



Financial Reporting Council

# Consultation Document: Firm-level Audit Quality Indicators

June 2022

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# Contents

	<b>Page</b>
1. Executive Summary	2
2. How to Respond	3
3. Introduction	4
4. Scope and Application	7
5. Reporting	10
6. Publication	16
7. General Question	17
8. Summary of Consultation Questions and Next Steps	18
Appendix 1. List of firm-level AQIs considered but not proposed	19
Appendix 2. List of AQIs agreed for reporting by the Policy & Reputation Group of large audit firms	23

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## 1. Executive Summary

In May 2020 we published an FRC Thematic Review of Audit Quality Indicators (AQIs)<sup>1</sup>. In it, we committed to publishing a consultation on publicly-reported firm-level AQIs.

Public reporting of firm-level AQIs (i.e. those at the level of the audit practice as a whole), which are measured on a consistent and comparable basis, will broaden the range of information regarding audit quality available to audit committees and other users of audit services beyond the FRC's Audit Quality Review (AQR) scores – something which has been a frequent request from stakeholders. Being able to make comparisons between firms on AQIs beyond external inspection results, including between the largest firms and the challenger firms, and then discuss these factors with the firms themselves, will help audit committees make a more informed choice when selecting an auditor. It supports the FRC's objectives of assessing the application of high standards in audit, promoting innovation and improvement, and increasing audit market resilience. It is also in line with our development as a more assertive regulator and, by increasing transparency, will help improve the functioning of the market for audit services.

This consultation explains why we are making these proposals at this time. It proposes AQIs and also contains a number of questions on related topics, such as the scope of coverage (both firms and audited entities), as well as inviting suggestions to mitigate any aspects of concern.

We recognise that AQIs are not mechanistically or formulaically linked to audit quality. We believe that used effectively they would prompt rich discussions between Audit Committee Chairs (ACCs) and firms, and potentially broaden ACCs' views of firms when making recommendations on the appointment of external auditors. It is these discussions that should lead to increased focus on quality.

We propose to also develop a methodological/guidance note to ensure firms describe and measure their AQIs in the same way – we will offer firms the chance to cooperate on developing this guidance after publication of the feedback statement towards the end of 2022.

We welcome the views of all stakeholders – including users of audit services, investors, audit firms, and others with an interest in this topic.

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<sup>1</sup> FRC Thematic Review of Audit Quality Indicators: [https://www.frc.org.uk/getattachment/f116f7d7-94d8-4c82-94b2-ba24e3b195eb/AQTR\\_AQI\\_Final.pdf](https://www.frc.org.uk/getattachment/f116f7d7-94d8-4c82-94b2-ba24e3b195eb/AQTR_AQI_Final.pdf)

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## 2. How to respond

Answers to the questions set out in this consultation document are requested by 18 August 2022. Responses should be sent by email to [AQIs-consultation@frc.org.uk](mailto:AQIs-consultation@frc.org.uk)

or in writing to:

Shamima Hussain  
Financial Reporting Council  
8th Floor  
125 London Wall  
London  
EC2Y 5AS

Please note that it is advisable to send your response electronically. All responses will be acknowledged.

It is the FRC's policy to publish on its website all responses to formal consultations unless the respondent explicitly requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure. The FRC does not edit personal information (such as telephone numbers or email addresses) from submissions; therefore only information that you wish to be published should be submitted.

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## 3. Introduction

### The purpose and objectives of the FRC

The FRC's purpose is to serve the public interest by setting high standards of corporate governance, reporting and audit and by holding to account those responsible for delivering them. Our purpose aims to produce a variety of benefits including engaged investors, better governance, better reporting quality, and rigorous audit. This will contribute to overall benefits for a wide range of stakeholders including greater transparency for decision makers such as ACCs and investors, and increased trust in UK markets.

The FRC's objectives that are particularly relevant to public reporting of firm-level AQIs are to:

- Set high standards in corporate governance and stewardship, corporate reporting, auditing, and actuarial work and assess the effectiveness of the application of those standards, enforcing them proportionately where it is in the public interest.
- Promote improvements and innovation in the areas for which we are responsible, exploring good practice with a wide range of stakeholders.
- Create a more resilient audit market through greater competition and choice.

