIG will continue to review and challenge the actions taken in response to investigations, case matters and other contentious matters, as well as key and thematic findings from both internal and external inspections.

CIG will also review, monitor and challenge the SQP, challenging whether key remedial actions are given sufficient priority and performing a rolling review of the high priority areas identified in the SQP.

A self-evaluation of the effectiveness of CIG and ADG will be conducted every two years, with the first self-assessment scheduled for Autumn 2023.

### **Key findings**

We have reflected on each of the key findings arising on individual audits and, following an assessment of the root cause themes arising and actions already taken during the inspection cycle in these areas, determined where further action is required. All findings have also been communicated in our monthly partner and director briefings on areas of regulatory focus. Actions are incorporated and monitored through the Audit Quality Plan (AQP) and, where deemed necessary, as priority focus areas within the SQP.

## **1. Revenue**

In response to the inspection findings and the primary root causes relating to technical skills and the application of methodology together with assumed knowledge impacting critical thinking and the effectiveness of direction, supervision and review, we have appointed a partner to develop a revenue centre of excellence. The approach which is being developed will involve experienced partners and directors within Audit covering a variety of industries. The involvement of the centre of excellence will focus on the overall approach to revenue testing, including an end-to-end view of revenue, the risk assessment, planned controls and IT and substantive work and will take place during the key stages of the risk assessment, planning and execution stages of an audit. We intend on using best practice examples identified in inspections alongside the root cause analysis we have performed to drive continuous audit quality enhancements in this area.

## **2. Cash equivalents and cash flow statements**

We took action early during the inspection cycle in order to respond to the findings identified and primary root causes relating to direction, supervision and review and technical skills and knowledge. Our actions focused on clarifying existing guidance, upskilling and coaching less experienced team members and ensuring that appropriate focus was given to the review of the audit work performed on cash and cash equivalents by more experienced members of the engagement team.

## **3. Provisions**

This is often a judgemental and complex area of an audit, and we acknowledge that findings were raised in this area in both the current and previous inspection cycle. We see the nature of the findings as varied within and between the inspection cycles, and in many cases relate to entity specific areas, or to certain specific aspects of a provision. We have seen examples of findings arising in lower risk balances or assertions and therefore our focus has been on reiterating the importance of evidencing challenge and stand back assessments across all material provisions, regardless of risk assessment.

We are pleased to see examples of good practice highlighted by the FRC for our robust procedures over provisions. We have seen improvements in our work in this area, particularly where a significant risk has been identified, which reflect the positive impact of previous actions taken to address identified root causes. The actions we have taken this year, reflect our drive for consistency in execution, particularly where balances have been identified as lower risk.

Our annual technical training in summer 2022 included specific content on the audit of complex estimates and provisions and we expect to see the positive impact of this in future inspection cycles. We have also issued new templates and support guidance and highlighted common 'assumed knowledge' pitfalls in relation to management estimates in our weekly technical update. To further address the mindset and critical thinking root causes, our 2023 Summer Technical Training will also include a focus on the *Experienced Auditor Mindset* to support our people in ensuring that audit evidence captures the story of the audit process and challenge therein.

In addition, we are currently in the pilot deployment phase of our new cloud-based audit platform. This new platform will serve to further support our people to consistently deliver high quality audits, bringing together new technology, content and guidance and driving greater standardisation and consistency in the work that we perform across our audits.

#### **4. Impairment reversals**

We are pleased that the actions taken over recent years to address previous impairment findings continue to be effective and welcome the good practice identified by the FRC in this area. The findings in the current year were specific to impairment reversals and we have taken action in the year to address these, including the release of a specific bitesize learning on impairment reversals to support technical skills.

#### **Independence and ethics**

We remain committed to continuing to embed and monitor compliance with the Revised Ethical Standard and welcome the ongoing open and constructive dialogue with the FRC on matters relating to Independence & Ethics. We are pleased that there was no reoccurrence of the prior year independence related findings on individual inspections this year.

We continue to enhance our policies and guidance so as to improve practitioners understanding of the application of the Revised Ethical Standard. In respect of the appropriate assurance that network firms are obtaining approvals from UK audit partners we are committed to undertaking further monitoring to confirm adherence with our existing policies and to further validate that the existing controls that we have in place continue to be sufficient and effective. We have also developed a new UK long association rotation policy in the year applicable to FRC PIEs, Market Traded Companies (MTCs) and other listed entities, to further mitigate the familiarity threat arising from long association. This policy, which caps the extent of involvement of any individual to a maximum of seven years and therefore goes beyond the technical requirements of the Revised Ethical Standard, will allow for a phased team rotation and compliance and effectiveness will be monitored.

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## **Central internal quality monitoring**

Whilst the number of in-flight reviews captured as part of our formal internal quality monitoring programme has not increased, there are also a large number of in-flight activities conducted in addition to these. We have made a focused effort to expand these over recent years, particularly in adopting a 'centre of excellence' approach in a number of areas, which we believe have a direct, positive impact on audit quality. In addition to our EQCR and Professional Standards Reviews (PSR), these include, but are not limited to, consultations and in-flight reviews performed by our Credit Centre of Excellence, Impairment specialists, Quality Corporate Reporting Centre of Excellence, Climate Specialists, Group Audit coaches, Much Greater Than Normal Risk programme team, National Risk Partner programme team and specialist challenge panels.

Our intention, nevertheless, is to increase the number of formal in-flight reviews over the coming years and refocus our in-flight reviews to capture a broader spectrum of our portfolio within our overall in-flight programme.

## **Conclusion**

We are proud of what our teams have achieved over the last twelve months and are committed to continuously and relentlessly raising the standards of audit quality. Our focus remains on building a business that is resilient and fit for the future, through continued investment in our people, systems and technology. Our Audit & Assurance business plays a critical role in driving confidence and trust in business, with audit quality central to this. Looking ahead, we will continue to build and nurture our culture as we seek to move closer to our Cultural Ambition and foster an inclusive environment where our people take pride in the work that they do to deliver high quality audits.

## 2. Review of individual audits

We set out below the key areas where we believe improvements in audit quality are required. As well as findings on audits assessed as requiring improvements or significant improvements, where applicable, the key findings can include those on individual audits assessed as requiring limited improvements but are considered a key finding in this report due to the extent of occurrence across the audits we inspected.

### Improve the effectiveness of the testing of revenue and margin recognition

Revenue is a key driver of operating results and a key performance indicator on which investors and other users of the financial statements focus. Auditors should obtain sufficient and appropriate audit evidence to assess whether revenue is accurately recognised in the financial statements.

