



Financial Reporting Council

ERNST & YOUNG LLP

AUDIT QUALITY INSPECTION

JULY 2020

The FRC

Our purpose is to serve the public interest by setting high standards of corporate governance, reporting and audit and by holding to account those responsible for delivering them.

transparency



We have responsibility for the public oversight of statutory auditors.

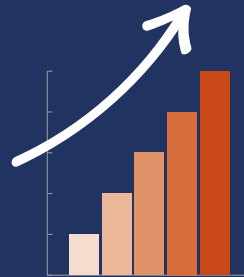
The FRC works with European, US and global regulators to promote high quality audit and corporate reporting.



AQR

We monitor the quality of UK Public Interest Entity audits.

+0.55%	0.20%	+2.27%	-11.48%	POS	-3.2320
+0.20%	0.21%	+2.83%	-15.93%	NEG	-3.9993
+0.85%	0.14%	+2.42%	-17.67%	POS	-4.2421
+0.38%	0.27%	+2.19%	-18.32%	NEG	-4.2083
+0.11%	0.22%	+2.28%	-14.73%	NEG	-3.5708
+0.26%	0.26%	+2.76%	-20.12%	NEG	-2.8339



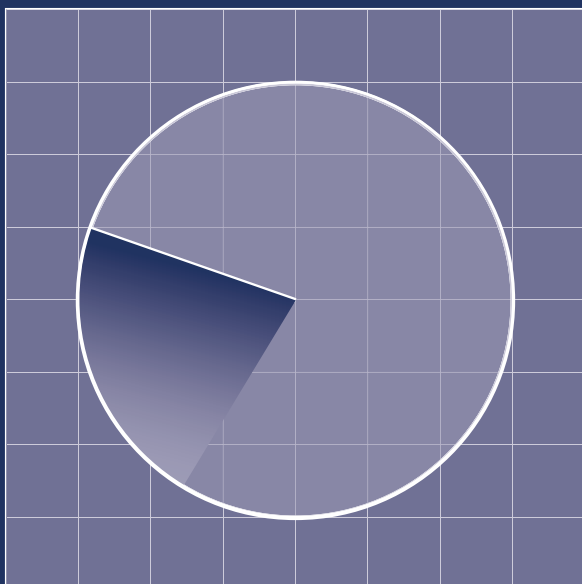
We promote continuous improvement in audit quality.

Our team of over 50 professional and support staff has extensive audit expertise to provide rigorous inspection of audit firms.



The Firm

EY has 349 audits within the scope of AQR inspection, including 18 FTSE 100 and 53 FTSE 250 audits.



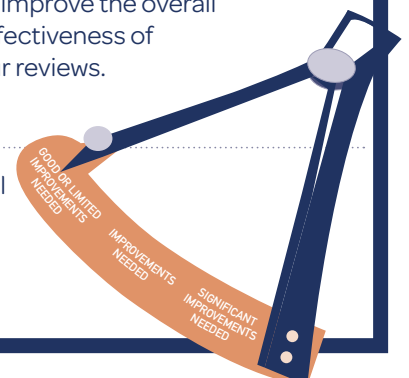
Our inspection process

There are around 3,000 audits within the scope of AQR inspection. Of these, we inspected 130 audits in 2019/20, including the 14 EY audits covered by this report.



We work closely with audit committee chairs to improve the overall effectiveness of our reviews.

We assess the overall quality of the audit work inspected.



Financial Reporting Council

Ernst & Young LLP

Audit Quality Inspection

The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

We consider whether action under the FRC's enforcement procedures is appropriate for all reviews assessed as requiring improvements or significant improvements. In practice, audits assessed as requiring significant improvement, and some of those assessed as requiring improvement, will be referred to the FRC's Case Examiner for consideration of further regulatory action. The Case Examiner will consider the most appropriate action, including Constructive Engagement with the audit firm or referral to the FRC's Conduct Committee for consideration of whether to launch a full investigation. This may result in a sanction being imposed and enforced against a statutory auditor and/or the audit firm in accordance with the FRC Audit Enforcement Procedure.

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This report sets out the principal findings arising from the 2019/20 inspection of Ernst & Young LLP ("EY" or "the firm") carried out by the Audit Quality Review team ("AQR") of the Financial Reporting Council ("the FRC"). We conducted this inspection in the period from February 2019 to March 2020 ("the time of our inspection"). We inspect EY, and report publicly on our findings, annually.

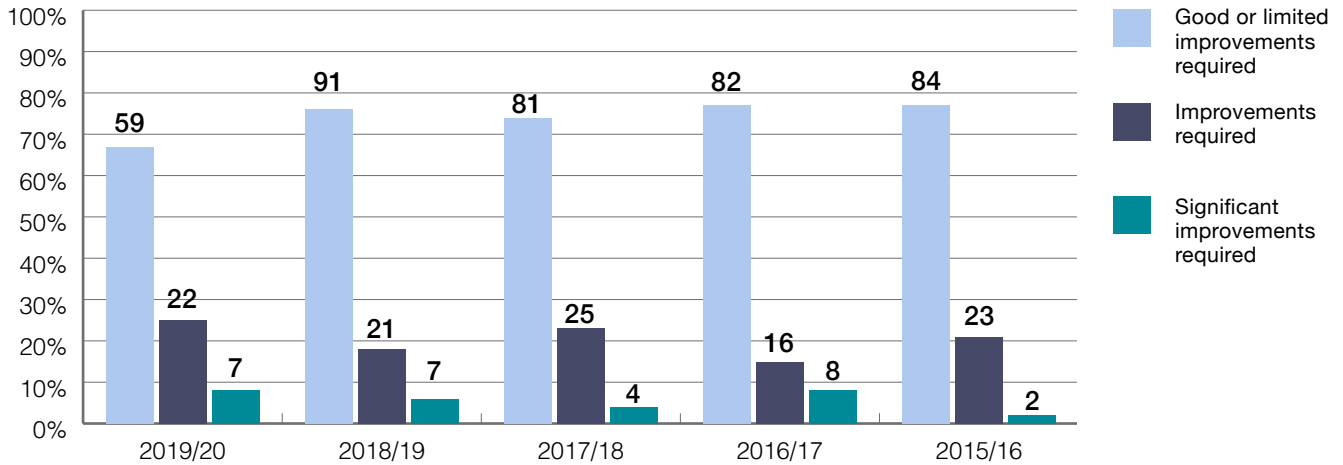
Our report focuses on the key areas requiring action by the firm to safeguard and enhance audit quality. It does not seek to provide a balanced scorecard of the quality of the firm's audit work. Our findings cover matters arising from our reviews of both individual audits and the firm's policies and procedures which support and promote audit quality.

High quality audit is essential to maintain investor confidence by providing an independent, impartial view of a company's financial statements. Poor auditing may fail to alert management, shareholders and other stakeholders to material misstatements (including those arising from fraud) or financial control weaknesses, in those cases where management have not identified or appropriately amended them. The combination of management not meeting their responsibilities in this respect and poor auditing could potentially put businesses and jobs at risk. High quality audit matters and we will drive audit firms to implement the necessary changes to reach the required standards.

Our priority sectors for inspection in 2019/20 were Financial Services, General Retailers, Business Support Services, Construction and Materials, and Retail Property. Of the 108 audits that we reviewed in the year across all firms (excluding Local Audit inspections), the number in priority sectors was: Financial Services – 18, General Retailers – 16, Business Support Services – 6, Construction and Materials – 3, and Retail Property – 8. We also paid particular attention to the following areas of focus: going concern and the viability statement, the other information in the annual report, long-term contracts, the impairment of assets and fraud risk assessment.

