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Doing the right thing
Delivering quality audits

This report on audit quality also includes our UK Transparency Report.

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We have prepared the Transparency Report, in respect of the financial year ended 30 June 2011, in accordance with the provisions of the Statutory Auditors (Transparency) Instrument 2008 (the 'Instrument') issued by the Professional Oversight Board ('POB') of the Financial Reporting Council ('FRC'). This report also incorporates the key drivers of audit quality set out in the Audit Quality Framework issued by the FRC in February 2008.

In addition to the Instrument's requirements, we have included those matters specified to be included in the Transparency Report by the Audit Firm Governance Code issued by the Institute of Chartered Accountants in England and Wales ('ICAEW') in January 2010.

This Transparency Report has been prepared solely in respect of the UK limited liability partnership of PricewaterhouseCoopers LLP and does not relate to any of its subsidiary or associated undertakings, or any fellow member firm of PricewaterhouseCoopers International Limited.

PricewaterhouseCoopers LLP is referred to throughout this report as 'the firm', 'PwC UK', 'we', 'our' and 'us'. 'Group' refers to PwC UK and its subsidiary undertakings in the United Kingdom, Channel Islands and the Middle East, which are listed in Section 1 of the Transparency Report.

This report was approved by the Executive Board of PricewaterhouseCoopers LLP and signed on its behalf by Richard Sexton, James Chalmers and Keith Tilson on 30 September 2011.

Contents

Thank you for taking the time to read our latest Audit Quality and Transparency Report for the year to 30 June 2011.

Chairman's statement

Ian Powell

Chairman and Senior Partner

This report is an important part of the ongoing discussions we have with our clients and wider stakeholders to explain the PwC approach to delivering high-quality audits as well as fulfilling our statutory obligation to publish certain 'transparency' information. I hope it provides you with a clear account of our culture and values as well as the governance and management systems we have in place.

Over the past 12 months I've been struck by the number of clients who want to talk about the culture and values of our firm and the importance they place on this in making choices about their suppliers for audit and other professional services. Quality is fundamental to those values and I aim to set the right tone from the top on this in all my communications with our partners and staff. You can find out more about our culture and values in the 'Who we are' section of our website.

There has also been considerable focus on the level of competition and choice in the audit market. From a PwC perspective we are clear that this remains a fiercely competitive market. Our clients are sophisticated buyers and they rightly demand continuous quality and performance improvements, which we strive to deliver. All of our appointments are for one year only, after which the shareholders must vote again and that is after review by the independent non-executives, comprising the Audit Committee. We are also seeing a growth in the number of audit tenders for large listed companies, and in the past year we are aware of around ten FTSE 100 companies that have put their audit out to a competitive tender process, a trend I expect to see continued in the coming year. Not surprisingly, a number choose to stay with their existing auditor while others appoint a different firm.

A key criterion in all of those proposals – and indeed the annual reviews that don't lead to a proposal – is quality that reflects the very significant investments we make in our people, our audit methodology and technology in the UK and across the PwC Network.

As in previous years we have gone further in this report than is required, simply to comply with regulation. We promote best-in-class standards of corporate governance and reporting to our clients and I firmly believe we should continue to put our advice into practice. The creation of a new role on the PwC Executive Board with responsibility for reputation and regulatory policy and the establishment of a new Public Interest Body, a dedicated public interest governance body with a majority of senior independent non-executive members, are two key developments that are profiled in this report.

Feedback from clients, stakeholders and our regulators helps us to continue to improve the quality of our reporting and I would welcome any comments you have on any aspect of this report.

Ian Powell

Ian Powell
Chairman and Senior Partner

A message from the Chairman of the Public Interest Body

Sir Richard Lapthorne

Chairman of the Public Interest Body

The Public Interest Body (PIB) is a new departure not only for the firm, but also for me and each non-executive member. All of us have extensive experience on boards of public companies and public bodies, but PwC is a different type of organisation with very different governance needs. You can read the detailed disclosures about the PIB's terms of reference and membership on pages 6 and 7, and I am pleased to give my thoughts as PIB chairman on the first few months of our existence.

The Audit Firm Governance Code states that the independent non-executives should improve confidence in the public interest aspects of the firm's decision-making, dealings with stakeholders and management of reputational risks. The PIB's membership and activities reflect those objectives, and are designed to complement the firm's already well-established governance structure. The Executive Board manages the firm, day-to-day, while the Supervisory Board holds the executive to account on behalf of the wider partnership. What's more, the firm is subject to independent oversight and regulation by the Financial Reporting Council (FRC), the Financial Service Authority (FSA) and the ICAEW, among others.

That is why the PIB includes two representatives from each of the firm's Executive and Supervisory Boards (including the chairs of those two boards), together with the five non-executives. The non-executives have the majority and one of us acts as chair. This arrangement allows the non-executives to hear directly from those responsible for decision making in the firm, and to ask questions. In addition, full agendas and minutes from meetings of those boards are made available to us.

It is worth emphasising that the non-executives on the PIB are not the same as non-executives on a PLC unitary board. On a public company board, all directors participate in, and are responsible for, decisions of the board. By contrast, the PIB gives advice for PwC's management to consider; we do not have powers to ask that this advice is followed. Although we have certain duties that come from the Code on matters of public interest, I believe that the best way for us to 'add value' is in giving the firm's leaders a different perspective.

How we have spent our time

We had our set-up meeting in November 2010 and two full meetings since (in February and May of 2011). Aside from the necessary administrative tasks to get us going, we have established regular slots on our meeting agendas to hear reports from the Executive and Supervisory Boards and to be updated on the firm's risk and quality processes.

My view is that we have a very good level of participation in our meetings. We are able to engage directly with the firm's leaders and our observations are listened to.

To help the non-executives to have a better understanding of the firm's activities and procedures, we have asked for 'teach-ins' on a number of topics, beginning with those we consider most relevant to the public interest. So far we have talked to the people responsible for risk, quality and independence in assurance and tax. We have also travelled to a number of PwC offices outside London to meet partners and staff to get a better understanding of their business and market. We will arrange similar sessions on other topics in the future. I have been genuinely surprised by the range of areas in which the firm operates, and the comprehensive steps it has to take to make sure the firm meets appropriate quality and independence standards.

The Public Interest Body (PIB) is a new departure not only for the firm, but also for me and each non-executive member.

A regular feature of our meetings is to hear updates on the regulatory and public policy agenda – on how the firm has responded to initiatives such as the EC Green Paper on Audit, and the inquiries in the UK by the House of Lords and the Office of Fair Trading (OFT). This is a challenging agenda.

We have also taken a strong interest in the nature of the firm's relationship with its regulators. In particular, we have observed and been briefed on the firm's public and private inspection reports from the Audit Inspection Unit of the FRC.

What we are going to do

We have been meeting for less than a year, so we are certainly not yet in a position to claim we have 'done everything', but the experience of the first few meetings has given us an excellent platform. We will continue getting to know the full range of the firm's activities, relevant to the public interest.

Speaking for the independent non-executive members, we are beginning to form opinions about the environment in which PwC's business operates. While the public interest must be protected, we would be concerned if one of the UK's more successful industry sectors and one of the drivers of economic growth was put under pressure to adopt bureaucratic solutions to perceived regulatory risks. I hope that we can be more forthcoming with our views as we become more established in our role.

Talking to stakeholders

To keep in touch with opinion, issues and concerns, the firm needs to talk to its stakeholders about matters covered by the Governance Code. The Code is not very clear about precisely how this should happen, so, as the non-executives are expected to play a part in this process, we are speaking to some of the Code's authors to understand what they had in mind. This is already enabling us to design our engagement programme for the coming year with a broader understanding of the sometimes diverse views presented in these consultations.

In the meantime, if any of PwC's stakeholders in the investor and corporate communities would like to raise issues related to the Code with me, do please get in touch.

Sir Richard Lapthorne
Chairman of the Public Interest Body

The Public Interest Body presently comprises five independent non-executives and two members from each of the firm's Executive Board and Supervisory Board.

The Public Interest Body

The firm established the Public Interest Body (PIB) in the year ended 30 June 2011. This followed the introduction of the Audit Firm Governance Code (the 'Governance Code'), which applied to PwC UK for the first time for the year ended 30 June 2011: The PIB's purpose is to enhance stakeholder confidence in the public interest aspects of the firm's activities through the involvement of independent non-executives.