The FRC's 2020 thematic review of AQIs stated that firms should continue to develop AQIs and increase their usage in decision-making both at engagement- and firm-level, to enable more effective oversight. The review discussed the categories of AQIs (see below) and suggested that AQIs should be reported to audit committees and through Transparency Reports. The review also proposed next steps that should be taken by firms, the FRC, audit committees, and investors. Those for the FRC included consulting publicly on a core set of AQIs for publication, and monitoring the internal development and use of AQIs as part of our routine supervision of large audit firms.

ACCs have said that they would like a wider set of information on audit quality, going beyond AQR scores. Publishing firm-level AQIs will provide this, so that ACCs can have richer conversations about quality with audit firms, especially when tendering for new auditors. Being able to make comparisons between firms on AQIs beyond external inspection results, including between the largest firms and the challenger firms, and then discuss these factors with the firms themselves, will help audit committees make a more informed choice when selecting an auditor. In addition, increased emphasis on quality by users should in turn further increase audit firms' focus on this area.

### What are AQIs?

AQIs are quantitative and qualitative measures of external audit quality, including input, output, and outcome measures. They indicate the firm's historical, present or future ability to perform quality audits, as well as providing insights into audit quality when read with other AQIs and relevant context.

The difference between AQIs and Key Performance Indicators (KPIs) is that AQIs are viewed through a quality lens to either assess audit quality or determine actions that will improve audit quality.

The FRC's 2020 review of AQIs provides more detail.

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## Categories of AQIs

Three types of AQI can be identified:

- Engagement Level AQIs – shared confidentiality between firms and specific audited entities;
- Management AQIs – KPIs which are internal to the firm; and
- Firm-level AQIs – publicly-reported.

Engagement Level AQIs – These are the most granular AQIs, which can be used by engagement teams (and firm management) to monitor developments during an audit, and intervene as necessary to promote audit quality. These indicators can also be shared with audit committees to facilitate their oversight of the audit. The FRC and the largest audit firms are currently engaged in a pilot in which a number of individual audit teams are working with the engagement audit committees to identify the most useful AQIs for their audits. We intend to publish feedback from this pilot later in 2022.

Management AQIs – Over the past few years there has been a greater focus on developing AQIs for audit-firm management purposes, which the firms have been using to determine actions in improving audit quality during engagements and in enhancing their quality monitoring systems. The AQIs used within firms tend to cover more aspects than those reported publicly. The firms are developing and refining their AQIs to ensure that they are able to meet the requirements of the International Standard on Quality Management (UK) 1 (ISQM (UK) 1). These AQIs are expected to be aligned to the specific circumstances of each firm and its quality management system, and while there may be some commonality in the types of indicators used, they will not be directly comparable from firm to firm.

This consultation focuses on the third category, “firm-level AQIs” which are indicators of audit quality at a whole-firm (audit practice) level. These AQIs offer a consistent way of reporting, to provide measures which track how audit firms try to address audit quality. As well as the indicators themselves being of potential interest to users, outliers against the indicators may also be helpful in identifying issues that both contribute to and detract from audit quality. The most frequently cited firm-level AQI is the results of the FRC’s audit quality reviews. These are published by the FRC and most larger firms also publish them, along with certain other firm-level AQIs, in their Transparency Reports<sup>2</sup> as discussed next.

## Existing reporting of AQIs

Audit firms which audit 20 or more listed companies, are within scope of the 2016 Audit Firm Governance Code (“AFGC”), and are members of the Policy and Reputation Group (PRG),<sup>3</sup> voluntarily agreed to report on 11 AQIs across five areas set out by the PRG in 2015. These are listed in Appendix 2.

The PRG AQIs are reported in firms’ Transparency Reports. However, investors and ACCs were not always aware that they were published there. Also, the FRC’s thematic review of AQIs found that not all of these AQIs are reported consistently by the firms. These are not published on the FRC’s website.

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<sup>2</sup> Auditors of Public Interest Entities are required by law to publish reports containing details of their: legal structure and ownership; governance structure; internal quality control systems; and quality assurance and independence practices. See also the FRC’s thematic review of transparency reporting from September 2019, available at <https://www.frc.org.uk/getattachment/3c124043-70b7-428a-af03-9359b32652e2/Transparency-Reporting-Final.pdf>

<sup>3</sup> Composition of the PRG: <https://www.theprg.uk/who-we-are/>

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## The purpose and objectives of this proposal

One of the actions to which the FRC committed in our 2020 thematic review, mentioned above, was to consult publicly on a consistent set of firm-level AQIs. Many stakeholders have asked for other publicly-available measures of audit quality, besides the FRC's AQR inspection results.

