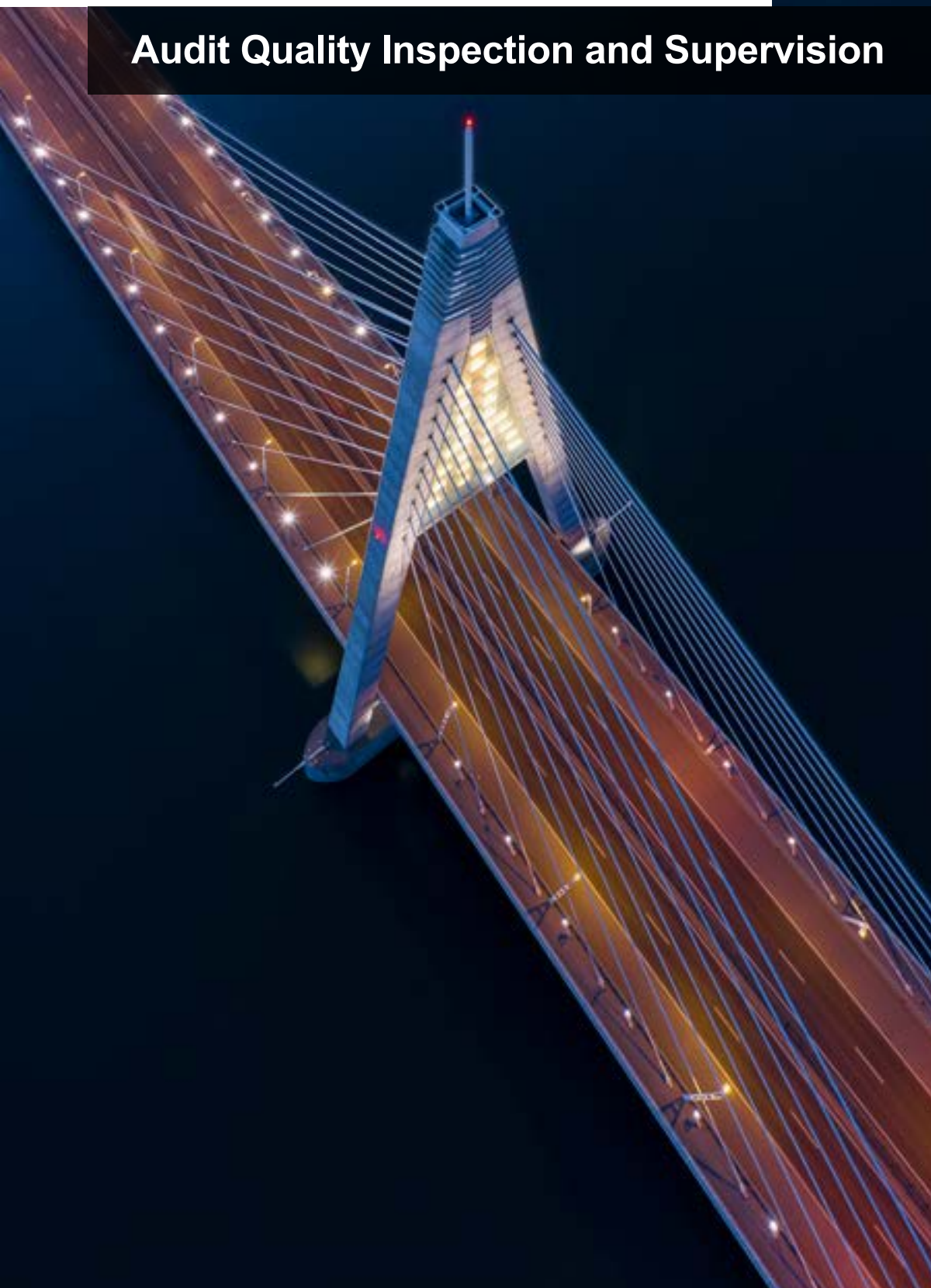




Financial Reporting Council

Grant Thornton UK LLP

Audit Quality Inspection and Supervision



July 2021

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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

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This report sets out the FRC's findings on key matters relevant to audit quality at Grant Thornton UK LLP (GT 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 (PIEs¹). 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 area².

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](https://www.frc.org.uk/getattachment/c1ec4c8f-0eb3-44b9-a4c7-5fe5e4c0e0f1/FRC-going-concern-review-letter-(phase-2).pdf)

