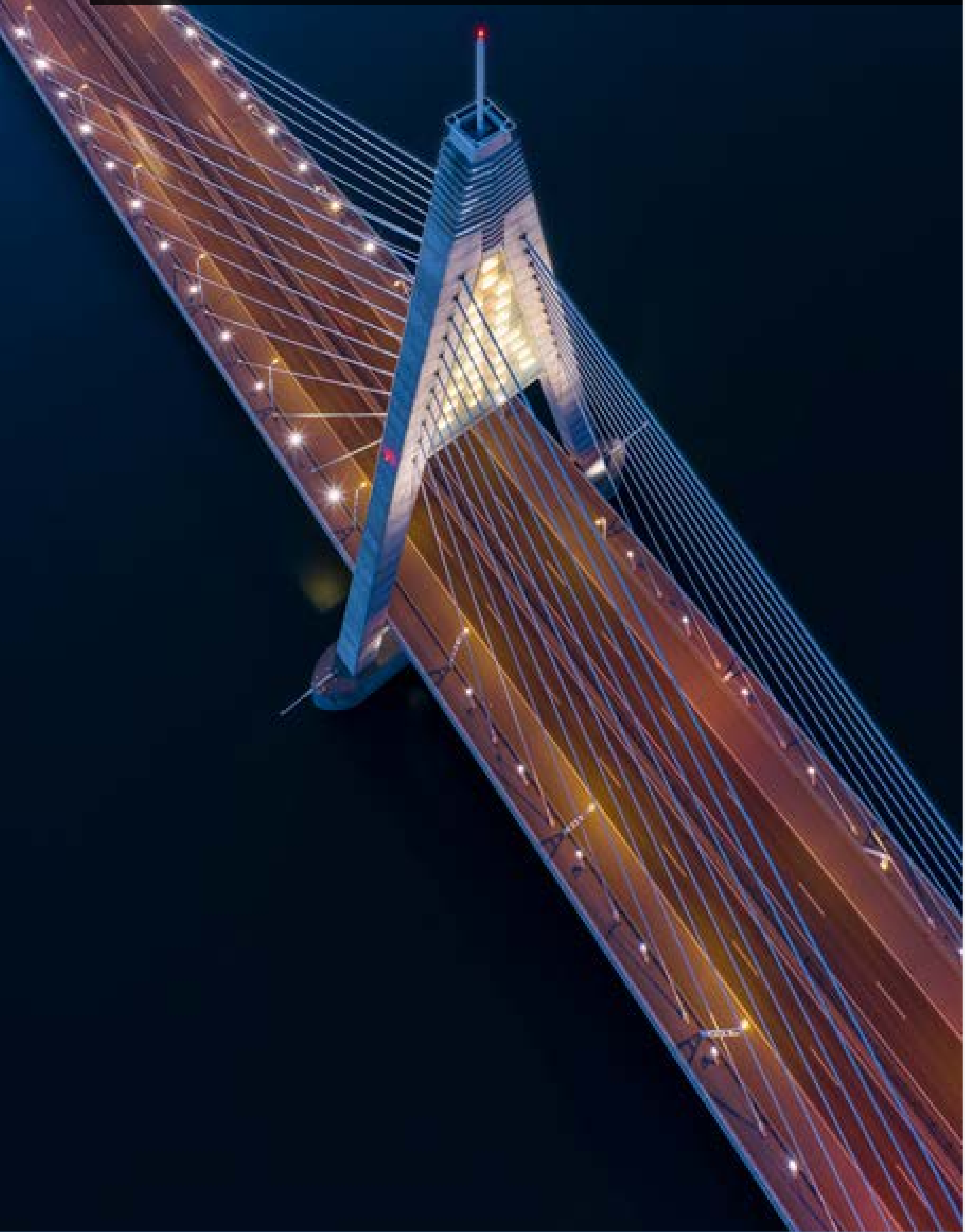
Financial Reporting Council

PricewaterhouseCoopers LLP

Audit Quality Inspection and Supervision



July 2021

Contents

Appendices

This report sets out the FRC's findings on key matters relevant to audit quality at PricewaterhouseCoopers LLP (PwC or the firm). It is based on inspection and supervision work undertaken in our 2020/21 cycle, primarily our review of a sample of individual audits and our assessment of elements of the firm's systems of quality control.

The FRC's focus is on the audit of public interest entities (PIEs[1]). Our selection of individual audits and the areas within those audits for inspection continues to be risk-based focusing, for example, on entities which: are in a high-risk sector; are experiencing financial difficulties; have material account balances with high estimation uncertainty; or, where the auditor has identified governance or internal control weaknesses. The majority of individual audits that we inspect are of PIEs but we also inspect a small number of non-PIE audits on a risk-based basis.

Higher-risk audits are inherently more challenging as they will require audit teams to assess and conclude on complex and often judgemental issues, for example in relation to future cash flows underpinning assessments of impairment and going concern. Rigorous challenge of management and the application of professional scepticism are especially important in such audits.

Our increasing focus on higher risk audits means that our inspection findings may not be representative of audit quality across a firm's entire portfolio of audits or on a year-by-year basis. Our inspection findings cannot therefore be taken as a balanced scorecard of the overall quality of the firm's audit work. However, our forward looking supervision work now provides us with a holistic picture of the firm's approach to audit quality and the future development of its audit quality improvement initiatives.

As well as risk-based selections, we aim to review all FTSE 350 audits periodically.

To provide a more holistic assessment of audit quality, the report also includes reference to other measures of quality at the firm. The Quality Assurance Department (QAD) of the Institute of Chartered Accountants in England and Wales (ICAEW) inspects a sample of the firm's non-PIE audits, the results of which are summarised on page 8.

The firm also conducts internal quality reviews. A summary of the firm's internal quality review results is included at Appendix 1, together with the actions that the firm is taking in response.

At Appendix 2 are further details of our objectives and approach to audit supervision.

1 Public interest entity – in the UK, PIEs are defined in the Companies Act 2006 (Section 494A) as: - Entities with a full listing (debt or equity) on the London Stock Exchange (Formally "An issuer whose transferable securities are admitted to trading on a regulated market". In the UK, "issuer" and "regulated market" have the same meaning as in Part 6 of the Financial Services and Markets Act 2000); - Credit institutions (UK banks and building societies, and any other UK credit institutions authorised by the Bank of England); - Insurance undertakings authorised by the Bank of England and required to comply with the Solvency II Directive.

1 Overview

Commentary on our inspection work at the largest audit firms

We completed more audit inspections at the largest seven firms in 2020/21 (103) than in 2019/20 (88). Our overall inspection findings are similar to last year, with 71% of audits (73 out of 103 inspections) requiring no more than limited improvements compared to 67% last year (59 out of 88 inspections).

The number of audits that we have assessed as requiring improvements remains unacceptably high. This year the results varied more between firms and we found inconsistencies, with good practice in some audits but deficiencies in the same areas in other audits at the same firm.

The most common key findings in our public reports are in relation to revenue, impairment of assets and group audit oversight. These are recurring issues but we also identified good practice in these areas in some audits.

We also identified good practice during our 2020/21 thematic review of the audit of going concern, where we found that firms had responded positively to the increased risk arising from Covid-19, by enhancing their procedures in this area[2].

Four of the largest firms (Deloitte, EY, Grant Thornton and PwC) had a year-on-year improvement in their overall inspection results, with around 80% or more of audits requiring no more than limited improvements. While this is encouraging, these improved results still fall short of our expectations.

Overall inspection results at KPMG did not improve and it is unacceptable that, for the third year running, we found that improvements were required to KPMG's audits of banks and similar entities. In addition, our firm-wide work on KPMG's IFRS 9 procedures and guidance identified that further improvements are required to provide a stronger basis for KPMG's banking audit teams to deliver high quality audits in this area. KPMG has already invested significantly in its banking audit practice and considers that, based on steps it has already taken, it will be able to demonstrate improvements in 2020 year-end audits. In response to our findings this year, the firm's senior leadership has committed to make the further changes necessary to improve audit quality in time for 2021 year-end audits. We will monitor these closely to assess on a timely basis the extent to which they address our findings.

This year, we increased the sample of audits we selected for review at BDO and Mazars, given their growth, with a focus on complex audits. Five of the nine audits that we reviewed at BDO and three of the seven audits that we reviewed at Mazars needed more than limited improvements. These firms have grown the size of their PIE audit practices and have plans to grow further, which will increase competition and choice in the market. Our engagement indicates that these firms are genuinely committed to improving audit quality but they must put in place the necessary building blocks for the consistent execution of high quality audits as they grow.

71%

Overall, the number of inspections requiring no more than limited improvements fell short of our expectations.

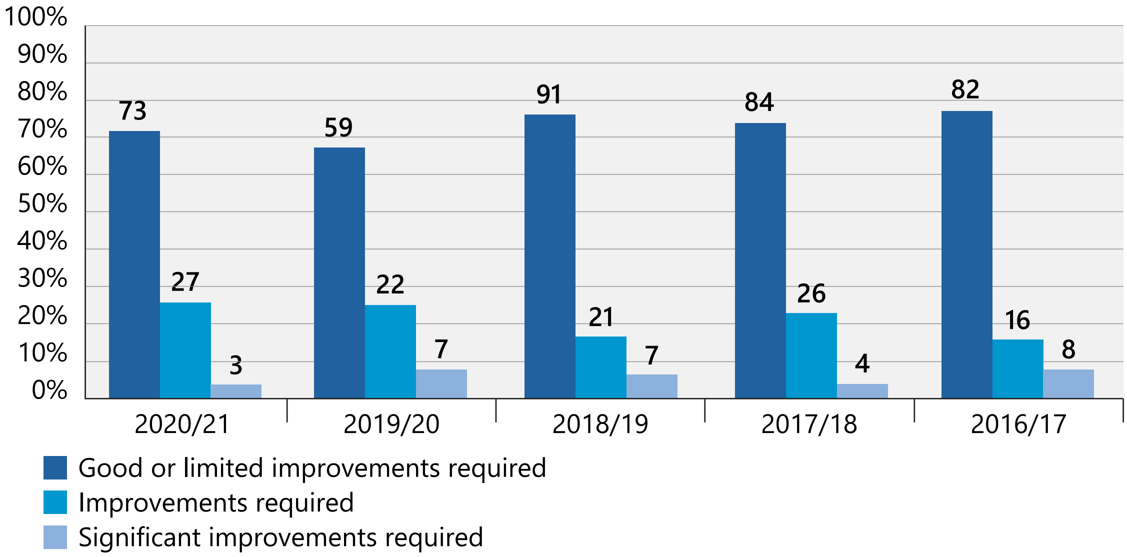
This year, results varied more between firms and we found inconsistencies, with good practice in some audits but deficiencies in the same areas in other audits at the same firm.