#### Key findings



We reviewed the audit of revenue on the majority of audits and raised findings on seven of them, including two assessed as requiring improvements:

- **Revenue and margin recognition on long term contracts:** On one audit, the audit team did not perform adequate substantive analytical and other procedures over margin forecasts. This included inadequate justification of the basis of the expectation, insufficient challenge and corroboration of outliers identified in the analytical procedures and inadequate justification of the sampling approach used in the substantive testing.
- **Response to privilege user access risks:** On another audit, the audit team performed insufficient procedures to address an identified privilege user access risk and therefore did not adequately respond to the risk of fraud relating to revenue recognition. The audit procedures were not adequately designed to identify whether any changes to certain underlying data had been made.
- **Reliance on Information Prepared by the Entity (IPE) and revenue testing:** On four audits, certain information provided by the entity (such as internal reports) was not adequately tested. For three of these audits, there was insufficient evidence that the audit team had verified that certain types of revenue transactions had occurred. On two of those audits, the audit team did not adequately consider whether certain controls relied upon were adequately designed. For one other audit, the audit team did not obtain all relevant Service Organisation Controls (SOC) reports to support a web-based platform.



**We reviewed the audit of revenue on the majority of audits and raised findings on seven of them.**

## Improve the audit of cash equivalents and cash flow statements

Cash equivalents include short-term deposits with maturity dates of three months or less. External bank confirmations of these balances provide audit evidence that the deposits and related disclosures are independently verified. Auditing Standards state that, where external bank confirmations are not received, alternative audit procedures should be performed to obtain relevant and reliable audit evidence.

### Key findings



We reviewed the audit of cash and cash equivalents or cash flow statements on all audits inspected and raised findings on six of them.

- **Confirmation of cash equivalents:** On three audits, the audit teams did not seek external confirmations for certain short-term deposit accounts and instead performed alternative audit procedures, which were not sufficient. On one of those audits, the group audit team also did not adequately justify how sufficient audit evidence was obtained for the cash balances relating to out-of-scope components; while none of these balances were individually material, they were material in aggregate.
- **Disclosure of cash equivalents:** For one audit, there were insufficient audit procedures to verify the accuracy of the short-term deposit disclosure and whether these adequately reflected the different notice periods required by the bank. On another audit, the audit team did not adequately assess whether the classification of certain accounts as cash equivalents was correct.
- **Cash flow misclassifications:** For one audit, there was insufficient evidence obtained for the classification of certain elements of the cash flow statement, which resulted in a misstatement between financing and operating cash flows not being identified.



**We reviewed the audit of cash or cash flow statements on all audits inspected and raised findings on six of them.**

## Improve the consistency of the audit of estimates for certain provisions

Provisions often involve estimation uncertainty and rely on the assumptions and judgement of management. Auditors are expected to adequately assess and challenge management's judgements relating to estimates and perform appropriate procedures to respond to the relevant risks.

### Key findings



We raised findings on the audit of provisions on four of those audits, including one assessed as requiring improvements.

- **Restoration provision:** On one audit, the audit team did not obtain sufficient appropriate audit evidence for a restoration provision. There was insufficient challenge of the appropriateness of the calculation basis supporting the restoration provision and over the data sources used.
- **Property related provisions:** On one audit, the audit team did not reassess the appropriateness of the provision at the year end to reflect any additional information or changes since the previous formal assessment. On another audit, a look-back test was not performed to evaluate whether management's estimation technique for customer refunds was appropriate.
- **Expected Credit Loss (ECL) provisions:** For one audit, there were insufficient audit procedures performed in relation to aspects of the assessment and testing of significant increases in credit risk (SICR) and ECL models.

This was also identified as a key finding last year, although relating to different types of provisions. As we continue to identify inconsistencies, both findings and good practice, the firm must continue to consider the effectiveness of its actions relating to the audit of provisions.



**The firm must continue to consider the effectiveness of its actions relating to the audit of provisions.**

## Enhance the assessment of impairment reversals

The evaluation of management's impairment assessment often involves significant judgement, including the estimation of future cash flows. The circumstances that led to an impairment can change, resulting in an impairment reversal, for example as a result of market conditions or management's actions to remediate the situation. Auditors should challenge and corroborate management's basis for the revised recoverable amount.

### Key findings



We reviewed the audit over the valuation and impairment of assets, including both tangible and intangible assets, on all audits we inspected where this was identified as an area of significant risk.

### Impairment reversals

We raised the following findings:

- On one audit, insufficient audit procedures were performed to support the fair value and recoverable amount of a building, and therefore the validity and accuracy of the impairment reversal.
- On another audit, the audit team did not adequately evidence its evaluation or challenge over the impairment reversals recognised in the year. There was a lack of consideration of the magnitude of the reversals in comparison to previously recognised impairments and the reasonableness of certain inputs.



**We raised findings in respect of impairment reversals on two audits inspected.**



We identified examples of good practice in the audits we reviewed, including the following:

### Risk assessment and planning

The risk assessment and planning phase of an audit is important to ensure a timely and appropriate risk assessment, enabling the audit team to tailor an effective audit approach responding to those risks.

- **Effective climate risk assessment:** For three audits, an independent risk assessment of climate change was performed and mapped to the relevant financial statement line items. For one further audit, the auditor's report included a section that detailed the considerations of climate-related risks and their impact on the financial statements.
- **Robust fraud risk assessment:** For one audit, forensic specialists were engaged to develop an enhanced fraud risk assessment and appropriate responses. On another audit, the audit team adopted the firm's updated templates early to demonstrate the entity-specific response to fraud risks. For a third audit, the audit team performed a detailed stand-back analysis of the aggregate population of untested journal entries that met pre-set risk criteria.
- **Effective consultation for continuance assessment:** For a high risk audit, there were ongoing meetings and consultations with a designated central partner throughout the audit, resulting from the continuance assessment. A detailed tracker was maintained of the matters raised and how to incorporate suggestions into the audit approach.

### Execution

The execution of an audit plan needs to be individually tailored to the facts and circumstances of the audit.

- **Effective group oversight:** In three cases, the group audit team engaged well with component auditors through interactive planning and clear group audit instructions. There was also a detailed log of the challenges put to the component auditors and how these were resolved.
- **Thorough data analytic procedures for revenue:** On two audits the data analytical procedures enhanced the effectiveness of assurance over the completeness and accuracy of revenue.