The Governance Code states that the independent non-executives should enhance confidence in the public interest aspects of the firm's decision-making, stakeholder dialogue and management of reputational risks, including those in the firm's businesses that are not otherwise effectively addressed by regulation. In addition to those duties prescribed by the Governance Code, the members of the PIB are also expected to provide input on other matters, including the public interest aspects of: the firm's strategy; policies and procedures relating to operational risk management, internal control, quality and compliance with regulation; and external reporting.

The PIB presently comprises five independent non-executives and two members from each of the firm's Executive Board and Supervisory Board.

Public Interest Body members attendance at Board meetings for the year ended 30 June 2011.

	Board meetings	
	A	B
Sir Richard Lapthorne (Chairman)	2	2
Sir Graeme Davis	2	2
Dame Karen Dunnell	2	2
Sir Ian Gibson	2	2
Paul Skinner	2	2
Ian Powell	2	2
Richard Sexton	2	2
Duncan Skailes	2	2
Pauline Campbell	2	2

A = Maximum number of meetings could have attended.
B = Number of meetings actually attended.

The independent non-executives are appointed by the Supervisory Board from candidates nominated by the Senior Partner, following consultation between the Senior Partner and the Supervisory Board. Each independent non-executive has a service contract that sets out their rights and duties.

The Senior Partner and Supervisory Board respectively decide which of the members of the Executive Board and Supervisory Board will sit on the PIB.

Biographies of the independent non-executive members of the PIB are set out opposite.

The PIB is expected to meet at least four times yearly. As the PIB was only established partway through the period, two full meetings were held during the year, in February and May. These were preceded by an inaugural meeting in November. A part of each meeting is set aside to allow the independent non-executives also to meet as a separate group to discuss matters relating to their remit.

The PIB also has time allotted in its programme of meetings during the year to:

- review and discuss people management policies and procedures with the firm's leadership
- review and discuss reports on issues raised under the firm's whistleblowing policies and procedures.

The PIB is given full agendas and minutes of meetings of the Executive Board and Supervisory Board together with other documents and information asked for. As the workings of the PIB evolve, further information will be supplied to them as the need is identified.

Independent non-executive members of the Public Interest Body are:

Sir Richard Lapthorne

Sir Richard Lapthorne is the current Chairman of Cable & Wireless Communications plc. Sir Richard's executive career spanned British Aerospace plc, where he was Vice-Chairman and Finance Director, and Courtaulds plc, where he was Finance Director. He spent his first 18 years working for Unilever plc in the UK, Africa, Holland and France. As a non-executive he was a part-time Chairman of Nycomed Amersham plc, New Look plc, Morse plc, Arlington plc, and has served as a non-executive director of Orange plc, Robert Flemings and Oasis International Leasing in Abu Dhabi.

Sir Ian Gibson

Sir Ian Gibson is currently Chairman of Wm Morrison Supermarkets plc and also Chairman of Trinity Mirror plc. His executive career was spent mainly in the automotive industry, with 18 years at Nissan Motor Company Ltd where he was Chief Executive in the UK and Europe, and was on the Japanese main board. Previously, he was at Ford Motor Company for 15 years. Sir Ian has been a non-executive director at several companies, including GKN plc, Northern Rock plc and BPB plc, a Member of the Court of Directors at the Bank of England and has had several Government advisory roles.

Sir Graeme Davies

Sir Graeme Davies is Emeritus Vice-Chancellor of the University of London, having served as Vice-Chancellor and President from 2003 to 2010. He has been vice-chancellor of three different universities in the UK, and was also previously chief executive of the Universities Funding Council and the Higher Education Funding Council for England. He also serves on the boards of a number of other bodies involved in the higher education sector and has served on the board of London First.

Paul Skinner

Paul Skinner is a non-executive director at Standard Chartered plc, Air Liquide SA and the Tetra Laval Group. He is also Chairman of Infrastructure UK, a body that advises HM Treasury, and a Board Member of INSEAD. Paul spent his 40-year executive career with Royal Dutch Shell, with his final position being as Group Managing Director and CEO of the Group's global oil products business. He was later Chairman of Rio Tinto plc and a member of the Defence Board of the MoD.

Dame Karen Dunnell

Dame Karen Dunnell is a professional statistician and most of her career was spent at the Office for National Statistics where she latterly held the post of National Statistician and Chief Executive. She is currently a visiting fellow at Nuffield College, Oxford, an Honorary Fellow at Cardiff University and a Trustee of the British Heart Forum.

PwC members (not pictured)

Ian Powell^, Richard Sexton^,
Duncan Skailes†, Pauline Campbell†
^ Member of the Executive Board
† Member of the Supervisory Board

Independence of the non-executives

The non-executives are subject to an independence policy that makes sure they remain independent of the firm, its partners and staff, and its assurance clients. In developing this policy the firm considered the UK Corporate Governance Code, issued by the Financial Reporting Council (FRC), and the Ethical Standards, issued by the Auditing Practices Board (APB), as well as considering what a reasonable third party would expect of an independent non-executive.

Under the policy all non-executives should have no personal or business relationship with a partner or member of staff of the firm, nor can they be a director of an assurance client of the firm, nor hold a material financial interest in any assurance client.

The non-executives must confirm compliance with this policy in respect of their financial, business and personal relationships before being appointed and every year thereafter. Every non-executive at 30 June 2011 confirmed their compliance with this policy upon their appointment to the PIB.

Other matters

Appropriate indemnity insurance is in place in respect of any legal action against any independent non-executive and sufficient resources are provided by PwC UK to enable each independent non-executive to perform their duties, which includes, where considered appropriate and necessary to discharge their duties, access to independent professional advice at the expense of PwC UK.

A process has also been established to resolve disputes between the independent non-executives and the governance structures and management of PwC UK. Details of this process can be found at the website www.pwc.co.uk/eng/aboutus/terms-of-Reference-Governance-structure.html.

Reputation and regulatory policy

Richard Sexton

Executive Board member
Reputation and Regulatory Policy

This is our fifth annual Transparency Report and over this period we have continued to listen and action feedback from investors, management and regulators, to refine its structure and content and to offer a clear account of the way we manage and operate the UK's largest professional services and audit firm.

Having been involved in our first four Audit Quality and Transparency Reports as Head of Assurance, this is the first time I have contributed in my new capacity as the Executive Board member responsible for Reputation and Regulatory Policy. I now have responsibility for leading our firm's contribution to the current debates and reviews that will shape the future of the auditing profession, and the standards and regulation within which it operates.

This reflects the increasing significance of the role of auditors – and the increase in scrutiny and interest that comes with it. As a multidisciplinary firm, we recognise that many aspects of audit quality depend on our wider professional capabilities and operations, and for that reason my responsibilities cover all areas of our UK firm's activities.

Within that context, audit quality remains of paramount importance to us and we continue to focus on quality in its widest sense and not simply to meet specific regulatory requirements. Where we see opportunities to improve the quality of audit and wider corporate reporting, we do all we can to act on them.

Audit quality

Independent, robust regulation and oversight of the audit profession has enhanced audit quality in recent years. But I firmly believe that the major impetus to deliver high-quality audits must first come from within the audit firm itself, based on the very simple premise that an audit firm is first and foremost dependent on its reputation for delivering high-quality audits. That reputation is impacted by the actions and behaviours of our people – day in day out – in all of their work.

Building public trust

As the UK's largest audit firm we recognise that we have a very significant public interest responsibility and we take it very seriously. We believe this responsibility extends beyond simply meeting the various audit regulations and standards, and includes making a significant contribution to the wider corporate reporting landscape. This is part of a concerted effort to continuously improve the quality of corporate reporting and, in turn, to begin to restore trust in business.

As the UK's largest audit firm we recognise that we have a very significant public interest responsibility and we take it very seriously.

One example of this approach is our Building Public Trust Awards programme. Now in its ninth year, the awards reflect our view that both private and public sector reporting should:

- encourage organisations to give better, not just more, information
- improve the link between what is being reported and strategy
- make sure narrative statements are backed by sound data
- set historic performance in context, especially when it's about future ambition.

But we know that these steps alone are not enough. For that reason we used the 2010 Building Public Trust Awards event to launch an initiative to work with our clients on a voluntary basis to improve the level of disclosure in the Audit Committee's report to shareholders of the debate that takes place between auditors and their clients. That theme has subsequently been reinforced by the Financial Reporting Council (FRC) through its governance proposals. I have been encouraged by the response, particularly from Audit Committee chairs and a number of clients who are already producing enhanced disclosures of the debate with their auditors in their latest annual report and accounts.