The purpose of publishing firm-level AQIs is 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 more consistent basis, with the knowledge that AQIs across the firms will be calculated in the same way; and thus
- Enable users of audit services to have rich conversations about audit quality and correlated factors with audit firms. These AQIs would be in addition to other sources of information on audit quality and different users will use them to varying degrees, but it is useful for there to be a clear, concise, and comparable set of published AQIs available.

The published AQIs must be clear, understandable, and easily accessible, without the onus being on the reader to consult all the different firms' Transparency Reports. In turn, this should improve the transparency and consistency of audit-quality related information and thus, in due course, improve the functioning of the audit market.

AQIs are another way to stimulate discussions around audit quality. However, we do not wish to suggest that the indicators discussed in this document are mechanistically related to quality. Nor, in general, do we suggest that there is a 'optimal' or 'target' value for most of them. Nevertheless, they are useful in illuminating factors which are frequently linked to quality, and are therefore worthwhile considering during discussions between users of audit and auditors.

## Stakeholder engagement

We undertook informal outreach to support the development of this consultation. We met ACCs, investors, audit firms, professional bodies, academics, regulators both in the UK and abroad, and held a number of roundtables.

We are now seeking more formal input. Therefore the FRC invites a broad range of stakeholders to provide their views on AQIs and what they would find most useful (see Section 8 on p.18 for Next Steps).

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## 4. Scope and application

This section considers some overarching aspects relevant to the public reporting of AQIs, as follows:

- which firms would be expected to provide their AQI information;
- which types of audits (audited entity) should be included in the data that the firms report; and
- the reporting period that the AQIs should cover.

Currently, audit firms publish some AQIs in their Transparency Reports. However, the metrics are not necessarily defined in precisely the same way, making comparisons between the firms much harder, and some firms are still developing their suite of AQIs for external reporting. The recently published research into ACCs' views and approaches to audit quality highlighted that only limited numbers of ACCs read firms' Transparency Reports.<sup>4</sup>

### Scope – which firms and audits should be included?

The FRC would like the information published to be usable, which includes both concision and comprehensiveness. There is therefore a trade-off between greater coverage (more firms, more data, more granularity) and not over-burdening the user with information that may be less relevant to them. We would welcome views on where to strike this balance.

In 2020, the largest four firms were the statutory auditors for 94% of the FTSE350<sup>5</sup> and each audited large numbers of other Public Interest Entities (PIEs) as well. There are four other firms that audited FTSE350 companies that year – all are in either Tier 1 (the seven largest firms) or Tier 2 (the next five firms)<sup>6</sup>. While only the largest four firms provided audit services to the FTSE100 between 2016-2020, in the same period the number of firms that provided audit services to the FTSE250 has increased from six to eight.

To attain balance between greater coverage and not over-burdening smaller firms we suggest that we should align the scope with the FRC's recent publication of the revised Audit Firm Governance Code (AFGC), which will apply to all firms that audit more than 20 PIEs or at least one FTSE350 company. We propose that firms should start reporting AQIs when they enter the scope of the AFGC, as asking all 31 PIE audit firms to report their AQIs might be too burdensome and onerous for the smallest firms.

### Which audits should be included?

All firms within the scope of the AFGC audit both PIEs and non-PIEs. This raises the question as to whether the AQIs which are reported should be based on the entire audit practice, or only on each firm's PIE engagements. Both are useful, but some indicators might be difficult to compare across firms with different proportions of PIE audits. Therefore we propose a segmented approach, i.e. where AQIs are presented for PIE and non-PIE audits separately.