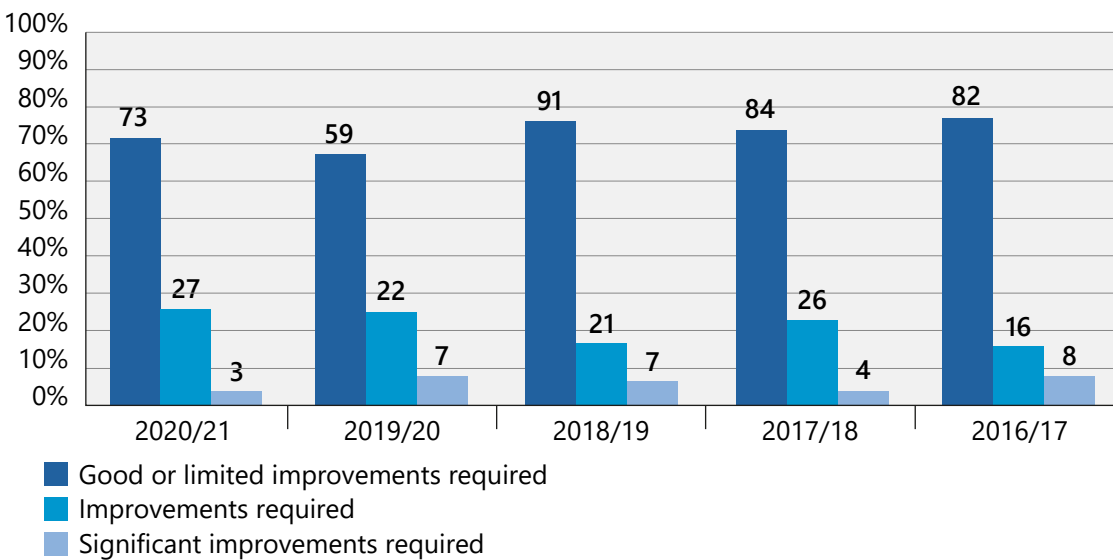
Central to achieving consistent audit quality is a healthy culture within the audit practice that encourages challenge and professional scepticism, as we set out in our letter to Heads of Audit in [December 2020](#). We have a major project underway to examine audit culture, including an international 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 teams³ 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.



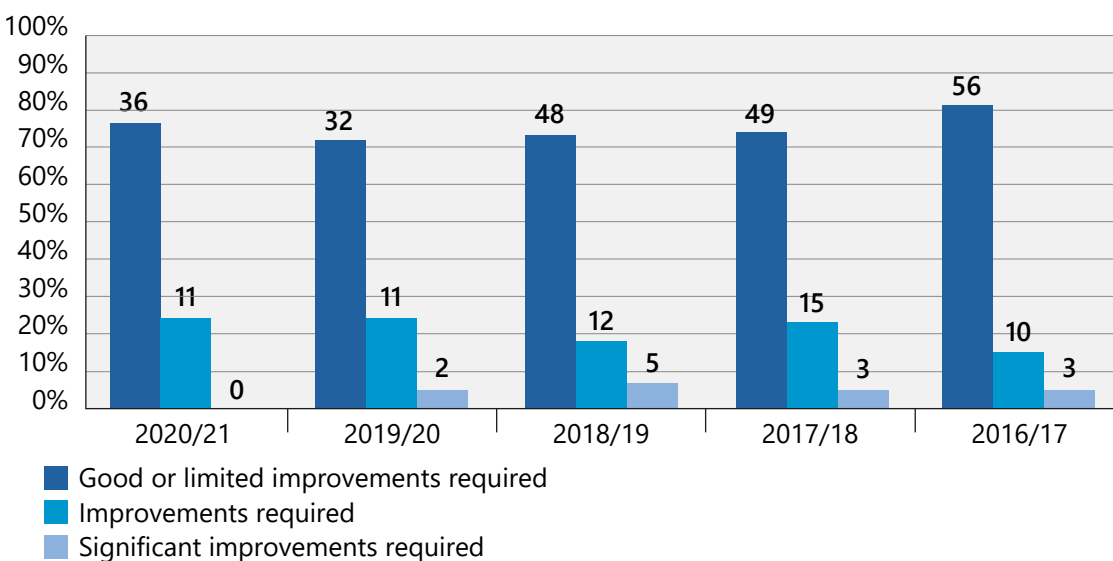
Our supervision teams are increasing the range of pro-active and forward-looking work.

All reviews



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

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>

Grant Thornton overall assessment

We reviewed seven individual audits this year and assessed six (86%) of them as requiring no more than limited improvements.

The number of audits reviewed was reduced from previous years to reflect the fall in the number of audits within the scope of the FRC. There has been a significant improvement in the number of audits requiring no more than limited improvements compared to the number of such audits identified in both our 2019/20 and 2018/19 public reports. While it is too soon to identify this improvement as a trend, it is nonetheless an encouraging signal. The finding that contributed most to this year's inspection results on individual audits related to the challenge and corroboration of key judgements and estimates.

Grant Thornton initiated its three-year audit quality plan, the Audit Investment Plan (AIP or the plan) in Spring 2019 to improve audit quality. The AIP covers a range of initiatives and is well established and understood throughout the firm. The current plan is due to end early 2022 and needs to be extended on a rolling basis to ensure that audit quality remains a priority focus in the longer term. Regular progress reports are provided to the Audit Quality Board (which includes an independent non-executive dedicated to the audit practice) and the Audit Executive and an overview is provided to the firm's Senior Leadership Team, the Partnership Governance Board and the Public Interest Committee. We have seen evidence of oversight and challenge from the Audit Quality Board. The firm would benefit from extending its assessment to include the effectiveness of the overall AIP. The firm has been responsive to the points that were raised in the prior year, however, further enhancements and focus are needed on previous key findings identified in respect of continuing to strengthen a culture of challenge.