Those of us leading the auditing profession have also to be open to change. The financial crisis was a case of systemic market failure and one of the key lessons it highlighted was that auditing has to move forward if it is to be regarded as relevant and valued. Independent reviews have concluded that the financial crisis was not driven by audit failure, but the audit must evolve and could contribute more to help avoid any recurrence.

As participants in the market, and as a matter of public interest, the audit profession should examine its role and responsibilities and how they might be changed. I welcome the increasing public debate about the value and relevance of audit and the calls for auditor reporting to be more informative. We intend to be at the forefront of making the changes that are needed.

Creating a progressive agenda

Although there is no single right answer to what the changes might be, there is a broad spectrum of reforms that we have developed and call the 'Progressive Agenda'. We believe that it will make a positive impact. Some actions can be taken immediately and others will take longer as they require market participants to act together and therefore need to be accepted by our clients, regulators and other interested parties.

I believe there are five priority areas for reform and action:

- Firstly, as auditors, we push from within the firm for higher standards of excellence. If one of our audits is found wanting against today's standards, that is one too many. So we'll continue to develop our own ideas as well as acting on the feedback we get from our regulators.
- Second, we will improve the transparency of the scope, processes and decision-making in an audit. As a profession we have not done a good job explaining what an audit is, so we can hardly complain if auditing is not well understood. Changing the format of the audit report will take time. A more immediate way to consider giving more information is through the Audit Committee's governance report, where there is discretion over content. Our audit partners have been discussing this idea with our clients and I'm pleased to report that a number of Audit Committee chairs have volunteered to improve the disclosure of these matters in the latest reporting cycle. We need to encourage more and would invite others to do the same.
- Third, we are looking at how the 'front half' of the Annual Report could be improved – the narrative information that goes with the financial statements and that is not covered by the audit report. At the moment, we report by exception and we should find ways of making that reporting more useful. In our conversations with investors it is clear that many already, and wrongly, believe that all quantified information is subject to audit.
- Fourth, we call for changes to the standards for reporting and auditing to give clearer and better assured information in the areas that received focus in the financial crisis. For example, this would include the uncertainties and judgements that underlie financial statements and the assumptions and sensitivities that underpin going concern assessments.
- Fifth, we need longer term, more fundamental reform of the corporate reporting model, including governance, remuneration, risk and sustainability information. The changes I have talked about so far are important and would represent real progress, but they would still be piecemeal. Technical complexity and volume have grown in recent years, making reports harder to understand.

Our Progressive Agenda has been launched in the UK and I hope in the future it will grow into an international reform agenda.

Protecting the public interest

The creation of our dedicated Public Interest Body (PIB) is an important part of our ongoing efforts to further strengthen our corporate governance. The PIB is already serving the public interest through talking to our stakeholders and by engaging with our Executive Board on the aspects of the firm's strategy, policies and procedures relating to reputational risk management, internal control, external reporting, quality and compliance with regulation.

As one of the two executive members of the PIB I believe that this body is already helping us to improve not only our corporate governance, but also the confidence that our stakeholders can have in the management of all aspects of our operations.

Our global network

The structure and operation of our global network is of considerable interest to regulators, clients and other stakeholders. The legal structure and ownership of our firm, and the nature and governance of our international network are explained at length on pages 20 to 23 of this report.

It is important that we have a globally consistent approach to managing audit quality. Our global network has very wide geographic coverage and operates in more than 150 countries, including places where the audit profession and corporate governance are not as mature as in the UK. So it's in performing audits in these territories that we rely upon the strength and consistency of our network. This year, I have also taken on the role of Deputy Global Assurance Leader, and that will help make sure that our UK practice is ever-better connected to drive this important agenda across our network.

An ongoing debate about audit quality

Our firm does not operate in a vacuum and it is critical that we have open and honest discussions with all of our stakeholders. Many of the challenges that face us relate to all market participants, not just us as auditors, but we certainly recognise the important role we have to play. We have never been more ready or willing to respond.

Richard Sexton

Richard Sexton
Executive Board member
Reputation and Regulatory Policy

Audit quality

James Chalmers

Executive Board member
Assurance

As the newly appointed Head of Assurance, I am committed to delivering high-quality audits. I am also determined to continue to improve our transparency and accountability and so for the first time this year, we explain how we are delivering audit quality rather than just provide the details required by regulation.

Audit quality is more than just achieving regulatory compliance. Ultimately it depends on our ability as a firm to recruit, train and motivate intelligent professionals who take personal responsibility to deliver high-quality work. We provide the support and infrastructure necessary for them to operate effectively in the business environment. Quality not only delivers regulatory compliance, but it also enhances the experience for all of our clients and people.

We continually look to improve the quality of the work we deliver, not just on audits, but across the firm. We are keen to get feedback from all our stakeholders on all aspects of the services we deliver and reports that we issue. Without such feedback we cannot continue to improve the quality of our work. Sometimes we succeed in delivering audit quality, but sometimes we fall short of our own exacting high standards. We often learn more from these failings than we do from our successes as they help us to improve and change not just what we do, but how we deliver quality audits.

Leadership responsibilities for quality within the firm

The firm's leadership is committed to quality work and has established a culture of upholding the values of integrity, independence, professional ethics and professional competence.

Quality is a key component of the Assurance strategy, which is explained to all our people who are expected to develop measurable objectives as to how they will deliver quality in the coming year. In addition, we have put in place processes to help deliver and regularly assess quality, including the Quality Key Performance Indicator (KPI) process and the Engagement Compliance Reviews (ECR). Although Audit Regulations require us to have a process like the ECR in place, we would have in any event established a quality review process because it is the right thing to do, and which is why all non-audit work performed in Assurance, which is considerably less regulated than audit, is also subject to the same process and consequences for quality failings.

Quality messages are communicated through a variety of training routes, including webcasts, regular email and local briefing updates.

Audit quality is critical to the success of our practice and we devote significant resources to support teams on the ground, day in and day out. Last year, the time spent on all risk and quality activities, including training, equated to about 20 partners and 600 staff, which represents 7% and 12% of the respective populations in Assurance. This time excludes the risk and quality activities embedded within the audit process itself, such as documentation and review of work done.

Relevant ethical requirements

We take compliance with ethical requirements seriously and try to embrace the spirit and not just the letter of those requirements. All partners and staff undertake regular mandatory training and assessments so that they understand the ethical requirements under which we operate. Partners and staff uphold and comply with the standards developed by the PwC Network and PwC UK, and we monitor compliance with these obligations.

We have developed the PwC UK Code of Conduct (the 'Code'), which is given to all partners and staff. The Code sets out what we stand for and is underpinned by the following overarching principles: acting professionally; doing business with integrity; upholding our and our clients' reputations; treating people and the environment with respect; acting in a socially responsible manner; working together and thinking about the way we work; and considering the ethical dimensions of our actions.

Compliance with independence regulations by the firm and our staff is an essential requirement of what we do, but an area that is often complex to understand and apply. We have extensive policies, procedures and practices relating to independence and these are explained in more detail in Section 6. These policies and procedures are reviewed regularly to take account of changes in laws and regulations. Consequently, in the year to June 2011, the UK Independence Policy, the Statements of Permitted Services, our training programmes and supplementary guidance were updated for the revised Ethical Standards. Additionally, a team of specialists are available for consultation with the practice and who help the firm apply robust and consistent independence policies, procedures and tools.

Data security and confidentiality is a priority for our firm. As can be seen from the issues that have faced a number of organisations this year, the reputational damage of data loss or mishandling can be significant – our clients rightly have an expectation that we will protect their data and not mishandle it in any way. As a result, this year we sought and obtained ISO 27001 certification in respect of our data handling and security procedures, many of which had been in place for some time. We also have in place clear procedures for reporting data loss in the rare circumstances when loss arises. These procedures are supported by disciplinary procedures as appropriate.

Acceptance and continuance of client relationships

We have developed various processes and software to help teams with the process of deciding whether to accept or continue with a client, or a specific engagement. We do not just take on every prospective client, and just because a client has been a client of the firm for many years does not mean that they will continue to remain one. We re-evaluate our client relationships to make sure that they continue to meet the criteria of a party with whom we want to do business. We consider resigning from any client where it is appropriate to do so. Our reputation has been too hard won to do otherwise.

Last year, the time spent on all risk and quality activities, including training, equated to about 20 partners and 600 staff, which represents 7% and 12% of the respective populations in Assurance.

