



Financial Reporting Council

Feedback Statement

Firm-level Audit Quality Indicators Consultation

December 2022

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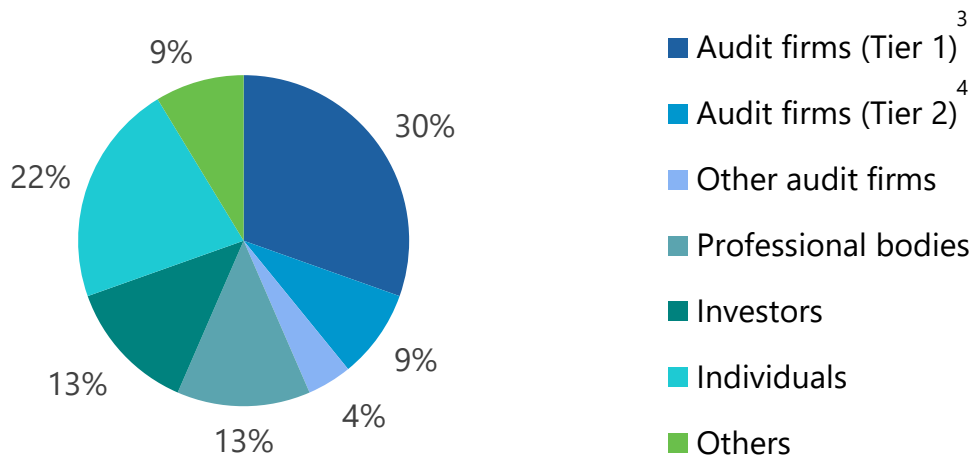
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Introduction

1. On 22 June 2022 we published our consultation¹ on publishing firm-level² audit quality indicators (AQIs) for the audit practices of the largest UK audit firms.
2. The proposals were intended to:
 - provide users of audit services with more information regarding factors that contribute to audit quality at the firms, to help them make an informed choice when selecting an auditor and throughout the subsequent audit engagement;
 - enable users of audit services (and other stakeholders) to assess firms on a consistent basis, with the knowledge that AQIs across the firms will be calculated in the same way based on a definitions note (previously referred to as a methodological / guidance note in the consultation document) to be developed by FRC in co-operation with firms; and
 - enable users of audit services to have rich conversations about audit quality and correlated factors with audit firms.
3. The consultation closed on 18 August 2022, and we received 23 responses. The breakdown of those responding was as follows:

Response by type



4. In addition to the written consultation, we have engaged with stakeholders, including Audit Committee Chairs (ACCs), in a number of different forums. The feedback from these discussions is not included in the quantitative information in this document but has been valuable in shaping our response.

¹ FRC Consultation Document: Firm-level Audit Quality Indicators (June 2022): https://www.frc.org.uk/getattachment/a2080b36-f3f6-4fa3-85b1-beeba16ef0d7/FRC-Consultation-Document-Firm-level-Audit-Quality-Indicators_2022.pdf

² Throughout this document, “firm-level” is used to distinguish these AQIs from engagement-level ones. In fact, the AQIs mainly cover the audit practice, rather than the firm as a whole.

³ The Tier 1 audit firms are: BDO LLP, Deloitte LLP, Ernst & Young LLP, Grant Thornton LLP, KPMG LLP, Mazars LLP and PwC LLP.

⁴ The Tier 2 audit firms are: Crowe U.K. LLP, Haysmacintyre LLP, MHA Macintyre Hudson LLP, PKF Littlejohn LLP and RSM UK Audit LLP.