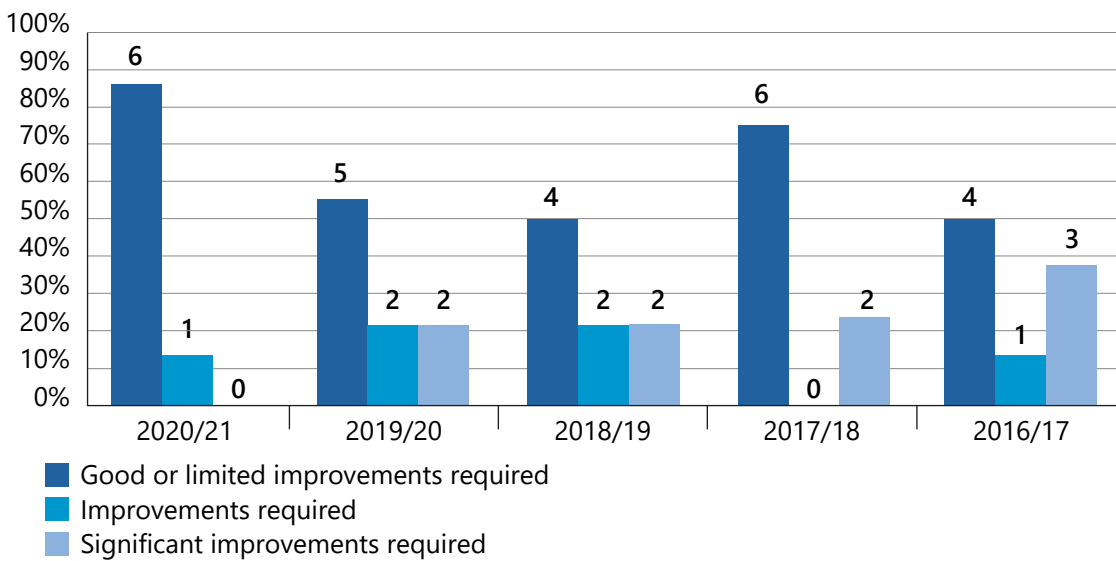
The firm has continued to strengthen its root cause analysis (RCA) team and processes. The firm's RCA is conducted on an ongoing basis, enabling themes and responses to be developed and responded to promptly. Findings are regularly shared with senior members of the audit practice as well as those responsible for audit governance. These findings would benefit from further analysis of the root causes including a greater depth and quality of interrogation. In addition, consideration should be given to widening the breadth of scope of RCA analysis including in respect of firm-wide reviews.

Given the significant audit quality issues identified in both 2019 and 2020, we are encouraged by the improvement in results this year. It is imperative that the firm ensures that this progress continues, including in respect of the challenge and corroboration of key judgements and estimates in conjunction with ongoing focus on the firm-wide findings.

86%

At Grant Thornton, 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: Grant Thornton UK LLP



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

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. We were not provided with access to certain audit working papers for one of the audits we reviewed on the grounds that they were legally privileged and the entity declined to waive privilege.

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 was of an acceptable standard. Eight of the ten files were either satisfactory or generally acceptable. One audit required improvement and one audit required significant improvement. The grading profile has improved slightly with proportionately more audits in the top two grades in 2020. The review of one audit was limited in scope because the audited entity exercised legal privilege over matters relating to professional indemnity provisions and contingent liabilities and ICAEW was unable to review work in those areas.

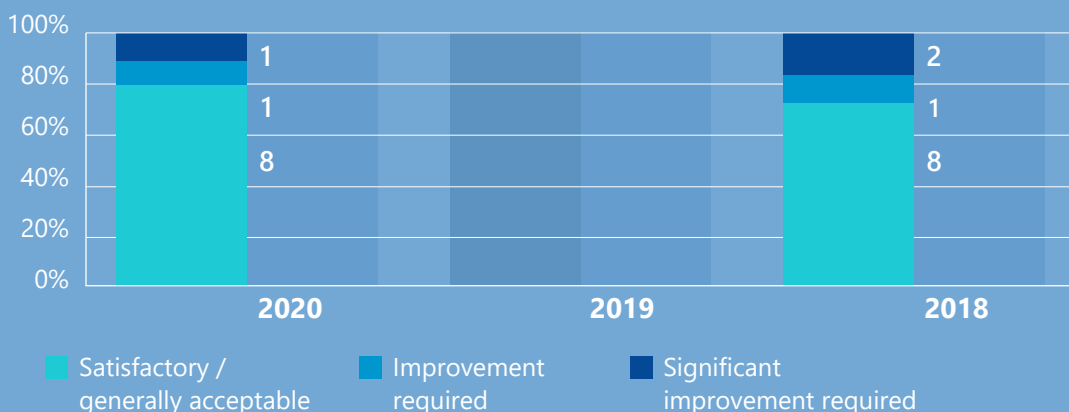
On the audit requiring significant improvement, there was insufficient evidence of the team's consideration of the recoverability of a number of debtor balances and the potential impairment of an investment. There were also material late adjustments, which were not explained and a number of errors in the financial statements.

The audit requiring improvement did not adequately justify why a very material related party debtor was recoverable. There was also a lack of disclosure in the financial statements relating to a material additional VAT charge.

On the audits assessed as generally acceptable, there were evidence gaps in limited areas in addition to matters relating to testing the completeness of revenue, which had been a thematic finding at previous visits.

ICAEW identified a number of good practices and found that audit work was generally better recorded and evidenced than at the previous full visit.

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



Note: 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.

80%

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

Review of individual audits

Our key findings related primarily to the need to:

- Improve the challenge and corroboration of key judgements and estimates.

Good practice observations



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

- Evidence of challenge of management in areas of key judgement.
- Robust procedures relating to issue of the audit report.
- Use of certain internal specialists.
- Consultation on certain audit matters.
- Audit data analytics.

