



Financial Reporting Council

GRANT THORNTON UK 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.

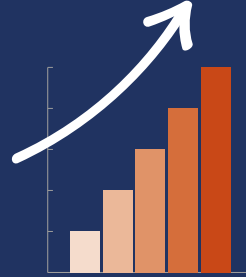
The FRC works with European, US and global regulators to promote high quality audit and corporate reporting.



AQR

We monitor the quality of UK Public Interest Entity audits.

+355	0.20%	+2.27%	-11.48%	POS	-3.2320
+520	0.21%	+2.83%	-15.93%	NEG	-3.9993
+365	0.14%	+2.42%	-17.67%	POS	-4.2421
+338	0.27%	+2.19%	-18.32%	NEG	-4.2083
+272	0.20%	+2.26%	-14.73%	NEG	-3.5708
+272	0.20%	+2.76%	-20.12%	NEG	-2.8339



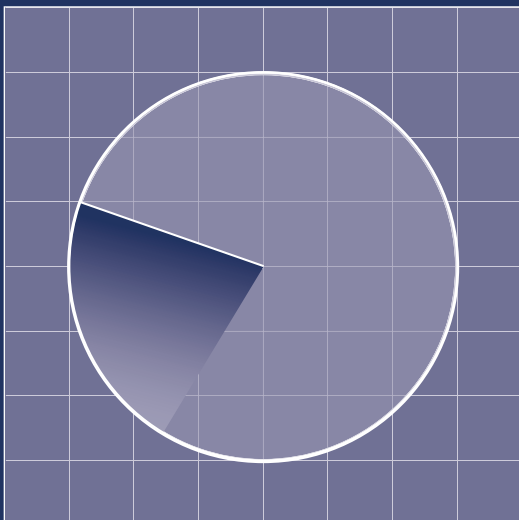
We promote continuous improvement in audit quality.

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



The Firm

Grant Thornton UK LLP has 50 audits within the scope of AQR inspection, including 4 FTSE 350 audits.



On 29 March 2018 the firm announced that it has taken the strategic decision to move away from tendering for statutory audit work in the FTSE 350. It will continue to serve its existing FTSE 350 clients.

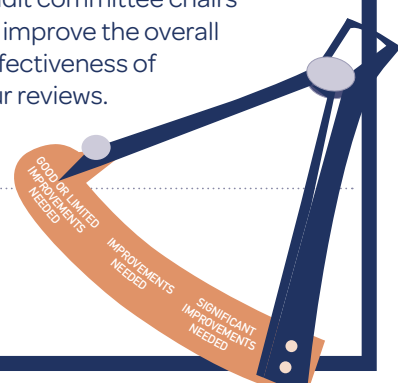
Our inspection process

There are around 3,000 audits within the scope of AQR inspection. Of these, we inspected 130 audits in 2019/20, including the 9 Grant Thornton 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

Grant Thornton UK 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.

Contents

1	Overview	5
2	Audit quality plan	15
3	Review of individual audits	20
4	Review of firm-wide procedures	26
	Appendix 1: Firm's internal quality monitoring results	29

This report sets out the principal findings arising from the 2019/20 inspection of Grant Thornton UK LLP ("GT" 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 April 2019 to March 2020 ("the time of our inspection"). We inspect GT, and report publicly on our findings, annually.

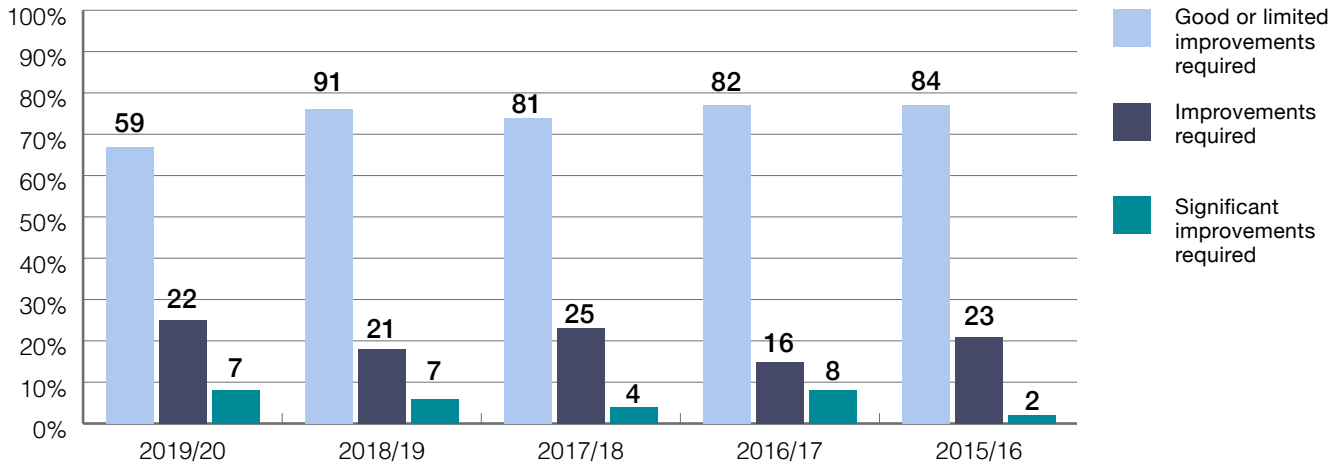
Our report focuses on the key areas requiring action by the firm to safeguard and enhance audit quality. It does not seek to provide a balanced scorecard of the quality of the firm's audit work. Our findings cover matters arising from our reviews of both individual audits and the firm's policies and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

