Public Report

Financial Reporting Council

May 2013

PricewaterhouseCoopers LLP

Audit Quality Inspection

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London WC2B 4HN

+44 (**0)20 7492 2300**

www.frc.org.uk

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

The Financial Reporting Council Limited is a company limited by guarantee.
Registered in England number 2486368.
Registered Off ce: 5th Floor, Aldwych House, 71-91 Aldwych, London WC2B 4HN.

Contents

1. Background information and key messages

1.1. Introduction

This report sets out the principal findings arising from the inspection of PricewaterhouseCoopers LLP ("PwC" or "the firm") carried out by the Audit Quality Review Team of the Financial Reporting Council ("the FRC"), during the year to 31 March 2013 ("the 2012/13 inspection"). We inspect PwC annually. Our inspection was conducted in the period from April 2012 to January 2013 (referred to as "the time of our inspection"). The objectives of our work are set out in Appendix A.

Our inspection comprised reviews of individual audit engagements and a review of the firm's policies and procedures supporting audit quality.

We reviewed 14 audit engagements undertaken by the firm. These related to FTSE 100, FTSE 250, other listed and major public interest entities with financial year ends between September 2011 and March 2012. Our reviews were selected on a risk basis, utilising a risk model; each review covered only selected aspects of the relevant audit.

Our responsibility is to monitor and assess the quality of the audit work performed by the UK firm. Accordingly, our reviews of group audits covered the planning and control of the audit by the group engagement team, including their evaluation of the adequacy of the work performed by component auditors, and selected aspects of other work performed by the UK firm at group and/or component level.

Each year we select a number of audit areas of particular focus. For the 2012/13 inspection these were: the valuation of assets held at fair value; the impairment of goodwill and other intangible assets; the recoverability of deferred tax assets; the assessment of going concern; revenue recognition and related party relationships and transactions.

In addition, we undertook two follow-up reviews to assess the extent to which our prior year findings on those audits had been addressed in the following year's audit.

Our review of the firm's policies and procedures supporting audit quality covered the following areas:

Tone at the top and internal communications

Transparency report

Independence and ethics

Performance evaluation and other human resource matters

Audit methodology, training and guidance

Client risk assessment and acceptance/continuance

Consultation and review

Audit quality monitoring

Other firm-wide matters

We exercise judgment in determining those findings which it is appropriate to include in our public report on each inspection, taking into account their relative significance in relation to audit quality, both in the context of the individual inspection and in relation to areas of particular focus in our overall inspection programme for the relevant year. In relation to reviews of individual audits, we have generally reported our findings by reference to important matters arising. Where appropriate, we have commented on themes arising or issues of a similar nature identified across a number of audits.

Further information on the scope of our work and the basis on which we report is set out in Appendix A.

All findings requiring action set out in this report, together with the firm's proposed action plan to address them, have been discussed with the firm. Appropriate action may have already been taken by the date of this report. The adequacy of the action taken and planned will be reviewed during our next inspection.

The firm was invited to provide a response to this report for publication. The firm's response is set out in Appendix B.

We acknowledge the co-operation and assistance received from PwC's partners and staff in the conduct of our 2012/13 inspection.

1.2. Background information on the firm

PwC is a UK limited liability partnership and the UK member firm of the PwC global network. The firm operates from 34 offices in the UK and through four principal "lines of service", being Assurance, Consulting, Deals and Tax. All statutory audit work is performed within the Assurance line of service, which is divided into business units for operational purposes based on geography and industry sectors.

For the year ended 30 June 2012, the firm's turnover was £2,621 million, of which £963 million related to audit work and other assurance services. At that date, the firm had 872 partners, of whom 221 were authorised to sign audit reports, and 162 employees (audit directors) who were authorised to sign audit reports[1].

We estimate that the firm audited 488 UK entities within the scope of independent inspection as at 29 February 2012. Of these entities, our records show that 197 had securities listed on the main market of the London Stock Exchange, including 36 FTSE 100 companies and 60 FTSE 250 companies.