2 https://www.frc.org.uk/getattachment/953261bc-b4cb-44fa-8566-868be0ff48dc/FRC-going-concern-review-letter.pdf; and https://www.frc.org.uk/getattachment/c1ec4c8f-0eb3-44b9-a4c7-5fe5e4c0e0f1/FRC-going-concern-review-letter-(phase-2).pdf

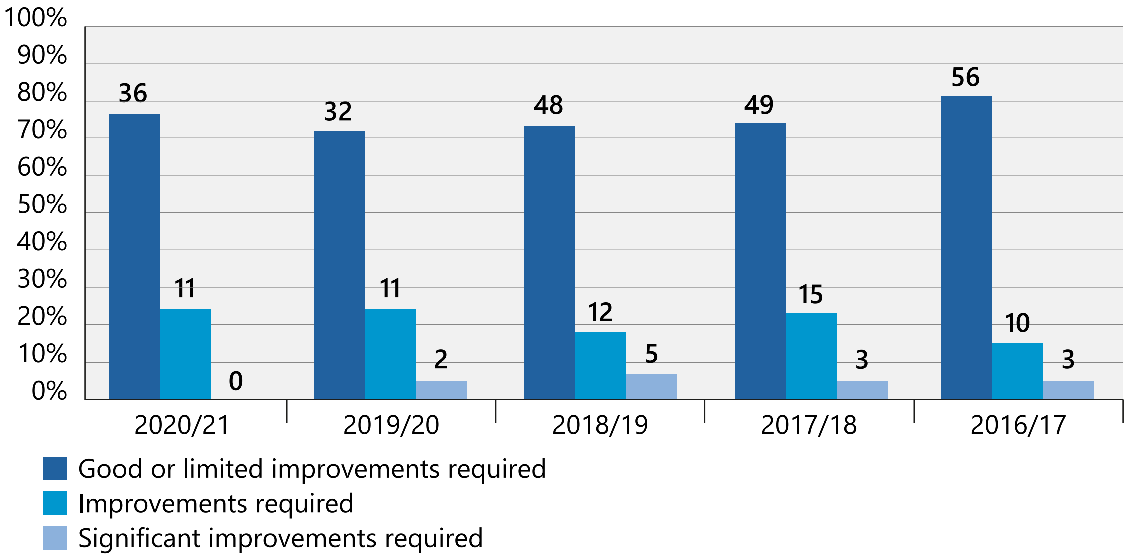
Central to achieving consistent audit quality is a healthy culture within the audit practice that encourages challenge and professional scepticism, as we set out in our letter to Heads of Audit in December 2020. We have a major project underway to examine audit culture, including an international conference held in June this year on the subject. Operational separation of audit practices from the rest of the firm should help the largest firms to focus on developing an appropriate audit culture.

Our supervision teams[3] are increasing the range of pro-active and forward-looking work they are carrying out with the largest seven firms in areas such as audit quality plans, root cause analysis, quality control procedures and audit quality indicators with a focus on how firms are responding to recurring findings. We report privately to firms on our findings in these areas, in order to share good practice. In 2021/22 we will continue to focus our inspections on KPMG banking audits and we will increase audit inspections at BDO and Mazars. Our 2021/22 inspections will also focus on and take into account the impact of Covid-19 on audits.

All reviews



FTSE 350



3 Our approach to supervision is set out in the March 2021 publication, https://www.frc.org.uk/getattachment/db4ef2e0-72f6-4449-bda0-c8679137d1b1/FRC-Approach-to-Audit-Supervision-FINAL.pdf

Our supervision teams are increasing the range of pro-active and forward-looking work.

In 2021/22 we will continue to focus our inspections on KPMG banking audits and we will increase audit inspections at BDO and Mazars.

PwC overall assessment

We reviewed 20 individual audits this year and assessed 16 (80%) as requiring no more than limited improvements. Of the ten FTSE 350 audits we reviewed this year, we assessed nine (90%) as achieving this standard.

The firm has taken steps to address the key findings in our 2019/20 public report, with actions that included increasing resources, focused training and updates to audit guidance and work programmes. We have identified improvements, for example, in the group oversight of component audits and the audit of long-term contracts, both key findings last year. We also identified good practice in a number of areas of the audits we reviewed (including enhancing procedures to respond to heightened audit risks due to Covid-19 and the continued use of internal specialists and experts) and in the firm-wide procedures (including a number related to methodology and training).

The main recurring findings related to the evaluation of management's impairment and going concern assessments.

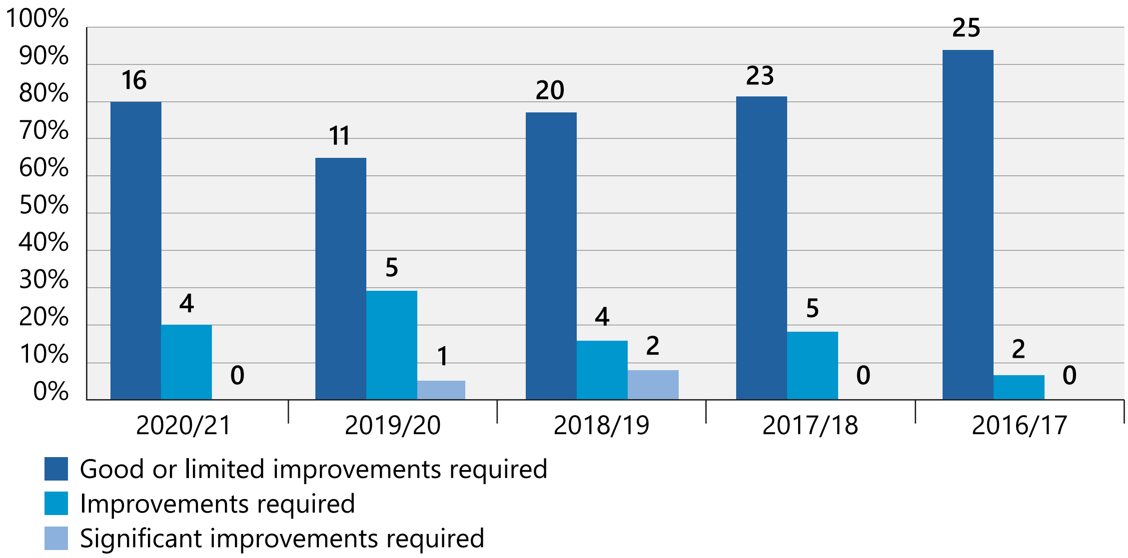
PwC introduced a Programme to Enhance Audit Quality (PEAQ or the plan) in Summer 2019. The plan is being phased over a three-year period and contains four workstreams. It also includes the development of a framework for assessing the benefits of key actions and its progress and achievements are overseen by the newly established independent Audit Oversight Body. Culture, including encouraging healthy challenge, is central to the success of PEAQ and the firm is well advanced in embedding "the critical few" behaviours into key areas such as career progression, reward and recognition and performance management. The framework for assessing the benefits of key actions is good practice. PEAQ formally ends in 2022 and the firm should develop an ongoing audit quality plan to ensure that continuous improvement of audit quality remains a top priority within the audit strategy that has sufficient prominence to be effective.

The firm has undertaken root cause analysis (RCA) for a number of years and follows methodology and guidance set out by the global network, supplemented by UK specific procedures. The processes have been improved, including in response to findings that we raised last year. The enhancements include establishing a dedicated team to undertake RCA on a continual basis throughout the year, across internal and external reviews, and using trends and emerging issues from multiple sources across the firm. This and some of the initiatives being established by this team are good practice. Importantly, the firm has begun to monitor the effectiveness of actions taken as a result of the RCA process, and will use the same "benefits realisation framework" used for measuring the success of initiatives taken under PEAQ. While the firm's RCA includes techniques to respond to recurring findings, further analysis still needs to be undertaken for the audit of impairment and going concern. We will continue to review the progress of PEAQ and the firm's assessment of the benefits arising.

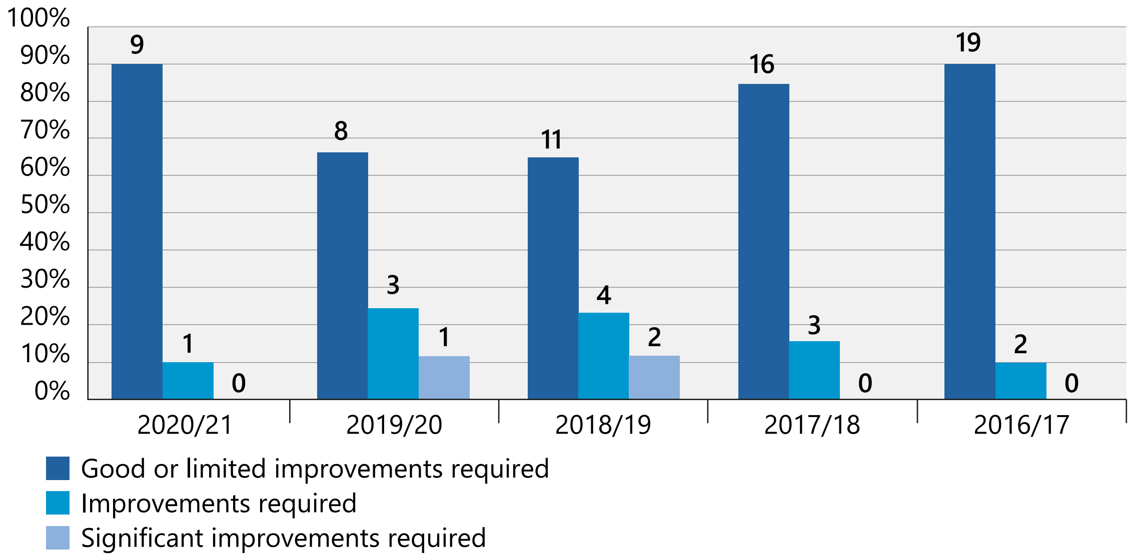
80%

At PwC, more of the audits reviewed in the current inspection cycle were assessed as either good or limited improvements required.