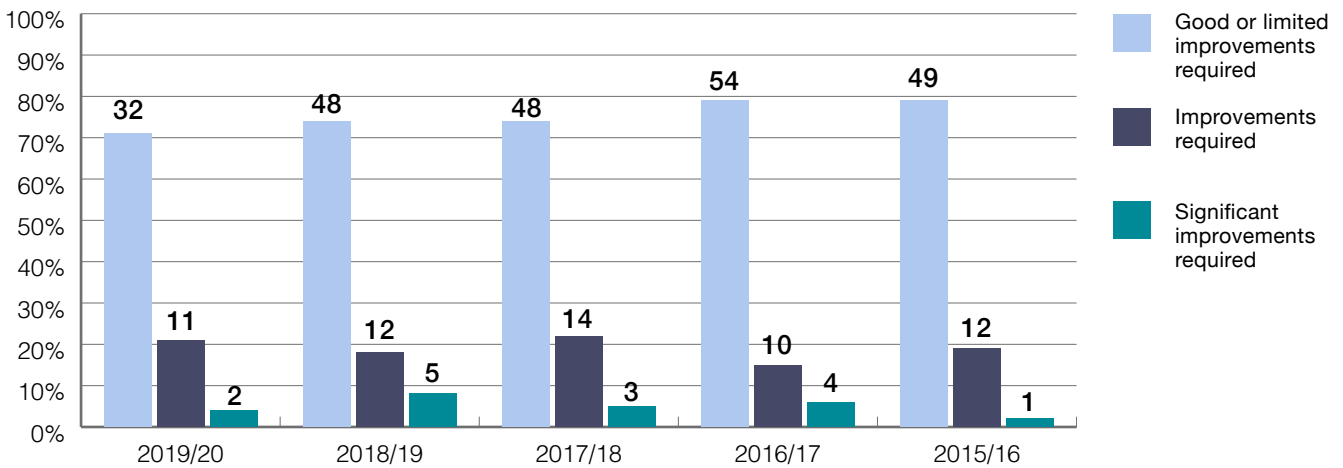
Our assessment of the quality of audits reviewed

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, although the number of inspections at Grant Thornton increased. 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 inspections (39%), 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.

GT Overall assessment

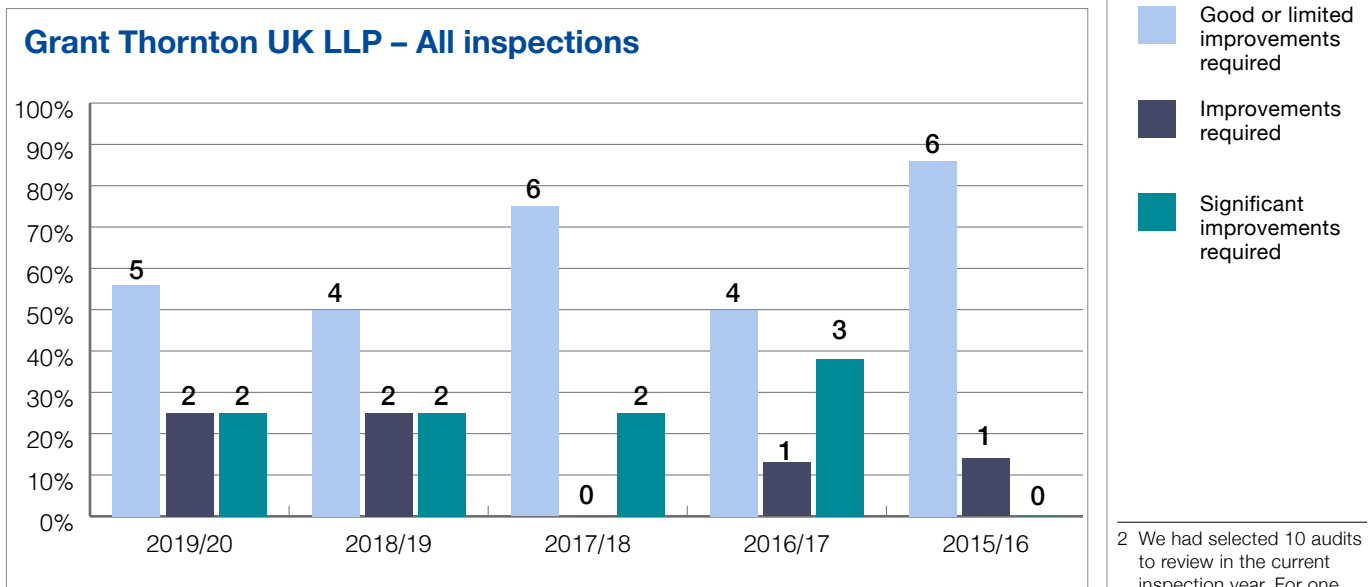
We reviewed nine² individual audits this year and assessed only five (55%) of them as requiring no more than limited improvements.

In response to the very poor audit quality identified in our 2019 report on the firm, GT initiated an audit quality plan which GT refer to as its Audit Investment Plan (“the plan” or “the AIP”) in Spring 2019. We therefore increased our scrutiny of the firm as explained in Section 2. Due to the timing of the plan, it had not yet had any significant impact on the quality of the audits we reviewed in this inspection cycle.

The firm has taken steps to address the key findings in our 2019 public report through the AIP, including focused training and standardising the firm’s audit work programs. We have identified improvements, for example, in the audit of going concern, a key finding last year. We also identified good practice in a number of areas of the audits we reviewed (including delaying signing the audit opinion until all evidence had been provided by the audited entity) and in the firm-wide procedures (including engaging external consultants in its root cause analysis process).

The overall inspection results remain unacceptable following poor inspection results last year. We continue to have recurring findings that contributed to this year’s inspection results. These include the effectiveness of the audit of revenue and appropriate levels of challenge and scepticism in areas of judgement. The firm needs to ensure that the specific actions taken to address the root causes of our findings also consider the actions needed to deal with the recurring nature of the issues.

Our assessment of the quality of audits reviewed



² We had selected 10 audits to review in the current inspection year. For one of these audits, Sports Direct International plc, the inspection was unable to proceed within the AQR inspection window due to difficulties in obtaining the relevant information.

Audit Quality Plan

In this inspection cycle, as part of “increased scrutiny”, we expanded the scope of our work to review key aspects of the plan and increased the number of audits reviewed. We have reviewed the firm’s plan in detail. The actions to date demonstrate the firm’s commitment to improving audit quality, although it was expected that any significant impact on the audits we review will not be until the next inspection cycle due to the time between new initiatives being implemented and audits being subject to review.

The initial AIP has subsequently been developed into the firm’s Audit Strategy to 2022 (“the Strategy”). It is important that the Strategy retains the audit quality improvement elements as a priority and that moving from the AIP to the Strategy does not undermine the message to the audit practice by suggesting that quality issues have been fixed.

We were provided with the Strategy in February 2020; it includes a number of projects aimed at improving audit quality, such as focused risk-based activities to support audit teams. In a continuation of our “increased scrutiny”, we plan to review each of the Strategy’s project streams in the next inspection cycle to assess whether the Strategy remains sufficiently focussed to achieve the necessary improvements to audit quality.