In addition, we also assess every engagement we undertake to make sure that it meets the client's needs – being a client of the firm does not mean that we will agree to deliver any and every service that is asked of us. We need to make sure that the engagement genuinely meets a need, so we work with clients to understand what exactly they want, why they want it and agree how best to structure the work. An example of this has been where companies want assurance over their environmental disclosures. In some situations, assurance may be the wrong initial product. But by working with the company and really understanding what they want, we may initially deliver an advisory engagement to help them understand what systems and information are needed to enable an assurance opinion to be issued. We then deliver a factual findings (agreed-upon-procedures) engagement the following year to confirm the systems are operating effectively. Finally, we would be able to issue an assurance opinion over the environmental data in the subsequent year.

Quality experiences for our people

Edward Gray talks about how his recent experience in our Assurance Risk and Quality (ARQ) team in London has helped with his personal development and how this experience will deliver long-term benefits for our clients.

Find out more at www.pwc.co.uk/annualreport

Our people

We depend on our ability as a firm to recruit, train and motivate intelligent professionals who take personal responsibility to deliver high-quality work.

We make a big effort to develop our people and help them advance their careers. A critical measure of our success is what the market says about our performance as an employer. We take great pride that for the eighth year running in the UK, we have been voted the country's leading graduate employer, according to The Times Top 100 Graduate Employers' survey. We were also listed as a leading employer of women in The Times Top 50 Employers for Women 2011. Our people once again voted for us as one of the top big companies to work for in the Sunday Times annual survey.

We continue to invest in equipping our partners and staff with the technical, coaching and management skills needed to deliver quality work and also give regular, honest feedback to help in their development.

The firm's internal training curriculum provides a broad range of technical solutions as well as business and personal skills' programmes. The ethical values and behaviours needed to meet our public interest obligations are embedded in our skills' training. The overall aim of the training programmes is to give training specific to the needs of the individual, based on their experience, grade and role. Further details of our training programmes within Assurance can be found on page 36.

Training is only one aspect of our people's development. We try to give an optimal mix of on-the-job experience, coaching and training programmes. This is supported by additional development opportunities such as secondments, international assignments, community partnerships and voluntary programmes.

Engagement performance

We continue to invest heavily in the effectiveness of our audits, in the skills of our people and in our underlying audit methodology, as well as in making the right amount of time and resources available.

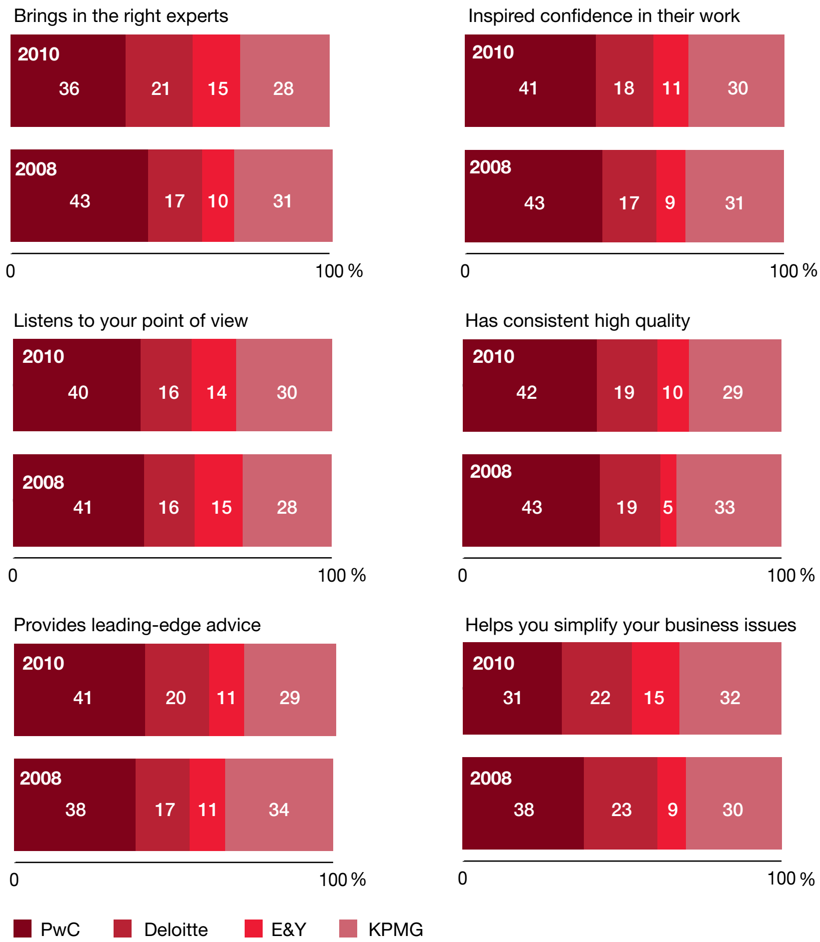
We pay close attention to what our audit clients need from us, what they tell us we need to improve and to the findings of regulatory inspections on the quality of our work.

Every two years, the Brand Health Index helps us keep track of our performance, relative to the market. It is an independent survey and includes research into the UK Big Four audit providers.

Interviews are conducted with senior management at 400 organisations, including 222 people specifically involved in buying audit services. Respondents are asked which firm is most associated with a range of criteria. The 2010 results continue to show PwC leading share of mind as well as market share.

But we recognise that we can always do better and we have strategies in place to improve our performance across the board. We currently lead five of the six categories and our aim is to lead all six by 2012.

PwC Brand Health Index 2010



The network operates a common audit methodology and process, supplemented by local regulatory requirements and which adheres to International Standards on Auditing as well as being flexible in its application. PwC's UK firm continues to make a significant contribution to the development of the firm's global audit methodology and one important aspect of this contribution is the importance we attach to the application of professional judgement.

The last year has seen significant change in the audit practice. PwC UK has completed the roll-out and training of our audit software 'Aura' to the entire audit practice. Aura makes it possible for teams to apply our methodology more effectively by creating greater transparency of the linkage between risks and the work done to address those risks, as well as providing enhanced project management capabilities. The effect is that the quality of our audits improves as teams are able to focus their efforts on areas of risk. PwC UK is also rolling out new software for our non-audit work, which will improve compliance with our policies and the quality of our documentation.

In addition, we have updated all our guidance, templates and tools for the clarified auditing standards, which applied for periods ending on or after 15 December 2010. Training on the new auditing standards was given to partners and staff.

The last year has seen an increase in the number of activities performed, and time spent, by the network's delivery centres in Kolkata and Katowice. We have been clear from the outset that the aim of establishing the delivery centres is to improve audit quality and efficiency. The centres are in place to assist client teams by performing administrative and repetitive tasks, which need no judgement, and so let our client team focus on applying their judgement and professional scepticism in the audit process.

Teams are supported in their work by central functions, which work with teams in applying policies and guidance as well as developing new guidance when a need is identified.

Professional scepticism

The application of professional scepticism on an audit is a vital ingredient for audit quality. Professional scepticism is often demonstrated through the robust challenge of management; being objective and independent in our approach, audit work and thinking; coming to our own views and not simply accepting what we are told by management at face value. Ensuring we do this continually and evidencing the application of professional scepticism on the audit file requires ongoing reinforcement.

We included professional scepticism within our 2011 mandatory training programme. This involved not just reminding people of the requirements of auditing standards and the situations where enhanced professional scepticism is needed, but it also allowed people to share their experiences in this area – it is often through the sharing of experiences together with regular coaching that an individual's professional scepticism develops and is enhanced. In addition, we reinforced the need to improve our documentation, which demonstrates how we planned and performed the audit with professional scepticism. This has been supplemented by introducing a new KPI for the current financial year to ensure that the appropriate behaviours are further embedded.

Supervision and review

The engagement leader and audit manager supervise the audit, review the work done, coach the team and oversee audit quality. In addition to reviews by the engagement leader and audit manager, all staff are expected to critically self-review their own work to make sure that it meets the relevant requirements.

We appoint a Quality Review Partner (QRP) to conduct engagement quality control reviews of the audits of listed clients, other public interest entities and clients identified as high risk. The QRP is responsible for reviewing key aspects of the audit, including independence, significant risks and their responses, judgements, uncorrected misstatements, documentation of work done in the areas reviewed, the financial statements, communications with those charged with governance and the appropriateness of the audit report to be issued. QRPs are involved throughout the audit process so that their input is timely. Second partners are required to be appointed to certain types of non-audit work and often fulfil a role similar to that of a QRP on an audit.