Our assessment of the quality of audits reviewed: PricewaterhouseCoopers LLP



FTSE 350



The audits inspected in the 2020/21 cycle included above had year ends ranging from 30 June 2019 to 31 January 2020.

Changes to the proportion of audits falling within each category reflect a wide range of factors, including the size, complexity and risk of the audits selected for review and the scope of individual reviews. Our inspections are also informed by the priority sectors and areas of focus as set out in Appendix 2. For these reasons, and given the sample sizes involved, changes from one year to the next cannot, on their own, be relied upon to provide a complete picture of a firm's performance and are not necessarily indicative of any overall change in audit quality at the firm.

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

Monitoring review by the Quality Assurance Department of ICAEW

The firm is subject to independent monitoring by ICAEW, which 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-wide controls as it places reliance on the work performed by the FRC.

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

ICAEW has completed its 2020 monitoring review and the report summarising the audit file review findings and any follow up action proposed by the firm will be considered by ICAEW's Audit Registration Committee in September 2021.

Summary

Overall, the audit work we reviewed was of a good standard, with nine of the ten reviews either satisfactory or generally acceptable. One audit required improvement. These results are better than the prior year reviews, when seven of the ten audits were either satisfactory or generally acceptable, two required improvement and one required significant improvement.

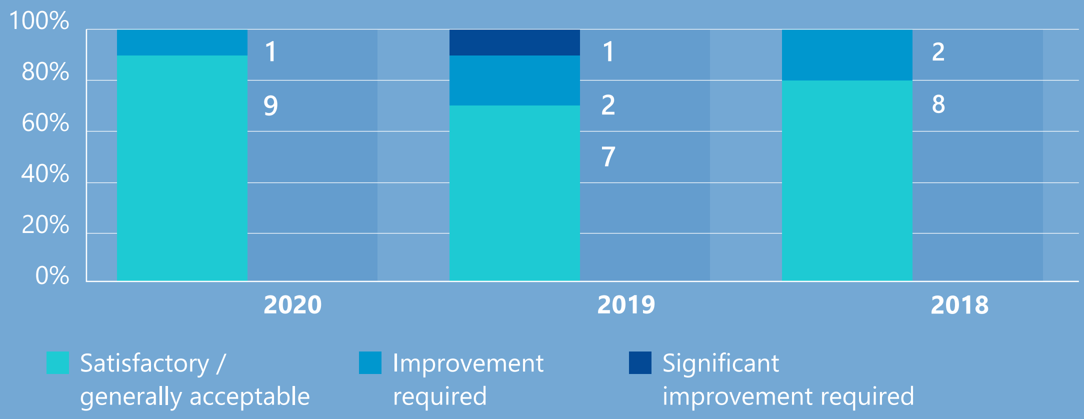
For the audit requiring improvement, there was insufficient challenge of management in relation to the revenue recognition policy originally adopted in prior years, and a lack of evidence on the audit file of the audit team's continued consideration of the basis on which management recognise revenue.

On the audits assessed as generally acceptable, there were isolated gaps in the documentation of key audit work and judgements, including work on contract accounting, inventory provision, accounting treatment of an intercompany loan write off, and revenue recognition.

ICAEW identified and shared examples of good practice on some of the reviews.

Results

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



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.

ICAEW

90%

Of the ten ICAEW reviews, nine were either satisfactory or generally acceptable.

Review of individual audits

Our key findings related primarily to the need to:

- Improve the evaluation of aspects of management's impairment and going concern assessments.
- Enhance the testing for the valuation of certain pension assets.
- Improve the audit procedures for the residual journal population in response to the risk of management override.

Good practice observations

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

- Effective group oversight.
- Robust assessment of management's going concern assumption.
- Effective use of the firm's internal experts and specialists.
- Effective procedures over revenue and long term contracts.
- Quality of the firm's summaries of audit responses to significant risks and related findings.

Review of firm-wide procedures

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

- Audit quality initiatives.
- RCA process.
- Audit methodology and training.

The reason for the focus on RCA and audit quality initiatives is the importance of taking effective action to address recurring inspection findings. On both of these areas we have assessed the firm's progress on the findings set out in last year's public report and re-assessed overall progress.

Audit quality initiatives

Our key findings in this area were related to the need to:

- Develop an Audit Quality Plan for the future to operationalise the audit strategy, ensure audit quality remains a top priority beyond PEAQ and capture key audit quality initiatives to be regularly reports on to the firm's Audit Oversight Board.

RCA process

Our key findings in this area were related to the need to:

- Undertake further analysis through RCA and an action effectiveness assessment given certain recurring findings included in this report.

Audit methodology and training

We had no key findings to report.

Good practice observations

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

- **Audit quality initiatives** – The introduction of a benefits realisation framework to assess both progress and impact; and The governance of PEAQ remains strong, with regular reports and updates on both progress and benefits realised.

- **RCA process** – Use of a dedicated RCA team; The introduction of a taxonomy of risk factors; Continual RCA activities; Embedding culture in RCA activities and materials; and Analysis of AQIs and correlations with lower rated reviews.

- **Audit methodology and training** – Clear consequences for not completing mandatory training; Identification of residual knowledge gaps following training; Monitoring the number of attempts an individual takes to pass a post course assessment; The frequency and quality of ongoing communications to partners and staff; The guidance to audit teams on common controls at banking entities; and Use of an economics tool on certain banking audits to compare management forecasts to independent forecasts.

Firm's overall response and actions

We are encouraged by the improved inspection results for audits selected by the FRC as part of the 2020/21 inspection cycle, and in the audits selected by the Quality Assurance Department (QAD) of the ICAEW for their 2020 inspection. Whilst we continue to focus on achieving consistent high quality, particularly in respect of the evaluation of management's impairment and going concern assessments which was the main finding in this year's FRC inspection, we are pleased that other previous recurring findings, in respect of long term contract auditing, and the audit of groups, were not identified. We also welcome the broader range of good practice examples identified by the FRC and QAD during their inspections. We remain focused on identifying and addressing risk factors which have contributed to the lower rated inspections and, more broadly, on continuous improvement to achieve consistently high quality audits.

We welcome the number of examples of good practice that were identified during the firmwide review cycles, including on PEAQ, RCA, methodology and training and within the feedback received on the 2020/21 thematic review cycles, including going concern. We continue to focus on supporting our engagement teams and appreciate the observations in respect of our audit quality plan and root cause analysis. Our designated methodology and training teams are focused on providing high quality updates, training and guidance to our audit practice. Investment in training has also been a key feature of PEAQ. The identification of good practice by the FRC assists these teams in replicating their approach across all activities.

We also welcome the enhanced approach to supervision following the FRC's restructure of its supervisory organisation in October 2020. The co-ordination of activities between the Audit Firm Supervision team, the Audit Quality Review team and the Audit Market Supervision team has already been seen to help bring together activities and facilitate more regular interactions. We look forward to the continued sharing of good practice insight, raising of concerns and issues, and timely discussions of emerging topics for auditors which this structure will facilitate. We also consider the proactive approach to more timely thematic briefings to have been beneficial for all audit stakeholders.

Programme to Enhance Audit Quality (PEAQ)

The PEAQ was launched in June 2019 as a three year programme covering the period to June 2022. It includes a wide-ranging and fundamental package of measures, with the single objective of delivering consistently high quality audits. The PEAQ underpins our audit strategy, which is centred around a commitment to high quality, embedding this approach into all our activities.

The PEAQ identified four change workstreams - Structure and Governance, Culture and Recognition, Supply and Demand, and Quality Control Activities. During the first two years of the PEAQ, a number of the original workstreams set out have evolved to incorporate new actions as the programme has progressed, and additional challenges have been identified through RCA activities. As part of our Culture and Recognition workstream, the critical audit behaviours, 'challenge and be open to challenge', 'team first' and 'take pride' were launched in September 2019.

In late 2020 we developed a benefits realisation framework to assess whether the actions within the PEAQ were effective and whether the changes required to underpin audit quality were embedding. Whilst a number of inspected audits were performed shortly after the programme launch we believe there are many positive indicators that the PEAQ is embedding the desired change. When the PEAQ is completed, our aim is for the primary focus on audit quality to be fully embedded, both in our audit strategy and the activities and behaviours of our audit practice.

Our Audit strategy for FY23 and beyond will incorporate the plan for audit quality, including the regular reporting of any audit quality initiatives to the Audit Oversight Body (AOB). This will be developed during FY22.

Continuous Improvement

The Continuous Improvement Team (CIT) was established in July 2020 to deliver RCA activities on a dedicated and consistent basis. Our CIT aims to proactively support our audit practice by analysing data and insight obtained from internal and external review activities, and by evaluating action timing and action effectiveness, to determine rapid and effective responses to emerging quality matters. The CIT also aims to identify and share best practices to provide our engagement teams with insight into positive audit behaviours and promote consistently high quality audits.