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<sup>4</sup> Pg 25, YouGov report "Audit Committee Chairs' views on, and approach to, audit quality", January 2022. Available at <https://www.frc.org.uk/getattachment/5aae6dc1-c67a-49c5-b15b-38d797d840ea/YouGov-FRC-Audit-Committee-Chairs-Research-2022.pdf>

<sup>5</sup> "Developments in Audit", FRC, November 2021. Available at <https://www.frc.org.uk/getattachment/c5580fd0-64f3-4abd-b57a-b05f01dc9841/FRC-Developments-in-Audit-November-2021.pdf>

<sup>6</sup> The FRC's tiers of audit firms are discussed in "Our Approach to Audit Supervision", FRC, March 2021. Available at <https://www.frc.org.uk/getattachment/db4ef2e0-72f6-4449-bda0-c8679137d1b1/FRC-Approach-to-Audit-Supervision-FINAL.pdf>



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We also note that the Government’s response to its consultation document<sup>7</sup> states that it intends to expand the definition of PIEs; therefore certain non-PIE engagements will become PIE engagements in future. As a result, the number of firms in scope is likely to increase.

Question 1. **Do you agree that the firms reporting their AQIs should be aligned to the scope of the revised 2022 Audit Firm Governance Code? If not, what scope would you prefer and why?**

Question 2. **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?**

### Reporting date and period

The effective or start date for reporting AQIs is subject to the outcome of this consultation. However, we intend to publish a final version of our proposals in late 2022. We will then produce a guidance note providing definitions, to aid consistency.

One way to make the data more comparable would be for the AQIs to cover the same 12 months across all firms, and to be published on the same date. This would differ from Transparency Reports, which are aligned with each firm’s financial year, which vary across the firms.

We appreciate that firms collect data throughout the year but may only verify this data annually, which may mean the introduction of a common reporting period may add costs. However, if firms report AQIs based on their own financial year, data provided for a common publication date would be significantly older for certain firms than for others. We therefore propose that the reporting of AQIs should cover the period 1 April – 31 March for each year.

We propose that these AQIs will take effect from 1 April 2023, from which point the firms will be expected to start collecting the data. This time-frame also aligns with the FRC’s audit inspection cycle, and should lead to publication in the Summer after the relevant period ends, starting in Summer 2024, possibly alongside the FRC’s inspection and supervision reports on the Tier 1 firms.

However, we recognise that a transition period may be needed by some firms, namely those which do not currently publish AQIs but which are within whatever scope is decided on following this consultation (for example, those firms which will come into scope of the revised AFGC, as proposed). Therefore we propose that only firms currently publishing AQIs in their Transparency Reports should be expected to report for the period 1 April 2023 to 31 March 2024.

We recognise that some of our proposed AQIs may need data to be collected slightly differently from some firms’ current practice, as well as being checked at a different time of the year. However, firms are already collecting and monitoring the same or very similar metrics as part of their ISQM (UK) 1 implementation plans and for internal management purposes. We welcome views on these issues, including likely costs.

Question 3. **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?**

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<sup>7</sup> “Restoring trust in audit and corporate governance: Government response”, BEIS, May 2022. Available from: <https://www.gov.uk/government/consultations/restoring-trust-in-audit-and-corporate-governance-proposals-on-reforms>

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### Additional 'busy period' data

Some indicators, for example those concerning staff utilisation rates (chargeable hours per week, noted on timesheets), may vary significantly between busier and less busy times of the year. For many firms, a large number of their audited entities have 31 December as the year end, and so audit teams may be particularly busy between January and March. The reason that utilisation rates are of interest is because of the concern that excessive time pressures may cause risks to audit quality. Therefore indicators which average out busier and less busy periods may not be sufficiently informative by themselves.

We therefore propose that firms should report data for the staff utilisation indicator both for the whole year **and** for the three months of January to March (see #9 in the list of AQIs below).

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## 5. Reporting

This section considers the reporting aspects for firm-level AQIs, which are as follows:

- use of supporting narrative;
- number of AQIs;
- setting of targets against AQIs;
- reporting of averages and trends; and
- the proposed list of AQIs.

### Supporting narrative

Users may benefit if the quantitative AQIs are supported by specific contextual information. Therefore firms could also be given a certain amount of space for text to provide supporting narrative for the numerical data. An example of such a narrative might be an explanation of why a certain metric has changed significantly between different years.

Our outreach found broad support for AQIs being supported by textual material from the firms. However, some stakeholders were concerned that such material might not be very informative and the FRC would not be able to provide assurance to readers over such material.