Audits of entities incorporated in Jersey, Guernsey or the Isle of Man whose securities are traded on a regulated market in the European Economic Area are subject to inspection under arrangements agreed with the relevant regulatory bodies. Our records show that the firm had 14 such audits, including two FTSE 100 companies.

[1] As disclosed in the annual return to the ICAEW as at 31 December 2012.

1.3. Overview

We focus in this report on matters where we believe improvements are required to safeguard and enhance audit quality. We set out our key messages to the firm in this regard in section 1.4. While this report is not intended to provide a balanced scorecard, we highlight certain matters which we believe contribute to audit quality, including the actions taken by the firm to address findings arising from our prior year inspection.

The firm places considerable emphasis on its overall systems of quality control and, in most areas, has appropriate policies and procedures in place for its size and the nature of its client base. Nevertheless, we have identified certain areas where improvements are required to those policies and procedures. These are set out in this report.

Our file review findings, as set out in Section 2, largely relate to the application of the firm's procedures by audit personnel, whose work and judgments ultimately determine the quality of individual audits. Fewer recurring findings than in the prior year arose in our audit areas of particular focus. However, we identified findings in other audit areas.

1.4. Key messages

The firm should pay particular attention to the following areas in order to enhance audit quality or safeguard auditor independence:

- Ensure that in all cases sufficient substantive audit procedures are performed, and evidence obtained, in the audit of revenue.
- Improve the effectiveness of the engagement quality control review process.
- Undertake measures to improve compliance with personal independence requirements.
- Take steps to achieve greater consistency in audit quality across business units and industry groups.
- Ensure the firm's change programme does not have an adverse impact on audit quality.

2. Principal findings

The comments below are based on our reviews of individual audits and the firm's policies and procedures supporting audit quality.

2.1. Reviews of individual audits

Follow-up of audits reviewed in the prior year

We undertook two follow-up reviews of audits we reviewed in the prior year. The issues arising from our prior year review had been addressed on these audits, resulting in improvements to audit quality in the relevant areas.

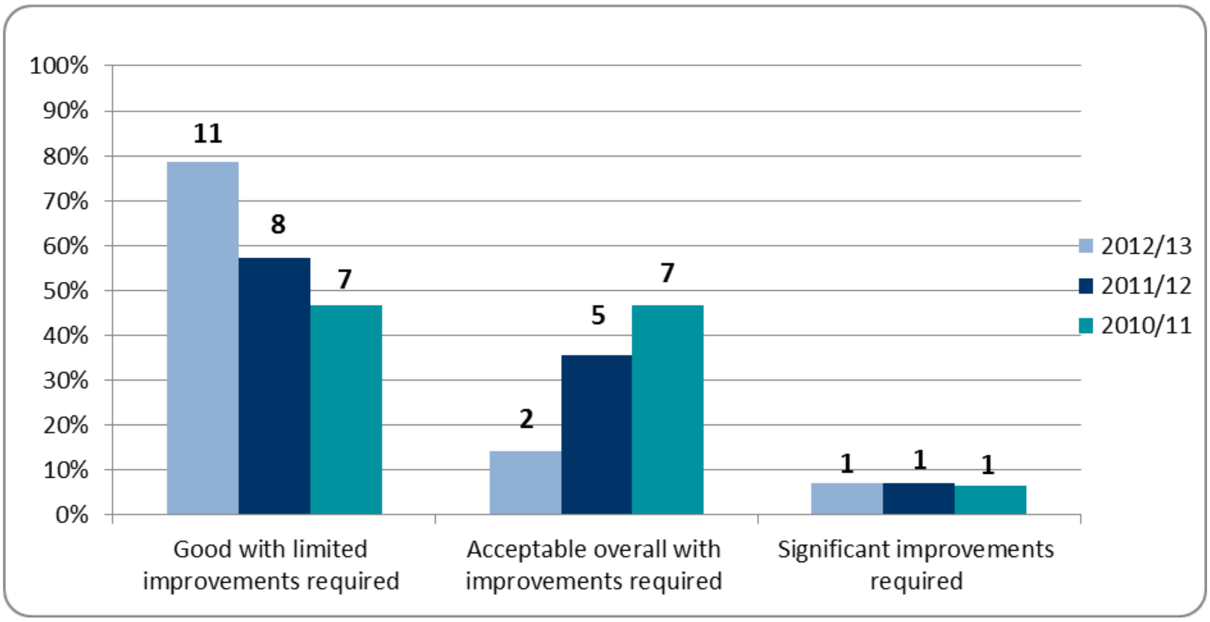
Audits reviewed in the current year

We reviewed and assessed the quality of selected aspects of 14 audits (2011/12: 14 audits).