Summary of responses

5. The majority of responses from stakeholders who are considered as intended AQI users were supportive of our proposals. A few audit firms were also supportive. However, seven out of the ten audit firms, who will be expected to produce the AQI data, were broadly against changing from the existing form of reporting, namely in firms' Transparency Reports where some AQIs are already published. (There were no particular differences between firms in Tier 1 and Tier 2.)
6. The firms, as producers of the information, may well have a different perspective from potential users of the information – whose responses were generally much more favourable. For example, one investor wrote "We are ... hopeful that these firm-level AQIs will further encourage investor engagement with audit quality". Another investor wrote that AQIs could help ACCs "make more informed choices when selecting an auditor [by] ... enabling comparisons between the largest firms and challenger firms on AQIs which extend beyond external inspection results." Other respondents were also supportive of it being published by the FRC, as were ACCs during our discussions with them. Given our objectives for this initiative, including providing information that is more comparable between firms than that currently included in Transparency Reports, we have placed more weight on the views of users.
7. The aspects of our proposals which attracted the most support, from those who were supportive in principle, were:
 - alignment of audit firms in scope with the revised Audit Firm Governance Code (AFGC);
 - firms' inclusion of supporting narrative to supplement the numerical AQIs; and
 - specific proposed AQIs on staff / culture survey results, external inspection results, training and diversity of firm's audit leadership.
8. Areas where there was no clear consensus among respondents and where concerns were raised include:
 - scope of audits;
 - segmentation of AQIs data between public interest entity (PIE) and non-PIE audits; and
 - data collection and reporting period.

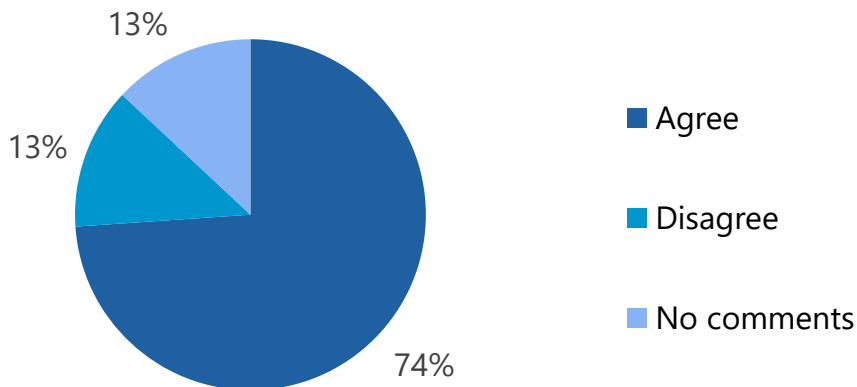
Detailed analysis

Audit firms in scope

Q1: Do you agree that firms reporting their AQIs should be aligned to the scope of the (revised) Audit Firm Governance Code? If not, what scope would you prefer and why?

9. The breakdown of those responding to this question with respect to the proposed scope of audit firms was as follows:

Responses to Q1: Audit firms in scope



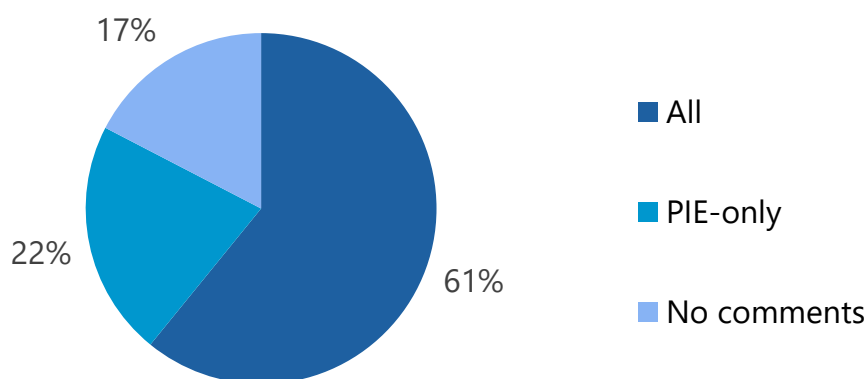
10. The majority of respondents agreed that the scope of audit firms to be included for reporting of firm-level AQIs should be aligned to the scope of the revised Audit Firm Governance Code (AFGC) issued in April 2022. The AFGC's scope is firms that audit 20 or more public interest entities (PIEs) or firms that audit one or more FTSE350 companies. Approximately ten audit firms are currently in the proposed scope.
11. Respondents who disagreed suggested that the scope should apply to all 31 firms that audit PIEs ("PIE audit firms") or any firm that is likely to be selected for PIE or FTSE350 audit engagements, as the narrower scope may disadvantage the firms that fall outside it as their data will not be made easily accessible to users.
12. We are mindful that expansion of the proposed scope to all PIE audit firms may bring a disproportionate reporting burden to firms that audit a small number of PIEs, and an overload of data for potential AQI users.
13. Taking into account the overall aims of the consultation, and balancing the views of different stakeholders, we have decided to align the scope of audit firms to that of the revised AFGC.