Our preferred option is for the FRC to provide an indicative word count for firms' textual responses. Another option would be for the FRC to allow firms simply to provide a link to their own webpage where they could publish relevant material. However, this is less convenient for users, who would have to visit a number of different websites to gain a picture of all the firms' responses.

**Question 4. 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.**

### Number of AQIs to be reported

Subject to consultation responses on the AQIs proposed below, we plan to compile a list of indicators, possibly supplemented by supporting narrative. Our informal outreach found that there was general support for a total of between eight and sixteen indicators. Stakeholders suggested that too few indicators would not provide enough variety of information on which to base discussions between users and the firm, while too many indicators might make the data harder to use, especially if the number of firms in scope increases. However, segmenting the data into PIE and non-PIE audited entities, as discussed elsewhere, effectively doubles the amount of information presented. We recognise that this may affect the total number of indicators that should be presented while maintaining ease of use.

Reporting firm-level AQIs by different segments, for example by industrial sector or size of audited entity, i.e. producing more granular data, would potentially provide users of audit services with more targeted information specific to the areas of their particular interest. However, the more granular the AQIs data become, the higher the volume of information to be reported and published, and therefore the more onerous to provide and use. Therefore, we only plan to ask firms to report AQIs at firm level, possibly segmented into PIE and non-PIE data as per Question 2. (Of course, if firms wish, they may provide more granular information on their own websites or in their Transparency Reports.)

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## Reporting comparators, averages, and trends

Some stakeholders suggested that it would be valuable to augment a given year's data with information relating to previous years' values for that indicator or to report an average for each AQI over time to provide an additional perspective.

We propose that, from the second year of implementation, the prior year comparative will be published for each AQI. Subsequently we can consider if a number of years' prior data should be averaged. We expect that firms will discuss trends in these indicators with ACCs and others on request.

## Setting targets

We are not proposing to set targets for the indicators. There are many reasons why any particular AQI may vary between firms and from one year to the next; it may well be valuable for ACCs and other users of audit services to discuss these variations.

## List of proposed AQIs

We list below our preferred 11 AQIs, to be reported by audit firms in scope and published by the FRC. We also list four others as possible alternatives/additions. The candidate AQIs are grouped in categories aligned with those in the FRC's publication "What Makes a Good Audit?"<sup>8</sup>.

We have considered a number of other indicators when developing our list of possible AQIs but ultimately felt they were not suitable for inclusion; they are listed in Appendix 1 for information.

A guidance note will accompany the list of AQIs to be reported. For the purposes of consistency and comparability it will be important to define each AQI precisely.

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<sup>8</sup> What Makes a Good Audit? FRC, November 2021. Available at <https://www.frc.org.uk/getattachment/117a5689-057a-4591-b646-32cd6cd5a70a/What-Makes-a-Good-Audit-15-11-21.pdf>

## A. Performance monitoring and remediation

	Area	AQI description	Proposed indicator	Why is this AQI important
<b>Proposed</b>				
1	Staff / culture survey results	Audit staff responses to certain annual staff / culture survey questions	Percentage of favourable and unfavourable responses to the survey questions.	Results from the firm's audit staff / culture survey results can show whether staff feel that the firm is committed to audit quality and receive adequate support and guidance in pursuing audit quality.
2	Audit planning milestones	Completion of audit planning phase	Percentage of audits meeting key planning milestones by the target completion date.	Meeting planning milestones indicates that an audit has been thoughtfully planned before the fieldwork is commenced. Firms' own root cause analyses indicate that lack of timely planning is correlated with poor audit quality.
<b>Alternatives/additions</b>				
3a	Proportion of audit hours by phases of audit	Proportion of audit effort by audit phase	Average audit hours spent before the financial year-ends of audits in scope, as a percentage of total audit hours.	A higher percentage of hours spent upfront, at the planning phase, may indicate that audits have been better planned, or work that can reasonably be done early has been completed, to alleviate higher workloads later.
3b			Average percentage of audit hours spent in the two weeks before sign-off.	A high percentage of hours spent just before sign-off may indicate key audit issues being identified late. Being under time pressure may impact on audit quality.