In our view, 11 of the audits we reviewed (2011/12: eight) were performed to a good standard with limited improvements required; two audits (2011/12: five) were performed to an acceptable overall standard with improvements required; and one audit (2011/12: one) required significant improvement in relation to the sufficiency of audit evidence relating to the entity's accounting records maintained by service providers, the valuation of the entity's investments and certain other matters, details of which are set out below.

An audit is assessed as requiring significant improvement if we had significant concerns in relation to the sufficiency or quality of audit evidence or the appropriateness of audit judgments in one or more key audit areas or the implications of concerns relating to other areas were considered to be individually or collectively significant. This assessment does not necessarily imply that an inappropriate audit opinion was issued.

The bar chart below shows the percentage of the audits we reviewed in 2012/13 falling within each grade, with comparatives for 2011/12 and 2010/11.



Changes to the proportion of audits reviewed falling within each grade from year to year reflect a wide range of factors, which may include the size, complexity and risk of the individual audits selected for review, changes to our areas of particular focus and the scope of the individual reviews. For this reason, and given the small sample sizes involved, changes in gradings from one year to the next are not necessarily indicative of any overall change in audit quality at the firm.

Findings in relation to audit evidence and judgments

Our reviews focused on the audit evidence and related judgments for material areas of the financial statements and areas of significant risk. We draw attention to the following findings which the firm should ensure are addressed appropriately in future audits.

The implication of such findings for our grading of an audit depends on their significance in the context of the individual audit. Even where our overall assessment of an audit was that the improvements required were limited in nature, we include the relevant findings in this report if we consider them important in the broader context of improving audit quality at the firm.

Recurring findings

The firm took a number of steps in response to our prior year findings to achieve improvements in audit quality. These included further training for engagement leaders and enhanced pre-issuance quality control procedures for a sample of the firm's higher profile audits. The firm also improved its template for reporting to Audit Committees. We identified fewer recurring findings than in the prior year, but issues continued to arise as described below. The firm should review the effectiveness of its actions in these areas.

Goodwill and other intangible assets

We reviewed the firm's audit of goodwill and other intangible assets in eight audits, including four FTSE350 entities. In two audits, we identified issues concerning the sufficiency of evidence or of challenge of the appropriateness of management's assumptions supporting goodwill and/or other intangible assets.

In one of them, there was insufficient evidence of challenge of the reasonableness of the allocation of forecast revenues between two reportable segments.

Group audit considerations

We assessed the quality of the firm's audit work in this area, as applicable, on all the audits we reviewed. We identified that in one case, the firm instructed another PwC network firm, as component auditor, to carry out the audit of the whole of the entity, including the audit of the consolidation process. The UK firm was fully involved in the identification of significant and elevated audit risks, in determining the planned response to them by the component auditor and reviewed the component auditor's work on the consolidation. However, under Auditing Standards, a group auditor cannot delegate responsibility for performing the audit as a whole, including the audit of the consolidation process, to a component auditor.

New findings

Audit requiring significant improvement

One audit we reviewed required significant improvement in relation to the sufficiency of audit evidence for several key aspects of the audit. The audit team did not obtain sufficient audit evidence in respect of the entity's investment accounting records or the general ledger which were maintained by service providers. Furthermore, insufficient audit evidence was obtained to confirm the valuation of the entity's significant portfolio of investments. We also identified weaknesses relating to financial statement disclosures which we report below under that heading.