For the 2020/21 inspection cycle, the CIT has undertaken detailed RCA using our global network RCA guidance, supplemented by the standardised UK RCA approach which was approved by the Audit Executive in February 2020. The current year RCA on FRC inspection findings began with a comparative analysis of the key findings from the inspection activities, for 2020/21 as compared with 2019/20, to understand how the specific matters arising had evolved. This analysis also enabled the CIT team to evaluate in-progress action effectiveness, and an identification of additional actions required for any systemic matters.

The UK RCA methodology uses a risk factor taxonomy to consistently assess and score causal factors from data analysis, interviews and focus groups. These causal factors are referred to as 'risk factors' to reflect the fact that usually the root cause of matters arising on audit inspections relate to a combination of risk factors, rather than one factor. This methodology enables the CIT to identify whether there are any risk factors that are pervasive across engagements, those that are concentrated in the reported key findings, or factors that feature significantly in lower rated inspections. Factors identified as specific to lower rated inspections are assessed separately to ensure there are no further actions required over and above those already proposed in response to any pervasive factors or those relating to key findings, either for PwC Audit or at an engagement team level.

The establishment of the CIT also helps ensure a focus on best practice, that actions are designed effectively, with our engagement teams directing their efforts appropriately. For all inspected audits, actions to address the specific findings were also agreed by the engagement team with the FRC.

Risk Factors and actions

In previous years, our RCA has identified a number of risk factors as being pervasive across the engagements subject to inspection by the FRC. This year, whilst the FRC report includes key findings in recurring topic areas, the RCA found the specific nature of the detailed findings to have narrowed within these topic areas since the 2019/20 inspection cycle and the risk factors arising were not seen consistently across the engagements. As such, no pervasive risk factors were identified this year, rather the risk factors arising were either specific to the engagement or to the key finding, or topic area identified.

Our RCA highlighted that the PEAQ cultural change programme has had a positive impact on high performing engagement teams. Through discussion with these teams, it was clear that the critical few behaviours resonated, and they provided clear examples of how the behaviours had been embedded in their engagements. There was a focus on strong teamwork ('Team First'), engagement team members challenging themselves and management to deliver a high quality audit ('Challenge and be open to Challenge'), all underpinned by pride in the work performed ('Take Pride'). We will continue to focus on embedding the cultural change programme.

The most significant risk factors identified by the CIT for the 2021/22 inspection cycle were:

- Insufficient scepticism or challenge due to an over-reliance on broader client knowledge or the prior year audit approach. Whilst this factor was present in the previous year, this year we also identified a number of good examples of robust challenge of management, including in lower rated inspections. We will continue to focus on embedding the cultural change elements of the PEAQ, and in particular the Challenge and be open to Challenge behaviour, to further improve auditor consistency in this area; and

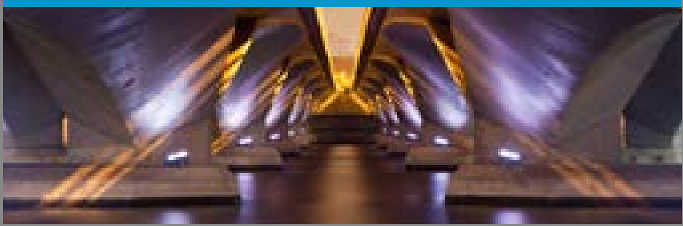
- Poor quality audit deliverables and the need for improved project management, particularly at the conclusion of the audit process. During FY21, we piloted our "Breaking the Audit Cycle" (BtaC) initiative which introduced audit planning milestones. For FY22, BtaC will be implemented by all audit teams, and will be expanded to include milestones for the execution phase of the audit. This will help to facilitate the development of an effective project timetable, including the agreement of quality audit deliverable responsibilities with management.

These risk factors were primarily identified in relation to the main key theme identified by the FRC, the evaluation of aspects of management's impairment and going concern assessments. They did not predominantly feature in the key findings raised on testing of pension asset valuation or residual population testing for journals where changes in and application of methodology and guidance were the more predominant risk factors. Additional risk factors specific to the lower rated engagements included isolated resourcing or team composition challenges and an expectation gap relating to the extent of evidence required to support an auditor conclusion.

On a continual basis, the CIT undertakes a holistic approach to action planning across all RCA activities. Action planning either enhances actions already in progress, for example within the PEAQ programme, or identifies new actions where necessary. All additional actions are consolidated into a single delivery level Action Plan, which the CIT monitors for both completion and effectiveness of actions. Further details of the RCA and actions are incorporated in our responses within each finding in section 2 of the report.

Our supervisory approach

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



The supervisory staff producing our reports

70+

The **AFS, AMS** and **AQR** teams comprise over **70** experienced professional and support staff assessing the risks to audit quality and resilience at each firm and the actions needed to address those risks.

PwC[4]

RIs **334**

Offices **20**

24,883 Professional Staff

PwC
Audits within the FRC's inspection scope

Inspection Cycle[5]	FTSE 100 audits	FTSE 250 audits	Total audits in FRC scope
2021-22	22	67	481
2020-21	28	62	515
2019-20	28	66	547

PwC
Audit fee income[6] £m

2018	2019	2020
673	713	754

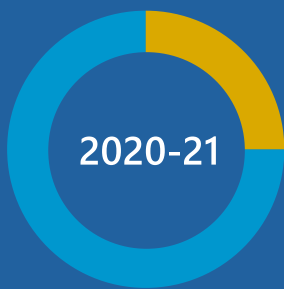
PwC
Audits inspected by the FRC[7]

2020-21: **20**

2019-20: **17**

2018-19: **26**

PwC
Local audits[8]



Major audits **1**
Non-Major audits **3**
Major audits inspected by the FRC **0**

4 Source – the ICAEW's 2021 QAD report on the firm.
5 Based on data compiled by the FRC, dated 31 December 2020, 2019 and 2018 respectively and used to select audits for inspection in the relevant inspection cycle.
6 Source – the FRC's 2019, 2020 and 2021 editions of Key Facts and Trends in the Accountancy Profession.
7 Excludes the inspection of local audits.
8 The FRC's inspection of Major Local Audits are published in a separate annual report to be issued later in 2021. The October 2020 report can be found here.

2 Review of individual audits

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

The assessment of impairment and the going concern assumption often involves significant judgement. Changes to key assumptions in the assessment of goodwill and other assets could result in a material impairment. Any material uncertainties for going concern will require enhanced disclosures in the financial statements. Auditors should obtain sufficient and appropriate evidence to assess the reasonableness of these assessments made by management.

Key findings

Last year we raised a key finding relating to the extent of challenge of short-term cash flow growth assumptions in relation to impairment reviews and going concern assessments. Given the potential impact on the financial statements, a large proportion of audits reviewed this year included the auditors' assessment of these areas, particularly where they had been identified as areas of significant risk.

Impairment
We continued to identify issues in this area. While there was good practice on some audits, findings were identified on nine audits, including three assessed as requiring improvements. On these audits we had findings over the sufficiency of the auditor's assessment or challenge of aspects of cash flow forecasts to support the annual assessment of goodwill impairment. Our findings included the following:

- On one audit there were improvements required in relation to the audit team's consideration of the assessment of the achievability of the cash flow assumptions, where revenue growth, margin improvements and cost savings were not adequately assessed for one cash generating unit that was sensitive to changes in key assumptions. On another audit, improvements were required to the adequacy of challenge of certain key assumptions, by the audit team, in concluding on the appropriate level of impairment.

- On five of these audits the audit team did not adequately assess management's historical forecasting accuracy with, in most cases, the "look back" period being limited to one year. We also had findings related to the adequacy of the auditor's consideration of sensitivity analysis for key assumptions on four of these audits.

- On three of the audits, we raised findings in relation to the model integrity testing used in management's goodwill impairment assessment. In one of these, the audit team identified an error in the model but did not ensure that the amendments had been appropriately updated in the final model in all respects. We also raised findings where the allocation of central costs were not adequately assessed in two of the audits, nor was there adequate assessment of the terminal value and the calculation of the discount rate on another audit.

We continue to identify issues in the evaluation of management's impairment and going concern assessments.

- On one audit, there were improvements required to the audit team's evaluation and challenge of management's assessment of property valuation impairment triggers and the extent of impairments recognised.

Following last year's findings, the firm took additional actions to address this area but, in some cases, these audits were undertaken before these actions had been fully rolled out. In other cases, it appears that they were not effectively applied to the relevant audits. The firm should continue to focus on ensuring there is greater consistency in the implementation of the actions in this area on individual audits.

Going concern
We also raised the following additional findings relating to the consideration and challenge of management's going concern assessments on three of these audits.

- On two of these audits insufficient procedures were performed over covenant compliance. In particular, on one audit, there were improvements required in relation to the audit team's interpretation of a key banking covenant, where there had not been direct confirmation from the lenders or independent legal advice obtained. On the other audit there was no evidence of the evaluation of management's assessment of covenant compliance.

- As with impairment, on all three audits we raised findings in respect of the extent of work performed on certain key assumptions in management's cash flow forecasts.

Two of these audits occurred before the firm had enhanced its procedures to respond to the increased risks relating to going concern arising from Covid-19. We found a number of good practices in this area following those improvements.

Firm's actions

As the primary finding identified in the FRC inspection cycle, our RCA began with a comparative analysis of the key findings from the inspection activities, to understand how the specific matters arising had evolved since the prior inspection findings. Whilst in a recurring audit area, this analysis concluded that the nature of the detailed findings have become more specific as our engagement teams' have focused on this area of audit.

The audits within the FRC sample were undertaken in early 2019 through to early 2020, during which time PEAQ commenced and our key actions of providing additional support, guidance and training to engagement teams were ongoing. Whilst many of our auditors have demonstrated increased scepticism and challenge of management forecasts, with extensive changes made by audited entity management to forecasts, headroom and impairment charges as a result of this challenge on a number of the inspected audits, these have not been demonstrated consistently across all engagement teams. We note that a number of good practices were identified in relation to our work on goodwill impairment on three inspected audits, and also in respect of enhanced going concern procedures in response to the current operating environment and the challenges resulting from Covid-19.