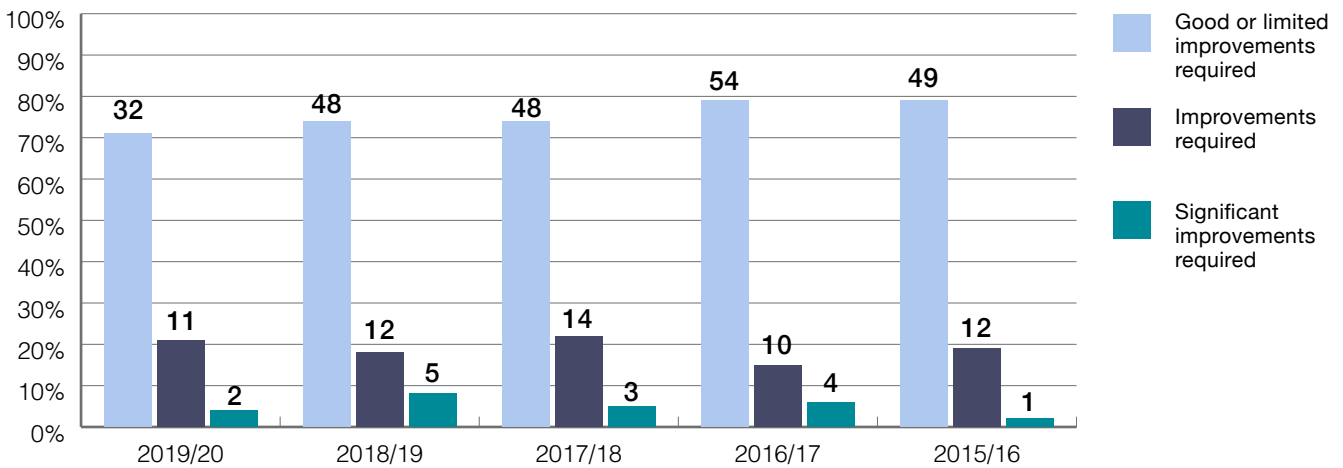
Our assessment of the quality of audits reviewed

All reviews – for the seven firms inspected annually



An audit is assessed as good or limited improvements required where we identified either no or only limited concerns to report. Improvements required indicate that more substantive improvements were needed in relation to one or more issues. Significant improvements required indicate we had significant concerns, typically in relation to the sufficiency or quality of audit evidence or the appropriateness of key audit judgements.

FTSE 350 reviews – for the seven firms inspected annually



Due to resourcing constraints, we reviewed fewer audits overall than in recent years. Across all firms, we completed 130 audit inspections compared to 160 in 2018/19. We did broaden the scope of our reviews to include more aspects of the audit, including the auditor's response to fraud risk. Changes to the proportion of audits falling within each grading category reflect a wide range of factors, including the size, complexity and risk of the audits selected for review and the scope of individual reviews. Our inspections are also informed by the priority sectors and areas of focus referred to above. We are also cognisant, when making our selections, of the Competition and Market Authority's recommendation that FTSE 350 entity audits should be subject to inspection approximately every five years. For these reasons, and given the sample sizes involved, our inspection findings may not be representative of audit quality across a firm's entire audit portfolio; nor do small year-on-year changes in results necessarily indicate any overall change in audit quality at the firm. Nonetheless, 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.

1 Overview

Commentary on our inspection work at the largest audit firms

Overall, 59 (67%) of the 88 audits reviewed in our 2019/20 inspection cycle, across the seven firms inspected annually, required no more than limited improvements. The number of audits requiring more than limited improvements, 29 (33%), remains unacceptable.

Firms have made some improvements and we have observed good practices (for example, better group audit oversight and effective integration of specialists into the audit team at some firms). We acknowledge the steps taken by firms seeking to address the key findings in our 2019 public reports.

However, firms are still not consistently achieving the necessary level of audit quality. They need to make further progress. For example, we continue to find improvements needed in the same three audit areas: impairment of goodwill and intangibles; revenue and contracts; and provisions, including loan loss provisions. Over the past three years, 76 of the 166 (46%) of the findings driving reviews requiring more than limited improvements have been in these areas. These findings often relate to insufficient challenge of, and standing up to, management in areas of complexity and forward-looking judgement. Other audit areas in which we had findings for more than one firm this year include: audit of inventory, group oversight, going concern and investment property valuations.

We take robust action for all reviews assessed as requiring improvements or significant improvements. To date, for the past three inspection cycles, we have referred 28 audits, across all firms inspected, for consideration of possible enforcement action.

We focused this year on key firm-wide procedures to improve audit quality, including firms' audit improvement plans and their processes to analyse the root causes of audit failings. We have raised findings in these areas to help firms build more effective quality improvement processes going forward. We will continue to focus on ensuring that the firms develop their vital root cause analysis processes to identify areas for improvement and implement change on a timely basis.

We have seen some instances of good practice where audit teams have concerns with the most significant audit judgements. Firms' senior management need to be clear that taking difficult decisions is an appropriate response to improving audit quality, even if it might sometimes mean delaying or modifying opinions, and ultimately losing some audit engagements. The tone from the top needs to support a culture of challenge and back auditors making tough decisions.

We are initiating a number of significant changes to improve audit quality, including:

- Increasing our focus on proactive supervision of the large audit firms. We will identify priority areas to improve audit quality, request the firms to implement suitable actions to achieve them and hold the firms accountable for delivery.

- Moving ahead with plans to increase the transparency of our audit quality assessments through publishing the scope and key findings of each of our individual audit inspections. We plan to publish our first set of these reports, where we have obtained the consent of the audit firm and the audited entity, next year alongside these annual reports on each of the largest audit firms.
- Asking the Big 4 firms, beginning from 2021, to implement operational separation of audit practices from the rest of the firm, so that the audit practices are focused above all else on achieving high audit quality.
- Strengthening the AQR team to increase the number of inspections in our 2020/21 cycle. We inspected a limited number of private companies and significant overseas components of groups during 2019/20, in line with the recommendations of the Kingman Review, and we will build on this as part of our overall target of 145-165 inspections for 2020/21.

We wrote to the major audit firms in December 2019¹ setting out elements that we observe consistently on high quality audits, especially on high risk engagements. The hallmarks of such audits include:

- Significant involvement of partner and other senior team members.
- Good use of specialists.
- Consultation on complex areas.
- Challenge of management leading to changes where assumptions are too optimistic.
- Robust quality control procedures.
- Clear and timely communication to Audit Committees.

We recognise the challenges posed currently by the Covid-19 pandemic, both in relation to the level of uncertainty surrounding forward estimates and projections, and inability to carry out physical procedures (for example, stocktakes). We will consider such matters carefully during our 2020/21 inspection cycle.

Audit selections

In recent years we have selected for inspection an increasing number of 'higher-risk' audits. Reliable reporting and high-quality audit matter most for these companies. This year 42 of the 108 (39%) inspections, excluding public sector reviews, were higher risk compared to 32% in the previous year. We define audits as higher risk where the group or entity: is in a high-risk sector or geography; is experiencing financial difficulties; has balances with high estimation uncertainty; or where the auditor has identified governance or internal control weaknesses. Higher-risk engagements frequently require audit teams to assess and conclude on complex judgemental issues, for example:

- Materiality becomes a key factor in determining the significance of audit judgements for entities that have low profitability.

¹ [https://www.frc.org.uk/news/december-2019-\(1\)/letter-to-audit-firms-on-high-quality-audits](https://www.frc.org.uk/news/december-2019-(1)/letter-to-audit-firms-on-high-quality-audits)

- Headroom on impairment assessments may be lower and the entity's balance sheet may be more sensitive to changes in key assumptions.
- Going concern assessments are less clear cut.

Rigorous challenge of management and the application of professional scepticism are therefore especially important.

Perhaps because higher-risk audits are more challenging, we find that their audit quality tends to be lower. Of the audits that required more than limited improvement this year, we had identified almost half as higher risk. This year 40% (47% last year) of the audits that we identified as higher risk were assessed as requiring improvement, compared with 27% (13% last year) of audits not identified as higher risk.

Other factors that may lead both audit quality and our inspection results to vary over time include:

- The economic cycle: audit can be more difficult in an economic downturn when corporate profitability is lower.
- Changes in accounting, auditing and ethical standards: new standards can require more complex and forward-looking estimates which are more difficult to prepare and audit. Examples in recent years include forward-looking provisioning under IFRS 9 and assessing progressive revenue recognition under IFRS 15.

We have increasingly focused on higher-risk audits because they are where reliable reporting and high-quality audit matter most. Firms must perform audits to the same high standards regardless of the risks associated with the audited entity and the difficulty of the audit work.

We accept that our increased focus on higher-risk audits means that the grade profile of our inspection findings may be less representative of audit quality across the whole portfolio of an audit firm. The change in our approach to audit selection over time also means that historical comparisons of results need to be treated with care.

EY overall assessment

We reviewed 14² audits this year and assessed ten (71%) 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.