## B. Quality Monitoring

	Area	AQI description	Proposed indicator	Why is this AQI important
<b>Proposed</b>				
4	Internal quality review	Extent of review by firms' internal quality review teams	Internal quality review hours as a percentage of total audit hours. <sup>9</sup>	The greater the investment of time in internal quality reviews, the more likely the firm is to identify issues in audit quality that can then be remediated.
5	Inspection results – external	Results of external inspections of the audit firm <sup>10</sup>	Percentage of audits inspected, by quality grading.	These results provide an external perspective of key matters relevant to a firm's audit quality based on a review of a sample of individual audits.
6	Inspection results – internal	Coverage and results of internal inspections by the audit firm	Number of audits internally reviewed as a percentage of total number of audits completed during the period, with quality grading. <sup>11</sup>	These inspection results may indicate the effectiveness of the firm's control environment for undertaking audits to ensure high quality.
<b>Alternative/addition</b>				
7	Involvement of Engagement Quality Control Reviewers (EQCRs) <sup>12</sup>	Involvement by EQCRs in audits	EQCR hours as a percentage of total audit hours.	Higher involvement of EQCRs as a proportion of total audit hours implies more effort spent in providing separate evaluation of audits, by an internal qualified independent reviewer, on or before the accounts are signed off, and may therefore be indicative of higher audit quality.

<sup>9</sup> Internal quality review hours refers to hours carried out in conducting 'cold reviews' which review at least one completed engagement for each engagement partner.

<sup>10</sup> Depending on the scope of audits to be decided for public reporting of AQIs, the inspection results could include that of the Financial Reporting Council (FRC), the Institute of Chartered Accountants in England and Wales's Quality Assurance Department, and the Public Company Accounting Oversight Board in the United States (for work done on UK components of US audits).

<sup>11</sup> We are aware that firms have different internal quality inspection grading systems and so comparison across firms might be limited. However there may still be benefits from allowing users to see them in one place.

<sup>12</sup> EQCRs are independent audit partners allocated to eligible individual audits, who are responsible for performing ongoing reviews as an audit is being carried out. EQCRs are expected to complete the review and be satisfied with the quality of the audit file before the audit is signed off and concluded. EQCR reviews are only applicable to PIE audits.

## C. Resource planning and people management

Area	AQI description	Proposed indicator	Why is this AQI important	
<b>Proposed</b>				
8	Partner involvement in audits	Extent of involvement of and/or supervision in audits by engagement partners	Average hours spent on audits as a percentage of total audit hours by engagement partners and key audit partners.	Higher ratios indicate a greater involvement of / supervision by partners and may be indicative of higher audit quality.
9a	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.	High utilisation rates may indicate work overload, which may impact audit staff's performance in delivering a quality audit.
9b			Separate number for busy period (January to March).	
10	Staff attrition	The rate at which staff leave the firm's audit practice	Average staff attrition rates by grade in the audit practice.	High attrition levels may be indicative of resourcing pressure in completing audits, and therefore lower audit quality.
<b>Alternatives/additions</b>				
11	Use of specialists	Extent of involvement of specialists, by types of specialised skills generally used in audits	Average hours spent by specialists on audits as a percentage of total audit hours.	Appropriate use of specialists improves the level of technical input, challenge, and quality of audits.
12	Staff / partner & staff / manager ratios	Capacity of audit partners and managers to supervise junior audit staff in the firm, and the level of professional support for audit partners and managers	Average number of audit staff managed by an audit partner / manager.	Higher ratios indicate a higher number of staff an audit partner or manager is required to supervise, which may distract supervising individuals from giving appropriate attention to each individual and each audit. Higher ratios may also indicate either relatively few partners, or that a firm is better resourced with professional staff to support partners.

## D. Information and communication

Area	AQI description	Proposed indicator	Why is this AQI important	
<b>Proposed</b>				
13	Training	To demonstrate the level of investment in training offered to partners and staff	Average number of mandatory training hours per person.	Supporting a culture of high quality in audit necessitates a significant investment in training of people in the audit practice. The type, quality, and relevance of the training are also important considerations.

## E. Governance and leadership

Area	AQI description	Proposed indicator	Why is this AQI important	
<b>Proposed</b>				
14	Diversity and inclusion	Gender and ethnic diversity of the firm's audit leadership	Percentage of individuals in the audit leadership, by gender and ethnicity. <sup>13</sup>	A diverse and inclusive leadership is better at considering a wide range of matters that firms need to focus on in the long term, which will bring more effective decision-making in relation to important issues, including audit quality.