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 these areas related primarily to the need to:

- Ensure that the plan continues on an iterative and evolving basis and incorporates medium term initiatives.
- Strengthen the procedures to monitor the effectiveness of the overall audit quality plan.
- Continue to strengthen the culture of challenge in the audit process.

RCA process

Our key findings related primarily to the need to:

- Expand the scope of the reviews.
- Increase the depth and quality of the interrogation of the root cause analysis.

Audit methodology and training

Our key findings in these areas related primarily to the need to:

- Ensure audit practitioners complete their mandatory training on a timely basis.
- Introduce audit specific training for the firm's IT and tax specialists.
- Issue guidance in relation to auditing lease accounting and financial instruments accounting under IFRS 16 and IFRS 9 respectively.

Good practice observations



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

- **Audit quality initiatives** – oversight and governance; breadth of the plan; and central monitoring and challenge.
- **RCA process** – use of dedicated RCA review staff; oversight and communication with the firm; and continual RCA activities.

Firm's overall response and actions



In our response to the AQR 2019 report, we stated that we were confident that the actions we have taken through our wide-ranging Audit Investment Plan would have a significant impact on the audits reviewed as part of this cycle and are pleased that 86% of our files have achieved a good grade, and that no engagement files were graded as requiring significant improvements.

These results demonstrate the impact of the fundamental changes we have made in how we approach audit quality as a firm. This change has been effected both through the 100+ workstreams within our Strategic Implementation Plan and the early culture changes we have already started to make within our audit practice.

We are pleased to see that both the FRC and the QAD's inspection results show a significant improvement and that we only have one key finding theme this year in the AQR report compared to five in the previous year which is demonstrable progress. We note that, of the two files requiring improvement identified by the QAD, both of those files were audits performed before the commencement of the Audit Investment Plan.

We are also encouraged to see a significantly larger number of good practice areas highlighted on individual files, which show both a breadth and depth of good practice points identified, particularly around the challenge of management although as this was still a finding, we will continue our focus in this area. We are also pleased to see good practice points raised below in terms of consultation and the use of Audit Data Analytics which are both areas which have been significantly strengthened under the Audit Investment Plan. We will continue focus on these, and other good practice areas, through subsequent audit cycles to ensure we simultaneously address the key finding identified in this year's public report and build on the multiple good practice points identified to ensure a sustainably high audit quality practice.

Our first iteration of our Audit Strategy (which seeds the Audit Investment Plan, Strategic Implementation Plan and Ongoing Monitoring Plan) is currently being developed into the next three-year quality plan to embrace both medium term milestones as well as shorter term milestones and to prepare for the market opportunity that the BEIS consultation may offer us.

We have continued to invest both in our client facing and technical teams over the last 12 months and continue to focus both on training, guidance, in-flight reviews, IT auditing skills and our coaching and project management tools.

We remain fully committed to audit quality and will continue to invest to ensure consistent, sustained high quality audits are maintained in parallel with our successful ongoing growth of our complex client base.

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

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.



GT⁴

Rls
96

Offices
26



3,594
Professional Staff

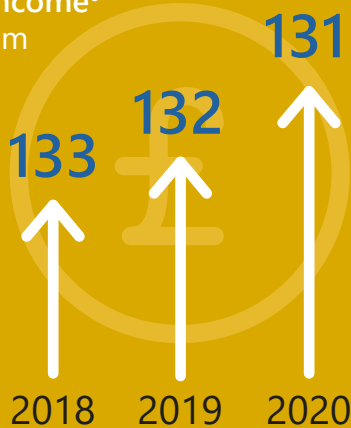
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Audits within the FRC's inspection scope

Inspection Cycle ⁵	FTSE 100 audits	FTSE 250 audits	Total audits in FRC scope
2021-22	0	4	39
2020-21	0	4	50
2019-20	0	6	60

GT

Audit fee
income⁶
£m



GT

Audits inspected
by the FRC⁷

2020-21

7

2019-20

9

2018-19

8

GT

Local audits⁸

2020-21

Major audits **120**
Non-Major audits **216**
Major audits inspected
by the FRC **9**

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 area 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 this area.

Improve the challenge and corroboration of key judgements and estimates

Financial statements typically include balances which are subject to estimation and judgement, including the calculation of fair values and assessing goodwill and other intangible assets for impairment. These estimates and assumptions can be highly judgemental, sensitive to small changes and susceptible to management bias or error. Audit teams should therefore obtain sufficient and appropriate audit evidence in relation to the significant judgements and estimates made and challenge management on their appropriateness.

Key findings



We reported in previous years that audit teams needed to improve their challenge of management and exercise greater scepticism, in particular for areas of significant judgement on higher risk audits. We reviewed the audit of significant judgements and estimates on all audits inspected in this cycle and saw an improvement in audit quality compared with prior years. However, we identified instances of insufficient challenge on three audits:

- On two audits, there was insufficient assessment and challenge of certain key assumptions and judgements supporting the fair value of assets (including intangible assets) and liabilities arising on acquisitions.
- On one audit, the audit team did not sufficiently evidence certain key assumptions underpinning the goodwill impairment assessment, including the reasonableness of forecast growth in cash flows. The basis of the sensitivities applied was not adequately justified.
- On one audit, there was an insufficient assessment of a lender's ability to provide funding, as and when required. The working capital forecasts assumed this funding would be available to support the going concern conclusion.