Scope of audits

Q2: Do you agree that the AQIs should include all audit engagements, but segmented between PIE and non-PIE audits? If not, which engagements do you think should be included?

14. The breakdown of those responding to this question with respect to the proposed scope of audits was as follows:

Responses to Q2: Scope of audits



15. Many responses were in favour of bringing all audits into the reporting scope as audit quality is required across the whole population of audits. Those who were against, which included three Tier 1 firms, suggested scoping in PIE audits only as that would be aligned with the nature of the proposed scope of audit firms. Two firms questioned if AQIs reporting for non-PIE audits is in the public interest.
16. In recognition of stakeholders' expectation that high audit quality is expected on both PIE and non-PIE audits, and that audit quality is in the public interest regardless of the nature of audits, we have decided to bring all audits into scope.
17. There were mixed views regarding segmentation of the AQI data between PIE and non-PIE audits. Those who were in favour expressed the view that PIE and non-PIE audits are significantly different.
18. A few of the respondents, who were against segmentation, stated that segmentation would put smaller firms with small PIE audit portfolios at a disadvantage, that it would risk overwhelming the intended AQIs users with large number of disclosures, and that audit firms would incur additional complexity and costs in reporting AQIs.
19. Some responses suggested that segmentation of AQI data depends on the nature of each of the proposed AQIs (i.e. some are measured at the level of the audit practice as a whole and cannot be segmented). We have considered the various views, and decided to segment some but not all the AQIs. Details can be found in Appendix 1.

Reporting period

Q3: Do you expect any additional costs to be incurred by firms reporting over a period which is not aligned with their financial years? Are there ways to minimise these costs?

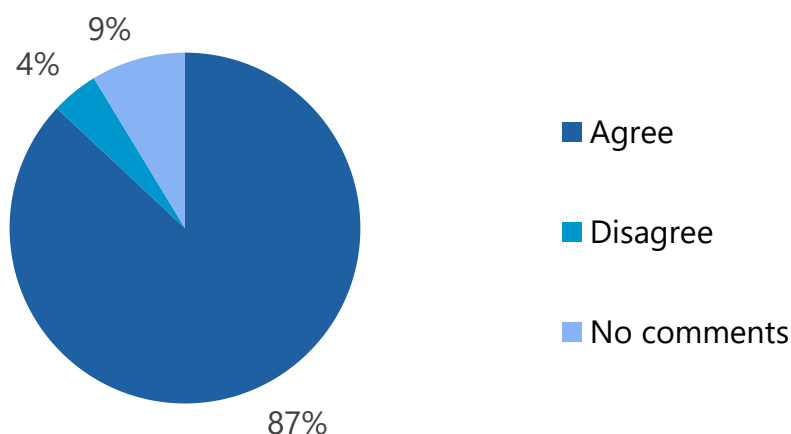
20. Some of the largest audit firms suggested that the costs in modifying their systems to collect the specific AQI data required would be significant, while smaller firms suggested that the initial costs to develop system-based solutions could be substantial if they are not already monitoring the AQIs proposed in the consultation. Some firms also noted that incremental costs would be incurred from performing additional governance and review over any AQI data to be submitted to and published by the FRC, at a different time of the year from when they publish statutory documents (which is usually around four months after their respective financial year-ends).
21. Some stakeholders suggested ways to minimise additional costs. These included leveraging the attestation process currently being implemented at firms as part of compliance with the International Standard on Quality Management (UK) 1 (ISQM (UK) 1).
22. Responses were mixed amongst the firms and professional bodies on whether reporting should be over a period which may not be aligned with the firms' financial years (which vary between firms). Investors were in favour of a common reporting period of April to March.
23. Some of the largest firms suggested that the costs of reporting over a year which is not aligned with their financial years would be significant, while some smaller firms suggested that the costs would be minimal as long as the proposed reporting period coincided with the quarter-ends of their respective financial years.
24. The firms also noted that some of their internal processes related to the proposed AQIs are mandated by their global network. Therefore, it would be challenging for them to adapt these processes to be aligned with a reporting period from April to March.
25. A number of firms also suggested a 12-month reporting period ending either on 30 June or 31 December as the AQI data would be more aligned to the reporting deadlines for many PIEs.
26. Taking into account the overall aims of the consultation, and balancing the views of different stakeholders, we have decided to modify our original proposal and allow firms to produce the AQI data covering any 12-month period that they choose. However, all firms within scope should provide FRC with their data by mid-June each year for publication shortly thereafter. Firms should indicate to us the coverage period applicable to their AQIs, which we would also publish.
27. We believe this approach would allow firms to decide the 12-month AQI data coverage period that would be best for them, while still given users a set of AQIs which are published on a single date and remain stable for a year.