Good practice examples included effective group oversight and robust procedures over provisions, impairment and valuations, revenue and bank reconciliations

- **Robust procedures over provisions:** For two audits the audit teams engaged specialists to assist in scoping and risk assessment over actuarial reserves and expected credit losses. This ensured an effective examination of inputs to the respective provision models. On one audit the audit team robustly challenged management's judgements in relation to the expected credit loss provision. On another audit, the audit team held a specialist panel to establish the reasonableness of providing for legal claims and demonstrated effective challenge to management which resulted in enhanced disclosures.
- **Effective procedures for impairments and valuations:** On three audits there was robust challenge and assessment of inputs into an impairment model. Also, specialists were used to effectively assess management's inputs into a financial derivatives valuation model on one audit and into the valuation of pension assets for another audit.
- **Effective procedures over bank reconciliations:** On one audit, the team performed a stand-back analysis and critical evaluation of the nature and type of each reconciling item for in scope component bank reconciliations. This assisted in addressing the risk of fraud and error.

### Completion and reporting

The completion and reporting phase of an audit is an opportunity to stand back and assess the level of work performed against the audit plan and ensure that the reporting of the outcome of the audit is appropriate and timely.

- **Effective reporting to Audit Committees:** The reports to the Audit Committee on three audits were of a particularly high standard and aided effective communication. These included effective use of a dashboard for significant risks. For one of these audits, the audit team reported on shared engagement level Audit Quality Indicators, that set out the areas which the audit partner and Audit Committee Chair found to be particularly important in delivering a high quality audit.

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## Monitoring review by the Quality Assurance Department of ICAEW

The firm is subject to independent monitoring by ICAEW. ICAEW undertakes its reviews under delegation from the FRC as the Competent Authority. ICAEW reviews audits outside the FRC's population of retained audits, and accordingly its work covers private companies, smaller AIM listed companies, charities and pension schemes. ICAEW does not undertake work on the firm's firm-wide controls as it places reliance on the work performed by the FRC, except for review of continuing professional development (CPD) records for a sample of the firm's staff involved in audit work within ICAEW remit.

ICAEW reviews are designed to form an overall view of the quality of the audit. ICAEW assesses these audits as 'good', 'generally acceptable', 'improvement required' or 'significant improvement required'. Files are selected to cover a broad cross-section of entities audited by the firm and the selection is focused towards higher risk and potentially complex audits within the scope of ICAEW review.

ICAEW has completed its 2022 monitoring review and the report summarising the audit file review findings and any follow up action proposed by the firm will be considered by ICAEW's Audit Registration Committee in July 2023.

### Summary

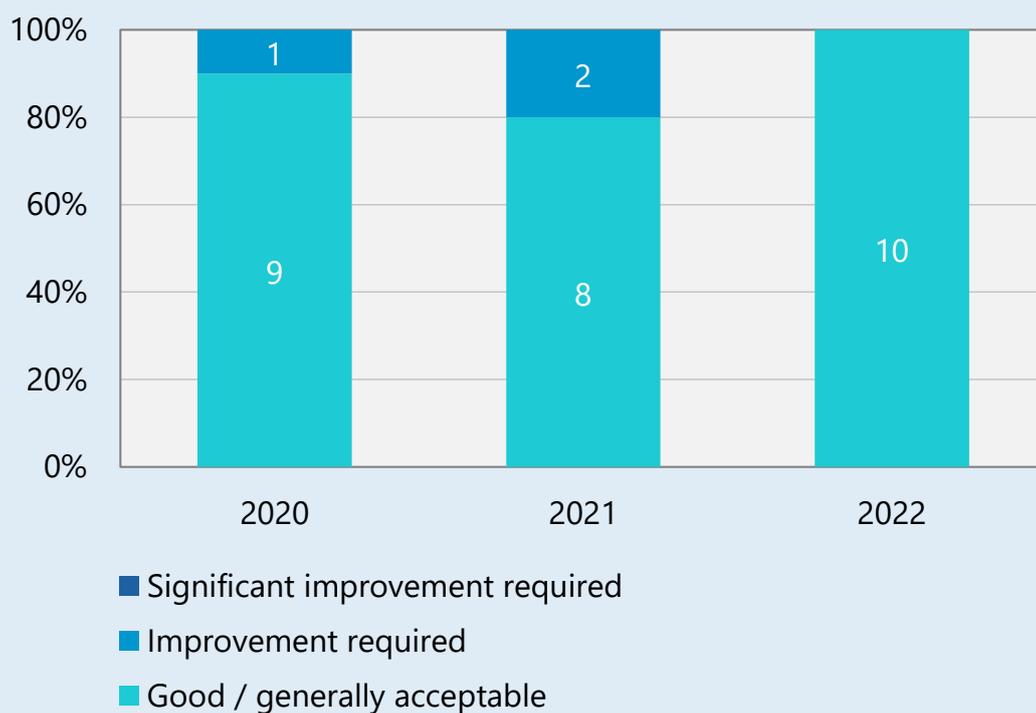
Overall, the quality of audit work reviewed demonstrated an improvement compared to our previous visit, with all ten files being concluded as good or generally acceptable. In 2021, eight files were either good or generally acceptable, and two files required improvement.

### Results

Results of ICAEW's reviews for the last three years are set out below.



**100%**  
of the ICAEW  
reviews were  
assessed as  
either good  
or generally  
acceptable.



Given the sample size, changes from one year to the next in the proportion of audits falling within each category cannot be relied upon to provide a complete picture of a firm's performance or overall change in audit quality.

### Good practice



ICAEW identified some examples of good practice across all of the files reviewed, including:

- Thorough and robust risk assessment procedures.
- Clear and comprehensive documentation, particularly in areas of greater risk, for example, impairment testing.
- Use of specialists for complex areas.
- Robust challenges and documentation in respect of going concern assessments.

### 3. Review of firm-wide procedures

We reviewed firm-wide procedures, based on those areas set out in ISQC (UK) 1, on an annual basis in certain areas, and on a three-year rotational basis in others.

In this section, we set out the key findings and good practice we identified in our review of the four areas of the firm’s quality control procedures, which we reviewed this year under our three-year rotational testing. We performed the majority of our review based on the policies and procedures the firm had in place on 31 March 2022.

Matters arising from our review of the quality control procedures assessed on an annual basis are included, where applicable, in section 4.