The audit of revenue

We reviewed the firm's audit of revenue in all the audits we inspected. In the majority of cases, audit teams undertook sufficient appropriate audit procedures in response to the risk of fraud and significant audit risks in revenue recognition. However, we identified weaknesses in relation to the sufficiency of substantive audit evidence.

In one case, the group audit team was not sufficiently involved in the planning and conduct of the audit of revenue in a significant component. In this case, the component audit team did not test the IT general controls of the entity's key systems, by means of which the accounting entries for revenue were initiated and processed, and performed insufficient procedures to test the accuracy and reliability of reported revenue. As a consequence, the component audit team obtained insufficient audit evidence in relation to the entity's reported revenue.

In two other cases, the audit teams placed reliance on the testing of audited entities' controls and carried out certain substantive tests of detail, but did not perform substantive procedures that specifically addressed the overall amount of reported revenue.

In a further case, a financial services entity, the audit team did not perform any substantive procedures to confirm that interest charged to customers was in accordance with underlying agreements.

Controls testing

We reviewed aspects of the firm's work on entities' control environments in the majority of the audits we inspected and identified findings in three audits.

In two cases which concerned the testing of controls that were assessed as 'automated controls', there was insufficient justification of the reasons for the approach taken in the particular circumstances of the audits.

In the third, when reporting to the audit team, the firm's team responsible for carrying out IT controls testing omitted to explain the extent of the involvement of staff from the audited entity's internal audit function in the testing of certain key controls identified for audit purposes.

Financial statement disclosures

In three audits, we identified deficiencies in financial statement disclosures which should have been brought to the attention of the Audit Committees so that appropriate adjustments could be made.

In one case, the audit team did not identify that part of the premium over the par value of shares issued in the year could not be treated as realised and therefore was not distributable.

In the case of the audit that required significant improvement, there was insufficient consideration of the accounting treatment and disclosure of the investments held by subsidiaries and there were omissions in the disclosure of related party transactions.

Other findings

Reporting to Audit Committees

We considered the sufficiency, quality and timeliness of the firm's reporting to Audit Committees on all the audits we reviewed. There was generally strong linkage between the significant risks identified at the planning stage of audits and the reporting of audit findings and follow-up matters to Audit Committees.

In response to our key messages last year, the firm changed its template for the reporting to Audit Committees of the nature and extent of threats to the firm's objectivity and independence arising from non-audit services provided to audited entities and related safeguards. These were reported satisfactorily on the audits we reviewed.

However, we identified four cases in which other improvements were required. In one case, the categorisation of audit risks was not communicated appropriately at the planning stage of the audit. In two other cases, there was insufficient reporting of the outcomes of the firm's audit work on management's goodwill impairment testing. In the fourth case, being the audit that required significant improvement, we identified a number of inaccuracies and omissions in the firm's reporting to the Audit Committee.

Auditor's report

We identified one audit, covered by Crown Dependency Audit Rules, in which there were errors in the form of the auditor's report and the manner of its signing. In this case, the requirements of the applicable legislation concerning listed entities were not identified, so the auditor's report was drawn up as if the audit were non-statutory. The auditor's report was therefore addressed to the directors instead of the members and the body of the report did not explain that the audit was undertaken in accordance with the requirements of the relevant legislation. In addition, the auditor's report was signed in the name of the firm instead of in the engagement partner's name as required.

2.2. Review of the firm's policies and procedures

The firm's policies and procedures are largely developed globally and the UK firm invests significant resources in implementing them and monitoring compliance with them. This is carried out by the firm's central functions that support quality, many of which are subject to our review, and include the management of the firm's audit system, technical training, audit quality monitoring, risk management, regulatory compliance and human resources.

During the year, the firm continued its major change programme, known as "Assurance Transformation", to which we referred last year, which is being undertaken in conjunction with a number of other PwC network firms. The programme, the stated objectives of which are quality, efficiency and insight, involves simplifying and standardising various aspects of the audit process to enable audit teams to focus on key judgment areas. As part of the change programme, the firm introduced new documentation standards and issued a number of audit guides. The firm expects to issue more audit guides in 2013, One of the key drivers of the change programme is to achieve efficiencies given continued fee pressures in the market. We will therefore continue to monitor the impact of these efficiencies on audit quality.