Our RCA identified that on specific engagements, there was insufficient validation, or evidence obtained over aspects of management forecasts where over-reliance was placed by engagement teams on prior year audit, entity or industry knowledge. Our audit behaviour of 'challenge and be open to challenge' empowers engagement teams to recognise, and challenge, this over-reliance. In addition to the specific actions agreed on each inspection, our first key action is for the CIT to develop a plan of different ways to share good practice to educate and help our engagement teams in understanding what good looks like, and helping them to remain confident in capturing sufficient evidence to support conclusions.

Secondly, and as noted in last year's inspection report, the quality of management's audit deliverables has a direct impact on the auditor's approach to execution and review of impairment assessments. Working closely with entity management to agree quality deliverables at appropriate milestones through our Breaking the Audit Cycle (BtAC) initiative aims to bring key audit procedures forward to earlier points in the audit cycle. This second key action will also support improvements in our engagement team project management activities.

Finally, our RCA identified that in respect of the going concern matters identified there was a need to improve the sufficiency of audit evidence obtained to support the conclusion of an auditor expert or specialist. Our third key action is to reinforce this need through our Higher Profile Client (HPC) training programme for the Engagement Leaders and Quality Review Partners of these audits.

Enhance the testing for the valuation of certain pension assets

Defined benefit scheme assets are included at fair value and often include investments, such as pooled investment vehicles (PIVs), which can be harder to value. Auditors should focus sufficiently on testing the valuation of these investments to be able to identify material misstatements of pension assets.

Key findings

Last year we raised a key finding relating to the sufficiency of audit procedures for pension assets, in particular those performed over the valuation of PIVs (investment funds that use funds from numerous investors). This year we reviewed the audit work on pension assets in six audits. The audit approach to testing pension assets generally consisted of a combination of controls reliance (including review of third-party service organisation controls reports) and substantive testing. We raised findings on aspects of the audit procedures in this area on five of these audits, again largely concerning the valuation of PIVs, as set out below:

- On four audits we had findings with the audit team's assessment of the appropriateness of valuation controls operating at investment managers. In two of these cases, reliance was placed on bridging letters. In both cases the audit team did not make it clear as to the extent of the assurance obtained as a result of these valuation controls and therefore whether any further substantive audit procedures were required.
- On two audits, we also raised findings with aspects of the substantive audit procedures performed over valuations, including testing of recent transaction prices, assessment of audited financial statements supporting the underlying investments and the completeness and accuracy of input data used by management in calculating the value of annuity policies held.

The firm has taken action in response to our prior year findings, including updating its methodology and guidance for audit teams. The timing of these actions will have been too late to impact some of the above audits. However, the firm should continue to take action to ensure that audit teams are implementing the changes and complying with the most up-to-date guidance.

We continue to identify issues in relation to testing of certain pension assets.

Firm's actions

We are disappointed that the inspections continue to identify required improvements in this area. Our CIT has identified that the inconsistent application of methodology, due to the availability of third party information and deliverables, and/or a lack of clarity of responsibilities between specialist pension auditors, and the engagement team, has resulted in variations in the extent of evidence retained on our file in respect of certain complex PIVs. Our first key action, which is in progress, is to develop a database to contain information on common PIVs to enable engagement teams to share learnings and information and to facilitate a consistent approach.

Secondly, we have commenced a longer term review of the structure, processes and activities of our pension auditors to ensure that the model is appropriately designed to facilitate the delivery of a high quality audit. Thirdly, in the short term, additional training, guidance and support is being provided to our specialist pension auditors, and through our External Auditor Training programme to engagement team members.

Improve the audit procedures for the residual journal population in response to the risk of management override

The testing of journals is one of the key audit procedures to respond to the risk of management override. Auditors should perform appropriate testing of journals, including over any residual population of the higher risk journals, in response to the risk of management override.

Key findings

We reviewed the audit team's testing of journals on most of the audits we inspected and raised the following findings relating to the risk of management override or coverage of testing:

- On five audits, where journals testing was based on determined risk criteria, there was insufficient evidence of the audit team's evaluation of the residual aggregated risk in the remaining untested population. This included two cases where there was insufficient evidence of assessment of the residual higher risk journal population after targeted testing.
- We had findings with the appropriateness and range of risk criteria used by the audit team for selecting journals for testing on two of these audits.
- For one of these audits, the audit team did not perform additional procedures over the accuracy of the journals listing following the identification of an error through the testing.

We reviewed the testing of journals on most audits inspected and had findings on five of them.

Firm's actions

Our RCA identified that, whilst these findings did not lead to any lower rated inspections, that on certain engagements, journal procedures were being performed without sufficient oversight from more senior team members, a requirement which has been reinforced in our 'team first' audit behaviour and through our mandatory External Auditor Training programme and leadership communications.

In December 2020, our engagement teams were reminded of the need to clearly explain the identified risk criteria rationale, and to ensure qualitative assessments of residual populations were captured sufficiently. In a further action, amendments are being made to underlying work programmes to facilitate this.

Good practice

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

- **Effective group oversight:** We observed a number of examples of effective oversight of component audits by group audit teams. This included effective planning and risk assessment procedures and good evidence of the group audit team's oversight of, and challenge of, the work performed by component auditors. In addition, on two audits, the quality of the evidencing of the EQCR's discussions with Key Audit Partners was of a high standard.

- **Robust assessment of management's going concern assumption:** Covid-19 started to have an impact on going concern assessments this year. The firm enhanced its procedures earlier in the year, to respond to the increased risk relating to going concern. We observed examples of good practice on two audits where there was a heightened going concern risk as a result of Covid-19. On one audit, there was detailed evidence of audit review and challenge by the firm's technical panel in the case of a material uncertainty relating to going concern. On another audit, the audit team demonstrated enhanced professional scepticism by developing a 'traffic light system' to assist with the assessment of key assumptions used in management's going concern assessment.

- **Effective use of the firm's internal experts and specialists:** We continue to see good examples on individual audits of the use of the firm's internal experts and specialists, including the effective integration of specialists into the audit team. Examples in the current inspection cycle included:
  - The effective use of valuation experts to challenge management and management's experts over a purchase price allocation on acquisition.
  - The use of the internal actuarial specialists in the audit of the insurance contract liabilities contributing to a well-integrated and coordinated audit of the insurance contract liabilities.
  - For a financial services entity, the use of credit modelling specialists to independently recode elements of ECL models, resulting in a robust means of providing assurance over the ECL calculation.

We also continue to see extensive use of IT and tax specialists on audits.

- **Effective procedures over revenue and long term contracts:** On two audits, comprehensive data analytics procedures were performed in the audit of revenue, demonstrating a detailed understanding of the entity's systems and processes. These data analytics were performed alongside other audit procedures and proved effective in obtaining assurance over revenue. We also observed good practice in the audit of a contracting business where the audit team robustly challenged and corroborated contract revenue adjustments through agreement to third party evidence and discussions with technical personnel.

- **Quality of the firm's summaries of audit responses to significant risks and related findings:** The firm requires all audit teams to prepare significant matter summaries to provide an overview of the audit responses to significant risks and related findings. We continue to observe that significant matter summaries for most audits we reviewed were of a good standard.

Good practice examples included the effectiveness of group audit team oversight, use of the firm's internal experts, the audit of long term contracts and going concern assessments.

3 Review of firm-wide procedures

We review firm-wide procedures, based on those areas set out in International Standard on Quality Control (UK) 1 (ISQC1), in some areas on an annual basis and others on a three-year rotational basis. The table below sets outs the areas we have covered this year and in the previous two years:

Annual	Current year 2020/2021	Prior year 2019/2020	Two years ago 2018/2019
• Audit quality initiatives, including action plans to improve audit quality. • RCA process. • Audit quality focus and tone of the firm's senior management. • Complaints and allegations processes.	• Audit methodology and training.	• Partner and staff matters. • Acceptance and Continuance (A&C) procedures.	• Ethics and Independence. • Internal Quality Monitoring. • Quality Control matters (including consultation and EQCR). • Audit documentation and data security.

In this section we set out the key findings and good practice we identified in the firm-wide work we have conducted this year, and a summary of our findings reported publicly in the previous two years, and the firm's related actions, with updates where relevant, as follows:

- Audit quality initiatives.
- RCA process.
- Audit methodology and training.
- Firm-wide findings and good practice in prior inspections.

Audit quality initiatives

Background

Firms should develop audit quality plans that drive measurable improvements in audit quality. Audit quality plans should include initiatives which respond to identified quality deficiencies as well as forward-looking measures which contribute directly or indirectly to audit quality.

PwC introduced the PEAQ in Summer 2019, to improve audit quality. PEAQ is phased over a three-year period, contains four workstreams and includes the development of a framework for assessing the benefits of key actions. It focuses on the key areas for change that the firm has determined will enhance audit quality over the three-year period. One of these areas is culture, and specifically embedding a culture of challenge in the audit practice which the firm sees as central to the success of the plan.

Audit quality plans should include forward-looking measures which contribute directly or indirectly to audit quality.

When we reviewed PEAQ last year, we identified good practice in implementing the new critical behaviours in the audit practice and increasing central resources through the Chief Auditor Network, which continues to support quality throughout audit teams. We also found that the firm should improve the plan and/ or quality initiatives by:

- Increasing the number and depth of in-flight reviews (one form of internal quality review undertaken during the audit).
- Enhancing project management procedures, such as through a formal milestone programme.

PwC's response to these findings did not require changes to the structure of the overall PEAQ programme or the four work streams but included changes to the actions within workstreams. The actions are being taken as planned.