It is important that the firm achieves and demonstrates a consistently high level of challenge and obtains appropriate and sufficient corroborative evidence in areas of judgement. The firm should ensure that a culture of challenge continues to be developed and embedded as part of the response to improving audit quality.

We continue to identify instances of insufficient challenge by audit teams of certain key judgements and estimates.

Firm's actions



Challenge and corroboration remain a key focus for us and ties strongly to the cultural work we have been doing and which we are scheduled to expand in 2021.

Culture is key as challenge and corroboration can lead to tensions in client relationships and, sometimes, delays in signing (a good practice point in three of our audits reviewed by the FRC this cycle, and also seen in other audits of the firm) and we have been upskilling our teams on how to manage those tensions. We see our culture of ensuring the audit report is not signed until we are confident we have completed our audit work to a sufficiently high quality as a key element of audit quality. To that end, we have been working with our clients to ensure they understand what is required from them in terms of providing appropriate and sufficient auditable evidence to ensure the audit can proceed effectively and efficiently.

Challenge and corroboration are one of the cornerstones both of the training we have been providing in the last 12 months but will also be a key area of focus for our three-day summer training event in 2021.

We have appointed a new Head of Audit Culture and are working with external specialists as part of a wider range of measures including ensuring teams better understand what and how to challenge, additional guidance and central support around the challenge of management along with educating teams to continue to challenge their own expectations and potential biases during the audit. These combined measures, amongst others, are designed to ensure we have a strongly embedded and effective culture of challenge within our audit practice.

Good practice



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

- **Evidence of challenge of management in areas of key judgement:** On three audits there was good evidence of how the audit team had challenged management and corroborated certain key assumptions relating to investment valuations, revenue recognition and impairment. As highlighted in the key findings above, we have equally identified instances where audit teams did not sufficiently challenge management. These examples of good practice should be used to assist in addressing these inconsistencies.
- **Robust procedures relating to issue of the audit report:** On three audits, the firm delayed issuing its audit report until appropriate evidence was obtained and evaluated by the audit team.
- **Use of certain internal specialists:** On three audits, there was evidence of proactive involvement of internal specialists regarding IT controls and pension liabilities. This included detailed and clear evidence to show the resolution of the matters raised by the specialists.
- **Consultation on certain audit matters:** On two audits, there was detailed consultation on accounting policy adoption and disclosure where alternative treatments were possible.
- **Audit data analytics:** On two audits, audit data analytic techniques were used effectively on revenue and journals to enable a targeted audit response to risks identified in those areas.

Good practice examples included effective use of internal experts and detailed consultation on certain audit matters.

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 out 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
<ul style="list-style-type: none"> • 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. 	<ul style="list-style-type: none"> • Audit methodology and training. 	<ul style="list-style-type: none"> • Partner and staff matters. • Acceptance and Continuance (A&C) procedures. 	<ul style="list-style-type: none"> • 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.

Grant Thornton initiated its audit quality plan, the AIP, in Spring 2019 to improve audit quality. The plan covers a three-year period and incorporates ten focus areas including people, clients, technology and culture. It follows the principles set out by the global firm which are then supplemented by UK specific procedures.

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

When we reviewed the AIP last year, we found that the firm should further improve the plan, particularly in relation to:

- Accountability and governance – ensuring that there was effective monitoring and oversight of the plan.
- Overall strategic objective and tone at the top – the strategy should set appropriate goals and define audit quality with clear links to overall success criteria and milestones.
- Project management - improvements were needed to the formal project management and the clarity around accountability.
- Independent reviews – appropriate processes needed to be in place to ensure the findings of independent review into the audit practice and four root cause analyses commissioned by the firm flowed into the quality aspects of the Strategy.
- Risk assessment and audit support panels – continue to develop the risk assessment process whereby those audits that would benefit from an audit support panel would be identified.
- Audit methodology – embedding the new audit process had resulted in the introduction of a number of standard templates. The firm should ensure that the demands of completing standard documentation does not distract teams from identifying risks and applying robust professional judgement.
- The firm’s culture – there had been persistent findings from past file reviews in areas including judgement, scepticism and revenue. The plan aimed to change the firm’s culture to address this.
- Reward and recognition – change the approach to reward and recognition with an increased focus on quality.
- Audit partner assessment test – the technical test for audit partners focused on core financial reporting skills; this needed to also encompass auditing skills.

This year, we have not conducted a detailed benchmarking of all firms’ audit quality plans 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 plan, 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 plan.
- Considering the oversight of the AIP at the firm including presentations made to the Independent Non-Executives (INEs) and the Audit Quality Board.
- Assessing the extent to which culture and the challenge of culture have been incorporated into the plan.
- Considering, in hindsight the effectiveness of the AIP and key initiatives with reference to current year findings and observations.

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

- The firm has been responsive to the points that were raised in the prior year. The majority of these have been addressed or are in progress. Further enhancements and focus are needed on prior year key findings relating to the firm's audit culture (discussed in the key findings section) and audit methodology (including as noted below).
- The firm continues to focus on its audit methodology. While templates have been updated and modified to encourage better linkages and justification of the thought process, the firm needs to continue to ensure that standard templates do not result in a 'tick box' approach.
- There is increased central oversight and risk monitoring although this primarily focuses on audited entities that fall within, or are close to meeting, the FRC's scope. There would be benefit from extending these processes to other higher profile and higher risk entities.