At the end of an engagement, teams put together the hard copy paper file and then archive both this and the electronic files. The files are kept in secure systems in accordance with our data management policies.

Monitoring

In addition, we monitor the quality of the audit work through the ECRs and the Quality KPI process.

The ECR involves a 'cold' review of completed audit and non-audit engagements with each engagement leader being reviewed at least once every three years for audit work, or at least once every five years for non-audit work. Depending on the nature of the audit or non-audit work performed, the engagement leader can be reviewed more frequently.

Reviews are conducted by experienced partners supported by directors and managers who are independent from the office and business unit that performs the work, as well as the engagement leader being reviewed. The results are reported to the Assurance Executive and Executive Board of PwC UK. In 2011, 163 audit engagements (2010: 149 audit engagements) and 75 non-audit engagements (2010: 60 non-audit engagements) were reviewed.

Each engagement reviewed is classified as either 'compliant', 'compliant with review issues', or 'non-compliant'. A 'non-compliant' classification means that relevant GAAS and PwC Audit requirements and/or relevant GAAP requirements and/or documentation requirements were not complied with in respect of a material matter. Notwithstanding that an engagement is classified as 'non-compliant', the audit opinions issued were considered to be appropriate.

The results of the 2011 ECR process show that the quality of our audits has marginally deteriorated and that 94.4% of our audits (2010: 96.0%) were classified as compliant or compliant with review issues. The 2011 ECR results show that the quality of our non-audit work also deteriorated this year with 96.0% of our non-audit engagements reviewed (2010: 100%) being classified as compliant or compliant with review issues.

The breadth of non-audit work now undertaken by the Assurance practice is very wide, ranging from consulting and advisory engagements through to non-audit assurance engagements and reports on controls at service organisations. The range also mirrors diversity in the standards and regulations governing such work with little regulation covering some and international standards governing other work. The introduction of new software for non-audit work together with improved guidance, which is continually developing and expanding, will help teams better navigate non-audit work and achieve better quality in the future.

The results of the ECR generate an action plan that charges specific individuals to make sure that actions are implemented. We have increased the focus on making sure these actions are being implemented and this year are focusing more effort on assessing the effectiveness of those actions.

We introduced Quality KPIs for Assurance five years ago. The aim was to create behavioural change on certain aspects of the audit where improvements were needed.

In the year to 30 June 2011, 13 (2010: 14) audit quality KPIs were assessed, covering various aspects of the audit from planning to completion and 8 (2010: 8) non-audit quality KPIs were assessed, covering various aspects of non-audit engagements.

The KPIs are assessed quarterly through the 'hot' review of files by partners and staff who are independent of the engagements under review.

The KPIs are reassessed annually and changed to include areas where the ECR or the regulators indicate improvement is needed. We remove those KPIs where the scores indicate that such focus is no longer needed as the changes we envisaged have now become embedded. The increased focus on certain aspects of the audit is further reinforced by the linkage of KPI results, at the Assurance, Business Unit and individual levels, to remuneration. Over the years, the regulators have commented that they believe the KPI process helps maintain or improve audit quality in specific areas of the audit.

The overall audit quality KPI score for the year ended 30 June 2011 was 94.9% (2010: 94.8%) against a target score for both years of 95%. The overall non-audit quality KPI score for the year ended 30 June 2011 was 94.7% (2010: 92.7%) against a target score for both years of 95%. Although the scores are near the target levels, we are not complacent about the quality of our work and recognise that continued focus is needed. So we have changed the KPIs for the year ending 30 June 2012 to reflect points arising from the Audit Inspection Unit (AIU) public report and the 2011 ECR to drive further improvement in quality.

Externally, the AIU and the Quality Assurance Department (QAD) of the ICAEW carry out inspections every year on our work and on our procedures and processes. In the case of the AIU, a public report is available on their website. In their latest report on the 2010/11 inspection, the AIU graded 1 audit (2009/2010: 1 audit; 2008/2009: 2 audits) as 'significant improvements required'. The table opposite shows the number of audits reviewed in 2010/11 by the AIU by grading of the engagement.

The detailed findings from the AIU and QAD inspections can be found in Section 7. While we strive to have no audits graded as 'significant with improvements', we value the findings raised on all audits reviewed by our regulators as they help us to improve the quality of our audit work – independent opinions are always valuable in keeping us honest in our views on the quality of our audit work.

In any business of our size, there will always be instances of where we fall short of our exacting standards and the number of jobs rated by the AIU as 'significant improvements required' and by the ECR as 'non-compliant' is higher than we would like. But the results of the ECR, KPIs and regulatory reviews provide us with learnings that we can pass on to teams through training, additional or updated guidance and other communications to make sure that they are not repeated.

Another UK regulatory body we deal with is the Accounting and Actuarial Discipline Board (AADB). The AADB deals with cases that raise or appear to raise important issues affecting the public interest in the UK and which need to be investigated to determine whether or not there has been any misconduct by an accountant or accountancy firm, or by an actuary. We have a number of open AADB investigations. In the case of the preparation of reports to the Financial Services Authority regarding JP Morgan Securities Limited, it became apparent that we had fallen short of the standards required of us and we stepped forward and acknowledged that fact.

Where we do fall short we ask to discuss and resolve the issues with the client, or other concerned party. We also review the matter independently for lessons learned and communicate those lessons to the relevant part of our business. The aim is to learn from our mistakes so as to improve the quality of the work we deliver in the future.

The other regulator we work with indirectly is the Financial Reporting Review Panel (FRRP) of the Financial Reporting Council where we help clients to respond to letters received from the FRRP about their financial statements. While the FRRP issue many letters to our clients asking for further information about disclosures in their financial statements, very few become public through an FRRP press notice.

Conclusion

The aim of this section was to tell more of the story and overview of how we are delivering audit quality rather than just giving the details required by regulation. The next section contains our Transparency Report, which meets the various regulations with which we are required to comply. Please read it as it contains a lot of information about our structure, our systems and controls, and what we do and how we do it. We believe that if we are not open and transparent about what we do and how we do it, we cannot ask the same of others.

James Chalmers
Assurance

Review of audit engagements
2011 Audit Inspection Unit report

	2010/11	2009/10	2008/09
Good with limited improvements required	7	7	7
Acceptable but with improvements required	7	10	5
Significant improvements required	1	1	2
Number of audits reviewed	15	18	14

1. Legal structure and ownership

In the United Kingdom, PricewaterhouseCoopers LLP is a limited liability partnership incorporated in England and Wales.

(a) Ownership of PwC UK

PwC UK is wholly owned by its members, who are commonly referred to as partners. During the year, the average monthly number of partners was:

	2011 number	2010 number
UK partners	**815**	820
Partners on secondment overseas	**28**	25
	843	845

(b) UK office structure

PwC UK operates out of 38 offices throughout the United Kingdom – a full list can be found at the back of this report.

(c) Subsidiary undertakings of PwC UK

The principal subsidiary undertakings of PwC UK as at 30 June 2011 are:

All company shareholdings are 100% owned by PwC UK and are incorporated in England and Wales, with the exception of PricewaterhouseCoopers (Middle East Group) Limited, which is incorporated in Guernsey and in which PwC UK owns 100% of the ordinary shares and the local Middle East partners own 'B' shares.

The members of PwC UK do not share in the profits of PricewaterhouseCoopers Legal LLP. The profit and capital attributable to the members of PricewaterhouseCoopers Legal LLP is shown as a non-controlling interest in the consolidated financial statements of PwC UK, as is the profit and capital attributable to the members of PricewaterhouseCoopers CI LLP and the Middle East partners of PricewaterhouseCoopers (Middle East Group) Limited.

(d) Principal lines of business

PwC UK operates through three principal Lines of Service (LoS) in the UK. These are Assurance, Advisory and Tax. Support services are provided by Internal Firm Services.

Subsidiary undertaking	Principal activity
Companies	
PricewaterhouseCoopers Services Limited	Service company and employment of staff
PricewaterhouseCoopers (Resources)	Employment of staff
PricewaterhouseCoopers (Middle East Group) Limited	Professional services
Sustainable Finance Limited	Professional services
PricewaterhouseCoopers Overseas Limited	Professional services
Diamond Advisory Services Limited	Professional services
Limited Liability Partnerships	
PricewaterhouseCoopers CI LLP	Professional services in the Channel Islands
PricewaterhouseCoopers Legal LLP	Legal services

The primary services provided by each of the three principal Lines of Service are as follows:

Assurance

Assurance and regulatory reporting – statutory audit, financial accounting, compliance with new and existing regulations and remediation, risk and regulatory monitoring, International Financial Reporting Standards (IFRS) conversion and assurance on capital market transactions, reporting and assurance on non-financial information and waste and resource use management.