The table below sets out the areas that we have covered this year and in the previous two years:

Annual	Current year 2022/23	Prior year 2021/22	Two years ago 2020/21
<ul style="list-style-type: none"> <li>• Audit quality focus and tone of the firm’s senior management</li> <li>• RCA process</li> <li>• Audit quality initiatives, including plans to improve audit quality</li> <li>• Complaints and allegations processes</li> </ul>	<ul style="list-style-type: none"> <li>• Relevant ethical requirements – Compliance with the FRC’s Revised Ethical Standard 2019</li> <li>• Partner and staff matters, including recruitment, appraisals, remuneration and promotion</li> <li>• Acceptance, continuance and resignation procedures</li> <li>• Audit methodology (settlements and clearing processes for banks and building societies)</li> </ul>	<ul style="list-style-type: none"> <li>• Implementation of the FRC’s Revised Ethical Standard 2019</li> <li>• EQCR, consultations and audit documentation</li> <li>• Audit methodology (fair value of financial instruments with a focus on banks)</li> <li>• Internal quality monitoring</li> </ul>	<ul style="list-style-type: none"> <li>• Audit methodology (recent changes to auditing and accounting standards)</li> <li>• Training for auditors</li> </ul>

We also set out a summary of our prior year findings (in the two previous years) later in this section.

Going forward firm-wide monitoring will be performed under ISQM (UK) 1, which came into effect on 15 December 2022 (see further detail on our approach later in this section).

## Relevant ethical requirements: Compliance with the FRC's Revised Ethical Standard 2019

In the current year, we evaluated the firm's compliance with the FRC's Revised Ethical Standard 2019. The work considered the breadth of the Ethical Standard, focusing on the areas where there were more significant changes to the requirements in the 2019 revisions. This testing involved checking for:

- Prohibited non-audit services.
- Timely approvals of non-audit services.
- Identification and assessment of threats and safeguards for non-audit services.
- Compliance with fee ratios for non-audit services.
- Robust evidencing of consultations.
- Timely rotation of individuals off audit teams.
- Financial independence of individuals.

We also held biannual meetings with the firm's Ethics Partner to inform our understanding of their current challenges and priorities.



**Firms must have policies, procedures, and internal monitoring to drive compliance with the FRC's Revised Ethical Standard 2019 and identify and address deficiencies and breaches.**

### Key findings



We identified the following key findings where the firm needs to:

- Obtain appropriate assurance that network firms are adhering to the global policy to obtain approvals from UK audit partners for relevant non-audit services. Such approvals should be obtained before the network firm commences the service.
- Undertake robust assessments of familiarity threats arising for individuals with long association with audited entities. The firm is addressing such long association by implementing a new rotation policy for UK staff. The firm should embed this new policy as soon as is practical and then undertake testing to ensure it is effective.

## Good practice



We identified the following area of good practice:

- The firm has a comprehensive policy provided to external consultants and agency staff on audits, which clearly explains the matters to be considered when confirming independence.

## Partner and staff matters: recruitment, management of partner and senior staff engagement portfolios, appraisals, remuneration and promotion

Recognition and reward of partners and staff, particularly those involved in the delivery of external audits, is a key element of a firm's overall system of quality control and is integral to support and appropriately incentivise audit quality. Robust recruitment processes are also essential in creating a culture and environment that supports audit quality. We reviewed the firm's policies and procedures in these areas and tested their application for a sample of partners and staff for the firm's 2021 appraisal year processes.

Appropriate allocation and management of partner and senior staff portfolios enables a firm to ensure its audits are being led and staffed by auditors with appropriate skills, experience and time. We reviewed the firm's policies and procedures around the accreditation of auditors (Responsible Individuals or RIs) to sign audit reports, the allocation of RIs to audits, and the review of responsibilities and workloads for audit staff and partners. We tested the application of these policies for a sample of RI accreditations.



**Recognition and reward, of partners and staff, is a key element of the firm's overall system of quality control.**

## Key findings



We did not identify any key findings within partner and staff matters.

## Good practice



We identified the following area of good practice:

- The firm produces quality metric reports that show: internal and external file review results; compliance with mandatory training deadlines; compliance with archiving deadlines; and any ethics breaches. These are

prepared for all staff above manager level and are rated red, amber, or green. These reports are used within the firm's appraisal and promotion processes to drive a more consistent and complete consideration of quality.

- The firm has strong mechanisms to reward positive staff quality, including: Annual bonuses based on the appraisal process; Bonuses for positive external file review results; Ad-hoc financial and non-financial recognition schemes rewarding demonstrations of the firm's values; and Publicised awards for exceptional examples of the firm's values.

## Acceptance, continuance, and resignation procedures

A firm is required to establish policies and procedures for the acceptance and continuance of audits to ensure that it only undertakes audits: that it is competent to and has the resources to perform, where it can comply with the ethical requirements, and where it has considered the integrity of management, those charged with governance and, where relevant, the owners of the entity. This assessment needs to be made prior to the acceptance or continuance decision for each engagement.

We have reviewed these policies and procedures, including the firm's wider risk assessment of entities and audits as part of acceptance and continuance decisions. In addition, we have considered the firm's policies relating to withdrawal or dismissal from audits and the required communication on ceasing to hold office.

We also reviewed the application of these policies, and quality of evidence retained, for a sample of audits accepted, continued and ceased in the year.

### Key findings



We identified the following key finding where the firm needs to:

- Improve the timeliness of audit continuance assessments to ensure that the firm clearly demonstrates how the relevant factors (such as resourcing needs and availability, management integrity, ability to comply with the Ethical Standard and reputational risk factors) were considered before the firm agrees to the next audit.



**Firms must have comprehensive policies and procedures in respect of acceptance and continuance.**

## Good practice



We identified the following area of good practice:

- The firm has a formal process for notifying management of an audited entity where they have concerns regarding management's behaviour and attitude towards the audit that may lead them to resign from the audit unless prompt remedial action is taken by management.

## Audit methodology (cash and payments processes for banks and building societies)

In the current year, we evaluated the quality and extent of the firm's methodology and guidance relating to the audit of the cash and payments process cycle for the audit of banks, building societies, other credit institutions and payment services providers. Our evaluation focused on assessing the firm's guidance and templates provided in relation to:

- Understanding the relevant financial statement line items and their linkage to internal and external applications.
- Performing appropriate risk assessment procedures.
- IT specific guidance, including the assessment of matching and other configuration rules and system generated report logic.
- Testing bank reconciliations (covering both control and substantive testing).
- Guidance over external confirmations.

## Key findings



We identified the following key finding where the firm needs to:

- Issue a focused guide covering all key elements of the audit of the cash and payments process, to support the firm's core audit and IT methodology manual.

## Good practice



We identified no specific examples of good practice in our review.



The firm's audit methodology, and the guidance provided to auditors on how to apply it, are important elements of the firm's overall system of quality control.