Supporting narrative

Q4: Do you agree that it would be useful to include supporting narrative? Please provide suggestions to ensure that the information is concise and useful for users of audit services.

28. The breakdown of those responding to this question was as follows:

Responses to Q4: Supporting narrative



29. The majority of responses were in favour of firms being able to provide narrative to support the AQIs. Stakeholders saw supporting narrative as essential in ensuring the AQI data is interpreted appropriately.
30. Three Tier 1 firms were in favour of an indicative word count on supporting narrative. The professional bodies and some audit firms were not supportive because they felt having a word count would risk reducing the quality and context of the supporting narrative.
31. Taking into account the views of different stakeholders, we have decided to allow firms to provide narrative supporting the AQIs, with an indicative word count of 500 words in total, to ensure that the narrative is concise and useful for intended AQI users.
32. Some responses expressed the view that allowing firms to provide a link to their own websites, where they could publish relevant AQI material, would create inconsistency and might result in a lack of clarity for users of the information. It was also noted that this could lead to similar issues stakeholders currently experience with Transparency Reports.
33. Based on the feedback and our discussion with intended users of AQIs, we have decided to allow firms to provide links to relevant FRC publications and webpages, however not to the firms' own websites.
34. In recognition of stakeholders' requests, we will include guidance on what is expected to be included in the supporting narrative in the definitions note that we will issue.

List of AQIs proposed in the consultation

Q5: Do you agree with our proposed AQIs? If not, or in addition, do you prefer some of the alternatives presented in Appendix 1 of the Consultation Document? Please explain, using the reference numbers.

35. Considering the overall aims of the consultation, and balancing the views of different stakeholders, we have decided to progress with all except one of the 11 AQIs initially proposed. In addition, we have decided to include one of the alternative AQIs with a slight modification, which measures the ratio of each firm's staff to partners or Responsible Individuals⁵ (we had previously only referred to partners in the consultation document). Appendix 1 lists the final set of AQIs.
36. Most responses were against the proposed AQI on audit planning milestones. Firms have different audit methodologies and therefore different audit planning milestones, hence comparison across firms would be difficult. Stakeholders were also concerned that a standardised approach to setting out audit planning milestones would risk promoting a 'one size fits all' approach for firms. Firms also responded that different audits are subject to varying timing and scope, and hence milestones, depending on the nature, size and complexity of the audits. Taking account of the views of stakeholders, we have decided to modify our original proposal and remove this AQI from the list. However, as ACCs are often interested in firms' approaches to planning, offering an engagement-level version of this indicator could be explored further.
37. Four Tier 1 firms and two investor organisations were in favour of the alternative AQIs measuring staff to manager and staff to partner ratios, as this data would provide users of audit services with insight into the level of supervision capacity embedded within a firm's operating structure. Stakeholders who were not supportive of these AQIs stated that these indicators do not take tenure or experience of auditors into consideration. Balancing the views of stakeholders and mindful of the need not to provide an overwhelming amount of data, we have decided to include only one of these two AQIs, modified to staff to partners or Responsible Individuals (RIs) ratio, as mentioned above.
38. In response to general feedback requesting further clarification on the definition of the proposed AQIs, we will soon publish a definitions note to ensure firms measure their AQIs in a consistent way.
39. In response to feedback querying the people/culture survey questions, we confirm that the FRC will provide specific wording for three questions to be included in firms' surveys, for consistency. We understand that some firms might be required to use surveys designed by their respective global networks, and therefore use slightly different wording. If so, we

⁵ A "Responsible Individual" is a natural person who is a principal or employee of a Statutory Audit Firm and is registered with a Recognised Supervisory Body (RSB), as a Statutory Auditor. In other words, they are authorised to sign audit reports; they are often partners but sometimes are senior employees ('Directors').

encourage firms to make use of their supporting narrative to set out the actual questions they use.