Risk assurance – including IT risk assurance, business resilience, commercial assurance, performance assurance, treasury services and internal audit.

Actuarial – mergers and acquisitions, capital structuring, financial modelling, predictive modelling, insolvencies and run-off solutions, regulatory, risk and capital management, underwriting and catastrophe modelling, claims, reinsurance, insurance reserving and reporting, pensions and other benefit plans, performance benchmarking and insurance needs for the public sector.

Advisory

Consulting – finance, strategy, delivering deal value, operations, people, technology, governance risk and compliance, enterprise performance management (process transformation, systems implementation and application management), project and programme management.

Business recovery services – financial and operational restructuring, working capital management, corporate and personal insolvency, independent business reviews, chief restructuring officers, interim leadership (PwC Turnaround Panel), optimised exits, accelerated M&A, corporate liability management, pension scheme credit advisory, distressed property advisory and corporate simplification.

Forensic services – disputes including asset tracing, commercial, competition, intellectual property and shareholder disputes, construction and insurance claims; investigations including anti-money laundering, fraud and corruption, anti-trust, royalty examinations and warranty compliance; and forensic advisory including contract and project risk, fraud prevention, project delay analysis, litigation readiness and revenue leakage.

Transaction services – buy - and sell-side financial and operational due diligence, commercial and market due diligence, structuring, sale and purchase agreements, business modelling, valuations, bid support and defence.

Corporate finance – mergers and acquisitions advisory, private equity advisory, project finance and public private partnerships, debt advisory, public to private transactions and public company advisory.

Sustainability and climate change – impact reviews, strategic and performance planning, corporate governance and business ethics, policy development and roll-out, risk management, carbon markets planning and transactions, environmental tax and regulation, environmental health and safety management, ethical supply chain management, reporting and assurance of non-financial information and waste and resource use management.

Tax

Tax – corporate tax advisory, tax on transactions, transfer pricing, corporate and international tax structuring, finance and treasury, indirect taxes, property taxes, tax management and accounting services, dispute resolution, corporate tax compliance and outsourcing, private business tax advisory, personal tax advisory and compliance, tax valuations, sustainability and climate change taxes, research and development tax relief.

Human resource services – reward and compensation, employment services, pensions and retirement, international assignment solutions, HR management, including HR transaction advice, human capital metrics and benchmarking, HR function effectiveness and service delivery.

2. The PricewaterhouseCoopers network

'PricewaterhouseCoopers', 'PwC Network' and 'PwC' refer to the network of member firms of PricewaterhouseCoopers International Limited (PwC International), each of which is a separate legal entity.

Introduction

In our view, the key factors that differentiate PwC among the world's leading professional services organisations are the breadth of the PwC network and the standards with which PwC member firms agree to comply. These standards cover important areas such as independence and risk management, people management, brand and communications.

(a) Legal structure of the network

In most parts of the world, the right to practise audit and accountancy is granted only to national firms that are majority owned by locally qualified professionals. PwC is a global network of separate member firms, owned and operating locally in countries around the world. PwC member firms are members of PwC International and have the right to use the PricewaterhouseCoopers name.

The network provides the foundation for member firms to share knowledge, skills and resources, enabling PwC member firms to work together to provide high-quality services on a global scale to international and local clients while operating as local businesses.

PwC International is a private company limited by guarantee incorporated in England and Wales in which PwC firms are members. PwC UK is a member firm of PwC International. PwC International does not practise accountancy, provide services to clients, or do business with third parties. Instead, its purpose is to act as a coordinating entity for PwC member firms in the PwC network. PwC International works to develop and implement policies and initiatives that create a common and coordinated approach for PwC member firms where it's appropriate. PwC International focuses on areas like strategy, brand, and risk and quality.

Each member firm of PwC International is a separate legal entity and does not act as an agent of PwC International, or any other member firm. PwC International is not responsible or liable for the acts or omissions of any of its member firms, nor can it control the exercise of their professional judgement or bind them in any way. No member firm is responsible, or liable for the acts or omissions of any other member firm, nor can it control the exercise of another member firm's professional judgement, or bind another member firm, or PwC International in any way.

(b) Size of the network

Member firms of PwC International provide industry-focused assurance, tax and advisory services to enhance value for their clients. Close to 169,000 people in 158 countries in firms across the PwC network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

For the year ended 30 June 2010, PwC International member firms generated aggregate revenues of US$26.6 billion worldwide (2009: US$ 26.2 billion).

The 2011 Global Annual Review, which can be viewed at www.pwc.com/annualreview, contains further financial and other information about the PwC Network.

Global
158
countries
771
locations

Our global network

UK

38

offices

PwC people

168,710

(c) Governance structures of PwC International

The governance structures of PwC International are as follows:

- **Global Board (the 'Board')** – The Board consists of 18 elected members and is responsible for the governance of PwC International and oversight of the Network Leadership Team and approval of network standards. The Board does not have an external role. Board members are elected by partners from all member firms every four years. The current board took up office in April 2009. Board members may serve for a maximum of two terms of four years. The Board meets four times a year.
- **Network Leadership Team (NLT)** The NLT sets the overall strategy for the PwC Network and the standards to which all member firms agree to comply. The NLT is made up of the Senior Partners of the US, the UK and China member firms of PwC International, together with the chairman of the PwC Network and a fifth member appointed by the Board. The chairman of the PwC Network and the fifth member may serve on the NLT for a maximum of two terms of four years in their respective capacities. The NLT typically meets monthly and on further occasions as required.
- **Strategy Council** – The Strategy Council is made up of the members of the NLT and Senior Partners of some of the largest member firms of PwC International, who are, subject to approval by the Board, selected by the NLT. The Strategy Council, which meets between two and four times each year, agrees changes in the strategic direction of the network and facilitates alignment in the execution of strategy.
- **Network Executive Team (NET)** – This team, which reports to, supports and is appointed by, the NLT, coordinates key lines of service and functional areas such as Risk and Quality, Human Capital, Operations, and Brand and Communications across the PwC network. The NLT meets with the NET three to four times a year.

The names of the current members of each of the above bodies can be found at www.pwc.com/corporate-governance.

(d) Key features of the network

The PwC Network has a set of standards and policies with which all PwC member firms agree to comply. These network standards cover key areas such as independence, risk management, people management, and brand and communications.

In order to use the 'PricewaterhouseCoopers' name, PwC member firms agree to follow network standards and be subject to periodic reviews. PwC member firms' compliance with the network standards is monitored annually.

Membership in the PwC network depends on a member firm's implementation of common standards. Every member firm is responsible for its own risk and quality performance and, where necessary, for driving improvements. To support transparency and consistency, each member firm's Territory Senior Partner signs an annual confirmation of compliance with certain network risk management standards. As stated above, these cover a range of areas, including independence, ethics and business conduct, Assurance, Advisory and Tax risk management, governance, anti-bribery and data protection and privacy.

The NLT sets the overall strategy for the PwC network and the standards and policies with which all member firms agree to comply.

There are some common processes to help member firms apply the standards. The major elements include:

- the way we do business
- sustainable culture
- quality policies and processes
- quality reviews.

(i) The way we do business

PwC member firms undertake their businesses within the framework of applicable professional standards, laws, regulations and internal policies. These are supplemented by a Code of Ethics and Business Conduct for their partners and staff. The PwC UK Code of Conduct (the 'Code') is set out at www.pwc.co.uk/eng/aboutus/code-of-conduct.html.

PwC people have an obligation to know, understand and comply with the guidelines contained in the Code, as well as the values – Excellence, Teamwork and Leadership – on which the guidelines are based.

(ii) Sustainable culture

To promote continuing business success, member firms of PwC International nurture a culture that supports and encourages PwC people to make appropriate and ethical decisions, especially when they have to make tough decisions. PwC people have ready access to a wide array of support networks within their respective member firms, both formal and informal, and technical specialists to help them reach appropriate solutions. There is also a culture of objectivity, professional scepticism and cooperation between member firms, and consultation supports this culture.

(iii) Quality policies and processes

Each member firm has policies that are based on network standards. Member firms also have access to common methodologies and supporting materials for many services. These methodologies and materials are designed to assist member firm partners and staff to perform their work more consistently, and to support their compliance with the way we do business. Each client engagement leader is responsible to assigning partners and staff to a particular engagement and building the appropriate combination of professional competence and experience.