Further details of the plan are given in section 2, together with our key findings, good practices and the firm’s response.

Reviews of individual audits

Our key findings related principally to the need to:

- Further strengthen the effectiveness of the audit of revenue.
- Ensure audit teams urgently apply appropriate levels of challenge and scepticism, in particular on areas of judgement on high risk audits.
- Ensure materiality is consistently set at an appropriate level.
- Enhance the quality of the audit of inventories.
- Improve certain quality control procedures on audits.

Good practice observations

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

- Delayed signing the auditor’s report until all audit evidence was provided by the audited entity.
- Audit procedures performed on opening balances and comparatives on a first-year audit.
- Good challenge of management on adoption of IFRS 15.

Further details of our findings on our review of individual audits are set out in section 3, together with the firm’s actions to address them, as well as details of 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 FY18 performance year.
- Acceptance and Continuance (A&C) procedures.
- Root cause analysis (RCA) process.

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

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

Partner and staff matters

Improve the consideration of audit quality in relation to:

- Partner appraisals and remuneration.
- Staff appraisals and remuneration.
- Senior staff promotions.

A&C procedures

- Introduce centralised monitoring and review of key documents within the acceptance and continuance process.

RCA process

The firm should further improve its RCA process, in particular:

- Rationalising the process for classifying root causes identified on individual reviews into reported themes.
- Retaining evidence how the firm's analysis identified underlying root causes.

Good practice observations

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

- Enhanced consideration of potential damage to values, reputation and brand when making acceptance and continuance decisions.
- Engagement of external consultants in its RCA process.

Further details of our findings of these firm-wide areas are given in section 4, 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 are set out in Appendix 1. The firm did not receive a full ICAEW quality monitoring visit in the year and therefore no ICAEW inspection results are included in the appendix.

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 4 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:

- The firm has a good level of coverage of RCA.
- Reviews are undertaken across internal and external inspection findings and good practice, although the firm does not perform RCA reviews over firmwide findings, unlike some firms.
- The firm's report sets out the RCA themes in less detail than some other firms. It is not consistently clear how themes have been identified from individual RCA findings.
- Unlike some other firms, GT reports separately on RCA reviews for internal and external inspection findings, rather than identifying and reporting on the themes on a consolidated basis.
- The firm's actions have been reported in a reasonable level of detail. The firm has reported how these actions are incorporated into the Strategy.

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

Firm's overall response and actions:

In Spring 2019, we developed our Audit Investment Plan (AIP) as it was clear to us, at that stage of the 2018/19 review cycle that we recognised that we were not consistently achieving the high level of audit quality we expect to.

We also recognised that, at the start of our audit quality journey in Spring 2019, the changes we were making would not be evident in this 2020 report, due to the time lag between audits being performed and them being reviewed and reported on by the FRC – as such, whilst we are disappointed by the results of our reviews, we concur with the AQR view that the impact of the actions we have taken/continue to take would not be evident during this cycle of reviews.

We are, however, encouraged that those files where some of the direct actions we have implemented since Spring 2019 did impact on the audit work performed, were amongst the five files which achieved “Good” or “Good with limited improvements required” this year.

We are pleased that the FRC has highlighted as good practice a number of areas within our quality processes and within the five files which achieved “Good” or “Good with limited improvements required” and believe that the changes we have made, both in engagement approach, structure, governance, performance assessment and reward and consistency through mandatory template work papers amongst others will be evident in the FRC public report in 2021.

Our root cause analysis (RCA) on the two files which required significant improvements indicate that the steps we now have in place would have meant that those findings would not have occurred now.

As a firm, we will continue to invest in our people, their training and our processes and controls (including RCA) to ensure a sustainably high-quality audit record is achieved and maintained.

Details of our AIP were included in our response to the July 2019 public report and we have been in frequent and in depth dialogue with the FRC throughout the last 12 months as we continue to develop, roll out and embed the key facets.

In late 2019, we transitioned the AIP into a multi-year Audit Strategy to 2022 which was shared with the FRC early in 2020 and has been informed by our RCA programme to provide our blueprint for audit quality. During the year, we have further strengthened our RCA process through partnering with an external, specialist RCA provider which has been recognised as good practice by the FRC and have undertaken RCA on the inspection results to identify causes and required actions which relate to the areas identified for improvement.

We have also performed a wide-ranging independent RCA review of our audit practice to identify broader factors, such as behaviours and audit culture which has fed into our 2022 quality strategy.

The steps we have taken since Spring 2019 prepare the ground for consistent improvements in audit quality and include the establishment of our Audit Quality Board (chaired by Philip Johnson) in February 2020 and changes we have made (and continue to make) to our client base, training, recognition, progression and reward as part of a wider cultural change programme of challenge and support, including through the use of specialists. Our strategy to 2022 is underpinned by a Strategic Implementation plan (SIP), incorporating over 90 workstreams to address all aspects of audit quality throughout our practice. It specifically targets four areas:

- Cultural change – from 1 September 2019, the audit practice has been a separate service line within the firm for the first time in many years. Our technology specialist auditors (who work with our audit teams to ensure technology enabled audits are appropriately performed) are now also within our national team, which also has specialist sub teams for financial services, public sector audit, pensions audit, charities & not for profit. We have implemented higher levels of control around quality, being the primary recognition factor above all other factors amongst other actions to drive quality sustainably across all our clients. We have also commenced a programme of behavioural learning within audit, supported by an external provider, to ensure our teams feel more empowered to ask questions, challenge management and use techniques such as bias training to assist them in both challenging and assessing the work performed and the conclusions reached. We also commissioned an external review of our audit practice which was concluded in February 2020 highlighting a broad range of cultural and business practice factors which link back to the causal findings from our individual RCA reviews and which form the blueprint of the SIP.
- Review of our client base – commencing in Summer 2019, we set out criteria of the type of clients we wanted to audit and which we believe are conducive to high audit quality. These criteria included, critically, the openness of management and audit committees to open and robust dialogue and challenge. We note that similar characteristics are highlighted by the AQR in their definition of more high-risk audits. We have been discussing with, and educating our clients on their role in the audit process most recently around the Covid-19 situation and the resultant additional work they (and we) are required to do around their forecasts and have identified that the vast majority of our audit client base welcome this challenge and debate and are keen to play their part in achieving high audit quality. This review of our client base led to us resigning from a number of AQR-scope audits along with a number of non-AQR audits and we have since taken on new audit work with Companies who value and prioritise audit quality at Board level.
- In flight support and our second line of defence (2LoD) have been significantly strengthened as part of the AIP and the Strategy. In addition, findings from our RCA programme over the last year indicated clear benefits from a more centralised approach across a number of our audit processes and controls and we will expand this aspect of our investment, in both depth and scale to ensure a more consistent application of audit methodology together with continuing our Audit Support Panels and Internal Difference of Opinion panels for our engagement teams working in our most high profile or complex clients.