40. We received feedback that the AQI on training did not consider the impact on or relevance of training for audit quality. We understand that there are many factors contributing to the success of training and its impact on audit quality, however we believe that including an AQI in this area will provide stakeholders with an indicator representing the frequency and amount of information firms are communicating with their auditors to ensure their staff have appropriate knowledge and skills for their roles. Therefore, we have decided to keep this AQI in the list.
41. In response to feedback querying the limited scope of the proposed AQI on diversity and inclusion, and the lack of content specifically about inclusion, we have decided to remove the reference to inclusion, but keep the scope of diversity limited to gender and ethnicity, in alignment with reporting expectations set by the FCA for listed companies⁶.
42. Two Tier 1 audit firms responded that AQIs on staff utilisation and staff attrition are commercially sensitive information and so should not be publicly reported. However two investor organisations supported these AQIs. We accept that these metrics could be somewhat sensitive, however we do not think it will be commercially damaging to firms to disclose them when averaged over a number of months.
43. Additionally, we are aware that a number of audit regulators in other jurisdictions require audit firms to provide them with staff attrition as one of their AQIs⁷.
44. Therefore, giving weight to the public interest in transparency, we have therefore decided to keep them in the list of AQIs.
45. To ensure the selected AQIs remain relevant for users, the FRC will periodically review the suite of indicators and propose changes if appropriate. However, we are also aware that a suite which is reasonably stable over time is likely to provide more useful trend information.

⁶ The Financial Conduct Authority has published new rules requiring listed companies to disclose in their annual reports that status of their board's diversity focusing on gender and ethnicity, in April 2022: <https://www.fca.org.uk/news/press-releases/fca-finalises-proposals-boost-disclosure-diversity-listed-company-boards-executive-committees>

⁷ Audit Quality Indicators – A global overview of initiatives: Factsheet, published by the Accountancy Europe in May 2022 <https://www.accountancyeurope.eu/wp-content/uploads/220401-Factsheet-Audit-Quality-Indicators.pdf>

List of AQIs considered but not proposed in the consultation

Q6: Do you think there are any other firm-level AQIs that we should consider?

46. A few responses suggested that we also take forward some of the AQIs that we considered but did not propose, in Appendix 1 of the consultation document. There were as follows:

	Area	AQI description
N3	Consultations	Design and nature of a firm's audit technical consultation process
N4	Unplanned prior year adjustments / restatements (PYAs)	Number of PYAs which do not relate to changes in accounting standards
N7	External investigations related to audit and other matters, e.g. enforcement	Number of cases in the last 12 months in which: <ul style="list-style-type: none">The Tribunal has found against the firm or one of its members following enforcement proceedings by the FRC A disciplinary committee of any other regulatory body has found against the firm or one of its members
N8	Partner workload	Level of workload for partners in the audit practice
N14	Offshore delivery centres	Use of offshore delivery centres
N16	Investor liaison	

47. One response suggested including a metric on the extent of consultation support used by auditors, by measuring the ratio of 'consultants' to total professional staff. However, we have found that firms have different consultation policies and thresholds, and therefore varying technical consultation resources available to provide audit support, which would make it difficult to compare between firms.

48. As explained in the consultation document, we understand that prior year adjustments are not always under a firm's control. Public reporting of the number of PYAs requested by a firm may result in the unintended consequence of incentivising undesirable behaviour by audit firms.