(iv) Quality reviews

Each member firm is responsible for monitoring the effectiveness of its own quality control systems. This includes performing a self-assessment of its systems and procedures, and carrying out, or arranging to be carried out on its behalf, independent reviews at the individual engagement level. In addition, PwC International monitors member firms' compliance with network and professional standards. This includes monitoring whether each member firm conducts objective quality control reviews and engagement reviews consistent with regulation and established processes. Within Assurance, this is known as the Quality Management Review. This is explained further in Section 5. PwC International also monitors whether a member firm has appropriately identified significant risks and is responding appropriately to those risks.

The overriding objective of the quality review programme is to assess for each member firm that:

- quality management systems are effective and comply with network standards
- engagements selected for review were performed in accordance with professional standards and PwC Audit requirements
- significant risks are identified and managed appropriately.

For Assurance work, the relevant standard on which the quality reviews are based is International Standards on Quality Control 1: 'Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Related Services Engagements'. Full details of PwC UK's internal quality control systems are set out in Section 5.

If a member firm does not comply with its network obligations, the Network Leadership Team (and in certain instances the Global Board) will take appropriate action.

(e) Independence practices Policy

Auditors must be objective in all aspects of their work. Independence is a cornerstone of this objectivity and has two elements: independence of mind and independence in appearance. PwC member firms reinforce both these elements through a combination of setting the right tone from the top, independent consultation on judgemental issues, regular training and careful observance of independence requirements.

(f) Network profit-sharing arrangements

PwC UK and its subsidiary undertakings have no profit-sharing arrangements with other member firms of PwC International. Member firms operate their own partner and staff remuneration arrangements, which are independent and separate from other member firms of PwC International. The profit-sharing arrangements of PwC UK are set out in Section 9.

3. Governance structure of PricewaterhouseCoopers LLP

The governance structure of PwC UK for the year ended 30 June 2011 was made up of three main elements: an Executive Board responsible for directing and implementing the policies and strategies of the firm and for its day-to-day management; a Supervisory Board, which oversees the executive management from an internal perspective on behalf of the wider partnership, or members of the firm; and a Public Interest Body whose aim is to enhance confidence in public interest aspects of the firm's decision-making, stakeholder dialogue and management of reputational risks. More about our Public Interest Body can be found on pages 6 and 7.

(a) The Executive Board

The Executive Board is responsible for developing and implementing the policies and strategy of the firm, and for its direction and management.

The Executive Board sets and communicates the firm's strategic priorities, which feed into the firm's business planning process. The contribution of each part of the firm is monitored through balanced scorecard reporting.

The Executive Board is chaired by Ian Powell (the Chairman), whose term of office runs for four years from 1 July 2008 to June 2012. The Chairman is elected by the firm's partners and he appoints the other Executive Board members, all of whom are partners in the firm. Each board member has responsibility and accountability for a specific aspect of our business.

The Executive Board meets at least monthly, and conducts formal business at additional meetings as necessary.

Their lengths of service on the Executive Board and attendance records for the year ended 30 June 2011 are set out in Table 3.1.

With effect from 1 July 2011, the membership of the Executive Board changed. Richard Sexton took on the newly created role of Head of Reputation and Policy with James Chalmers becoming Head of Assurance and Kevin Nicholson Head of Tax. Gaenor Bagley, Stephanie Hyde and Richard Oldfield joined the Executive Board as Head of People, Head of Regions and Head of Markets and Industries, respectively. Barry Marshall and Paul Rawlinson stepped down from the Executive Board on 30 June 2011 to focus on full-time servicing clients in senior client facing roles.

Biographies of each Executive Board member as at 30 June 2011, together with biographies of the new members of the Executive Board, are set out in Appendix 1.

Executive Board members from 1 July 2011


Ian Powell


Richard Collier-Keywood


Keith Tilson


Richard Oldfield


Stephanie Hyde


Gaenor Bagley


Richard Sexton


Owen Jonathan


James Chalmers


Kevin Nicholson


Kevin Ellis

Table 3.1 Executive Board as at 30 June 2011	Length of service(years)	Board meetings	
		A	B
Ian Powell, Chairman and Senior Partner^^	5	11	9
Richard Collier-Keywood, Managing Partner	8	11	9
James Chalmers, Head of Strategy and Talent	3	11	9
Kevin Ellis, Head of Advisory	3	11	8
Owen Jonathan, General Counsel and board member responsible for Risk and Quality	9	11	10
Barry Marshall, Head of Tax	3	11	9
Kevin Nicholson, Head of Regions	3	11	11
Paul Rawlinson, Head of Markets and Industries	3	11	11
Richard Sexton, Head of Assurance^^	5	11	9
Keith Tilson, Chief Financial Officer	13	11	9

A = Maximum number of meetings could have attended.
B = Number of meetings actually attended.
^^ Member of the Public Interest Body

The Executive Board takes overall responsibility for establishing systems of internal control and for reviewing and evaluating their effectiveness. The day-to-day responsibility for implementation of these systems and for ongoing monitoring of risk and the effectiveness of controls rests with senior management.

The systems, which have been in place throughout the financial year and up to the date of approval of this report, include the following:

- The Risk Council, an Executive Board subcommittee, which is responsible for ensuring that the controls are in place to identify, evaluate and manage risk.
- Our Lines of Service and our internal firm services, which document risks and the responses to them, carry out risk assessments annually and report to the Risk Council on how effectively they have managed risk during the year.
- Reports of periodic reviews of performance and quality, which are carried out independently by the PwC network.
- Our internal audit team, which reviews the effectiveness of the financial and operational systems and controls throughout the Group, and reports to the Executive Board and the Audit and Risk Committee.
- Our risk and quality functions, which oversee our professional services risk management systems and report to the Executive Board.

Furthermore, we have procedures to assess the risks associated with new clients, including whether they meet the expected standards of integrity and to make sure that we are able to comply with independence requirements. As part of the annual audit cycle, we conduct risk reviews of audit clients, and decline to act for clients that, in our opinion, fall short of our standards.

Our internal control systems are designed to manage, rather than eliminate, the risk of failure to achieve business objectives or, in the case of financial controls, the risk of material misstatement in our financial statements. Accordingly, they provide only reasonable and not absolute assurance against such failure, or material misstatement.

The Executive Board has reviewed the systems of internal control in operation during the year and is satisfied with their effectiveness.

A more detailed explanation of the firm's systems of internal control and internal quality control is set out in Section 5.

Duncan Skailes

Chairman of the Supervisory Board

(b) The Supervisory Board

The Supervisory Board, which is independent of the Executive Board, is made up of 15 members who are elected by the firm's partners for three-year terms of office. The Supervisory Board elects its own Chairman. Ian Powell, in his capacity as the firm's Chairman, is an *ex officio* member of the Supervisory Board. Additionally, two partners in the firm who have been elected to the Board of PwC International, the global board of the PwC Network, are also *ex officio* members.

The Supervisory Board generally meets monthly but may occasionally hold additional meetings as necessary. The three year term of office of the current elected members of the Supervisory Board began on 1 January 2010.

Table 3.2	Length of service (years)	Board meetings	
		A	B
Duncan Skailes	5	13	12
John Dowty	5	13	10
Colin Brereton	5	4	4
Pauline Campbell	2	13	12
Paul Clarke	2	13	9
Katharine Finn	2	13	9
Roy Hodson	8	13	11
Rob Hunt	2	13	11
Pam Jackson	8	13	10
Mike Karp	5	13	11
Roger Marsh	2	13	11
Pat Newberry	8	13	11
Ian Rankin	5	13	9
Matthew Thorogood	2	13	13
Graham Williams	5	13	12
Ex officio members:			
Gerry Lagerberg	11	13	8
Murray Legg	2	13	12
Ian Powell	3	13	10

A = Maximum number of meetings could have attended.
B = Number of meetings actually attended.

The Supervisory Board is responsible for overseeing the activities of the Executive Board on matters that it considers to be of concern regarding the well-being of the LLP and the partners as a whole. These matters include national, legal, regulatory and fiscal requirements, implementation of global policies and the arrangements for effective communications between partners and the LLP's management. The Supervisory Board holds regular liaison meetings with partners to gauge their views on the strategy and management of the firm.

The Supervisory Board is also responsible for approving the Annual Report and choice of auditor, for recommending the admission of new partners and for approving transactions and arrangements outside the ordinary course of business; the Supervisory Board also has the ability to consult partners on any proposed significant change in the form or direction of the LLP. In addition, the Supervisory Board is responsible for the process leading to the election of the firm's chairman and for checking that the policies on partners' remuneration are being properly and fairly applied.