-
- Investment in training provided to our teams has been significantly improved and developed during the year with the creation of our Audit Quality Academy for our new starters to the firm. Our RCA highlighted that we needed to reinforce some aspects of our training underpinning the findings within our internal and external file reviews and, as such, additional training comprising several additional days, has also been provided to those teams working with our most complex clients and our 2020 training to date has focussed on areas highlighted as findings within this report, including audit of revenue. We are also proud that we are the first mid-tier firm to create a specialised “digital accountant pathway” as a core part of training for our trainee including modules on big data; data analytics and visualisation; cyber security; digital innovation and disruption and ethical and legal matters, delivered by a third party specialist.

Later in this document, as we respond to the AQR key findings, we have highlighted details of our root cause analysis findings relating to enhancing of our policies and procedures together with other elements relating to aspects of audit methodology and application.

We recognise that audit quality is a journey rather than a destination and, whilst we have commenced the journey with vigour underpinned by a significant commitment across the firm to achieve consistently high quality in our audit work, our strategy is a multi-year strategy and, over the longer term, fully embedding new practices within the business in a sustainable manner is a key priority for us.

We will monitor closely the promptness and effectiveness of the firm’s actions. Should these not address our concerns adequately, we will consider appropriate action.

2 Audit Quality Plan

In our 2019 report, we reported that the firm's level of audit quality was unacceptable. As a consequence, in Spring 2019, the firm initiated its AIP to improve audit quality. The firm has subsequently developed its Strategy to 2022, with the support of independent consultants, to continue to address audit quality issues and ensure a sustainable audit practice. In this inspection cycle, as part of "increased scrutiny", we expanded the scope of our work to review key aspects of the plan and increase the number of audits reviewed. We plan to review the Strategy as part of the 2020/21 inspection cycle.

A key aspect of the plan was the appointment of a new full-time Head of Audit who was, for the first time, also a member of the firm's Senior Leadership Team ("SLT"). The appointment was made in May 2019 and the new Head of Audit became responsible for delivering the plan. The plan did not start in earnest until Summer 2019 with an initial focus on improving the quality of Public Interest Entity ("PIE") audits. It did not, therefore, have any significant impact on the audits we reviewed in this inspection cycle. The review of the audit client portfolio, reallocation of audit teams, staff training and updated methodology were well progressed by December 2019. They have the potential to improve the quality of audits for our next inspection cycle.

The key elements of the plan were:

Right people – The AIP seeks to ensure that only those individuals with the appropriate skills perform PIE audits. An initial evaluation removed some audit partners from the audit practice. All remaining audit partners sat an assessment test in Autumn 2019 focused on technical skills and competence. There has been a similar review of managers involved in PIE audits. These steps should help to improve audit quality from 30 September 2019 year-ends onwards, as the firm's most complex audits will be resourced by those with a proven quality record. However, challenges remain in maintaining the pipeline of partners and staff to perform PIE audits given the reduction both in individuals used on PIE audits and the PIEs audited by the firm, although we have been informed partners have been and are continuing to be recruited with the appropriate experience.

Right clients – The AIP looks to ensure that the firm has sufficient capacity to deliver quality audits and only acts for entities with the right cultural fit and an appropriate risk/reward. The firm prioritised a review of audited PIEs and has withdrawn from a number of these audits. A similar review is ongoing for non-PIE entities. These steps should help to improve audit quality from 30 September 2019 year-ends onwards, removing some of the firm's higher risk audits (although this process may run over more than one audit cycle). Longer term, there is a risk that the firm may face significant challenges expanding its PIE audit base if the firm decides to do so in future.

Right tools – The global firm launched new methodology (LEAP) and software for 2018 year-ends. Although the methodology was implemented, the software proved to be unstable at scale and was withdrawn whilst further development is undertaken. For the next two audit cycles the firm has embedded the new methodology in the previous software with a suite of template work papers to drive consistency, quality and effectiveness.

Right support – The plan increased support to audit teams, including audit support panels for complex judgements on PIE audits; internal differences of opinion panels and continuous central monitoring of audits in progress. Due to the timing of our reviews, we will consider the effectiveness of these processes in our next inspection cycle.

Right governance/monitoring/communications – The plan has introduced an independent review of the audit practice, an enhanced RCA process supported by an external provider, clearer quality goals for audit partners and audit managers, and created an Audit Quality Board with an independent chair. These steps are anticipated to have a longer-term impact on audit quality and develop an appropriate culture for conducting high quality audits in the public interest. We will continue to monitor the progress of this part of the plan in our next inspection cycle.

Right reward/recognition – Quality will be properly reflected in profit shares for audit partners and bonuses for directors. For the FY19 appraisal cycle, there has been a change in audit partner goals and the remuneration model to ensure a clearer link between quality and reward.

Key findings

The new Head of Audit has focused on developing and implementing the plan with several significant changes having been achieved including partner departures, reallocating high quality staff to high risk audits and exiting certain audit relationships.

Our main findings are set out below and have been communicated to the Head of Audit during the year so that actions could be taken to improve the AIP:

- **Accountability and governance:** The firm's Senior Leadership Team (SLT) was responsible for the AIP before the creation of the Audit Quality Board. We were concerned whether the SLT had the time and resource for the effective monitoring and oversight of the plan. Creation of the Audit Quality Board has started to address this concern.
- **Overall strategic objective and tone at the top:** The initial plan targeted improving the quality of PIE audits. The strategy should set appropriate goals and define audit quality with clear links to overall success criteria and milestones. The firm should consider how the quality objectives of the plan are measured and how existing initiatives will transfer into business as usual.
- **Project management:** There was initially a lack of formal project management and accountability for each element of the AIP appeared to rest with the Head of Audit. In addition, there were no milestone dates set for each initiative making it hard to track progress. To succeed, the plan needs formal project management and clear delegated accountability for each of its elements. The firm has sought to address these concerns by putting in place a dedicated, specialist project manager.