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49. Enforcement proceedings against firms are usually historical and so would not reflect the current period or situation, limiting the insight into the firms' current audit quality. Also, not all cases are in the public domain, and investigations may be resolved in several different ways, of which formal enforcement action is only one.
 50. Based on our stakeholder outreach activities in the past year, ACCs did not see the value in monitoring partner workload but preferred to assess the percentage of time spent by partners against total audit hours. The ACCs consider this a better measure of partners' involvement and therefore supervision, in the pursuit of audit quality.
 51. We consider that the correlation between audit quality and the use of offshore delivery centres is not clearly established. The extent of use of offshore delivery centres varies from audit to audit. There is also a wide spectrum of operational models with varying level of maturity in terms of firms' use of offshore delivery centres, which makes comparisons difficult.
 52. An investor organisation suggested a metric on the average time auditors spent with investors in the planning phase of audits. As discussed in earlier paragraphs, audit planning milestones vary between firms depending on their audit methodology and the level of complexity in the audit, hence it is difficult to make comparisons. Metrics related to audit milestones seem better to measure at individual engagement level.
 53. Some responses also suggested other AQIs that were not proposed list nor included in Appendix 1 of the consultation document. These included: the value of non-audit services provided by each firm to audit clients; the percentage of tenders for which firms were invited to tender but where they declined to do so; and the number of recommendations firms received from the regulator as a result of audit inspections. The first of these is already in the public domain. The link between audit quality and the second and third suggestions is unclear. So, we have decided not to take these ideas forward.
 54. Two Tier 1 firms who were against with the consultation overall suggested a principles-based approach to reporting of firm-level AQIs. Under this approach, each individual audit firm would decide their own suite of quantitative and qualitative firm-level AQIs across the areas outlined in a framework that would be drafted to be consistent with ISQM (UK) 1 and FRC's audit supervisory approach. The firms suggested that these should be published in their annual Transparency Reports, with supporting narrative.
 55. We consider this proposal as not materially different from firms' existing reporting of AQIs in their Transparency Reports, in which information is not comparable across firms. Therefore, we do not see how this is an improvement on the current situation, and so we will not adopt this approach.

Other aspects/comments

Q7: Are there any other comments you wish to make about these proposals, including concerning costs, benefits, or impacts not discussed above?

56. Two Tier 1 firms, one Tier 2 firm, and two investor organisations were in favour of FRC being responsible for publishing the AQI information. This is aligned with the views collected during our outreach with stakeholders, including ACCs, before we issued the consultation document. Stakeholders were of the view that the information should be made available on a single website by a body independent of the firms.
57. Some firms expressed concerns about AQIs information being presented in a tabular format as it can be potentially perceived as a league table. We reiterate that we do not intend to rank the firms, they will be listed in alphabetical order in rows. We do not believe that this presentational approach will result in showing any kind of ranking.
58. Regarding presenting individual firm's contextual information alongside their AQI data, the FRC publishes a summary of such information on firms, for example, relative size per firm by audit fee income, and number of Responsible Individuals and audits in scope, in our annual audit quality inspection and supervision reports⁸. We have therefore decided not to request and publish firms' contextual information alongside their AQI data, in order to avoid duplication.
59. Regarding the implementation timeline, the consultation proposed that firms start collecting 12-month AQI data from 1 April 2023 for public reporting by FRC in summer 2024.
60. Three Tier 1 firms stated that firms that currently publish certain firm-level AQIs in their Transparency Reports are most likely to already have the necessary systems in place to produce our proposed AQIs. They therefore suggested providing a longer transition period for smaller firms which might be less likely to be able to produce AQI data in time for reporting in 2024.
61. Taking this and other views of different stakeholders into account, we have decided to implement a phased approach. In the first year of implementation, all firms in scope will participate in a pilot to collect the AQI data for private reporting in Summer 2024. As part of the pilot, firms will be asked to provide FRC with three data points for each AQI where segmentation is possible, representing all audits, PIE audits, and non-PIE audits. In the first year, we will consider publishing some indicative overall ranges of AQI data from the pilot, without publishing firm-specific numbers, to collect feedback from intended AQI data users on their usefulness.