The firm has taken steps to address the key findings in our 2019 public report, with actions that included enhanced portfolio reviews and an increase in the number of in-flight reviews. We have identified improvements, for example in the audit of the recognition of intangible assets, a key finding last year. We also identified good practice in a number of areas of the audits we reviewed (including in relation to IFRS 9 implementation and the audit of fair values) and in the firm-wide procedures (including the firm's initiatives to ensure audit teams understand the broader importance of audit and how their specific input contributes to audit quality).

The recurring findings that most contributed to these results were the need to improve the consideration and challenge of management's impairment assessments in relation to goodwill and other assets and the need to enhance group audit teams' oversight of component audit teams.

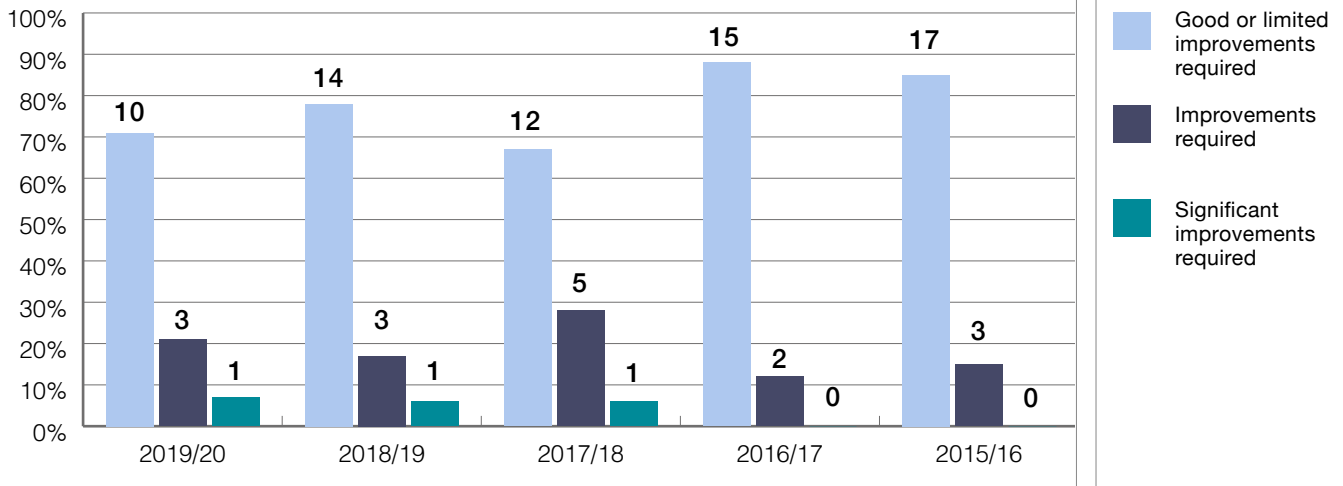
We have also highlighted in this report aspects of firm-wide procedures which should be improved, including strengthening the culture of challenge within the firm's audit process.

The firm needs to take specific action to address the root causes of our findings, particularly in relation to non-FTSE 350 audits, given the lower level of inspection results for those audits inspected this year.

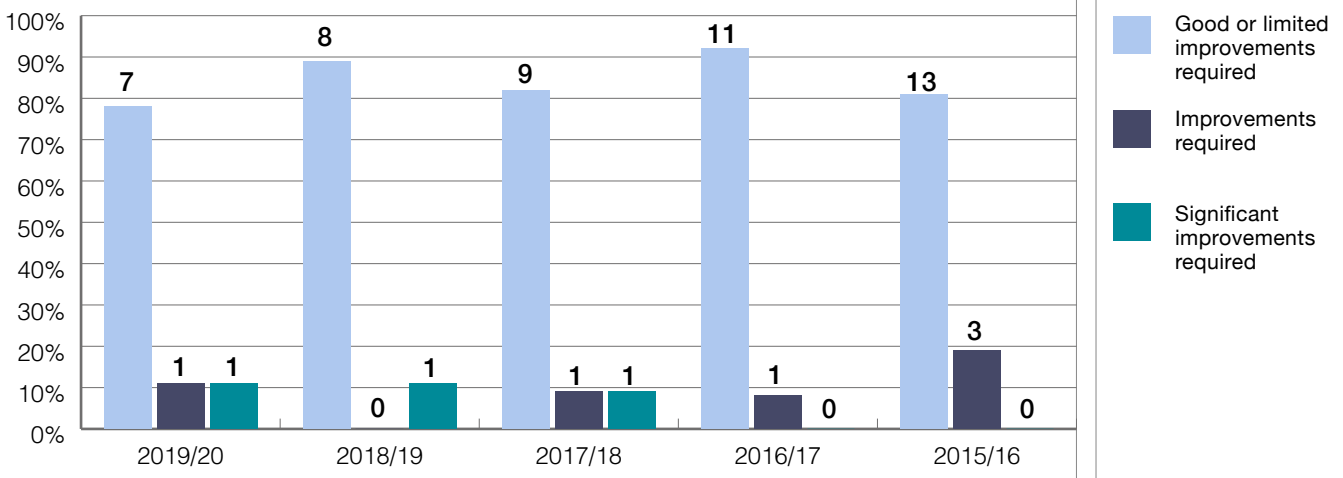
² We had selected 16 audits to review in the current inspection year. For one of these audits (Thomas Cook) the FRC's Enforcement Division decided to launch an investigation before the inspection was completed. In the other case (a non-UK company) it was not possible, for various jurisdictional and legal reasons, to start the inspection. Accordingly, only 14 audits are included in the numbers, although the findings for the audit that is subject to investigation are included within the key findings in this report.

Our assessment of the quality of audits reviewed

Ernst & Young LLP – All inspections



FTSE 350



Reviews of individual audits

Our key findings related principally to the need to:

- Improve the consideration and challenge of management's impairment assessments in relation to goodwill and other assets.
- Enhance group audit teams' oversight of component audit teams.
- Reinforce consistent quality control procedures on audits.

Good practice observations

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

- Effective group audit oversight.
- Goodwill impairment assessments.
- IFRS 9 implementation.
- Audit of fair values.
- IT audit testing of data migration.
- Engagement Quality Control Review (“EQCR”) involvement in the audit.

Further details of our findings on our review of individual audits are set out in section 2, together with the firm’s actions to address them, as well as details of the good practices identified in those audits.

Review of firm-wide procedures

This year, our firm-wide work focused primarily on the following areas:

- Partner and staff matters relating to the 2017/18 appraisal year.
- Acceptance and Continuance (A&C) procedures.
- Audit quality initiatives.
- Root Cause Analysis (RCA) process.

The reason for the focus on RCA and audit quality initiatives is the importance of taking effective actions to address recurring inspection findings.

Our key firm-wide findings in these areas related principally to the need to:

Partner and staff appraisals

- Improve certain matters related to the staff appraisal system implemented in late 2017.

A&C procedures

We had no significant findings to report.

Audit quality initiatives

- Enhance the monitoring of the audit quality initiatives by those independent of the audit practice.
- Strengthen the culture of challenge within the audit process.

RCA process

- Further improve the RCA process, in particular the coverage, and timeliness of formal reporting, of the RCA reviews on internal inspections and the reporting of RCA themes.

Good practice observations

We identified examples of good practice in our review of firm-wide areas, including the following:

- Partner and staff matters: incorporation of audit quality results into partner remuneration and manager promotion assessment processes.
- A&C procedures: involvement of the Board in monitoring and oversight of high-risk entities.
- Audit quality initiatives:
 - a formal milestone program, with expected dates for the phasing of the audit, and
 - the firm's initiatives to ensure audit teams understand the broader importance of audit and how their specific input contributes to audit quality.
- RCA process: timing of reviews and pre-set deadlines and use of questionnaires designed by behavioural specialists.

Further details of our findings of these firm-wide areas are given in section 3, together with the firm's actions to address them, as well as details of the good practices identified.

Firm's internal and ICAEW quality monitoring results

This year we have included, in each of our public reports, summary results of the firm's internal inspection results, together with, where performed, those of the ICAEW's latest quality monitoring. We consider that these results provide additional relevant information in relation to the assessment of the firm's audit quality.

The results of the firm's internal inspection results, together with those of the ICAEW's latest quality monitoring, are set out in Appendix 1.

Results of RCA and firm's related actions

Thorough and robust RCA is necessary to enable firms to develop effective action plans which are likely to result in improvements in audit quality being achieved.