Question 5. **Do you agree with our proposed AQIs? If not, or in addition, do you prefer some of the alternatives presented above? Please explain, using the reference numbers.**

Question 6. **Do you think there are any other firm-level AQIs that we should consider? If so, please explain. (If relevant, please refer to the list of AQIs we have considered but not proposed, in Appendix 1.)**

<sup>13</sup> Adapted from the accounting metric relating to workforce diversity and engagement included in the Professional and Commercial Services Sustainability Accounting Standard published by the Sustainability Accounting Standards Board (SASB) in October 2018: [https://www.sasb.org/wp-content/uploads/2018/11/Professional\\_Commercial\\_Services\\_Standard\\_2018.pdf](https://www.sasb.org/wp-content/uploads/2018/11/Professional_Commercial_Services_Standard_2018.pdf)



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## 6. Publication

Public reporting of AQIs can allow firms to make it clearer to stakeholders, and to the general public, how they are striving to ensure consistent, high-quality audits and what issues they are facing as a firm. This can help strengthen confidence in the audit firms.

This section considers:

- how the information is presented;
- the responsibility for publication; and
- any expectations of verification of the information.

### Presentation

We would like to make it easy for users of audit services to access and use AQI information. We propose to tabulate the AQI scores for each metric for each firm. This would make it easier to compare and contrast different indicators across different firms.

Depending on the results of this consultation (Question 5 above) the publication may also allow the firms to provide supporting narrative.

Contextual information could also be included, such as the number of partners/responsible individuals and staff by grade, number of professionally qualified staff, number of PIE audits undertaken by the firm, number of audits where the firm is the group auditor/component auditor etc. An alternative would be to provide links to other publications which provide this data.

### Responsibility for publication

During outreach, most stakeholders believed that the information needed to be made available on a single website, by a body which is independent of particular firms. We therefore propose that the FRC should be responsible.

### Expectations concerning verification

We have considered the level of verification that the FRC could undertake, and any expectations that others might have in this area. We propose that the audit firm's senior partner should provide an attestation confirming the accuracy of the information. The information would be annotated accordingly, including an FRC disclaimer similar to that used in certain other publications.

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## 7. General question

Question 7. **Are there any other comments you wish to make about these proposals, including concerning costs, benefits, or impacts not discussed above?**

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## 8. Summary of Consultation Questions and Next Steps

<b>1</b>	Do you agree that the 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?
<b>2</b>	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?
<b>3</b>	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?
<b>4</b>	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.
<b>5</b>	Do you agree with our proposed AQIs? If not, or in addition, do you prefer some of the alternatives presented above? Please explain, using the reference numbers.
<b>6</b>	Do you think there are any other firm-level AQIs that we should consider? If so, please explain. (If relevant, please refer to the list of AQIs we have considered but not proposed, in Appendix 1.)
<b>7</b>	Are there any other comments you wish to make about these proposals, including concerning costs, benefits, or impacts not discussed above?

### Next Steps

- The deadline for responses is 18 August 2022. If you have any questions during the consultation period, please contact [AQIs-consultation@frc.org.uk](mailto:AQIs-consultation@frc.org.uk).
- We aim to produce a feedback statement by the end of 2022. This will include a discussion of the costs of these proposals.
- Subject to consultation responses, we propose that from 1 April 2023 firms start collecting data for the selected AQIs (if not already doing so), with a view to reporting them to the FRC by the end of May 2024, for publication shortly thereafter.

## Appendix 1. List of firm-level AQIs considered but not proposed

The following table contains AQIs which the FRC is not minded to propose. There are various reasons for this, discussed below; one factor is the desire to keep the information published reasonably concise to make it more user-friendly. Some may currently be included in firms' Transparency Reports or elsewhere, and we do not wish to discourage their continued use by others who find them useful.

### A. Risk assessment

	Area	AQI description	Comments
N1	Independence compliance	Firm-wide audit independence compliance	Audit firms already declare their independence under the relevant professional standards.

### B. Governance and leadership

	Area	AQI description	Comments
N2	Governance	INEs' (or ANEs' where relevant) involvement in monitoring AQIs	During our outreach, stakeholders suggested that governance indicators are difficult to understand.