Key findings



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

- Ensure that the plan continues on an iterative and evolving basis and incorporates medium-term quality initiatives: the AIP was intended to run to 2022 and current initiatives are expected to be completed by early 2022. The plan should be extended on a rolling basis to include medium and long-term initiatives and to ensure that audit quality remains a priority focus. Progress reports would be further enhanced by including information on longer-term initiatives.
- Strengthen the procedures to monitor audit quality initiatives: while the firm is monitoring individual initiatives (including against milestones) and developing AQIs, the overall effectiveness of the AIP is not monitored.
- Continue to strengthen the culture of challenge in the audit process (prior year key finding): while a number of processes have been introduced to increase the level of central oversight and additional audit requirements have been mandated, there needs to be further focus on the culture of challenge.

Good practice



We identified the following areas of good practice:

- **Oversight and governance:** regular progress reports are provided to the Audit Quality Board and the Audit Executive. We have seen evidence of input and challenge from the Audit Quality Board and the Independent Non-Executive director.
- **Breadth of the plan:** the plan includes audit quality initiatives that cover a wide range of areas and are proactive as well as reactive.
- **Central monitoring and challenge:** the plan and associated processes are established and understood throughout the firm. Senior members of the Audit Practice discuss all PIE audited entities on a weekly basis. Where appropriate, additional support, challenge and intervention will be made by central support functions.

We will continue to assess the AIP and encourage all firms to develop their audit quality plans including the focus on continuous improvement and measuring the effectiveness of the key initiatives.

GT's audit quality plan is well established. The plan is due to end early in 2022 and needs to be extended on a rolling basis to ensure that audit quality remains a priority in the longer term.

Firm's response and actions



When we established the Audit Investment Plan, it contained over 100 different workstreams to achieve the quality improvements that we were seeking and we are pleased that the work undertaken and the changes made within our audit practice are now showing through in both our file gradings, and proportion of good practice points to findings identified across all our files.

Significant attention has been paid to each of those workstreams with the AIP benefitting from dedicated project management support and with progress across each workstream, including increased and decreased risks of delivery being reported to the AQB each month.

On completion of each of the workstreams, they are then monitored by our Ongoing Monitoring Plan to ensure that appropriate attention is retained on new initiatives within the practice which is also monitored by the AQB.

Our key areas of focus for 2021 within the AIP are around:

- Ongoing enhancement of our methodology, guidance, workpapers and consultation processes;
- Culture of challenge in audit (as detailed earlier in this report);
- Increasing use of digital audit techniques within our audit approach following this testing approach having been a key part of two audits reviewed by the FRC this cycle and having received good practice points on both.

Our AIP is now well established and well understood by the business and there are regular, whole practice, communications reiterating key developments within the plan and to clarify what each team members responsibilities are in delivering the AIP. We will continue this focus and continue to enhance the AIP both for the short and medium term.

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, we found that the firm had continued to develop and embed its RCA process, but should continue to further improve this, particularly 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.

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

- Assessing any key 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.

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

- 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 plan complies with the format set by the global firm with a significant element that is supplemented by UK specific procedures. There continues to be ongoing investment in the RCA team and developing its expertise.
- Root causes on individual reviews are categorised using a flowchart tool to aid the reviewer's judgement. Enhancements have been made in the year including introducing a mechanism to assign weight to causal factors. Some additional narrative could be included to record the basis of the underlying root cause.
- The process focuses on identifying the root causes for both good practice and negative findings. The conclusions are shared with the engagement team on file reviews.
- The firm amalgamates its internal and external inspection findings to identify and share the overall key themes.

Key findings



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

- **Expand the scope of reviews:** the scope and coverage should be further expanded to capture firmwide findings and good practices and include other types of inspections (for example, audits with PYAs).
- **Increase the depth and quality of the interrogation of the root cause analysis:** the analysis would benefit from further challenge and interrogation before concluding on the root causes.

Good practice



We identified the following areas of good practice:

- **Use of dedicated RCA review staff:** the core team has been expanded and continues to build its experience and breadth of knowledge. Where specific specialist expertise is needed, the firm continues to engage external consultants.
- **Oversight and communication within the firm:** RCA findings are regularly reported to the Audit Quality Board, the senior audit leadership team and shared with the audit practice. In particular, this has enabled the internal quality monitoring team to incorporate, where appropriate, RCA findings into the internal quality reviews. In addition, we note that findings on individual engagements are shared with key members of the engagement team.
- **Continual RCA activities:** RCA reviews are conducted on an ongoing basis which ensures that engagement teams can promptly address any key findings and themes can be quickly communicated within the audit practice.

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

GT has continued to strengthen its root cause analysis team and processes. Further analysis should be performed of the root causes, including a greater depth and quality of interrogation.

Firm's response and actions



Following the engagement of external consultants in the prior year and the recent further investment in the RCA team, the RCA process has continued to evolve and we are pleased with the good practice points identified.

We have implemented a strategy to focus in greater depth on those findings which influence the overall gradings of files (to address the findings above) whilst continuing to monitor all other findings for themes arising in order to enhance the quality of our analysis and support the firm's ongoing commitment to audit quality.

We are considering different ways in which to monitor effectiveness of actions and will continue to review and refine the RCA processes where necessary over the coming year.