In section 3 we have commented on the firm's RCA processes, based on our review of them earlier in the inspection cycle. The firm has since performed RCA in respect of our current findings and considered the outcome in developing the actions included in this report. We have reviewed the results (and related processes) of this and set out our key observations below, including whether there have been improvements in the related RCA processes since our review earlier in the year:

- There has been an improvement in the RCA-related processes, as set out in section 3, including the reporting of RCA themes and coverage of internal reviews. The firm has particularly good reporting of best practice themes.
- The firm performs proportionately fewer RCA reviews on audits rated "limited improvements required" than some other firms and excludes firm-wide inspection findings.

- The RCA themes are set out in a reasonable level of detail in the firm's RCA report, although not as detailed as some other firms. The trail between the individual RCA findings and the reported RCA themes was less clear than some other firms.
- Some of the firm's planned actions, relating to the initiatives in the firm's updated audit quality strategy (as referred to in the firm's responses), are in the process of development and we will review them when the relevant detailed plans have been completed.

We will continue to assess the firm's RCA process and encourage all firms to develop their RCA techniques and responsiveness of actions further.

Firm's overall response and actions:

We are committed to conducting high quality audits and meeting the expectations of our stakeholders. We have set a clear and unambiguous tone from the top that audit quality is the number one priority for all of our auditors and our approach to partner and staff recognition and advancement reflects this primacy of audit quality. Our audit leadership is clear that it will support audit partners in challenging discussions with the companies we audit which may include resigning from audit appointments when the directors do not respond appropriately to audit challenge. We also continue to evaluate all our audit engagements in the UK to ensure that the economic returns support the level of work, investments and financial resilience needed to deliver consistent high quality audits.

Through our Sustainable Audit Quality Programme, which started in 2014, we have made significant investments to improve audit quality which are driven and overseen by our Audit Quality Board which reports to the EY Board with oversight provided by our Independent Non-Executives. Since then we have invested substantially in our Programme, including developing and implementing new data analytical tools, expanding the size and scope of the activities of our in-flight audit file review team (Audit Quality Support Team) and expanding our Professional Practice Team, which provides real time support to audit teams as they seek to address complex audit and accounting issues. Further details of all these initiatives are set out in our Audit Quality Report which we published in October 2019 and which is available on our website. We are pleased the FRC note further improvement in our root cause analysis. We carried out 51 root cause analysis reviews compared to 43 in the prior year. This included 9 of the 14 audits inspected by the FRC ensuring we covered the lower rated audits and those audits with findings in the three key areas identified by the FRC. We use a bespoke on-line system to record all our work which requires we consider a first level cause and then a further level below this. The accumulation of these causes underpin the themes we have identified.

We are pleased the FRC has recognised the actions we have taken and has identified good practices in the areas of firmwide procedures it has highlighted as important, such as our partner remuneration, acceptance and continuance and our audit quality initiatives. Our firmwide controls are fundamental to our ability to perform high quality audits and we are further strengthening these to ensure our quality management system meets the requirements of ISQM 1, the quality management standard for

assurance engagements, which will be applicable in 2022. We are also pleased with the areas of good practice highlighted by the FRC in their inspections of individual audits, including in relation to our engagement quality control review procedures and the audit of highly complex and judgemental areas such as IFRS 9.

However, we are disappointed with the increase in the current year of audits assessed by the FRC as requiring more than limited improvements and that one of our audits was assessed as requiring significant improvements. We provide comments on the specific areas noted by the FRC in sections 2 and 3 of this report.

We also recognise we have not met the FRC's benchmark of 90% of our audits being assessed as requiring no more than limited improvements nor our own objectives. We are undertaking a major redesign of our Audit Quality Strategy which we see fundamental to achieving our audit quality ambition.

In redesigning our Audit Quality Strategy, we have taken account of emerging findings from the FRC, ICAEW and our own inspections as well as the output of our root cause analysis and the insights shared by the FRC in the December 2019 letter sent to major audit firms. During the last year we have conducted root cause analysis procedures on 51 audits, the majority following external or internal inspection reviews. The root cause analysis exercise has identified that our best audits incorporate a high degree of executive involvement, a well-resourced team, good team culture and strong project management. Conversely the themes that underpin the weaknesses identified are deficiencies in our review procedures, teams not applying sufficient professional scepticism, sub-optimal resourcing and a failure of teams to use guidance and tools available to them. Our redesigned strategy will support our adoption of ISQM 1 in driving consistent high audit quality and will address these issues and incorporates workstreams which we anticipate deeply impacting the operation of our audit business. The detailed plans for these workstreams are in development. We plan to present our redesigned strategy to the audit practice at our annual audit quality summit planned for September 2020. There are workstreams in each of the Six Pillars of our approach to Sustainable Audit Quality set out in our Audit Quality Report referenced above:

Tone at the top – We have a workstream which is dedicated to embedding further a culture of challenge and scepticism throughout the audit practice, recognising this is one of the key themes identified by our root cause analysis. Our previous work in this area has been focused on knowledge building, involvement of experts and the effective use of tools and templates. In response to the findings of our root cause analysis this workstream of our strategy will prioritise culture, mindset and behaviours. We have renewed our focus on addressing the risk of unconscious confirmatory bias as well as ensuring the appropriate identification and assessment of evidence that contradicts the positions reached by management. We will draw heavily on our positive root cause analysis findings from audits where we have done this successfully.

Exceptional talent – We have included workstreams focused on reviewing our operating model and one on the recruitment and retention of our people. We have identified resourcing as an important theme in our root cause analysis. Accordingly, we are going to re-challenge our operating model (the number and mix of audit partners

and staff including their experience and skills) to ensure it is appropriate to consistently deliver high quality audits, in line with our and the FRC's targets. We will ensure that we have those resources or manage the portfolio of audit activity accordingly. We are also reviewing the way we recruit our people to ensure we are recruiting those with the appropriate skills and mindset. We need to work harder to retain those people by supporting development alongside a good work life balance.

Accountability – Over the last five years we have developed and worked on Audit Quality Indicators to support us in identifying potential issues arising in our audit practice and on individual audits and enabling us to address them. We know we can develop the quantitative aspect of this further and we are using the insights provided by the FRC's recent thematic review to drive a workstream focusing on this area.

Audit technology and digital – The audit profession has been undergoing unprecedented transformation in its capabilities to leverage and interrogate data. We have successfully implemented a range of data analytic approaches. Our next step is to implement the EY Digital Audit which is a full transformation of the audit approach to be data driven and we have a workstream dedicated to the successful implementation of this over the next 2 years.

Simplification and innovation – We have a worksteam which is focused on further development of the EY audit team behavioural model which begins with a focus on ensuring audit teams appreciate the broader importance of audit in society, and how their specific input contributes to audit quality. Our positive root cause analysis supports this being a driver of high quality and we remain committed to developing it further. Effectively implemented it also ensures appropriate use of guidance and tools on the audit.

Enablement and quality support – Our root cause analysis has re-emphasised the importance of effective review and we therefore have a Quality Control workstream focused on three areas: detailed review procedures, Engagement Quality Control Review and our Audit Quality Support Team model. We will be reviewing the delivery models in place, the skills needed and how we drive consistent good practices in these areas. We recognise that we learn from carrying out robust and thorough root cause analysis and taking action on the insights that brings. We therefore have a workstream focused on continuous improvement of our work in this area alongside appropriate and timely responses to the findings. We will be using the feedback from the FRC in our work.

We have validated our initial redesign of the strategy against the overall root cause analysis outcomes to ensure the planned workstreams address all the weaknesses identified as well as ensuring we continue to build on initiatives that we know from experience make a difference to audit quality. Our Independent Non-Executives have reviewed and challenged the development of our redesigned strategy and how we plan to finalise and implement it. We will continue to benefit from the challenge they bring through monthly review meetings and will evolve, develop and add to this strategy to ensure that it remains responsive to issues and concerns arising.

Fundamental to the implementation of our new strategy is continued effective governance and supervision of the audit business to ensure it maintains its focus on audit quality. However, we also believe it is vital that the audit business retains access to specialists and also remains financially resilient. The current Covid-19 crisis is demonstrating the benefit of a resilient audit business with priority access to the firm's specialists outside the audit practice, to support difficult audit judgements in complex areas of accounting. Good use of specialists is also one of the elements the FRC note they observe on high quality audits. It is therefore vital that any operational separation reform proposed by the FRC should not have unintended consequences, not compromise these attributes and in turn risk audit quality. We also think it is critical that there is a recognition by all stakeholders that operational separation at some audit firms cannot be a panacea for audit quality across the industry. In the absence of the full body of reforms proposed by the Kingman and Brydon reviews to drive improved corporate reporting and governance and the establishment of ARGA to oversee those reforms we are concerned that an expectation gap around the improvement in audit quality will exist.