We identified good practice in ethical compliance, partner and staff matters and resignation procedures.

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## Firm-wide key findings and good practice in prior inspections

In our previous two public reports we identified key findings in relation to the following areas we reviewed on a rotational basis:

- Implementation of the FRC's Revised Ethical Standard (2021/22): The firm needed to improve its guidance on how to consider the perspective of an Objective Reasonable and Informed Third Party when taking decisions relating to ethics and independence. The firm also needed to improve its guidance to group audit teams to assess whether network firms/component auditors could have conditions and relationships that compromised the independence of the audit engagement.
- EQCR, consultations and audit documentation (2021/22): The firm needed to improve the process for appointing EQCR reviewers based on their experience, quality results, available time, and other factors.
- Audit methodology (fair value of financial instruments with a focus on banks) (2021/22): The firm needed to issue further methodology and improve the extent of IFRS 13 guidance on auditing the fair value of financial instruments for banks and similar entities.
- Internal quality monitoring (2021/22): The firm needed to ensure that the reviewer's professional judgements were recorded to support the depth of their review and the conclusions reached in key areas where no findings have been raised.

Further information on the firm's actions against these areas can be found in the 2021/22 and 2020/21 reports.



Good practice was identified in three areas:

- On Audit methodology and training the firm had established a 'credit centre of excellence' team and had developed and provided guidance with illustrative audit procedures to teams performing banking audits.
- On internal quality monitoring the firm performed thematic reviews on selected key topic areas, required a follow-up for all audits graded as "improvements needed or non-compliant," and required all grading decisions, including where no findings were raised, to go through a moderation panel.
- On audit methodology for fair value of financial instruments, aspects of the firm's guidance for model risk management and auditing IFRS 13 disclosures were identified as of a high standard.

## Implementation of ISQM (UK) 1

In the 2022/23 inspection cycle, prior to the implementation of ISQM (UK) 1, we have held discussions with the firm to understand its plans and progress for implementation, focusing on how the firm has:

- Ensured adequate oversight of and accountability for its system of quality management.
- Identified quality objectives, risks and responses and assessed the significance of its quality risks and the design and implementation of its responses.
- Identified the service providers and network resources that it relies upon in its system of quality management and how it will assess the reliability of these on an ongoing basis.
- Planned to undertake monitoring activities over its system of quality management on an ongoing basis.

Since the implementation of ISQM (UK) 1 we have begun our statutory monitoring under this standard.

In the 2022/23 inspection cycle, prior to the implementation of ISQM (UK) 1, (2023/24), we are focusing on the firm's identification of objectives, risk assessment processes and the completeness of the risks identified. In addition, we are reviewing certain components of the system of quality management, including governance and leadership, acceptance and continuance, network

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resources and service providers. In these areas we are looking at the design and implementation of responses. We will also review the firm's plans for ongoing monitoring and remediation of the system of quality management and the annual evaluation process.

On an ongoing basis, our inspection will be undertaken on a risk focused and cyclical basis, supported by targeted thematic work where we will perform in-depth reviews of particular aspects of firm's systems of quality management. Our thematic reviews in the 2023/24 inspection cycle will also cover the following areas:

- Audit sampling methodology, within the engagement performance and intellectual resources components.
- Hot reviews, within the engagement performance component.
- Identification and assessment of network resources and service providers, within the resources component.
- Root cause analysis, within the monitoring and remediation component.

We will also annually review elements of the ethics component. This continues to be a priority area for the FRC, where our work will again focus on ensuring firms adhere to the FRC's Revised Ethical Standard through: compliance testing; review of breaches reported; and regular interaction with the firm's ethics functions.

Other annual areas of review will include elements of monitoring and remediation, including root cause analysis and audit quality plans, and leadership and governance, including tone at the top.

## 4. Forward-looking supervision

This section of the report focuses on our forward-looking supervisory approach – identifying and prioritising what firms must do to improve audit quality and enhance resilience. We balance an assertive approach, holding audit firms accountable, with acting as an improvement regulator, identifying and sharing good audit practice to drive further improvements across the sector.

We employ, to differing extents, all four faces of supervision in our work. A fuller explanation of our forward-looking supervision approach is set out in [Our Approach to Audit Firm Supervision 2023](#).



We hold the firms to account through assessment, challenge, setting actions and monitoring progress. We do this through: assessing and challenging the effectiveness of the firm’s RCA processes; evaluating the developments of firms’ audit quality plans (AQPs); reviewing firms’ action plans - now including their Single Quality Plan - and monitoring the effectiveness of the firm’s responses to our prior year findings; assessing the spirit and effectiveness of the firm’s response to non-financial sanctions; and through PIE auditor registration.

We also seek to promote a continuous improvement of standards and quality across the firms by sharing good practice, carrying out benchmarking and thematic work, and holding roundtables on topical areas. In 2022/23 we held a roundtable, attended by the Tier 1 firms, sharing good practices and success stories on in-flight or hot reviews (internal reviews that take place during the audit, prior to the audit report being signed). We also carried out thematic work including on tone at the top and aspects of IFRS 9.

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Our observations from the work we have conducted this year, and updates from previously reported findings, are set out under the following areas:

- The firm's SQP, other quality improvement plans and audit quality initiatives.
- Root cause analysis.
- PIE Auditor Registration.
- Other activities focused on holding the firms to account.
- Culture and conduct.
- Initiatives to ensure compliance with the FRC's Revised Ethical Standard 2019.
- Operational separation.

Where our observation requires an action from the firm, we require its inclusion in the firm's SQP.

## **The firm's Single Quality Plan, other quality improvement plans and audit quality initiatives**

### **Background**

The SQP was introduced, as we required, by the Tier 1 firms during the year and is maintained by each firm as a mechanism to further facilitate our holding firms to account. Each firm should develop an SQP that drives measurable improvements in audit quality and resilience. The firm should also have an overarching plan and strategy for audit (AQP). The AQP should include initiatives that respond to identified quality deficiencies as well as forward-looking measures which contribute directly or indirectly to audit quality. Where a firm has poorer results, these audit plans should either be transformational in themselves or be supplemented with a plan that prioritises those initiatives that will quickly bring about the transformation needed to improve audit quality. These overarching plans should then be used in the development of the firm's SQP in terms of purpose and prioritisation of individual actions or in the development of core pillars or similar. The SQP allows the firm and us to monitor whether changes are being prioritised and made in a timely and effective way. Where they are not achieving the objectives, we will hold the firm to account against their plan and consider whether further actions are necessary.