-
- Independent reviews: The firm has commissioned independent input into the review of the audit practice and four root cause analysis reviews. Appropriate processes need to be in place to ensure the findings of these reviews flow into the quality aspects of the Strategy. We will consider the findings of these reviews as part of our review of the Strategy.
 - Risk assessment and audit support panels: The firm is starting to develop a risk assessment to identify those engagements that would benefit from an audit support panel (for example, combining audit and business risks). The current process allows for either the central team or the engagement partner to identify issues.
 - Audit methodology: The LEAP methodology is better aligned with auditing standards than the previous methodology and closer to the methodologies adopted by other major audit firms, with more focus on risk areas. Embedding LEAP through the introduction of standard templates into the previous audit tool may not, however, achieve the same improvements in quality, particularly through the loss of some functionality. Whilst we understand that this is a conscious decision to shift audit team behaviours, excessive demands of completing standard documentation may distract teams from identifying risks and applying robust professional judgement.
 - The firm's culture: The firm has had persistent findings from our file reviews in areas including judgement, scepticism and revenue. The plan aims to change the firm's culture to address these issues. We will assess how the firm addresses this significant challenge through the next inspection cycle.
 - Reward and recognition: The firm has demonstrated a commitment to changing its approach to reward and recognition with increased focus on quality. We will review the changes in the approach as part of our on-going review of the Strategy.
 - Audit partner assessment test: The firm's current technical test for audit partners focuses on certain core financial reporting skills. Further development to encompass auditing skills is essential to have an impact on improving audit quality. We acknowledge that the test demonstrates a determination to shift firm culture and, if the case study could be adapted to focus on audit considerations, it could contribute to improved partner input to the audit process.

Firm's actions:

Since Spring 2019, the changes we have introduced have been widespread across a number of areas of our practice.

We have changed the structure of our firm such that audit is now a separate service line, removing any geographic inconsistencies in messaging and approach and ensuring that all our audits and audit messaging is consistent, from our largest office to our smallest office. This has been particularly important and valuable, most recently, in dealing with technical matters arising through Covid-19. Creating a collaborative, supportive approach to audit quality matters is key to success in our journey. In addition, we created a new board position on our Strategic Leadership Team for a newly appointed Head of Audit, ensuring that audit is represented at the highest level of the firm. We have also created an Audit Quality Board, chaired by an independent director, Philip Johnson, to provide independent rigour to progress along our quality journey and to ensure that audit obtains the support and investment needed to achieve high quality files across all our client base.

Additional training has been provided in 2019/20 for all our auditors to ensure the quality improvement is evident across all our files with training linked both to the findings of the previous AQR review but also QAD and internal file review findings and topical matters such as Covid-19 in recent months.

We have also invested significantly in working with behavioural psychologists around the concepts of truth default theory and how to interact with our clients and teams from a truly objective standpoint.

From June 2019 performance review period onwards, we have strengthened and clarified the link between high quality work and reward and progression – this puts quality at the heart of reward decisions in a significantly enhanced way.

We made a conscious decision to centralise many of our first and second line of defences in Spring/Summer 2019 including the creation of both Audit Support Panels and Internal Difference of Opinion panel ensuring a consistent, efficient and high quality approach to our most complex clients. We have also strengthened the seniority and size of our second line of defence team.

We have invested significantly in our Root Cause Analysis work, including the use of a third party specialist RCA firm for many of our reviews. Our RCA work during 2019 highlighted a number of findings which we have addressed through the Strategic Implementation Plan (part of our 2022 strategy) including the implementation of a suite of standardised working papers and procedures, further changes to our recruitment, progression and reward processes, and additional training as detailed above along with the cultural change programme we have commenced within our audit teams through the work we are doing with behavioural psychologists.

In summary, our audit investment plan and 2022 Audit Strategy are progressing in line with expectations but we remain vigilant that we need to maintain momentum and also embed our new practices within our culture to achieve sustainably high quality audits going forward.

Good practice

We draw attention to the following good practices identified as part of our review of the AIP:

- **Risk review of client base and partner portfolios:** The review of the firm's PIE audits should have a positive impact on the firm's audit client risk profile.
- **Review of partner portfolios and concentrating PIEs in centres of excellence:** Allocating PIE audits to centres of excellence is a positive step together with reviewing the portfolios of those partners with PIE audits. The concentration of these audits amongst fewer individuals with a proven quality track records should help improve consistency and quality. The firm should, however, be mindful of concentration of risk on particular RIs. We understand that the firm is addressing this through external recruitment of audit partners.
- **Audit Quality Board:** We welcome that governance of the AIP has been transferred to the newly-created Audit Quality Board and the appointment early in 2020 of an independent chair of the Board who will provide dedicated oversight of the AIP and will hold the audit practice to account. We will monitor the effectiveness of the Board in our next inspection cycle.
- **Audit support and internal difference of opinion panels:** The Audit Support Panel and Internal Difference of Opinion Panels are used as a risk management tool. The ASP enables partners to seek the advice of their peers, encouraging consultation and development of the partner group. Strengthening the structure and process around the settlement of differences is a positive development, improving audit consistency and how judgements are made.

3 Review of individual audits

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

Further strengthen the effectiveness of the audit of revenue

Revenue is an important driver of a company's operating results and is often identified as a key performance indicator on which investors and other users of financial statements focus. Accounting for revenue recognition may be susceptible to error or manipulation. Auditors should therefore evaluate and address the related risks and obtain sufficient appropriate audit evidence to revenue recognised by the entities.

Key findings

We reviewed the audit of revenue on each audit inspected. We continue to identify issues in the firm's audit of revenue with the following issues identified on one or more of these audits:

- Insufficient relevant and reliable audit evidence was obtained to conclude on the occurrence and accuracy of the significant revenue stream. In particular, on one audit the audit team took assurance inappropriately from client systems rather than testing effectiveness of controls or obtaining evidence from independent sources.
- Insufficient evidence was obtained to confirm the effective operation of management's key controls over revenue recognition. On one audit, the audit team did not recognise that the control tested did not relate to the basis of revenue recognition under certain contracts.
- Insufficient evidence was obtained to mitigate control weakness identified during IT general control testing on a key system relied on for generation of revenue data.
- Analytical procedures were insufficiently detailed.
- Insufficient procedures were performed to conclude on the completeness of a sales returns provision.