### C. Performance monitoring and remediation

	Area	AQI description	Comments
N3	Consultations	Design and nature of a firm's audit technical consultation process	Firms have different thresholds to identify audits that require technical consultations. Achieving consistency and comparability would be difficult.
N4	Unplanned prior year adjustments / restatements (PYAs)	Number of PYAs which do not relate to changes in accounting standards	Not always under the firm's control. Difficult to compare.

## D. Quality Monitoring

	Area	AQI description	Comments
N5	Audit firm's internal quality review process	Design and nature of a firm's internal quality review process.	Firms' internal quality review processes vary. Quantitative measures would not capture such variability, resulting in limited comparability.
N6	Root Cause Analysis (RCAs)	Coverage of RCAs specific to the audit firm	Firms' RCA processes vary. Quantitative measures would not capture such variability, resulting in limited comparability.
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"> <li>The Tribunal has found against the firm or one of its members following enforcement proceedings by the FRC</li> <li>A disciplinary committee of any other regulatory body has found against the firm or one of its members</li> </ul>	The enforcement proceedings against a firm would not reflect the current period, limiting the insight into the firm's current position of audit quality. Also, not all cases are in the public domain, and investigations may be resolved in a number of different ways of which formal enforcement is only one.

## E. Resource planning and people management

	Area	AQI description	Comments
N8	Partner workload	Level of workload for partners in the audit practice	More appropriate to monitor as an engagement-level AQI, as audits vary in size and complexity.
N9	Staff tenure	Number of years of experience, post-qualification, of audit staff at the firm	More appropriate as an engagement-level AQI, to judge an appropriate balance in the team.
N10	Number of professionally qualified staff <sup>14</sup>	Number of professionally qualified staff, by grade, in the audit practice	More appropriately treated as background contextual information.

<sup>14</sup> Individuals who have undertaken a minimum of three years professional training and have been awarded a recognised professional qualification in accounting.

N11	Proportion of staff that are recent hires (< 2 years)	Number of staff that are recent hires (< 2 years)	It would be difficult to disentangle firm growth from this metric.
N12	Audit portfolio	Proportion of audits: <ul style="list-style-type: none"> <li>• which are UK only;</li> <li>• where the audit firm is the component auditor; and</li> <li>• where the audit firm is the group auditor.</li> </ul>	More appropriate to be considered as background information.

## F. Appraisals and rewards

Area	AQI description	Comments
N13	Correlation between audit quality and partners' / staff remuneration	Firms' remuneration policies are complex and it would be difficult to distil into one metric.

## G. Methodology and technology

Area	AQI description	Comments	
N14	Offshore delivery centres	Use of offshore delivery centres	The correlation between audit quality and the use of offshore delivery centres is not clearly established.
N15	Use of / investment in technology	Use of / investment in technology	Effect of auditors' use of technology in audits is not easy to measure, and its impact on quality is not easy to establish.

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## H. Information and communication

	Area	AQI description	Comments
N16	Investor liaison		Unclear how to define a metric, or how to measure its impact on audit quality.
N17	Reputation	Number of favourable and non-favourable news/events mentioned in the media for each firm	Reputation is often too abstract to be measured consistently across the firms.  Reputation can be easily impacted by a lagged one-off event at a point in time, which does not necessarily reflect the firm's current audit quality.

## Appendix 2. List of AQIs agreed for reporting by the Policy & Reputation Group of large audit firms<sup>15</sup>

	Area	#	AQI
A	Partner & staff surveys	1	Partner and staff survey results to three suggested questions
B	Investor liaison	2	Metrics on external investigations
C	Quality reviews (Internal and external)	3	Results of FRC reviews
		4	Results of Public Company Accounting Oversight Board <sup>16</sup> inspections
		5	Results of Institute of Chartered Accountants in England and Wales Quality Assurance department reviews
		6	Results of internal quality reviews
		7	Percentage of Responsible Individuals (RIs) subject to quality reviews
D	Investments in Audit	8	Metrics on investment in audit quality training
		9	Narrative description of investment in audit innovation
E	Quality reviews (Internal and external)	10	Metrics on investor liaison – qualitative description of investor liaison
		11	Metrics on Audit Committee Chair (ACC) impact – results of the ACC survey on audit quality

<sup>15</sup> <https://www.theprg.uk/who-we-are/>

<sup>16</sup> The audit regulatory body in the United States.





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