This year, we have not conducted a detailed benchmarking of all firms' audit quality plans (AQPs) and quality initiatives, but at each of the seven firms we have brought our view up to date by work including:

- Assessing any key changes to the firm's AQP, arising from the actions taken in response to our findings last year, or for other reasons.
- Undertaking meetings with the firm to discuss and challenge aspects of the AQPs.
- Considering the oversight of the AQP at the firm including presentations made to the Independent Non-Executives (INEs) and any audit oversight bodies.
- Assessing the extent to which culture and the culture of challenge have been incorporated into the AQP.
- Considering, in hindsight, the effectiveness of the AQP and key initiatives with reference to current year findings and observations.

As a result of our work, we have observed that:

- The number of in-flight reviews was increased and is planned to increase further, with the process strengthened. In addition, the Chief Auditor Network performed targeted reviews of Covid-19 and going concern significant matters. Further consideration of the right level of reviews may still be needed following the challenges of Covid-19 on workloads etc.
- An activity stream was added to the supply and demand workstream within PEAQ, which focused on how teams structure, manage and deliver their audits, and enhancing audit teams' project management skills. The phased implementation has started by focusing on planning milestones and was piloted with selected teams in 2020. The pilot is being rolled out to more engagements and the action remains open.
- The firm is well advanced in embedding culture-related "critical few" behaviours (team first, challenge and be open to challenge and take pride) into key areas such as career progression, reward and recognition and performance management. The firm has developed innovative initiatives to embed this change of behaviours such as culture champions and storytelling.
- A culture and behaviours survey in 2020 was used to analyse progress made in embedding behaviours and their impact on audit quality. We have encouraged targets to be set against which to analyse progress. The lack of targets or points for comparison makes the results difficult to interpret and there is a risk that benefits will be confirmed without consideration of further improvements that may be required for continual improvement.

Key finding

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

- Develop an AQP for the future: PEAQ is, as intended, a three-year transformation/change plan. The firm should develop an AQP for the future to operationalise the audit strategy, ensure audit quality remains a top priority beyond PEAQ and capture key audit quality initiatives to be regularly reported on to the AOB. This plan should ensure that lessons are learned on audit quality and actions can be put in place in response with sufficient prominence.

Good practice

We identified the following areas of good practice:

- **Benefits realisation framework:** This framework assesses each of the PEAQ actions, the progress made and the impact the actions have had on audit quality based on evidence from management information, audit quality indicators (AQIs), qualitative feedback from stakeholders and RCA on internal and external engagement inspections.

- **Governance of PEAQ:** The firm's recently established independent AOB now has responsibility for the oversight of PEAQ and more widely audit risk and quality. The governance over PEAQ remained strong, with regular reports and updates to the firm's governing bodies on both progress and benefits realised.

We will continue to assess PEAQ in its last year and encourage all firms to develop or continue to develop their audit quality plans, including the focus on continuous improvement and measuring the effectiveness of the key initiatives.

Firm's response and actions:

In 2019 the PEAQ was designed as a three year programme to enhance the quality of our audits, however we expected, and continue to expect, the PEAQ to have a positive impact on audit quality beyond the conclusion of the programme. Delivering high quality audits that meet the needs of investors, stakeholders and the organisation we audit is a key pillar within our audit strategy, with PEAQ designed to embed the structure, culture, behaviours and activities to support our strategic aims.

We are pleased that the FRC has recognised further good practice in year two of the PEAQ, following on from the good practice identified in the year of implementation. Our benefits realisation analysis has facilitated an evaluation of the programme to date and we are satisfied that the significant actions taken have made substantial changes to our audit practice, including embedding the cultural change aspects of the programme into our audit practice.

We expect continual improvements to be needed to keep evolving our audits to meet our required standards. To this end, we established the CIT in 2020, and into which we plan to transition the PEAQ by the end of FY22. In addition, we have a number of ongoing quality initiatives that sit outside of the PEAQ programme, including the action planning performed by the CIT, which support our engagement teams in delivering high quality audits. Our Audit strategy for FY23 and beyond will incorporate the plan for audit quality. This will be developed during FY22 and will ensure that our audit activities continue to be appropriately monitored, reported to, and discussed with the AOB governance group.

PwC's audit quality plan was introduced in 2019 and is well advanced in a number of quality and behavioural initiatives. The plan is due to end in 2022 and the firm should develop an ongoing audit quality plan to ensure that audit quality remains a top priority.

RCA process

Background

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

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

When we reviewed the firm's RCA process last year, and the RCA conducted on our 2019/20 inspection findings, we found that the firm had a well-developed process with various elements of good practice, such as focus group sessions and the involvement of behavioural specialists. Nonetheless, we found that the firm should further improve the RCA process by:

- Widening the scope of RCA processes conducted on FRC inspections assessed as requiring significant improvements.
- Setting formal deadlines for the completion of individual RCA reviews.

We also noted that, unlike some other firms, PwC reported separately on RCA reviews for internal and external inspection findings, rather than reporting on the themes on a consolidated basis. Also, there was less focus on good practice compared with some other firms.

PwC's response to these findings indicated that the firm would take clear actions and the findings have now been addressed.

This year, we have not conducted a detailed benchmarking of all firms' RCA processes, but at each of the seven firms we have brought our view up to date by performing work including:

- Assessing any changes to the firm's RCA process, arising from the actions taken in response to our findings last year or for other reasons.
- Conducting follow-up meetings with the firm to discuss and challenge aspects of the RCA process and linked processes.
- Considering the oversight of RCA at the firm and communication of key findings.
- Considering, in hindsight, the efficacy of the historical RCA process and the actions taken with reference to current year inspection findings.

As a result of our work, we have observed that:

- The coverage and scope of RCA has been standardised and further enhanced. At an engagement level, the firm includes all external inspections (e.g. FRC, ICAEW and PCAOB), a sample of internal reviews and a sample from other sources (including AQIs and trends/emerging issues). For firm-wide reviews (FRC and internal reviews), all findings are subject to RCA.
- In July 2020, the firm set up a Continuous Improvement Team (CIT) which delivers RCA on a continuous basis. This team and the initiatives/changes it has introduced have given rise to a number of good practice points.

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

- The CIT is beginning to monitor the effectiveness of actions taken as a result of the RCA and, going forward, the same "benefits realisation framework" used for PEAQ will be used to measure the success of CIT's RCA and action planning processes.

- PwC have focused more on good practice in their RCA report than last year, but continue to report separately on RCA reviews for internal and external inspection findings, rather than reporting on the themes on a consolidated basis. While this is largely because of the timing of the inspections, there would be benefit in some regular reporting, across inspections and through the course of each year.

Key Findings

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

- Further analyse the root causes of and actions taken in respect of recurring findings: The firm's RCA is responsive to recurring findings as it includes techniques such as the comparison of issues, consideration of timing of previous actions and analysis of the differing causal effects. Further analysis, however, through RCA and an action effectiveness assessment still needs to be undertaken given certain recurring findings included in this report.

Good practice

We identified the following areas of good practice:

- **Use of a dedicated RCA team:** The core team is dedicated to RCA. Behavioural specialists were used to provide training to the CIT in interview techniques, challenging mindset and the role of unconscious bias. The team will also monitor the effectiveness of actions taken. Additional resources to support the team are drawn from a pool of experienced partners and subject matter experts.

- **Taxonomy:** The introduction of a taxonomy of risk factors allows CIT to assess issues consistently and to provide a clear trail from issue to causes and actions.

- **Continual RCA activities:** The continual nature of the CITs approach allows RCA activities to be performed using multiple sources of quality issue/findings (for example through AQI monitoring and feedback from the Chief Auditor Network or in-flight reviews). A new process has also been established for identifying and tracking issues that brings together sources of intelligence and data.

- **Embedding culture in RCA:** The firm's critical behaviours have been embedded into the RCA activities and materials used.

- **Analysis of AQIs:** The firm's analysis of AQIs as part of the RCA process was used to identify correlations with lower rated inspection results. Where strong correlations are identified it may in the future enable the firm to intervene before an audit is complete where those AQIs are monitored during the audit.

PwC's root cause analysis processes are well developed.

We will continue to assess the firm's RCA process. We encourage all firms to continue to develop their RCA techniques as well as continuing to focus on measuring the effectiveness of the actions taken as a result.

Firm's response and actions

The establishment of the Continuous Improvement Team (CIT) in July 2020 has facilitated an increased focus on the nature and consistency of quality matters identified and the underlying drivers leading to those findings. We are encouraged at the extent of good practice identified by the FRC as part of their review, and in particular the observations in areas identified for improvement in prior years. We continue to focus on supporting our engagement teams and welcome the observations and insights from the inspections team in respect of RCA focus and activities.

Our RCA activities continue to be refined each year, and are becoming increasingly integrated into other quality focused activities and initiatives. To undertake RCA on a continual basis, the CIT proactively gathers information from a range of sources including the findings from external inspections and internal reviews, as well as intelligence from a number of other Audit Risk and Quality (ARQ) teams and live data sources (such as AQIs and internal monitoring activities). In bringing these sources together, the CIT aims to consider audit quality findings in a broader context and incorporates that intelligence into the RCA procedures performed.

For the 2020/21 inspection cycle, the CIT undertook an analysis of the inspection themes identified by the FRC, and underlying causal factors, to understand if these had evolved. The timing and relevance of actions was then assessed, including engagement specific level actions, to determine whether additional new or reinforcing actions were required. The CIT will continue to refine this process using a similar benefits realisation framework to the PEAQ to check in-progress actions are effectively addressing the causal factors or where changes or new actions may be required.

The RCA performed by our CIT has identified that the underlying causal factors in relation to the recurring theme of impairment reviews and going concern has become more specific, and in relation to PIV pension assets has not led to any lower rated inspections. The CIT has also identified a number of good practice examples where audit teams have been successful in implementing quality improvements, but this has not been consistent across all our audits. We therefore believe our approach to RCA remains effective, with the CIT focused on undertaking further analysis through existing RCA activities to understand the reasons for this lack of consistency in application.