In light of the previous findings raised on the audit of revenue, the firm should take prompt action to review its methodology and guidance on the audit of revenue and update them to reflect the issues that we continue to identify through the audit inspection process.

Firm's actions:

We note that the AQR reviewed revenue on most of the audits they inspected but only had findings on the topic on a small number of those reviews. We acknowledge that revenue is a priority area of any audit and, as such, improvements can and will be made. The root cause analysis highlighted the importance of understanding the systems in place at the entity along with the associated revenue streams. We have therefore taken/will undertake a number of actions to address this finding, including:

- A two-day summer training course in Summer 2019 was heavily focussed on testing of revenue;
- A new IT audit team embedded within the audit practice was established in Summer 2019 to provide additional expertise in the IT aspect of revenue testing;
- Our March – May 2020 quarterly training was heavily focussed on testing of scoping and risk assessment around revenue;
- Additional training has been given on fraud and IPE, (Information Prepared by the Entity) including national roadshows and podcasts;
- Our Summer 2020 training (2 days) focussed on controls testing within revenue;
- Quarterly training scheduled for Sept – November 2020 is focussed on controls testing, with a particular emphasis of testing of revenue; and
- Findings from the RCA on the relevant files has been shared with the business through a detailed RI/EQCR training session highlighting the findings from these reviews.

Additional focus being placed by the inflight review team on revenue testing new standardised procedures are also being developed for revenue and have been updated for scoping and risk assessment. We will review those workpapers to ensure they address the findings from both external and internal reviews and our Quality Monitoring team will assess/monitor the effectiveness of the actions being taken in response to this finding around revenue during the 2020 Internal Quality Review processes.

Ensure audit teams urgently apply appropriate levels of challenge and scepticism, in particular on areas of judgement on high risk audits

Audit teams can identify engagements as high risk for a number of reasons, including the entity:

- Being in a high risk sector or location;
- Experiencing financial difficulties;

- Accounting for balances with significant estimation uncertainty; or
- Having governance and internal control weaknesses.

On all audits, and in particular those that are high risk, audit teams should assess whether management's judgements and estimates, and related disclosures, are reasonable. This requires the audit firm to instil in its partners and staff a mindset of professional scepticism and challenging management. Audit teams should obtain sufficient audit evidence, including consideration of contradictory evidence to justify their conclusions.

Key findings

Previously, we reported that the firm should urgently improve the extent and rigour of challenge of management in areas of judgement. Whilst we have seen some improvement, we are concerned that we still identified instances of inadequate or insufficient challenge in the following areas on one or more audits:

- The appropriateness of assumptions underpinning the goodwill impairment assessment, including forecast growth assumptions, sensitivities and the appropriateness of including planned cost savings from reorganisation.
- Management's assumptions and judgements on capitalising internal costs as an intangible asset.
- Fair value assumptions and judgements applied on the acquisition of a business.
- Considerations and conclusions around loan loss impairment.

It is important that the firm achieves and demonstrates a consistently high level of challenge and professional scepticism when auditing areas of judgement. It should ensure that a culture of challenge is developed and embedded as part of the implementation of the Strategy.

Firm's actions:

Challenge of management has been an area of key focus for us since these findings were identified on early files reviewed, as such we had a detailed training session on impairment and challenge of management in our 2019 training. We believe that mindset of the auditor is a key factor in success in this area and are working to achieve this through a cultural shift, including the national reorganisation discussed earlier and changes of partners on some audit clients. In addition, we have also provided additional training and support to RIs on the behavioural aspects of challenge of management to ensure we are "sitting opposite the client" rather than "alongside" the client and bias training and are also more active at board level in supporting RIs with clients who do not welcome the increased challenge of management which the FRC has commented on in their public reporting for the last few years.

It is worth noting that none of the findings identified by the AQR gave rise to a material misstatement within the financial statements, however, we acknowledge that the evidence of the challenge we provided to management could have been better incorporated into the file.

Our root cause analysis highlighted that the quality of the evidence of our challenge of management is sometimes compromised by either tight reporting deadlines or the client's readiness for audit where these sometimes cause difficulties for the audit team in stepping back and considering the documenting of our audit evidence of challenge/how the evidence of our challenge is documented. Since these reviews, we have requested a number of our clients to postpone their announcements/signings to provide sufficient time for the step back objective consideration to take place.

We are also providing additional training on impairment and estimates during our Summer 2020 training including a strong emphasis on the use of professional scepticism and challenge and the behavioural aspects that can cause but also mitigate insufficient professional scepticism and challenge.

Ensure materiality is justified and set at an appropriate level

Materiality has a pervasive impact on the audit process, including the auditor's assessment of risks of material misstatement and the extent of audit evidence required in respect of those risks. Misstatements are considered to be material if they could be expected to influence the economic decisions made by users of the financial statements.

Determination of materiality is a matter of professional judgement considering the needs of the users of an entity's financial statements. For PIE audits, we would expect a profit-based measure to be selected with up to 5% of profit before taxation or adjusted profit before taxation being the most common benchmark selected.

Key findings

We reviewed the audit teams' determination of materiality on all audits inspected. We identified the following issues on the determination of materiality on two audits:

- Insufficient consideration of whether materiality based on 5% of earnings before interest, taxation and amortisation, was appropriate. This level of materiality was significantly higher than the firm's guidance on profit before taxation, and approximately 30% higher than 5% of profit before taxation the most commonly used profit based measure for the calculation of materiality.
- The audit team did not justify why materiality was significantly increased when profit before tax and EBITDA were largely unchanged year on year.

The firm has subsequently updated its guidance on materiality benchmarks.

Firm's actions:

Materiality is a cornerstone of the audit approach and as such, we are concerned by the findings above, albeit that the AQR raised no significant findings around materiality in the vast majority of files reviewed.

Since the findings, however, we have made clearer within our methodology both the benchmarks to be used and also additional procedures and central consultation required where materiality is set using a benchmark of anything other than profit before tax.

Ensure that sufficient audit evidence is obtained to confirm the existence and valuation of inventory

Inventory is material and a key operational metric for many entities. Auditors are required to obtain sufficient audit evidence to confirm the existence and condition of inventory recognised appropriately in the financial statements.