Last year we reported that we had reviewed key aspects of the firm's AQP which included longer term and forward-looking audit quality initiatives. The firm's first version of the SQP was provided to us in October 2022 and continues to be developed.



**Single Quality Plans should enable firms to identify the areas which contribute directly or indirectly to audit quality and to prioritise their actions.**

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When we reviewed the AQP last year, we assessed it as relatively mature, and we identified good practice in relation to the oversight of the AQP and the clarity around the key initiatives completed in the last year. However, we found that the firm should improve the AQP with improved focus and prioritisation, continual reassessment of the AQP's effectiveness and continuing to strengthen the culture of challenge in the audit process and more fully embed audit culture into the plan.

## Observations

We assessed the following:

- **Oversight of the SQP and AQP:** The firm's management and governance bodies have clear responsibilities in keeping the firm's AQP and SQP live and relevant. The Actions Development Group provides oversight of the process of developing actions and how these link to the firm's AQP. The CIG will provide input and challenge on the periodic reassessment of the SQP priority areas, review and challenge the AQP, and will also assess the effectiveness of actions. The AQP and SQP process, approval of priorities, and their ongoing review is subject to oversight by the Audit Governance Board.
- **Strengthening the culture of challenge in the audit process and identification of this as a priority area:** Whilst the firm has established processes in place to facilitate challenge, these must also be emphasised within audit behaviours. The firm's audit culture must support having the right mindset to challenge and acting in the public interest. Although the firm has developed audit behaviours there is more to do to embed these behaviours within the Audit practice. The firm also needs to consider its approach to monitoring audit behaviours.
- **Continue to strengthen the analysis, focus and prioritisation of the SQP:** The firm has developed its approach since inception and has identified and aggregated SQP priorities from the source information in the AQP tracker and has introduced a high-level dashboard. The recent migration of the SQP into a tool provides the opportunity for real-time analysis and oversight but should also further enhance the firm's SQP analysis, and allow the firm to take account of actions that link to multiple priorities or themes. The firm must continue to develop its analysis to support its prioritisation of actions that support audit quality and ensure that its dashboard presents an appropriate overall summary.



**Audit culture must support the right mindset to challenge.**

- **Measurement and reassessment of the effectiveness of the SQP and the AQP:** The firm has identified methods of measuring effectiveness of each of the priority areas in the SQP taking into account appropriateness, accuracy, timeliness and considering quantitative and qualitative measures. In some areas the approach needs to be further developed, and in all areas it is too early to conclude on the effectiveness of the measures. The firm must embed its approach to effectiveness assessment over the coming period and be alert for any inconsistent information.
- **Increasing the extent of remediation and monitoring:** Whilst the firm has made good progress in remediating the majority of its action plan items, this was slower than originally anticipated for certain key audit quality initiatives.
- **Reduction in central quality monitoring:** The number of completed internal quality monitoring and in-flight reviews has significantly reduced against the prior year with in-flight reviews falling significantly short of the firm's target. This reduces the extent and breadth of monitoring information available.

We will use the SQP alongside the AQP to monitor the progress of actions and how the firm measures their effectiveness. We will continue to assess the actions and/or initiatives the firm adds to the SQP to facilitate continuous improvement.

## Root cause analysis process

### Background

The RCA process is an important part of a continuous improvement cycle designed to identify the causes of specific audit quality issues (whether identified from internal or external quality reviews or other sources) so that appropriate actions may be designed to address the risk of repetition.

ISQM (UK) 1, introduced a new quality management process that is focused on proactively identifying and responding to risks to quality, and requires firms to use RCA as part of their quality remediation process.

When we reviewed the firm's RCA process last year, we assessed that the firm's overall approach to RCA was well developed and identified good practice in relation to the RCA team who had received appropriate training, involvement of relevant members of the engagement team that extended (where appropriate) to overseas component teams and offshore delivery centres and the ongoing development of learning from and responding to behavioural causal factors. However, we found that the RCA taxonomy and descriptors were constraining the firm's causal factor analysis and that there needed to be more clearly defined and dedicated responsibility for identifying and implementing a response to causal factors. We note that the firm has set up the Action Development Group to provide oversight of the process of developing actions.

The firm has continued to make refinements to its RCA process in the year.



**Root cause analysis is an important part of a continuous improvement cycle.**

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## Observations

We assessed the following:

- **Updated taxonomy including the descriptors:** The firm has updated its framework taxonomy to align with more common root causes and to facilitate linkage to ISQM (UK) 1. The descriptors chosen appear to be more flexible in allowing the more accurate identification of causal factors and thematic comparison of findings. The narratives in the firm's RCA summaries support the taxonomy and provide additional context on the causal factors. The firm must continue to embed the refreshed taxonomy and use it consistently.
- **Involvement of the engagement team and sharing with the wider audit practice:** The discussions during the RCA process, include all members of the audit team, specialists, component audit team members where relevant and the EQCR. Findings from RCA reviews and thematic reviews are actively shared with business unit leaders and across the audit stream through Essential Professional Updates. The firm has now taken steps to share the findings from thematic reviews quicker so that prompt action can be taken.
- **Responding to the causal factors:** Deloitte has implemented a clear separation of responsibilities between the Action Development Group, who are responsible for identifying appropriate remedial actions, and the Continuous Improvement Group who are responsible for providing oversight and challenge of the actions. This increases the independent consideration of the priority actions to support continuous improvement. CIG needs to continue to ensure that its ongoing oversight is timely in order that the firm's responses to recurring issues can be adjusted, or any necessary interventions made.
- **Scope of RCA analysis:** The firm undertakes RCA analysis on a broad range of sources including practice reviews, regulatory inspections, and on their system of quality management. In parallel, the firm seeks to capture and assess behavioural impacts and findings as an integrated part of the RCA process. RCA analysis is also used, where relevant, on ethical matters. The firm has extended the nature of prior year adjustments it performs thematic RCA analysis on and does so on a more frequent basis.
- **Granularity of analysis:** Although the firm does not weight causal findings in its RCA analysis and RCA summaries it has adopted an approach to ranking and labelling causal findings that allows better differentiation between primary and secondary causes. This allows the firm to give more consideration to common secondary factors and consider any necessary follow up.



The firm needs to ensure there is an effective response to recurring issues.

We will continue to assess the firm's RCA process as a crucial part of the feedback loop within ISQM (UK) 1 as well as part of our holding the firm to account. We encourage all firms to develop their RCA techniques further as well as focus on measuring the effectiveness of the actions taken as a result through the SQP.