We would like to thank the FRC for its work and the independent perspective it brings. UK business and the audit profession are facing an unprecedented time – improving audit quality has never been more vital and this continues to be our highest priority.

We will monitor closely the promptness and effectiveness of the firm's actions. Should these not address our concerns adequately, we will consider what further steps we need to take to both safeguard and improve audit quality.

2 Review of individual audits

We set out below the key areas where we believe improvements are required to enhance audit quality and safeguard auditor independence. We asked the firm to provide a response setting out the actions it has taken or will be taking in each of these areas.

Improve the consideration and challenge of management's impairment assessments in relation to goodwill and other assets

Goodwill impairment assessments include the estimation of future cash flows and are subjective. Changes in key assumptions could result in a material impairment. Auditors should therefore consider and challenge the key assumptions to assess whether they are reasonable.

Key findings

We reviewed the audit of impairment of goodwill and other assets on all audits that we inspected where this was identified as an area of significant risk. While there were some audits with good audit work, we identified the following issues relating to the consideration and challenge of management's impairment assessments on six audits:

- On three audits the audit teams did not sufficiently challenge and, on another audit, corroborate management's growth forecasts to assess the forecast levels of headroom for each CGU. On one of these audits there was insufficient evidence of the corroboration of the forecast cost and profit improvements and sensitivity analysis.
- On one audit there was insufficient evidence of the audit team's challenge in relation to the discount rate used. The audit team also did not perform sufficient sensitivity analysis or adequately assess the accuracy of the sensitivity disclosures in the financial statements.
- On another audit the audit team did not obtain sufficient evidence, for one of the CGUs, to support its assessment of a key assumption or ensure that the internal valuation specialists confirmed the reasonableness of the assumption. On another CGU in the same group, the audit team did not sufficiently challenge and corroborate the reasonableness of management's projected price increases, including the status of negotiations with key customers.

Firm's actions:

We are pleased that the FRC has identified examples of good practice in our audits. However, we recognise that we are not achieving this consistently and that we need to undertake further actions to achieve that consistency.

Our root cause analysis (RCA) indicates that on occasions our audit teams demonstrated an unconscious confirmatory bias towards corroborating management's estimates. Whilst in each case the audit teams believed they were challenging appropriately, this unconscious bias meant they were not always seeking to identify and evaluate all possible evidence, including evidence that may be inconsistent with management's conclusions.

This issue was compounded when our audit working papers were unclear as to the work undertaken and how management had responded. This was more likely to happen when work was completed under time pressure.

Conversely our RCA has identified that when teams applied the EY audit behavioural model fully, planned their audit strategy in detail and ensured that they had a clear understanding of the key assumptions they were far more able to fully test management's assessments. This also enabled an appropriately experienced team member to be given responsibility for comprehensively recording the work performed and the conclusions reached.

We have already undertaken a number of actions to address this area as findings began to emerge from the inspections:

- We included a case study based session on professional scepticism in our mandatory summer training in 2019.
- We delivered two training sessions during October and December 2019, which included reminders on this topic and the importance of resourcing decisions.
- We ran a further training session in all offices on exercising professional scepticism during December 2019 and January 2020.
- We have provided additional guidance to audit teams on impairment testing. This includes a guide to share with companies preparing impairment reviews and an improved template to facilitate better documentation.
- We are currently running a pilot with a provider of industry data to assess whether the audit teams would benefit from alternative sources of data to support them in their challenge of assumptions and as a source of alternative and potentially contradictory evidence. This provider offers sector analysis reports on over 400 sectors of the UK economy and are in a consistent format which are updated on a regular basis.
- Our in-flight AQST reviewers and the sessions we encourage through our EY audit team behavioural model support the work of our teams. We will continue to drive these initiatives, focusing more in-flight reviews specifically on this topic and focusing team behaviours on planning, allocation of work and senior team involvement.

However, we recognise that we need to take further action and in particular that we need to help our audit teams avoid the unconscious confirmatory bias discussed above. Accordingly, embedding a culture of challenge is a key component of our redesigned audit quality strategy discussed above. Alongside this we have a new focus on clear and concise writing skills for our teams. We will also be reminding audit teams and the companies we audit that delays in management providing their workings, documentation and key assumptions are likely to lead to delays in the completion of the audit. We will deliver further training to help teams to identify and respond to contradictory evidence, alongside sharing good practice.

Enhance group audit teams' oversight of component audit teams

The group audit team is responsible for the direction, supervision and coordination of the group audit, including work at component level and therefore need to demonstrate sufficient involvement throughout the audit process.

Key findings

For all group audits, we reviewed the level of involvement of the group audit partner and other group audit team members in the direction, supervision and review of the component audits. We identified some examples of good practice in relation to their involvement. However, in the following audits, there was insufficient evidence of the group audit team's involvement and oversight of aspects of the component auditors' work:

- On two significant components of a group audit, there was insufficient evidence of the group audit team's review of significant risk workpapers, discussions with the component audit team, the follow-up of late and incomplete component reporting and the resolution of challenges raised to the component audit team by the group audit team. On another audit, given the group audit partner's previous involvement on the audit of a significant UK component, another partner was assigned responsibility for the oversight of that component, however that partner was not sufficiently involved in the review of that component audit.
- On another significant component of a group audit there was no evidence of discussions between the group audit partner and the component audit team, including attendance at the closing meeting, and no review of the underlying work papers for significant risk areas. On another audit the group audit team did not review the largest component's key revenue audit work papers. On both of these audits, the EQCR did not discuss the results of their review with the component key audit partners, as required by Auditing Standards.
- On three audits, there was insufficient assessment and evaluation of the IT audit procedures performed by component audit teams.

Firm's actions:

We have had a consistent focus on the oversight of component audit teams and have delivered training and developed standardised templates to assist audit teams in meeting the requirements of the relevant auditing standard. We are pleased that this investment has enabled a number of our audit teams to apply and demonstrate effective group oversight as highlighted in this report. However, we have not achieved consistent audit quality in this area.

Our RCA has highlighted that some audit teams did not spend sufficient time during the audit planning phase designing, in detail, their approach to the oversight of component audit teams and ensuring it aligned with the judgements made in the setting of the audit scopes for those underlying components. This led to an inconsistent approach to the recording of interactions with component audit teams, including recording follow up and resolution of the matters arising from the primary team review. The RCA indicated that some teams had found it complex to apply the standardised guidance and templates to the specific circumstances of their audit. Further investigation has highlighted that teams would like access to a selection of good practice examples to supplement the templates and guidance and we will therefore be providing those to support teams and further updating our standard template to assist teams addressing more complex situations.

We delivered two training sessions during October and December 2019 as this finding began to emerge from the inspections. These included reminders of the updated guidance in relation to group audit requirements, including specific requirements in relation to the EQCR's discussions with key audit partners. In addition, we provided guidance as to the appropriate extent of oversight over IT audit work.

We will address the weaknesses identified in planning through continued application of our key quality initiatives on project management, the EY audit team behavioural model and AQST reviews to ensure there is an appropriate level of early executive involvement in the planning of this area and that this planning is carried out at a sufficiently granular level to drive the necessary audit response. We will carry out targeted checks on the detailed planning for this specific area.

Reinforce consistent quality control procedures on audits

Auditing Standards require the audit partner to take responsibility for the overall quality of the audit. This includes direction, supervision and review of the audit work performed by the audit team. Shortcomings in audit evidence should be detected by quality control procedures, so that they can be remedied before the audit report is signed.

Key findings

While we identified some good practice, such as in relation to the involvement of EQCRs on some audits, we identified the following deficiencies in quality control procedures on other audits we reviewed:

- On two audits there was insufficient evidence of consultations with audit technical and other internal experts, including how the audit team had resolved certain matters (for example, the response to fraud risk, addressing internal audit findings and bank covenant compliance for going concern purposes). On one of these audits, the audit team performed insufficient work to conclude on outstanding matters at the time the auditor's report was signed. The firm's quality control procedures did not identify a number of shortcomings, including a lack of evidence to conclude on these matters, inadequate consultation and insufficient or late review of certain matters by the EQCR.
- On two audits, where a number of audit workpapers had been modified after the auditor's report date (during the archiving period) there was insufficient evidence that the changes were only administrative in nature. We inspected other audits where, to a lesser extent, similar modifications had occurred. The firm should require more explanation of changes made to audit workpapers after the date of the auditor's report date and should improve its monitoring of this area.
- We also identified insufficient review procedures on the above, and three other, audits in respect of key areas of the audit, for example revenue, going concern and disclosure requirements.