Key findings

We reviewed the audit of inventory on two audits inspected and identified the following issues:

- The audit teams' approach to inventory stocktakes was not appropriate. On one audit, there was insufficient justification of why stocktakes were attended at only a small percentage of locations, and, where attended, a low number of sample counts were performed. On the other audit, there was insufficient evidence that the existence of significant finished inventory was adequately tested.
- On one audit, insufficient procedures were carried out to audit the movement in inventory between the stocktake and balance sheet dates.

Firm's actions:

The teams followed the firm's methodology in both instances, however, we have now amended our methodology to ensure such instances do not reoccur.

Improve certain 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 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. For the audit of listed entities and other high-risk audits, an engagement quality control review (EQCR) is required. The EQCR should perform an objective evaluation of the audit team's significant judgements.

Key findings

We reviewed the audit quality control procedures on all audits inspected. We identified the following deficiencies in quality control procedures:

- On one audit, there was insufficient evidence of timely review by the audit partner and EQCR reviewer of the audit procedures performed relating to a significant risk and no clear audit trail of the modifications made during audit completion.
- On the same audit, there was insufficient evidence of the matters discussed by the EQCR reviewer at the time the audit report was signed and how it was concluded that all outstanding issues had been satisfactorily resolved.
- On another audit, the audit team did not evidence the rationale for its conclusions on judgemental issues. The quality control and review procedures did not identify this shortcoming.

The firm should urgently develop effective actions to address these deficiencies.

Firm's actions:

Under our Audit Investment Plan, we have significantly strengthened our in-flight review team, both in scale and seniority to ensure we better identify areas where challenge is needed and the required audit work to be performed and documented. We have also implemented centrally-led fortnightly meetings (weekly in peak periods) across the various technical functions to identify any audits where additional support is required to ensure these findings do not reoccur.

We have also held an additional RI/EQCR training session to highlight the findings from these reviews and the level, nature and timing of reviews expected from our most senior team members. Review processes was also a focus area of the 2019 Internal File review programme. We will also be monitoring senior team involvement as part of our redeveloped suite of Audit Quality Indicators being launched in Summer 2020.

Good practice

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

- Delaying signing the audit report until all audit evidence was provided by the audited entity.
- Audit procedures performed on opening balances and comparatives on a first year audit.
- Good challenge of management and thorough corroboration of explanations received on adoption of IFRS 15.

4 Review of firm-wide procedures

We reviewed the 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 relating to the FY18 performance year.
- Acceptance and Continuance (A&C) procedures.
- 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 2018 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:

- Partner appraisals and remuneration: Partner remuneration for 2018 was determined based on a series of partner discussions and peer reviews, with no formal procedures for how audit quality matters should be considered in remuneration. There was insufficient evidence to demonstrate the linkage between audit quality and the final remuneration decisions for individual partners.

We also identified concerns in relation to the criteria and process followed to assess partner’s performance on audit quality and the appropriateness of the conclusions reached and annual quality objectives responding appropriately to previous adverse quality findings.

- Staff appraisals and remuneration: The firm did not have a formal process to ensure that the results of internal or external inspections were considered and appropriately reflected in objective setting, annual appraisals and remuneration decisions for senior staff. For four individuals in our sample, it was unclear how adverse quality findings had been considered in the final remuneration decisions.
- Senior staff promotions: The firm did not have a formal assessment process in place for manager and senior manager promotions, ensuring that audit quality is appropriately and consistently considered for all promotion candidates.

Firm's response and actions:

It is important to note that the period reviewed by the AQR was the remuneration/appraisal period to June 2018.

Significant changes have been made since then which have been shared with the AQR as part of our Audit Investment Plan to ensure that there is now a significant correlation between audit quality, progression, performance reviews and reward. The new processes have been implemented from FY19 onwards.

Acceptance and Continuance (A&C) procedures

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 firm-wide 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

We identified the following key findings:

- Centralised monitoring and review of key documents within the acceptance and continuance process: The firm should ensure that the engagement team have answered the questions relating to reputation risk, values and whether the entity and engagement aligns with the firm's mission and strategy.
- One of the client acceptances we reviewed was for a retailer and the audit engagement team failed to comment on key risks affecting the entity and the UK retail sector overall. This information was critical to the overall assessment on potential reputation risks and consideration of appropriate resource which would have an impact on the overall acceptance decision and whether additional safeguards were required.

Good practice

We identified the following area of good practice:

- **Enhanced consideration of potential damage to values, reputation and brand when making acceptance and continuance decisions:** The firm has recently undertaken a review of its client portfolio to ensure that this aligns with the firm's strategy. An additional assessment was introduced, increasing the prominence and visibility of the consideration by engagement teams of the impact that accepting or continuing a relationship with a specific entity has in terms of reputation, values and brands.

Firm's response and actions:

We are committed to a continual improvement of our client acceptance and continuance process and will take these findings on board. We are pleased with the good practice finding identified by the AQR.

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 some form of RCA for a number of years, enhancing its methodology over recent years. The global firm requires the firm to undertake an RCA. The global firm's policy includes a proposed methodology which member firms are encouraged to follow; the firm is contributing to this global methodology.

This year, we have reviewed the firm's process for undertaking its RCA, including resources and timing. We note that there have been significant changes in the RCA process during the current year including engagement of external consultants and that this will continue to evolve as the process is embedded.

Key findings

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

- Rationalising the process for classifying root causes identified on individual reviews into reported themes.
- Retaining evidence of how the firm's analysis identified underlying root causes.

Good practice

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

- **Engagement of external consultants:** The firm has engaged external consultants with a wide brief to undertake specific thematic reviews and provide training to its RCA team.

Firm's response and actions:

We commenced working with a third party RCA provider during Autumn 2019 and will take the findings identified on board. We are committed to RCA as a key part of our quality plan and all findings identified through RCA are now reviewed by the Audit Quality Board to ensure central and independent oversight of both the findings and proposed actions.