## PIE auditor registration

### Background

The FRC is now responsible for the registration of all firms which carry out statutory audit work on public interest entities (PIEs). This registration is in addition to the ongoing requirement for firms and Responsible Individuals (RIs<sup>8</sup>) to register with their Recognised Supervisory Body (RSB). The FRC's PIE auditor registration remit covers all firms and relevant RIs which audit one or more PIEs which are: listed on the London Stock Exchange (or on another UK regulated market); a UK registered bank, building society or other credit institution (but not credit unions or friendly societies); or are a UK insurance entity which is required to comply with the Solvency II regulations.

All firms and RIs carrying out statutory audit work on PIEs were required to register with the FRC by 5 December 2022 under a set of transitional provisions. Thereafter, any firm that plans to take on a PIE audit, or remain auditor to an entity that is to become a PIE, (for example, if it obtains a listing on the London Stock Exchange), together with relevant RIs, must register with the FRC before undertaking any PIE audit work.

Where appropriate, firms and/or RIs can be held to account through conditions, undertakings and suspension or involuntary removal of registration, adding to our activities focused on holding firms to account. Measures used through the PIE auditor registration process are not always published.

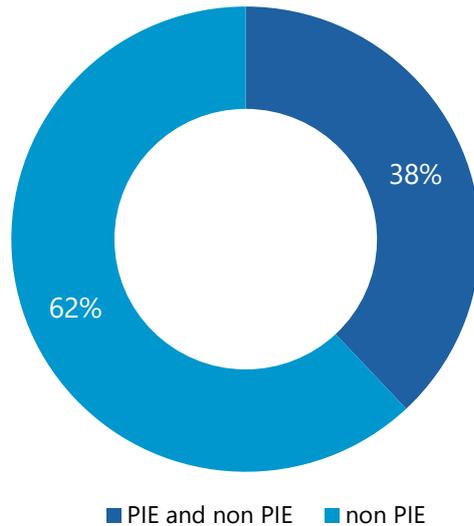
### Observations

On 5 December 2022 Deloitte's transitional application for registration as a PIE auditor was approved and as at 31 March 2023 117 RIs had been approved. The following diagram shows the number of PIE and non-PIE RIs as a percentage of the total RIs at Deloitte.



**The FRC is now responsible for the registration of all firms which carry out statutory audit work on public interest entities (PIEs).**

<sup>8</sup> Defined as a natural person who is a Principal or employee (but not a subcontractor or a consultant) of a Statutory Audit Firm and is registered with an RSB as a Statutory Auditor.



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## Other activities focused on holding firms to account

### Background

Our forward-looking supervisory approach includes a number of other activities designed to hold firms to account. We have carried out certain procedures during the year to consider tone at the top, the contents of the firm's Transparency Report and the firm's responsiveness to feedback, and where relevant to constructive engagement and non-financial sanctions. This firm was not subject to increased supervisory activities during the year.

### Observations

We assessed the following:

- **Tone at the top:** The firm continues to be clear and consistent in their communications around the importance of audit quality and proactive in sharing learnings from regulatory publications.
- **Transparency Report:** The firm was responsive to feedback on their Transparency Report on several key reporting sections. Improvements to the Transparency Report have made it easier for investors and audit committee members to navigate and engage with the content.
- **Effectiveness measures and KPIs:** The firm provides their INEs with regular reporting which is clear and includes good context. This reporting includes strategic KPIs with a defined red/amber/green risk assessment that report on delivering audit quality, resilience, and people and purpose. The firm should consider, in the round, the KPIs and effectiveness measures relating to audit quality to ensure that sufficient prominence is given to measures linked to SQP priority areas to enrich the overall view and support consistent messaging on audit quality.

- **Continuous improvement:** The firm established its Continuous Improvement Group (CIG) in May 2022. To date, the CIG team’s focus has been on the progress made in respect of non-financial sanctions and the implementation of the SQP. The CIG team must continue to broaden its oversight of remedial actions in order to gain a more holistic overview. It must also have access to up-to-date and relevant qualitative and quantitative information so that it can respond, adapt, change and challenge remedial actions in an effective and agile manner.
- **Non-financial sanctions:** The firm has now substantially completed key actions relating to non-financial sanctions for December 2021 year ends. The firm is on target to implement other non-financial sanctions and have taken steps through the CIG to increase the challenge over recommendations and proposed actions made through such sanctions.

## Culture and conduct

### Background

The firm’s culture has a significant impact on audit quality and the speed at which audit quality is improved. Firms that have more advanced cultural programmes, where desired audit specific behaviours are promoted through their wider policies and procedures (in particular training and coaching, performance management and reward and recognition), have better or improving audit quality.

Reported instances of integrity issues or misconduct matters have a significant impact on trust and confidence in the profession. Ethical conduct must therefore be an intrinsic part of all firms’ cultural programmes and the profession must strive to maintain a culture of integrity in which the highest standards of ethical values and professional behaviour are upheld.

### Observations

We assessed the following:

- **Audit culture:** Deloitte continues to make progress on its overall culture journey with the completion of a cultural review undertaken by its Risk Advisory team, and the recent appointment of a dedicated Culture Lead to the Audit & Assurance Executive. The firm must now roll out its audit specific behaviours and integrate these into the metrics used to measure the effectiveness of the firm’s culture initiatives and should also embed these behaviours in the performance management process. In addition, the firm would benefit from putting in place initiatives to improve (culture and ethics) survey participation rates.



The firm has heightened its focus on continuous improvement.



The firm’s culture has a significant impact on audit quality and the speed at which audit quality is improved.

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- **Ethical conduct:** We have seen examples of misconduct including exam cheating and breaches of integrity at certain firms that impact the reputation of the profession as a whole. All firms need to ensure that their culture promotes individuals to operate to the highest ethical standards in order to maintain public confidence and trust.

## Initiatives to ensure compliance with the FRC's Revised Ethical Standard 2019

### Background

During 2022, we held biannual meetings with the Ethics Partner, undertook compliance testing and reviewed the firm's biannual reporting of identified breaches. The specific findings from this work are detailed in section 3. However, we have the following, additional observations on the steps being taken to comply with the FRC's Revised Ethical Standard going forward.

### Observations

- **Rotation policy:** The firm is implementing a new policy to respond to previously identified rotation issues. The aim of the new policy is to restrict the length of involvement, of any individual, to a maximum of seven years. This will reduce the long association threat for individuals whose role on an audit engagement has evolved over a longer period of time.
- **Ensuring network firms obtain all necessary UK approvals for non-audit services:** The firm is looking to seek formal assurance that overseas network firms are adhering to the global policy which requires them to obtain approvals from UK audit partners for non-audit services.