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.

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 identified the following key findings where the firm needs to:

- Ensure audit practitioners complete their mandatory training on a timely basis: The firm needs to ensure that individuals complete their mandatory training on a timely basis, with clear and enforced consequences for any non-compliance.

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

We identified findings in all the firm-wide areas reviewed in the current year which the firm needs to address.

- Introduce audit specific training for their IT and tax specialists: The firm has established a new IT audit team. Currently, members of this team are required to attend audit induction training but do not receive any specific training tailored to their role. In addition, the firm does not require internal tax specialists, who assist on audits, to complete any audit specific training.
- Issue guidance in relation to auditing lease accounting and financial instruments accounting under IFRS 16 and IFRS 9 respectively: The firm does not have any work programmes, templates and related guidance in relation to auditing compliance with IFRS 16 and IFRS 9. These should be developed and issued to audit practitioners, including banking specific materials should the firm decide to perform audits in this sector.

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.

Firm's response and actions






We note and recognise the findings identified in the review of our training and methodology processes as to where we were 15 months ago. Significant actions and progress have been made in all these areas since March 2020, including:

- New policies for non-compliance with training were effective from Summer 2020 with clear escalation policies and a consequent impact on both manager and RI quality scores (which impact reward) for the financial year ended 31 December 2020. We are pleased to report that our flagship 3 day summer training event had 100% completion rate.
- IT and tax specialists both attend the annual audit summer training. IT specialists now receive mandatory training specific to their role which includes training on the audit of IT general controls, IT application controls and findings from both internal and external reviews. For tax specialists, appropriate mandatory training is currently being created.
- In respect of IFRS16 and IFRS9, up to March 2020 guidance and training was provided which for IFRS16 included mandatory online modules with an accompanying test for those working on our higher risk audits. In respect of IFRS9, mandatory consultations were (and remain) in place for hedge accounting and derivatives. In November 2020 a suite of workpapers was introduced which included substantive procedures in relation to IFRS16 and IFRS9. As part of our 2021 working paper review cycle, updated workpapers will be released in September 2021 which will include updated guidance and workpapers in these two areas.

Firm-wide key findings and good practice in prior inspections

The following table summarises the firm-wide findings and good practice 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.

Key findings in previous public report 	Update on firm's actions in response 	Good practice 
<p>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.</p>		
<ul style="list-style-type: none"> Partner remuneration for 2018 was determined based on a series of partner discussions and peer reviews and did not include any formal procedures for considering audit quality matters. Furthermore, a linkage between remuneration decisions and audit quality could not be evidenced. There were also concerns in relation to processes followed to respond appropriately to previous adverse quality findings when setting annual quality objectives. There was no 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. 	<ul style="list-style-type: none"> Significant changes have been implemented from FY19 onwards under our Audit Investment Plan to ensure that there is now a significant correlation between audit quality, progression, performance reviews and reward. 	<p>No specific good practice examples raised.</p>

- There was no formal assessment process in place for manager and senior manager promotions to ensure that audit quality is appropriately and consistently considered for all promotion candidates.

- We have continued to develop our policies in this area to ensure that all partners, directors & managers have a quality score for each financial year and that this quality score impacts on partner reward and director/manager bonuses. The application of these policies on partner reward was overseen by the Audit Quality Board and oversight over director/manager bonus impact was provided by the Audit Operations Board. Quality scores include file reviews, training compliance, ethics matters, positive contributors to quality and feedback. For a number of years, new RI's have needed to have an independent Quality Interview and during Summer 2020 we introduced a new policy whereby potential promotions to manager and senior manager were conditional on an independently set and marked technical assessment.

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.

- There should be centralised monitoring and review of key documents within the acceptance and continuance process to ensure that questions are answered relating to reputation risk, values and whether the entity and engagement aligns with the firm's mission and strategy.
- On one of the client acceptances we reviewed the audit engagement team failed to comment on key risks affecting the entity for the sector it operated in, which was critical to the overall acceptance decision and whether additional safeguards were required.

- We are committed to a continual improvement of our client acceptance and continuance process and will take these findings on board.
- Take on processes have been further developed with additional questions around reputational risk, values and whether the engagement aligns with the firm's strategy. For audit, all significant potential new clients or continuance decisions are now reviewed by a panel independent from the engagement team.
- In Summer 2020, we performed a full review of our entire audit client base to identify any clients which didn't fit with our risk appetite, values or strategy. A number of "yellow cards" were discussed with clients around strengthening finance teams and governance and we resigned from a number of clients as part of that review, as we considered the risk and governance aspects to be outside our desired parameters.

- When making acceptance and continuance decisions, the firm has included an additional assessment, 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.

We did not raise any other key findings or good practice points in 2018/19 or 2019/20.

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.