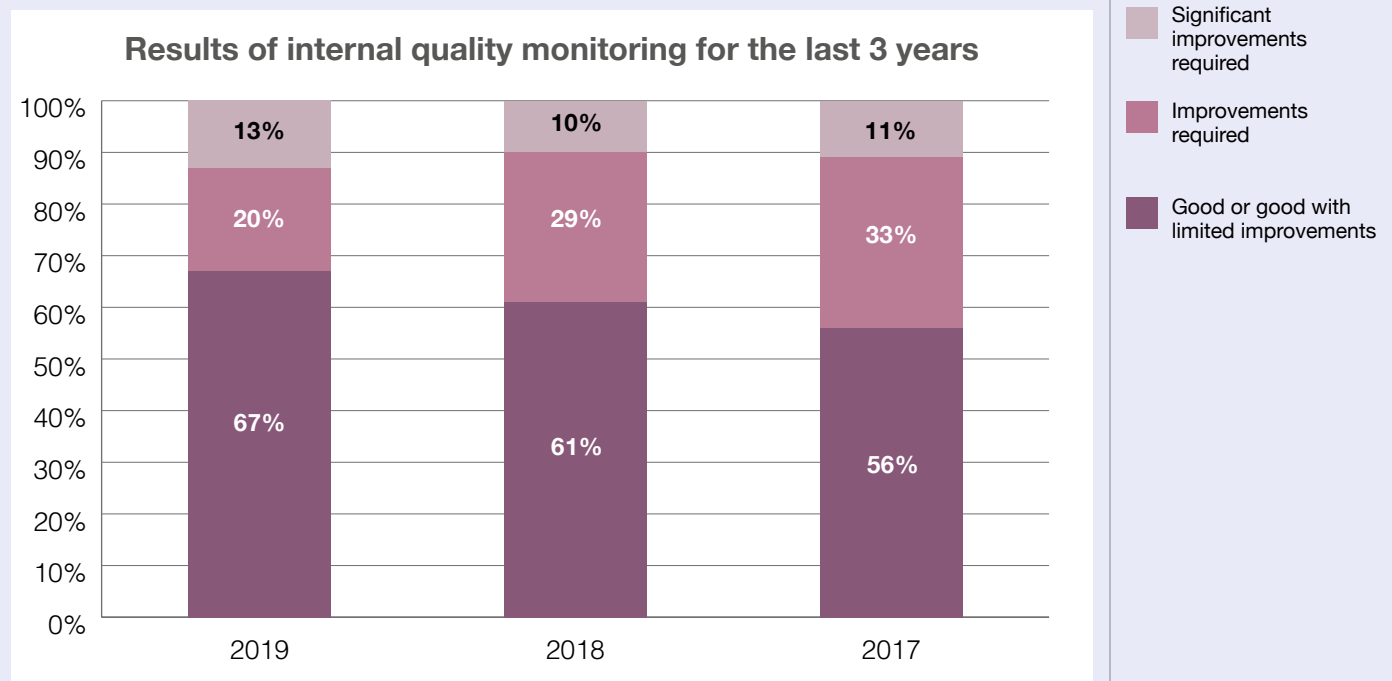
Appendix 1: Firm’s internal quality monitoring results

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, and its report to be published in 2020, which provide 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 National Audit Review (“NAR”), which comprised internal inspections of 45 individual audits with periods ending between December 2017 and March 2019, are set out below along with the results for the previous two years.



The grading categories used in the graph above are as follows:

- **Significant improvements required:** Significant concerns in relation to the sufficiency or quality of audit evidence, or the appropriateness of key audit judgments, or the implications of other matters that are considered to be individually or collectively significant.
- **Improvements required:** A number of matters in a number of areas but neither individually or collectively significant.
- **Good or good with limited improvements:** A limited number of concerns in a small number of areas.

Firm's approach to internal quality monitoring

The firm's internal inspection program considers the full population of audits performed. The NAR is designed to cover each engagement leader at least once every three years, with engagements biased towards more complex or higher-risk assignments. Audits that fall within the scope of the FRC's AQR are reviewed by the firm's central Audit Quality Monitoring Team ("AQMT"), with other reviews undertaken by experienced auditors and led by an experienced audit partner under the direction of AQMT. The setting of inspection grades is moderated by the AQMT to ensure consistency between reviews and with the approach of external regulators.

The firm undertakes Root Cause Analysis ("RCA") on all significant findings from the NAR. Findings are considered significant where audit procedures performed were not appropriate or where the audit procedure was not compliant with professional standards or the firm's policies. RCA is also completed on a selection of files graded as good or good with limited improvements to identify good practice. Local office leaders develop and implement targeted action plans to address the findings of all individual reviews undertaken and ensure that findings are addressed in the subsequent year's audit.

Firm's response and actions:

The scope of the NAR programme covers both PIE and non-PIE audits. The firm had set an expectation that all audits would be graded 'Good' or 'Good with limited improvements required'. The results of the 2019 inspection indicate that there are still improvements required to reach that goal.

The scope of the RCA programme mirrors that of the NAR programme and covers both PIE and non-PIE audits. The three most common root cause themes identified in relation to NAR findings in this cycle were as follows:

Technical expertise, particularly in relation to revenue

Related actions to improve the firm's results in this area include:

- Review of firm methodology and guidance in areas with a high number of related findings, such as revenue and impairment.
- Continued development of template working papers.
- Development of learning passports to deepen technical knowledge at each level.
- Quality control procedures, particularly in terms of review.

Related actions to improve the firm's results in this area include:

- Implementation of centrally led fortnightly meetings (weekly in peak periods) to identify any audits where additional support is required.

-
- Held additional RI/EQCR training session to highlight the level, nature and timing of reviews expected from our most senior team members.
 - Review processes were a focus area of the 2019 Internal File review programme.
 - Monitoring of senior team involvement as part of our redeveloped suite of Audit Quality Indicators being launched in Summer 2020.
 - Insufficient step-back, challenge and professional scepticism in judgemental areas.

Related actions to improve the firm's results in this area include:

- Detailed training session on impairment, challenge of management and professional scepticism in our 2019 annual training.
- Provision of additional training and support to RIs on the behavioural aspects of challenge of management and professional scepticism.
- Requested a number of clients to postpone their announcements/signings to provide sufficient time for step back objective consideration to provide space for scepticism and subsequent challenge where this is compromised by tight reporting deadlines or client's readiness for audit.
- Focus on challenge of management and professional scepticism and related behavioural implications in our 2020 annual training.

This report has been prepared for general information only. The FRC does not accept any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using this document or arising from any omission from it.

© The Financial Reporting Council Limited 2020
The Financial Reporting Council Limited is a company limited by guarantee.
Registered in England number 2486368.
Registered Office: 8th Floor, 125 London Wall, London EC2Y 5AS

**FINANCIAL REPORTING COUNCIL
8TH FLOOR
125 LONDON WALL
LONDON EC2Y 5AS**

+44 (0)20 7492 2300

www.frc.org.uk