Audit methodology and training

Background

The firm's audit methodology and the guidance provided to auditors on how to apply it are important elements of the firm's overall system of quality control. Our inspection primarily evaluated key changes to the firm's methodology and guidance including how it had been updated to incorporate recent changes to auditing and accounting standards, including:

- ISA 540 revised (Auditing accounting estimates and related disclosures).
- ISA 570 revised (Going concern).
- IFRS 9 (Financial instruments) with a focus on the audits of banks, building societies and other credit institutions (banking audits).
- IFRS 16 (Leases).

We also considered other key topics such as the policies for using specialists and experts on audits and updates to audit software. We performed the majority of this work on methodology and guidance in place on 31 March 2020, including a consideration of the firm's initial response to the impact of Covid-19.

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

Firms' training arrangements must provide auditors with the knowledge and skills necessary to fulfil their role effectively, and as such, are also an important element of the firm's overall system of quality control. Our inspection included an evaluation of the amount of training provided by the firm in the year ended 31 March 2020, the subjects covered and how the training was delivered. We also considered the firm's processes for monitoring course attendance and evaluating whether participants had met the learning objectives by conducting post-course assessments.

Key findings

We had no key findings to report.

Good practice

We identified the following area of good practice:

- **Completion of mandatory training:** while there are high levels of completion, there are also clear consequences for individuals that do not attend mandatory training within the required deadlines.
- **An analysis of post-course assessment results to identify residual knowledge gaps:** the firm has a process to analyse how often individual questions are answered incorrectly to identify topics that course attendees found difficult.
- **Monitoring the number of attempts an individual takes to pass a post course assessment:** the firm monitors the number of attempts an individual takes to complete post-course assessments. When the number exceeds a pre-set threshold an action plan is agreed with the individual and monitored.
- **The frequency and quality of ongoing communications to partners and staff on methodology and guidance:** the firm regularly issues guidance on new auditing and accounting standards and refreshers on existing standards that are of a high standard.
- **The guidance to audit teams on controls that are common at banking entities:** the firm has detailed guidance on the controls that are common at banking entities, and how those controls (if tested appropriately) can provide audit evidence for particular risks and assertions.
- **An economics tool to compare management forecasts to independent forecasts:** this is used on certain banking audits to inform the audit teams' assessment of economic and macro-economic assumptions.

In addition to the firm-wide procedures above, we performed a thematic review on the enhanced audit policies and procedures at the seven largest firms in relation to going concern, given the impact of Covid-19. The themes we observed were publicly reported in June 2020 and November 2020 and have not been included here.

We had no key findings to report in respect of audit methodology and training.

Firm's response and actions

We are encouraged that the firmwide review cycles on methodology and training have reported a number of areas of good practice, and that feedback during the thematic review cycles, including going concern, have been positive. Our designated methodology and training teams are focused on providing high quality updates, training and guidance to our audit practice, covering both existing and emerging topics. The identification of good practice by the FRC assists these teams in replicating their approach across all activities, and we are pleased that the quality of our Audit Guide, certain supporting tools and communications to the audit practice have all been identified as good practice during these reviews.

Firm-wide key findings and good practice in prior inspections

The following table summarises the firm-wide findings included in our previous two public reports, as well as the actions taken by the firm in response to our key findings, in those areas of ISQC 1 which we review on a rotational basis. We consider that the firm has appropriately responded to these findings based on the actions taken and planned.

Key findings in previous public report	Update on firm's actions in response	Good practice
Partner and staff matters (2019/20): 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 FY18 appraisal year, across the following areas: Appraisals and remuneration; Promotions; Recruitment; and Portfolio and resource management.		
• The firm does not have a formal process in place to ensure that all relevant quality metrics (including the results of internal or external inspections) are appropriately considered and reflected in senior staff appraisals. • The firm does not have a formal assessment process in place to ensure that audit quality is appropriately and consistently considered for manager and senior manager promotions across all business units.	• Since the inspection performed by the FRC on our performance year processes in Performance Year 2018 (PY18) the global network has implemented a new people management system. Workday was implemented during PY19, with a number of enhancements in respect of people management and performance evaluation. • We have recently completed our PY21 performance assessments, which included the completion of an audit quality assessment form and a self-assessment against the critical few behaviours. • Standardised promotion templates, including a more explicit consideration of audit quality, were implemented and have been used for the PY20 and PY21 cycles. • All identified actions in respect of this cycle of firmwide inspection have been completed.	• The partner appraisal forms we reviewed incorporated clear consideration of audit quality, including detailed commentary on the results of internal and external quality inspections in the year.

Key findings in previous public report	Update on firm's actions in response	Good practice
Acceptance and continuance procedures (2019/20): ISQC1 requires firms to have detailed policies and procedures relating to acceptance and continuance decisions for audited entities. We reviewed the firm's processes as at October 2019 and their application. We also discussed with senior leadership 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.		
• The firm's A&C form contains a set of standard client and engagement risk questions, which have a choice of pre-defined responses. There is limited functionality to enable preparers to justify and explain their responses, including the overall conclusion as to why it is appropriate to accept or continue acting for the entity. It does not give sufficient prominence to the assessment of the potential impact on the firm's brand and reputation risk. • In addition, the firm's processes allow the approval of an entity's A&C form before the completion of all independence and due diligence checks.	• The A&C system is a network-wide record of audit engagement risk designation. The A&C form is used by the engagement team to record its conclusions in respect of entity and engagement risks, and formally escalate the designation of higher risk audits to the Audit Risk Management Partner. • The Audit Tender Approval Process (ATAP) panel was implemented in December 2019 and has been applied to any potential new audit, or participation in any audit tender, including retenders, from that date until January 2021. • The development of a network-wide replacement for A&C is well progressed and is due to be launched in summer 2022. All other identified actions in respect of this cycle of firmwide inspection have been completed.	• Where the firm concludes that it should not accept or continue work on specific entities (for example, in respect of concerns relating to reputation risk, integrity of management or legal matters), the entity is added to a "black box" list with the relevant reason. This list is maintained centrally and is available to the PwC network.

Key findings in previous public report	Update on firm's actions in response	Good practice
Ethics and independence (2019/20 and 2018/19) Firms should have appropriate systems and procedures to ensure compliance with the revised Ethical Standard, including in relation to the approval of non-audit services.		
• In relation to non-audit services, the firm's systems do not require audit engagement partner approval before teams obtain engagement codes to charge their time. The systems also do not incorporate the Ethical Standard changes or functionality to help engagement teams identify non-permitted services. The firm is reliant on changes to global systems to address this, although these systems will not be fully implemented in 2019.	• In 2020 we introduced a bespoke control which is designed to complement the existing global processes and restricts the ability of non-audit services teams to charge time to engagement codes for restricted entities without an approved Authorisation for Services (AFS) being in place, and a number of further complementary controls within our acceptance and relationship checking processes. • During 2020, we released a new version of the AFS system used for approval of non-audit services to audited entities. Revised guidance was issued alongside this system upgrade to respond to the enhanced requirements of the Ethical Standard 2019. • In 2020, we also integrated AFS with the Client Relationship Management (CRM) system providing automatic creation of AFS documents when potential opportunities with restricted entities progress to an "interact" stage in their lifecycle.	No specific good practice examples raised.

	• All partners and staff have completed mandatory ethics and independence training, during 2019 and 2020, including modules on restrictions in respect of the delivery of non-audit services to audited entities. • All identified actions in respect of this cycle of firmwide inspection have been completed, or alternative actions undertaken.	

We did not raise any other key findings in 2018/19 or 2019/20. The following observation was also highlighted as good practice:

Internal quality monitoring (2018/19)

The firm has updated its approach to the firm-wide testing and internal quality monitoring procedures and the extent of its testing for firm-wide procedures.

Appendix 1

Firm's internal quality monitoring

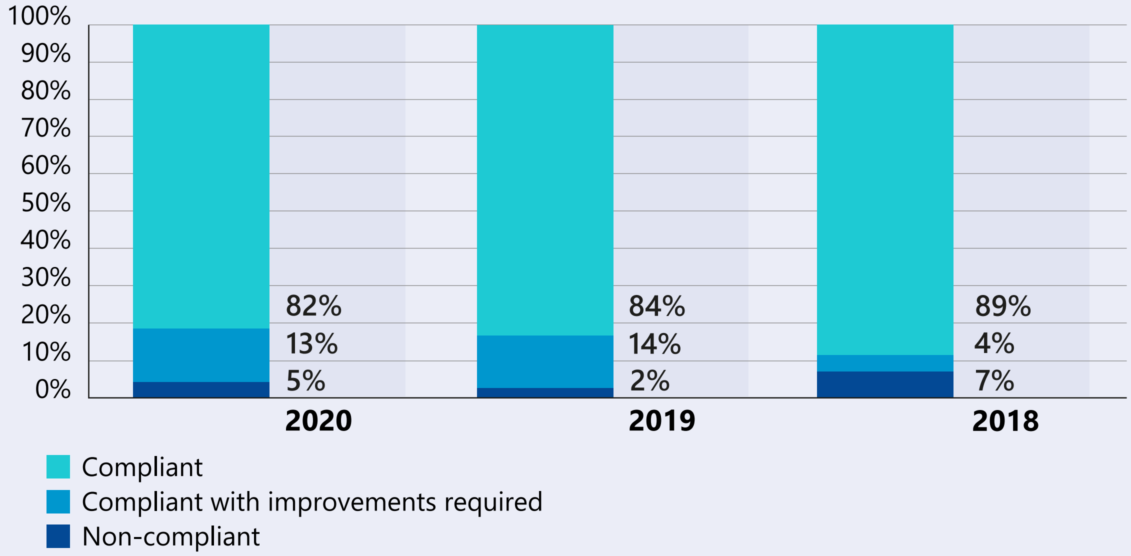
This appendix sets out information prepared by the firm relating to its internal quality monitoring for individual audit engagements. We consider that publication of these results provides a fuller understanding of quality monitoring in addition to our regulatory inspections, but we have not verified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

The appendix should be read in conjunction with the firm's Transparency Report for 2020, and the firm's report to be published in 2021, which provide further detail of the firm's internal quality monitoring approach and results and its wider system of quality control.