Firm's actions:

We have established a number of quality control procedures to help ensure that our audits are of a consistently high standard and we are therefore disappointed that, whilst the FRC identified some good practice there were deficiencies in this area on the audit rated as requiring significant improvements.

We believe that we have a strong culture of consultation within our audit practice, but our RCA has indicated that some teams placed undue reliance on "informal consultations" with our internal experts and, where combined with weak project management, this led to matters being left inadequately resolved. We have already taken action to improve aspects of our formal consultation process through the issuance of updated guidance to those involved in our Consultation Panels. Our focus on effective project management through our milestone programme and EY audit team behavioural model will, we believe, further help us to address this issue and we will also be using our EQCR forum to share best practice amongst those who act as EQCRs.

In relation to the FRC's findings on our work paper review processes, our RCA has identified that on occasions senior team members did not recognise that they had become too familiar with the detail of the audit work performed, through their own involvement, to undertake a sufficiently robust and independent challenge of the working papers when they subsequently reviewed them. We delivered training sessions on performing review procedures during December 2019 and January 2020 and plan to do more work in this area, including providing further guidance on ensuring that those assigned review responsibilities are able to do so with a "fresh pair of eyes".

Auditing standards permit audit teams to make administrative changes to audit documentation during a limited period post the signing of an audit opinion. However, our RCA has indicated that audit teams had found our previous guidance on the practical application of this requirement unclear. We have therefore issued new guidance which sets out more clearly how changes during the archive period should be recorded on the audit file. We have also changed our documentation and archive policy reducing the period during which administrative changes can be made as well as limiting what constitutes an administrative change. We are carrying out spot checks to ensure compliance with this revised policy.

Good practice

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

- **Effective group audit oversight:** on two audits, the group audit team's review of the work of component auditors work and on two other audits the IT audit oversight. On one of these audits, the group IT instructions were comprehensive, including tailored component IT work programs, which ensured consistency of audit work and reporting to the group audit team.
- **Goodwill impairment assessments:** on three audits, the evaluation of the goodwill impairment assessment. On one of these audits, there was a thorough assessment of management's ability to forecast accurately and the appropriateness of the pre-tax discount rate.
- **IFRS 9 implementation:** on one audit, the planned approach to, and implementation of, IFRS 9 (accounting for financial instruments). This included the extent of audit procedures performed, the challenge of management and audit evidence to support the conclusions reached over the IFRS 9 models and credit risk assumptions. There was also good use of data analytics.
- **The audit of fair value:** on the same audit as the good practice example for IFRS 9 implementation, the qualitative risk assessment of the fair value of financial assets and liabilities, which included harder-to-value financial instruments.
- **IT audit testing of data migration:** on two audits, the work performed over data migration including, on one of these audits, the consideration of the risks of incomplete and inaccurate data transfer.
- **EQCR involvement:** on two audits, the extent of review and involvement of the EQCR. On one of these audits, there was good evidence of discussions between the EQCR and the audit team throughout the audit and on another audit a high level of challenge of the audit work and evidencing of their final conclusions in significant areas of the audit.

3 Review of firm-wide procedures

We reviewed firm-wide procedures, based on those areas set out in International Standard on Quality Control (UK) 1 (“ISQC1”), as well as certain other key audit initiatives. We review some areas on an annual basis, and others on a three-year rotational basis.

This year, our firm-wide work primarily focused on the following areas:

- Partner and staff matters.
- Acceptance and Continuance (A&C) procedures.
- Audit quality initiatives.
- Root Cause Analysis (RCA) process.

Partner and staff matters

Background

Processes relating to the appraisal and remuneration of partners and staff are a key element of a firm’s overall system of quality control and are integral to supporting and appropriately incentivising audit quality. Our inspection included an evaluation of the firm’s policies and procedures, and their application to a sample of partners and staff for the 2017/8 appraisal year, across the following areas: appraisals and remuneration; promotions; recruitment; and portfolio and resource management.

Key findings

We identified the following key findings, where the firm needs to improve the consideration of audit quality in relation to:

- Improve certain matters relating to the staff appraisal system implemented last year: the firm’s new global system for performance management, LEAD, was used for the first time for the 2017/8 appraisal cycle. It is designed to support real-time feedback discussions, with reduced documentation. Across the staff appraisals reviewed, we identified several cases where there was insufficient evidence of how the appraiser had considered audit quality (including relevant findings from internal or external quality inspections), or of how quality ratings had been determined. We also noted that LEAD does not require staff to set objectives to respond to adverse quality findings identified in internal or external quality inspections.

Good practice

We identified the following areas of good practice:

- **Link from audit quality to partner remuneration:** there was clear evidence to demonstrate how audit quality results are incorporated into long-term remuneration for partners, in addition to their impact on in-year variable pay.
- **Manager promotion process:** the firm requires all candidates to attend and pass a formal assessment centre. The assessment of readiness for manager promotions is more robust than what we have observed at other firms.
- **Partner portfolio reviews:** the firm has a thorough process for the central review and monitoring of partner portfolios.

Firm's response and actions:

We are pleased that the FRC has identified the clear linkage between partner reward and audit quality as an area of strength. We believe that this evidences the strong tone from the top and the paramount importance of audit quality within the firm.

We believe, based on feedback from our staff, that our appraisal system LEAD has significantly improved the quality of our counselling process. We are also confident that our counselling and appraisal processes are robust and give full consideration to audit quality for all individuals with each person being graded specifically for audit quality at the end of the year. However, we recognise that certain of the features of LEAD may have contributed to the gaps identified by the FRC.

We have therefore enhanced the guidance we provide to our staff emphasising the importance of both assessing and documenting that assessment of each individual's performance in relation to audit quality including any internal or external inspection results. We are preparing a short training video for the coming year end to reiterate this. We will be monitoring completion of the year end documentation and carrying out sample checks on the quality of that documentation.

We have set an expectation that objectives must be designed to respond to adverse quality findings. These expectations are reiterated at the time staff set their objectives for the annual cycle and should be discussed with counsellors. Whilst LEAD does not facilitate recording of this, we will improve the way these objectives are captured to enable easier verification that this process has been followed.

Acceptance and Continuance (A&C) procedures

Background

Audit quality control processes incorporate risk management procedures and are undertaken at various stages of the engagement. In accordance with the requirements of ISQC1, the firm has detailed policies and procedures relating to acceptance and continuance decisions for audited entities. We have reviewed these processes and their application within our firmwide inspection activity this year.

Given the greater number of audit tenders in recent years, we assessed firms' acceptance and continuance processes as at October 2019. We also discussed with senior leadership any proposed changes to these processes together with each firm's strategic decisions. In addition, we considered firms' policies relating to withdrawal/dismissal from audits and, for a sample of audits, the statements provided to the public, successor auditors and the regulatory authority in connection with withdrawal/dismissal.

Key findings

There were no key findings arising from our review.

Good practice

- **Involvement of the Board in monitoring and oversight of high-risk audits:** There is clear evidence of direct Board involvement, including regular oversight and challenge of high-risk audits. This demonstrates the firm's commitment to assess the suitability of continuing to act for a specific entity. Moreover, it ensures that the Board is aware of any potential reputational or other risks arising and actions proposed to address them.

Firm's response and actions:

Our controls over the decisions we make when we accept and continue audit relationships are fundamental to our ability to deliver audit quality. In particular it is critical that we appropriately assess the risk of each audit and respond accordingly. Therefore, we are pleased that the significant investment we make in this process has been recognised by the FRC. However, we also recognise that this has to be an area of continued focus for us, particularly in the current difficult economic environment.

Audit quality initiatives

Background

We reviewed key aspects of the firm's plans to improve audit quality ("the plan"), including the firm's monitoring of the progress of the plan and other key audit quality initiatives. This included the consideration of recurring themes identified in the RCA of past inspection findings, in the following areas: culture of the firm, including challenge of management; in-flight reviews (internal reviews undertaken during the audit/central support); and project management/ milestone programs (monitoring the phases of completion of audits).