### Operational separation of audit practices

Operational separation aims to ensure that audit practices are focused, above all, on the delivery of high quality audits in the public interest and are financially resilient. In June 2021, Deloitte started its transition to operating a separate audit practice from the rest of the firm and has taken a number of steps to implement the principles of Operational separation including restructuring its governance framework, forming an Audit Governance Board (January 2021), and its work on promoting a differentiated audit culture.

Deloitte has four independent non-executives, and they perform the following roles: one is solely an Audit Non-Executive (ANE); and the other three are both an ANE and an Independent Non-Executive (INE) (dual function). The chairs of the Non-Executive Committee and the Audit Governance Board are both dual function.

After the end of the transitional period in 2024 we intend to publish an assessment of whether the four largest firms are delivering the objectives and outcomes of operational separation.

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# Appendix

## Firm's internal quality monitoring

This appendix sets out information prepared by the firm relating to its internal quality monitoring for individual audit engagements. We consider that publication of these results provides a fuller understanding of quality monitoring in addition to our regulatory inspections, but we have not verified the accuracy or appropriateness of these results.

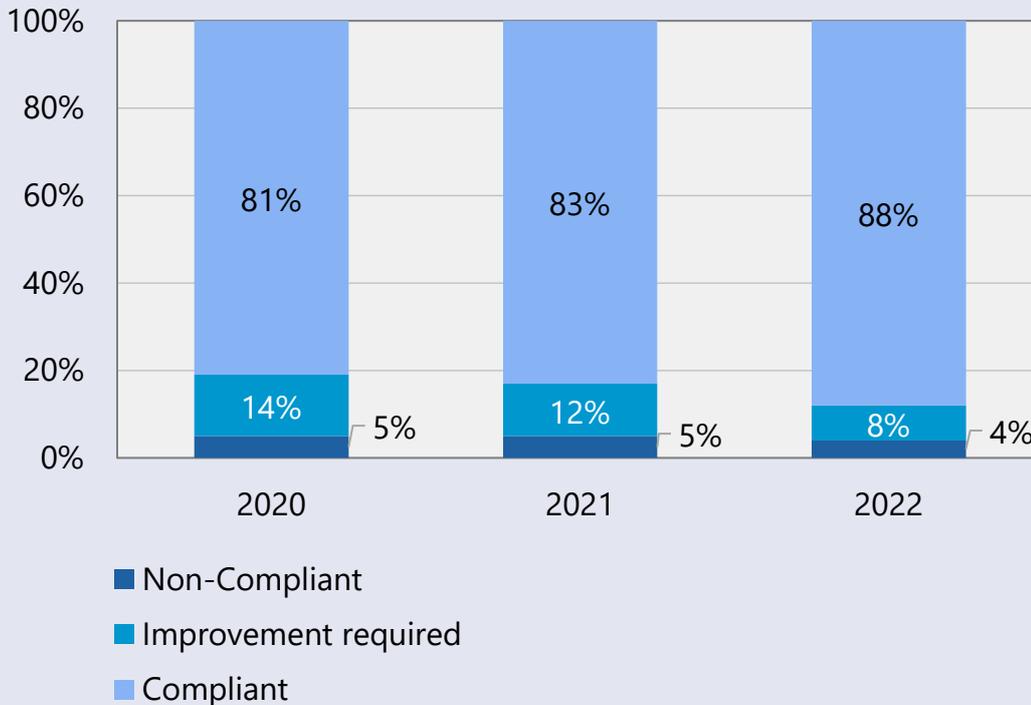
The appendix should be read in conjunction with the firm's [Transparency Report](#) for 2022 which provides further detail of the firm's internal quality monitoring approach and results, and the firm's wider system of quality control.

Due to differences in how inspections are performed and rated, the results of the firm's internal quality monitoring may differ from those of external regulatory inspections and should not be treated as being directly comparable to the results of other firms.

## Results of internal quality monitoring



The results of the firm's most recent archived engagements review, which comprised internal inspections of 76 individual archived audits with opinions signed between 1 June 2021 and 31 May 2022 (FY21 – 119), are set out below along with the results for the previous two years.



Archived engagement reviews are assigned an overall evaluation rating based on the engagement review findings noted. The ratings received are classified as either Compliant, Improvement Required or Non-Compliant. A Compliant rating indicates there are no exceptions or the exceptions identified are of a very minor nature relating to isolated instances of non-compliance with certain policies, requirements or standards; an Improvement Required rating indicates that there are a small number of findings relating to these areas, whereas a Non-Compliant rating indicates that non-compliance with several policies, requirements or professional standards or an individually significant matter was identified and it cannot be determined that policies, requirements or professional standards reviewed are fully implemented.

## Firm's approach to internal quality monitoring



The firm's internal inspection programme considers the full population of audits performed. Engagements are selected using a risk-based approach, focusing on high risk and/or high-profile engagements, and to ensure that, as a minimum, each Responsible Individual is subject to review every three years. Selected files are then subject to independent inspection by professionals comprising partners and senior auditors from the UK, NSE (North and South Europe) and overseas member firms. All members of the inspection team are given thorough training by the leaders in the central inspection team.

For all internal inspections, the firm uses moderation panels to rate individual findings and the overall engagement and takes into account the ratings applied by regulators when doing so. The moderation panel will include three members and will ordinarily be comprised of partners and directors in the central Audit Monitoring and Remediation team and experienced partners or directors from the UK, NSE or overseas member firms. These panellists are independent from the audit team and the team that undertook the inspection.

The firm undertakes RCA for all improvement required and non-compliant engagement inspections, a sample of positive results to identify factors to support audit quality, as well as any areas of thematic findings in internal inspections. In conjunction with the Actions Development Group, actions are developed for any thematic findings or root causes that are thematic to the wider internal review population and included within the Audit Quality Plan and monitored. The actions developed are reviewed and challenged by the Continuous Improvement Group. The firm performs retrospective remediation of all high and medium findings for an improvement required or non-compliant rated engagement, and prospective remediation on all findings regardless of the engagement rating in the subsequent year's audit.

## Internal quality monitoring themes arising



Progress has been made in a number of key areas of focus from prior years, with an overall decrease in the number and severity of findings in each of the key areas with findings (being preliminary planning activities, journal entry testing, fact based risk assessment and aspects of internal control testing). Thematic areas of findings have been identified in relation to aspects of journal entry testing for automated journals; the precision of some areas of risk assessment including the evidence of design and implementation conclusions of key controls relevant to that risk assessment; and certain concluding procedures on the audit.



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