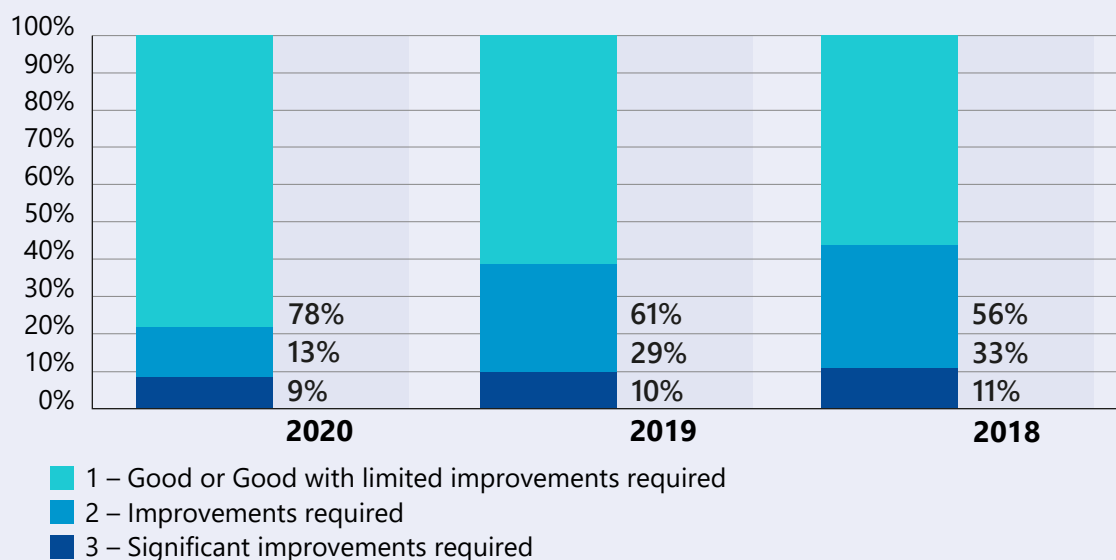
It should be read in conjunction with the firm's [Transparency Reports](#) for 2019, and for 2020 which provide further detail of the firm's internal quality monitoring approach and results, and the firm's wider system of quality control.

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

Results of internal quality monitoring



The results of the firm's most recent National Audit Review (NAR), which comprised internal inspections of 46 individual audits with periods ending between March 2019 and March 2020, are set out below along with the results for the previous two years.



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

Good or Good with limited improvements required: A limited number of concerns in a small number of areas.

Improvements required: A number of matters in a number of areas but neither individually nor collectively significant.

Significant improvements required: Significant concerns in relation to the sufficiency or quality of audit evidence, or the appropriateness of key audit judgements, or the implications of other matters that are considered to be individually or collectively significant.

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 or led by the 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 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.

Internal quality monitoring themes arising



The main themes arising from internal quality monitoring were professional scepticism and challenge of management, revenue (principally occurrence), quality control and quality of financial statements. These main themes are the same as last year except for quality of financial statements which has arisen as a new theme in the most recent NAR programme.

Firm's 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 2020 inspection indicate that although the results have improved on the 2019 inspection results there are still improvements required to reach that goal.

The firm has implemented the Audit Investment Plan (AIP) since Spring 2019 with the objective of improving audit quality across the practice. This has included further methodology guidance and training, development of mandatory standard template working papers, provision of additional support by our central technical teams for our high-risk audits, and central review of resourcing requirements on audits to ensure the right teams are performing the right work. The 2020 calendar year saw clarification on methodology points and significant training delivered to the practice on those thematic areas identified through previous years reviews. As a result of a significant part of this training having been delivered through 2020, the full impact of the AIP has not been reflected through the files reviewed in this cycle due to the timing of the reviews and therefore some findings identified have already been addressed through training implemented in 2020. We also continue to invest in the development of template working papers to aid audit teams in documenting auditor challenge, key judgements and conclusions reached and enabling them to "tell the story" of the audit.

In addition to these points, there are further actions being taken to address the specific themes as follows: Technical expertise, particularly in relation to revenue

- Development of learning passports to deepen technical knowledge at each level.
- Extensive training on the risk assessment and testing of revenue over the course of the 2020 financial year.

Quality control procedures, particularly in terms of review

- A proposal for monitoring senior team involvement as part of our redeveloped suite of Audit Quality Indicators launched to the RIs in early 2021.
- Development of an Engagement Quality Reviewer template and a Review Considerations template to improve documentation of reviews of the audit file and assist with planning and review considerations for the LEAP methodology.

Insufficient step-back, challenge and professional scepticism in judgemental areas

- Continued to request several clients to postpone their announcements/signings to provide sufficient time for step back and objective consideration, providing space for scepticism and subsequent challenge where required.
- Development of our mandatory Matters for Partner Attention template ensuring that audit teams are documenting the “story” in relation to the significant risk areas on an audit, as well as a template agenda to introduce an RI-led stand back meeting for high risk audits where audit team members present their work, key judgements, and conclusions for the rest of the engagement team, allowing the team to “stand back” to consider issues across the whole audit and exercise professional scepticism.

Quality of financial statements

- The annual audit training in 2021 will contain a focus on consideration of disclosure requirements arising from matters identified in the audit and then documentation of our audit of the related disclosures.
- The RCA team are currently investigating financial statement disclosure issues as a wider theme and will propose further actions for the firm to take once that analysis is completed.

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 ARGAs 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 firms⁹, 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 areas¹⁰:

Sectors	Audit areas
<ul style="list-style-type: none"> • Financial Services • Retail, including Retail Property and Travel & Leisure • Construction and Materials • Manufacturing 	<ul style="list-style-type: none"> • Going concern and the viability statement • The Other Information in the Annual Report • Long-term contracts • 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](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)



Financial Reporting Council



**Financial
Reporting Council**
8th Floor
125 London Wall
London EC2Y 5AS
+44 (0)20 7492 2300
www.frc.org.uk