EY has been evolving its audit quality plan and related initiatives for a number of years. The plan is influenced by the global Sustainable Audit Quality Plan, with a number of mandated areas.

The key areas of the plan include:

- Focus on the importance of the audit work using the EY audit team behavioural model: Purpose Led Outcome Thinking (PLOT).
- Resourcing.

- In-flight reviews (AQST) and support.
- Project management, through milestones.

Key findings

Our key findings are set out below and have been communicated to the audit leadership during the year so that relevant actions could be taken on a timely basis:

- Enhance the monitoring of audit quality initiatives by those independent of the audit practice: EY's audit quality initiatives are primarily monitored by the Audit Quality Board (AQB), a sub-committee of the Board, made up of members of the audit practice. There should be more input from individuals independent of the audit practice on the monitoring of the audit quality initiatives, in order to provide increased challenge on the sufficiency and effectiveness of those initiatives.
- Strengthen the culture of challenge in audit process: while EY has certain initiatives around culture, the firm has not sufficiently focused on embedding a culture of challenge in its audit process. There should be more emphasis on challenge of management in the values and expected behaviours of audit teams.

Good practice

We identified the following areas of good practice:

- **Project management procedures:** the firm has a formal milestone program, whereby the firm sets clear targets for when key phases of the audit should have been completed.
- **The EY audit team behavioural model and related programme (PLOT):** this is used on audits, and is partner led, to help audit teams understand the broader importance of audit and how their specific input contributes to audit quality.

Firm's response and actions:

We have put a great deal of focus on the use of the milestone programme and the EY audit team behavioural model in our audits, and we are therefore pleased that the FRC identified these as areas of good practice.

When we commenced our Audit Quality Programme in 2014, we established a Steering Committee, which included partners from outside audit, whose purpose was to challenge the objectives, implementation and effectiveness of the Programme. Once the Programme was established and supported by the extended Global SAQ Programme, this Committee was dissolved. The UK Audit Quality Programme continues to be monitored monthly by the Audit Quality Board and at each meeting of the Independent Non-Executives as well as being monitored by our Global Quality Leader. As we note on page 12 we are launching a major redesign of this Programme and as part of this we will be establishing a new oversight structure. We have designed a new Audit Quality Programme report, which will include status updates on all key initiatives. We plan to commence using this to report monthly to the Audit Quality Board to coincide with the redesigned strategy in the second half of 2020. It will also be presented at each meeting of the Independent Non-Executives.

We recognise the importance of a culture of challenge being embedded throughout the audit process. We currently have initiatives in this area as recognised by the FRC and as set out in our response on page 12, but we appreciate we need to do more to embed fully this culture and overcome challenges such as unconscious confirmatory bias. Our redesigned strategy has a workstream dedicated to this. We will continue to drive some of our work in this area through the EY audit team behavioural model, as our RCA aligns with the FRC's view that this is an area of good practice and it supports driving the right culture and behaviours throughout each audit team.

The Firm's RCA process

Background

The RCA process should be designed to identify the causes of inspection findings, in order to aim to prevent them from recurring. It is part of a continuous improvement cycle of inspecting audits, investigating the root causes for inspection results and improving the firms' ability to act on them through implementing effective actions.

The firm has been performing RCA for a number of years and follows methodology and guidance set out by the global firm, supplemented by additional UK specific procedures.

This year, we have reviewed the firm's 2018/19 process for undertaking its RCA, including resources and timing.

Key findings

The firm should further improve the RCA process, in particular in relation to:

- **Coverage:** the firm has reviewed a lower number of internally inspected audits than some other firms. It should consider extending its coverage of these reviews.
- **Reporting of RCA themes:** the annual RCA report focuses on external inspections and has less information about themes across all types of RCA reviews (including internal inspections). In addition, the results of the RCA reviews of internal inspections findings are not reported to the Board or INEs on a timely basis.

Good practice

The firm has continued to develop its RCA process. We identified the following examples of good practice in the RCA process:

- **Timing of reviews:** the firm sets deadlines for completion of RCA on individual audits. This ensures that the RCA is performed on an ongoing basis.
- **Use of questionnaires designed by behavioural specialists:** the audit team members complete the questionnaire to help the RCA team understand the behaviours that contributed positively or negatively to audit quality.

Firm's response and actions:

We continuously seek to improve our RCA process and we are pleased to see the good practice areas identified. The Audit Quality Board approved the 2019/20 RCA plan which incorporated further improvements for work completed during the last twelve months, the results of which are included in this report. This includes additional reviews compared to the number assessed by the FRC in their review of the firm's 2018/19 process: the total number of internal inspections on which RCA procedures were completed has been increased from 13 audits (8%) to 21 audits (19%). We have also introduced the use of focus groups across the practice to validate the findings and provide input into the proposed actions to respond to those findings. The status of all RCA work, findings to date and planned actions to be taken are reported monthly to the Audit Quality Board. The 2019/20 RCA report includes overall themes as well as themes arising for the different categories of review.

The firm's internal inspection process was completed in September 2019. The results of the RCA on internal inspections were summarised and presented to the audit practice in a webcast during December 2019. The results of the RCA reviews were reported in updates to the Audit Quality Board at their meetings in October, November and December 2019. The Audit Quality Board reports on key matters to the Independent Non-Executives and main EY Board for each of their respective meetings. Whilst reports to the Independent Non-Executives included a summary of the RCA work, it was not in the same level of detail as that considered by the Audit Quality Board. Going forward, we will share a more detailed summary of the results of RCA on internal inspections with the Independent Non-Executives and the EY Board.

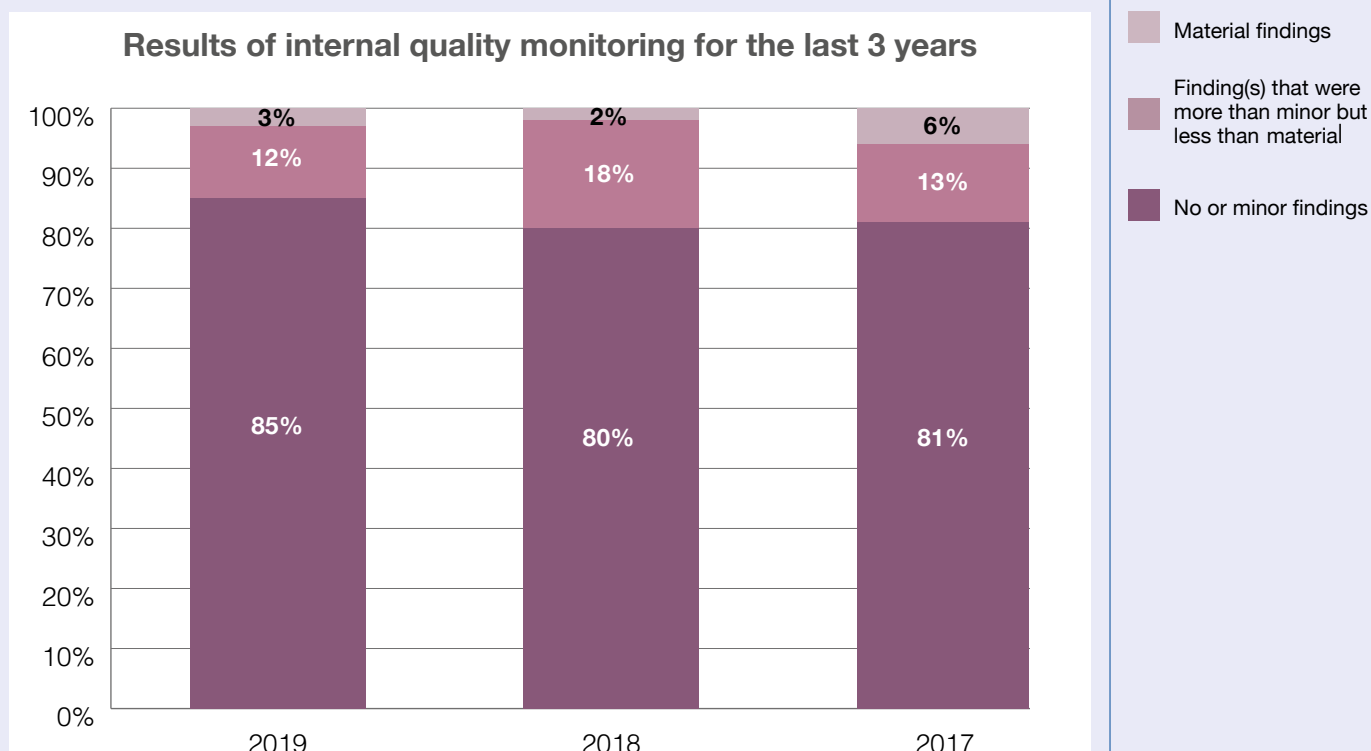
Appendix 1: Firm’s internal quality monitoring and ICAEW results

This appendix sets out information relating to the firm’s internal quality monitoring for individual audit engagements. It should be read in conjunction with the firm’s transparency report for 2019, which provides further detail of the firm’s internal quality monitoring approach and results, and the firm’s wider system of quality control. 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.