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

Results of internal quality monitoring

The results of PwC's most recent Engagement Compliance Review (ECR), which comprised internal inspections of 142 individual audits (FY19: 142), with periods ending between 31 August 2018 and 31 March 2020, are set out below along with the results for the previous two years.



An engagement is graded as:

Compliant (C) - when relevant auditing, assurance, accounting and professional standards have been complied with in all material respects;

Compliant with Improvements Required (CwIR) - when the issues identified for improvement (in either substantive or controls work) are mitigated by additional or alternative audit procedures which had been performed in the audit, the departure from accounting standards is not considered to be significant, or where there are audit report (opinion) issues that are more than grammatical/punctuation errors but which do not mislead the user; or

Non-Compliant (NC) - when relevant auditing, assurance, accounting and professional standards or documentation requirements were not complied with in respect of a material matter.

Firm's approach to internal quality monitoring

PwC's ECR program considers the full population of audits performed and is designed to cover both PwC's responsible individuals (RIs) and specific categories of audit clients. The ECR program involves a post-signing review of an audit engagement for each RI at least once every three years, and twice in any six-year period for audits identified by PwC as having a high public profile. ECRs are led by experienced partners and are supported by teams of partners, directors and senior managers who are independent of the audit under review. The outcome of each review is evaluated using a standard set of principles set by the PwC Global Network to assess whether relevant auditing, accounting and professional standards have been complied with. A moderation panel, composed of the review team, PwC's UK Quality Review Leader and a member of PwC's Global Inspections team, forms an overall engagement assessment considering the nature and severity of the individual findings in each review.

PwC's Continuous Improvement Team (CIT) undertakes RCA for all inspections with Non-Compliant outcomes and a number of Compliant with Improvements Required and Compliant engagements, including engagements identified as 'best in class'. The best in class analysis helps identify success factors that inform potential actions. Following RCA, a Quality Improvement Plan is developed to respond to the drivers of systemic issues and specific matters arising from the ECR. Responsive actions may be identified at either the engagement delivery and/or line of service levels. Completion of the ECR and Regulatory Findings action plans are monitored by the Audit Risk and Quality leadership, the Audit Executive and PwC's Audit Oversight Body.

Internal quality monitoring themes arising

The key theme arising from the ECR 2020 review cycle was in relation to errors or omissions in the auditors' report (opinion) or interoffice reporting between two PwC teams. Other findings identified leading to lower graded reviews included the extent of substantive work performed on specific financial statement disclosures, insufficient documentation or incorrect application of PwC audit methodology, and the extent of response to an identified IT matter. A common theme identified in non-grade driving findings was a lack of consistent 'telling the story' through the audit documentation. These findings are broadly consistent with the 2019 ECR cycle.

Firm's actions

As there has been a slight decline in the results of the 2020 ECR when compared to the 2019 review cycle our CIT has undertaken detailed RCA to understand the drivers of these outcomes. Whilst the finite number of Non-Compliant (NC) engagements has increased, we note that the majority of work on these audits was performed either before, or just after, the launch of the PEAQ in July 2019, with limited associated impact on the ECR outcome.

The focus of our ECR programme is broad, including questions relating to compliance, application of PwC audit policy and auditor judgements. With the exception of the high public profile entity rotation requirements, audits subject to ECR are not additionally risk targeted but are aimed at achieving coverage across all engagement leaders.

RCA was performed by the CIT covering both engagements with specific ECR findings and those identified as best in class (good practice). The most common theme identified in non-grade driving findings was a lack of clarity and completeness of documented explanation or rationale on the audit file.

As with the FRC 2020/21 RCA, there were limited overarching factors driving NC or Compliance with Improvement Required (CwIR) engagements. Specific factors around sufficiency of review, over-reliance on audited entity or prior year knowledge, focus or experience of senior engagement team members and application of audit methodology and policy were identified.

The CIT identified that an appropriate engagement team mix of industry and audited entity knowledge, and the prioritisation of engagement team coaching and supervision, helped drive better audit quality outcomes. In addition, the use of an evolving project plan and engagement team focus on clear articulation of procedures performed for more complex or unusual audit approaches also supported high quality audits.

The CIT have evaluated the relevant risk factors and behaviours and identified responsive actions. These actions, some of which were already in-train as part of the PEAQ, include a number of specific changes to audit work programmes, the issuance of additional guidance, and topic-specific auditor training. In addition, a focus on the critical few behaviours in auditor evaluation, and the ongoing review of senior auditor portfolios are incorporated in the PEAQ.

Appendix 2

FRC audit quality objective and approach to audit supervision

Audit quality objective

The FRC is the Competent Authority for statutory audit in the UK and is responsible for the regulation of UK statutory auditors and audit firms, and for monitoring developments, including risk and resilience, in the market. We aim, through our supervision and oversight, to develop a fair, evidence-based and comprehensive view of firms, to judge whether they are being run in a manner that enhances audit quality and supports the resilience of individual firms and the wider audit market. We adopt a forward-looking supervisory approach to audit firms, and we hold firms to account for making the changes needed to safeguard and improve audit quality.

Auditors play a vital role in upholding trust and integrity in business by providing opinions on financial statements. The FRC's objective is to achieve consistently high audit quality so that users of financial statements can have confidence in company accounts and statements. To support this objective, we have powers to:

- Issue ethical, audit and assurance standards and guidance;
- Inspect the quality of audits performed;
- Set eligibility criteria for auditors and oversee delegated regulatory tasks carried out by professional bodies such as qualification, training, registration and monitoring of non-public interest audits; and
- Bring enforcement action against auditors, if appropriate, in cases of a breach of the relevant requirements.

In March 2021 the Department for Business Energy & Industrial Strategy (BEIS) published a consultation document, Restoring Trust in Audit and Corporate Governance, which proposes broader supervisory powers for the FRC/ARGA covering auditors, audit committees and directors. The legislation that follows the consultation process will create ARGA and provide it with further powers.

Approach to audit supervision

In March 2021 we published Our Approach to Audit Supervision which explains the work that our audit supervision teams do.

These reports published in July 2021 provide an overview of the key messages from our supervision and inspection work during the year ended 31 March 2021 (2020/21) at the seven largest audit firms[9], and how the firms have responded to our findings.

In accordance with our commitment to transparency, for the first time we will also be publishing later this year anonymised details of the key inspection findings and good practice points on the individual audits we reviewed.

In addition to our public reporting, we report our findings in more detail privately to the firms and also to their Recognised Supervisory Body for the purposes of its decision on their audit registration. From 2022, the FRC will be assuming responsibility for the registration of all firms which audit PIEs.

9 The seven largest firms are: BDO LLP, Deloitte LLP, Ernst & Young LLP, Grant Thornton UK LLP, KPMG LLP, Mazars LLP, PricewaterhouseCoopers LLP. We have published a separate report for each of these seven firms.

Our inspection and supervisory work in 2020/21 included:

- 103 statutory audits conducted by the largest seven firms, 16 at smaller firms and four at the National Audit Office. These audits were of financial statements for years ended between 30 June 2019 and 2 May 2020. We also inspected 22 local audits, which we report on separately later in the year, three other audits at the National Audit Office and one Third Country Audit, making an overall 149 inspections.

- Certain areas of the firms' quality control procedures (against the requirements of ISQC 1). We review these on a three year rotation basis at the seven largest audit firms and periodically for smaller firms.

- A focus on the firms' audit quality plans and RCA, both of which are important means of addressing audit quality issues and driving continuous improvement.

In 2020/21 our inspections focused on the following priority sectors and audit areas[10]:

Sectors	Audit areas
• Financial Services	• Going concern and the viability statement
• Retail, including Retail Property and Travel & Leisure	• The Other Information in the Annual Report
• Construction and Materials	• Long-term contracts
• Manufacturing	• The impairment of non-financial assets
	• Fraud risk
	• Application of new accounting standards (IFRS 15: revenue and IFRS 16: Leasing)

Our firm-wide inspection work in 2020/21 focused on audit firms' methodology and training, particularly relating to: revised auditing standards on going concern and the audit of estimates; and new or recently issued accounting standards on financial instruments (IFRS 9), revenue (IFRS 15) and leasing (IFRS 16).

At the conclusion of all individual audit inspections that are assessed as requiring more than limited improvements, we will consider whether the audit should be referred for consideration under the FRC's enforcement procedures. UK statutory audits may be referred to FRC's Case Examiner for consideration under the Audit Enforcement Procedure (AEP)[11]. The Case Examiner then decides on the appropriate course of action, which may involve Constructive Engagement with the audit firm to resolve less serious potential breaches of auditing standards and other requirements or referral to the FRC's Conduct Committee to consider whether an investigation should be opened. An investigation may result in financial and non-financial sanctions being imposed on an individual statutory auditor and/or the statutory audit firm. The FRC publishes details of all sanctions imposed. From our 2020/21 inspections, 18 audits have so far been referred to the Case Examiner (compared to 13 from our 2019/20 inspection cycle). The FRC's Annual Enforcement Review, published annually in July, contains further details of audits considered under the AEP.

As well as planned supervision and inspection activities, we also respond quickly to emerging issues. For example, during 2020/21 we responded to Covid-19 by issuing guidance to audit firms (and companies) and carrying out a thematic review of the audit of going concern which included inspecting samples of audit work. Our findings were that firms had reacted well to the new challenges. Our 2021/22 inspections will also focus on and take into account the impact of Covid-19 on audits.

10 https://www.frc.org.uk/news/december-2019-(1)/frc-announces-its-thematic-reviews-of-corporate-re
11 Other procedures apply to audits of non-UK entities (such as those incorporated in the Crown Dependencies)

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