Improvements made during the year

The firm took action to address a number of our prior year findings and enhanced its procedures in certain areas, including those referred to in Section 2.1 above, in relation to the performance of audits.

In addition to clear messaging from the firm's Head of Assurance concerning the importance of audit quality, the firm carried out enhanced pre-issuance quality control procedures for a sample of the firm's higher profile audits that were within our scope. Our selection of audits for review included four that were subject to these enhanced procedures and each was graded in our highest category. The firm should consider how the benefits of these enhanced procedures may be cascaded throughout the audit practice.

Last year we reported that the firm had introduced a requirement for audit teams responsible for the firm's higher profile audits to demonstrate how professional scepticism was applied on those audits. On the audits we reviewed in our 2012/13 inspection, audit teams demonstrated the rationale for their judgments and how they had applied professional scepticism on each identified significant risk. This contributed to audit quality.

In response to one of our key messages last year, the firm introduced new requirements for the partner performance evaluation process which enabled partners to assess their performance against audit quality-related objectives. This provided much improved linkage to quality indicators in the process for determining partner remuneration.

Findings in the current year

We identified certain areas for improvement in the application of the firm's policies and procedures, as set out below, which need to be addressed.

Independence compliance

Each year, the firm carries out an independence confirmation process for all partners and staff and other procedures to monitor compliance with Ethical Standards and other independence requirements.

The firm's own monitoring procedures identified that a partner did not rotate off the audit of a listed entity in accordance with the Ethical Standards on account of incorrect information that was originally entered in the firm's rotation database.

The firm maintains a record of partners' financial interests and tests these records on a sample basis across the firm's lines of service. It identified a number of breaches which were reported to the firm's Executive Board. There was an increase in the proportion of partners being in breach, although there was no observable trend or pattern. Appropriate action was taken by the firm in these cases.

Consistency of audit quality

Our review of individual audits and the firm's own annual quality monitoring procedures identified certain business units and industry groups within the audit practice with poorer grades than other business units and industry groups. Although those units and groups were not significantly involved in the audit of listed entities, the firm should take steps to achieve greater consistency in audit quality across the audit practice.

Engagement quality control review

Our review of individual audits identified that the engagement quality control review was not always carried out effectively and, in one case, there was insufficient evidence of involvement by the quality control review partner. The firm should take steps to enhance the effectiveness of the engagement quality control review process.

Other matters

Transparency report

We reviewed the firm's transparency report for 2012, which was published in September 2012, to assess whether the information in the report was consistent with our understanding of the firm's quality control and independence procedures. We did not identify any such inconsistencies.

Off-shore service centres

The firm expects the changes being introduced through its Assurance Transformation programme to result in significantly fewer audit procedures being undertaken by its overseas service centres which will instead focus primarily on aspects of engagement administration.

The firm's service centre in Newcastle will continue to be used for the review of financial statements for FTSE 350 entities and the co-ordination of third party confirmations.

Andrew Jones
Director
Audit Quality Review
FRC Conduct Division
31 May 2013

Appendix A – Objectives, scope and basis of reporting

Scope and objectives

The overall objective of our work is to monitor and promote improvements in the quality of auditing. As part of our work, we monitor compliance with the regulatory framework for auditing, including the Auditing Standards, Ethical Standards and Quality Control Standards for auditors issued by the FRC and other requirements under the Audit Regulations issued by the relevant professional bodies. The standards referred to in this report are those effective at the time of our inspection or, in relation to our reviews of individual audits, those effective at the time the relevant audit was undertaken.

Our reviews of individual audit engagements and the firm's policies and procedures cover, but are not restricted to, the firm's compliance with the requirements of relevant standards and other aspects of the regulatory framework. Our reviews of individual audit engagements place emphasis on the appropriateness of key audit judgments made in reaching the audit opinion together with the sufficiency and appropriateness of the audit evidence obtained. We also assess the extent to which the firm has addressed the findings arising from its previous inspection.