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 Audit Quality Review (“AQR”), which comprised internal inspections of 109 individual audits (excluding public sector) with years ending between May 2019 and September 2019, are set out below along with the results for the previous two years.



Minor findings are generally limited to cases where additional explanation or documentation is required for clarity of the audit file. More than minor findings typically require more detailed documentation improvements or arise when a piece of audit evidence was omitted from the audit file. Material findings either require additional audit procedures to be performed subsequent to the audit opinion or significant remediation of the audit file.

Firm's approach to internal quality monitoring

The firm's internal inspection program considers the full population of audits performed. The AQR is designed to cover each individual responsible for signing audit opinions at least once every three years, and every FTSE 350 audit at least once every six years. Inspections are conducted by EY professionals from offices other than those in which the audit was undertaken, as well as a significant proportion of reviewers drawn from other EY member firms outside the UK. The reviews are subject to oversight from senior partners and associate partners of other member firms to ensure the rigour and integrity of the process and the consistency of application across all EY members firms.

The firm undertakes root cause analysis ("RCA") of the findings from a sample of audits reviewed in the AQR, including all significant findings as well as some audits where good practice was identified. The results of the RCA are fed back into the firm's audit quality programme. In cases where a material finding is identified, the firm considers if the audit file requires remediation and, where required, performs additional audit procedures. In addition, in all such cases, action plans are drawn up aiming to ensure the same issues do not recur on those engagements in the following year.

Firm's response and actions:

Our results above show a positive improvement in our audit quality over the last 3 years, in line with the ongoing investment in our Audit Quality Programme. In 2019 85% of audits reviewed had no or only minor findings. However, we were disappointed that three of the 109 engagements reviewed were rated 3 and we recognise that we need to do more to attain our audit quality objective that no audit reviewed in AQR will have a material finding. The 3-ratings were driven by the following findings:

- Insufficient audit work performed over three substantive areas where the audit work was performed in advance of the year end and there was a lack of appropriate roll forward procedures.
- Errors in the strategy and execution of inventory counts for a retail client.
- Insufficient audit work over a significant risk area.

For all three audits action plans have been developed and implemented to address the findings identified.

The results of our internal AQR process indicate a higher percentage of audits inspected as having no or minor findings than those reviewed by the FRC. The internal AQR process covers over 100 audits each year and with every audit carried out by EY in its scope is reflective of the full population of audits we carry out. The audits selected by the FRC for review (14 completed in the current year) are predominantly drawn from the population of listed and PIE company audits we perform, in line with the scope of its inspections disclosed on its website. As set out on page 6 of this report the FRC also focus on those audits which it sees as higher risk.

We have carried out root cause analysis procedures on 21 of the audits covered by the AQR process. This includes all those that had material findings, audits which included findings that were more common across the population as well as some of those audits that were identified as particularly high-quality audits with no or very limited findings.

The root cause analysis of positive review outcomes identified that the most significant contributor was a high level of involvement by the senior team members. We also identified that those audits with particularly high quality tended to have a good team culture, which links to the importance we have placed on our PLOT initiative, applied good project management and had good continuity in the composition of the audit team.

Conversely for those audits with findings the root cause analysis identified a number of underlying causes which included: on a number of audits there was an overreliance on audit strategies which had been developed in prior years which needed to be modified and updated, our file review procedures did not always identify matters which should have been addressed and in certain cases the team did not have the resources they had planned on. Deeper involvement of the engagement partner at the planning and execution phase should have enabled these weaknesses to be addressed.

The output from our root cause analysis on our internal inspections and on audits inspected by QAD have been fed into our overall audit quality strategy and related actions which is discussed in our responses to the FRC's findings in the body of this report.

Results of ICAEW monitoring

Background

The firm is subject to annual 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.

Scope

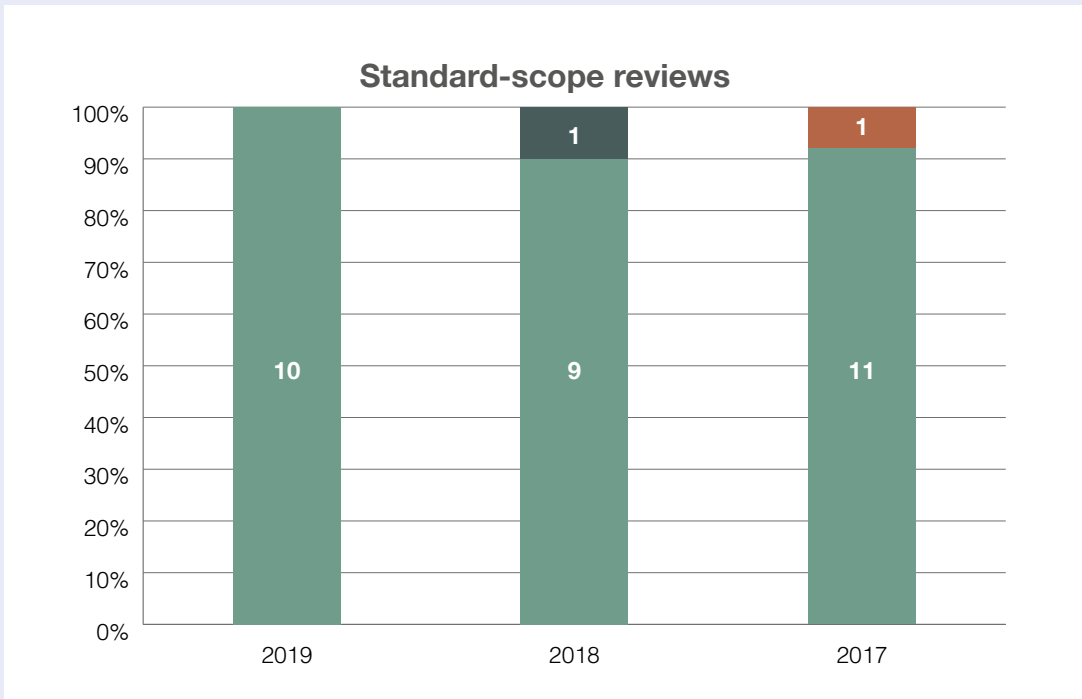
Reviews of audits are either standard-scope or focused. Standard-scope reviews are designed to form an overall view of the quality of the audit. ICAEW assesses the audits it reviews as either 'satisfactory / acceptable', 'improvement required' or 'significant improvement required'. Where appropriate, ICAEW also carries out focused reviews to follow up on significant issues highlighted in the previous year's file reviews or other specific risks. These reviews are limited in scope. Visit [icaew.com/auditguidance](https://www.icaew.com/auditguidance) for further information about ICAEW's audit monitoring process including its approach to assessing audits.

ICAEW has completed its 2019 monitoring review and the report summarising its audit file review findings and any follow-up action proposed by the firm will be considered by ICAEW's audit registration committee in September 2020.

Results

In 2019, ICAEW concluded that the firm has continued to maintain a generally good standard of audit work and all files were satisfactory or acceptable. ICAEW also carried out one focused review which demonstrated that the firm had fully addressed previous concerns. Findings related mainly to isolated aspects of audit evidence and documentation, with no particular themes. ICAEW identified and shared a number of examples of good practice.

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



- Satisfactory/acceptable
- Improvement required
- Significant improvement required

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.

Response from the firm

We are pleased to see improvement in the results of the file inspections over the last three years and that all of our files this year were assessed as satisfactory / acceptable. We have however undertaken RCA on the findings that QAD has identified and are incorporating actions to address those root causes in our updated audit quality strategy (discussed further in our response to the FRC on page 12).

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