⁸ FRC Audit Quality Inspection and Supervision Report: Tier 1 Firms – Overview (July 2022):

https://www.frc.org.uk/getattachment/264ac8d9-1e9b-4ee9-a1f2-fe2022c1d9e8/FRC-Audit-Quality-Inspection-and-Supervision-Public-Report-2022-Tier-1-Firms-Overview_July-2022.pdf

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62. In Summer 2025, firms will be asked to provide FRC with AQI data, segmented between all audits, PIE audits, and non-PIE audits where possible (for consistency checking). FRC will then publish the AQI data segmented between “all” and PIE audits.
 63. This phased approach will also give FRC and the firms an opportunity to share feedback regarding the AQI data produced and the challenges firms experience. This should help ensure the quality and usefulness of the data.
 64. Many stakeholders were in favour of publishing prior year comparative data as this would help stakeholders identify and discuss trends with firms. We have decided that, from Summer of 2025 (first year of public reporting), the previous year’s data should be published for each AQI.
 65. There was a further suggestion that FRC should undertake some level of verification of the AQIs provided by firms. We will consider the usefulness and feasibility of this during the pilot phase, including whether it would delay timely publication.
 66. Under this phased approach, we propose that a senior partner (generally the Head of Audit Quality or similar) in each firm provides attestation confirming the accuracy of the information, including the comparative data, in the second year of implementation for public reporting in Summer 2025.

Impact

67. It is difficult to quantify the costs of reporting firm-level AQIs to the FRC, partly because no responses to the consultation provided any specific cost information. We would not expect that firms which have already been producing audit quality-related management information for internal purposes and for Transparency Reports will incur significant extra costs to implement any changes to their existing systems and infrastructure in order to produce publicly-reported AQIs.
68. Firms which are in the scope of the new AFGC, but that do not already voluntarily publish AQIs in their Transparency Reports may have to produce data which they have not done before; however, the implementation of ISQM (UK) 1, from 15 December 2022, brings with it information-gathering requirements related to continuous monitoring of audit quality for firms' internal management purposes. This should provide a useful platform for gathering these publicly-reported firm-level AQIs.
69. We believe that reporting firm-level AQIs will lead to an improvement in the information available to stakeholders regarding factors that contribute to audit quality. Users of audit services will be provided with an additional source of information related to audit quality, which should facilitate detailed and robust conversations about audit quality with firms.

Appendix

A. Performance monitoring and remediation

Area	AQI description	Indicator	Segmentation (all/PIE audits)? (Yes/No)
1 People / culture survey results	Audit staff responses to certain annual staff / culture survey questions.	Percentage of favourable and unfavourable responses to the survey questions.	No

B. Quality monitoring

Area	AQI description	Indicator	Segmentation (all/PIE audits)? (Yes/No)
2 Internal quality review	Extent of review by firms' internal quality review teams	Internal quality review hours as a percentage of total audit hours.	Yes
3 External inspection results	Results of external inspections of the audit firm.	Percentage of audits inspected, by quality grading.	Yes
4 Internal inspection results	Results of internal inspections by the audit firm.	Quality grading of audits internally reviewed (expressed as the percentage of number of audits reviewed during the period).	Yes

C. Resource planning and people management

Area	AQI description	Indicator	Segmentation (all/PIE audits)? (Yes/No)	
5	Partners' and Responsible Individuals' involvement in audits	Extent of involvement of and/or supervision in audits by partners and Responsible Individuals	Average hours spent on audits as a percentage of total audit hours by partners and Responsible Individuals	Yes
6a	Staff utilisation	Number of hours worked per week, as a percentage of contracted hours.	Average staff utilisation rate by grade (or group of grades) in the audit practice.	No
6b	Staff utilisation for busy period (January to March)	Number of hours worked per week, as a percentage of contracted hours.	Average staff utilisation rate by grade (or group of grades) in the audit practice, for busy period (January to March).	No
7	Staff attrition	The rate at which staff leave the firm's audit practice	Average staff attrition rates by grade in the audit practice.	No
8	Staff / Partners or Responsible Individuals ratio	Capacity of partners/Responsible Individuals to supervise audit staff.	Average number of audit staff managed by a partner/Responsible Individual.	No

D. Information and communication

Area	AQI description	Indicator	Segmentation (all/PIE audits)? (Yes/No)
9 Training	To demonstrate the level of investment in training offered to partners and staff.	Average number of mandatory training hours per person.	No

E. Governance and leadership

Area	AQI description	Indicator	Segmentation (all/PIE audits)? (Yes/No)
10 Diversity	Gender and ethnic diversity of the firm's audit leadership	Percentage of individuals in the audit leadership, by gender and ethnicity.	No



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