We seek to identify areas where improvements are, in our view, needed in order to safeguard audit quality and/or comply with regulatory requirements and to agree an action plan with the firm designed to achieve these improvements. Accordingly, our reports place greater emphasis on weaknesses identified which require action by the firm than areas of strength and are not intended to be a balanced scorecard or rating tool.

Our inspection was not designed to identify all weaknesses which may exist in the design and/or implementation of the firm's policies and procedures supporting audit quality or in relation to the performance of the individual audit engagements selected by us for review and cannot be relied upon for this purpose.

The professional accountancy bodies in the UK register firms to conduct audit work. Their monitoring units are responsible for monitoring the quality of audit engagements falling outside the scope of independent inspection but within the scope of audit regulation in the UK. Their work, which is overseen by the FRC, covers audits of UK incorporated companies and certain other entities which do not have any securities listed on the main market of the London Stock Exchange and whose financial condition is not otherwise considered to be of major public interest. All matters raised in this report are based solely on the work which we carried out for the purposes of our inspection.

Basis of reporting

We exercise judgment in determining those findings which it is appropriate to include in its public report on each inspection, taking into account their relative significance in relation to audit quality, both in the context of the individual inspection and in relation to areas of particular focus in our overall inspection programme for the relevant year. In relation to reviews of individual audits, we have generally reported our findings by reference to important matters arising. Where appropriate, we have commented on themes arising or issues of a similar nature identified across a number of audits.

While our public reports seek to provide useful information for interested parties, they do not provide a comprehensive basis for assessing the comparative merits of individual firms. The findings reported for each firm in any one year reflect a wide range of factors, including the number, size and complexity of the individual audits selected for review which, in turn, reflects the firm's client base. An issue reported in relation to a particular firm may therefore apply equally to other firms without having arisen in the course of our inspection fieldwork at those other firms in the relevant year. Also, only a small sample of audits is selected for review at each firm and the findings may therefore not be representative of the overall quality of each firm's audit work.

The fieldwork at each firm is completed at different times during the year and comprehensive quality control procedures are applied. As a result, there may be a significant period of elapsed time between the completion of our inspection fieldwork at a firm and the publication of a report on the inspection findings.

We also issue confidential reports on individual audits reviewed during an inspection. These reports are addressed to the relevant audit engagement partner or director but firms are expected to provide copies to the directors or equivalent of the relevant audited entities.

Purpose of this report

This report has been prepared for general information only. The information in this report does not constitute professional advice and should not be acted upon without obtaining specific professional advice.

To the full extent permitted by law, the FRC and its employees and agents accept no liability and disclaim all responsibility for the consequences of anyone acting or refraining from acting in reliance on the information contained in this report or for any decision based on it.

Appendix B – Firm’s response

The Firm’s response is on the following page.

Andrew Jones
Director of Audit Quality
Financial Reporting Council
Aldwych House
71-91 Aldwych
London
WC2B 4HN

16 May 2013

Dear Mr Jones

2012/13 Audit Quality Inspection report on PricewaterhouseCoopers LLP

We appreciate the opportunity that you have given us to respond to the 2012/13 Audit Quality Inspection report on PricewaterhouseCoopers LLP ('PwC').

Quality is at the very heart of what we do: it is essential to our reputation, important to the work that we undertake for our clients and is a fundamental strategic objective for the firm. We therefore welcome your report and the findings noted during your inspection process. Such insights, observations and recommendations are an important contribution to helping us focus on and deliver continuous quality improvement.

We have again put in place a comprehensive action plan to respond to the issues you have raised. Together with our Assurance Transformation programme, we are confident that our responses will maintain our focus on audit quality.

Yours sincerely

James Chalmers

PricewaterhouseCoopers LLP, 1 Embankment Place, London WC2N 6RH
T: +44 (0) 20 7583 5000, F: +44 (0) 20 7822 4652, www.pwc.co.uk

Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London WC2B 4HN

+44 (**0)20 7492 2300**

www.frc.org.uk