The members of the Supervisory Board in the year ended 30 June 2011 were:

Elected members:

Duncan Skailes*^^, Chairman
John Dowty†, Deputy Chair
Colin Brereton*
Pauline Campbell†^^
Paul Clarke*
Katherine Finn
Roy Hodson††
Rob Hunt†
Pam Jackson**
Mike Karp†
Roger Marsh
Pat Newberry
Ian Rankin*†
Matthew Thorogood
Graham Williams

Ex officio members:

Gerry Lagerberg*^
Murray Legg^
Ian Powell

* Senior Management Remuneration Committee member
** Senior Management Remuneration Committee Chairman
† Audit and Risk Committee member
†† Audit and Risk Committee Chairman
^ Member of the Board of PricewaterhouseCoopers International Limited
^^ Member of the Public Interest Body

The Supervisory Board members' lengths of service and their attendance at Board meetings for the year ended 30 June 2011 are set out in Table 3.2. Their biographies are set out in Appendix 1.

(i) The Senior Management Remuneration Committee

The Senior Management Remuneration Committee is a committee of the Supervisory Board. It makes recommendations to the Supervisory Board, which sets the chairman's profit share, and approves the chairman's recommendations for the profit shares of the other Executive Board members.

(ii) Representation on the Public Interest Body

Duncan Skailes and Pauline Campbell sit, in their capacity as members of the Supervisory Board, on the Public Interest Body to make sure that there is effective communication between the two bodies.

(iii) The Audit and Risk Committee

The Audit and Risk Committee is a committee of the Supervisory Board which has responsibility for reviewing the policies and processes for identifying, assessing and managing risks within the firm.

The Audit and Risk Committee monitors and reviews:

- the effectiveness of the Group's internal control and risk management systems
- the firm's policies and practices concerning compliance, independence, business conduct and ethics, including whistle-blowing and the risk of fraud
- the scope, results and effectiveness of the firm's internal audit function
- the effectiveness and independence of the firm's statutory auditor, Crowe Clark Whitehill LLP (CCW)
- the reappointment, remuneration and engagement terms with CCW, including the policy in relation to the provision of non-audit services
- the planning, conduct and conclusions of the external audit
- the integrity of the Group's financial statements and the significant reporting judgements contained in them.

The Audit and Risk Committee met 12 times in the year ended 30 June 2011 (2010: seven times) covering the above topics.

The Chief Financial Officer and General Counsel, together with the internal and external auditors, attend the committee's meetings by invitation.

Both the internal and external auditors meet privately with the Audit and Risk Committee without management presence.

A report on the activities of the Audit and Risk Committee can be found in Section 4 of this report.

(c) Terms of reference

Terms of reference exist for the governance bodies of PwC UK, copies of which can be found on the website at www.pwc.co.uk/eng/aboutus/terms-of-Reference-Governance-structure.html.

4. The Audit Firm Governance Code

The Audit Firm Governance Code (the Governance Code) was published by the Institute of Chartered Accountants in England and Wales (ICAEW) in January 2010, following a recommendation made by the Market Participants Group set up by the FRC.

The ICAEW's Audit Firm Governance Working Group recommended that the Governance Code should apply to firms that audit more than 20 listed companies for financial years starting on or after 1 June 2010. The Governance Code is therefore applicable to PwC UK for the first time in respect of the year ended 30 June 2011.

The Governance Code consists of 20 principles and 31 provisions. These principles and provisions are organised into six areas being:

- leadership
- values
- independent non-executives
- operations
- reporting
- dialogue.

Pages 6 and 7 together with sections 3, 5 and 7 of this report include details of how we have applied many of the principles of the Governance Code. An overview of our compliance with the Governance Code is included below.

Leadership

The governance bodies of PwC UK are explained on pages 6, 7 and pages 24 to 27. Section 3 sets out the constitution, membership, duties, responsibilities and performance evaluation process of each of the governance bodies.

The Executive Board has responsibility and clear authority for the running of the firm, including the non-audit businesses, and is accountable to the partners. No individual has unfettered powers of decision. This is achieved through the governance bodies of the firm, each of which has clear terms of reference.

Each body has matters specifically reserved for their decision. The Supervisory Board provides internal oversight of the Executive Board. This is formalised in the Members' Agreement.

Values

The firm's leadership is committed to quality and has dedicated resources to establishing high standards in quality, independence, integrity, objectivity and professional ethics. Quality has been embedded throughout the firm and the detailed policies endorsed by the leadership team, including ethical, human resources and engagement performance.

Our reputation is built on our independence and integrity. We recognise the public interest vested in our audit practice and we take an uncompromising approach to audit quality, based on our core values of excellence, teamwork and leadership. We believe that audit quality begins with the tone set by the leadership of the firm.

PwC UK fully supports the Governance Code and has been working since its publication in early 2010 to prepare for its implementation. Section 5 contains further details with regards to our values and 'who we are', which have also been embodied within the PwC UK Code of Conduct. The PwC UK Code of Conduct is available at www.pwc.co.uk/eng/aboutus/code-of-conduct.html.

Consultation is a key element of quality control. Although the firm has policies setting out the circumstances under which consultation is mandatory, our consultative culture means that our engagement teams often consult with each other on an informal basis as well as with experts and regularly in situations where consultation is not formally required. We consider that this culture of openness and willingness to consult, share and discuss issues, can only be of benefit and enhance the quality of what we do and how we do it.

Independent non-executives

The Public Interest Body (PIB), established in the year ended 30 June 2011, comprises five independent non-executives and two members from each of the firm's Executive Board and Supervisory Board.

The PIB's purpose is to enhance stakeholder confidence in the public interest aspects of the firm's activities, through the involvement of independent non-executives.

Operations

The firm complies with professional standards and applicable legal and regulatory requirements.

Section 5 discusses our internal control and internal quality control systems and explains:

- our policies and procedures for complying with applicable legal and regulatory requirements, and international and national standards on auditing, quality control and ethics, including auditor independence
- policies and procedures for individuals signing group audit reports to comply with applicable standards on auditing dealing with group audits, including reliance on other auditors, whether from the same network or otherwise
- how we manage potential and actual conflicts of interest
- how people can report concerns about the firm's commitment to quality work and professional judgement and values.

Section 5 also sets out more information on the firm's policies and procedures for managing people across the firm in support of our commitment to quality.

Section 7 sets out the main findings from the most recent AIU public report and comments on the process in place to address areas of concern identified by the AIU and other regulators.

Reporting

The governance bodies receive timely and appropriate information to enable them to discharge their duties.

PwC UK prepares annual audited financial statements prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and UK laws and regulations. The 2011 Annual Report can be found at www.pwc.co.uk/annualreport.

The Annual Report includes:

- a statement of the responsibilities of the Executive Board for preparing financial statements
- a statement in respect of going concern
- a management commentary covering principal risks and uncertainties, and how those risks are managed.

This Transparency Report includes the disclosures required to be made by the Audit Firm Governance Code.

PwC UK has had an Audit and Risk Committee for many years. Section 3 sets out its membership and constitution and provides an overview of its responsibilities. The terms of reference are available on the website at www.pwc.co.uk/eng/aboutus/terms-of-Reference-Governance-structure.html.

Talking to stakeholders

The 'Message from Sir Richard Lapthorne', Chairman of the Public Interest Body, on pages 4 and 5, discusses activities in relation to talking with stakeholders.

Report on the activities of the Audit and Risk Committee

The Audit and Risk Committee met 12 times in the year ended 30 June 2011 (2010: seven times), covering the topics outlined in Section 3 of this report.

Internal control

The Audit and Risk Committee's review of internal control includes considering reports from the firm's Risk Council and from the firm's internal and external auditors.

During the year the Audit and Risk Committee considered and approved internal audit's work programme, including its risk assessment, proposed audit approach and coverage, and the allocation of resources. The Audit and Risk Committee reviewed the results of audits undertaken and considered the adequacy of management's response to matters raised, including the implementation of recommendations. The effectiveness of the firm's internal audit function was also assessed.

The Audit and Risk Committee also considered reports from other parts of the firm charged with governance and the maintenance of internal control, including in respect of compliance, independence, business conduct and ethics, including whistle-blowing and the risk of fraud.

The Audit and Risk Committee also reviewed and considered the statements in the Annual Report and in Section 3 of this report in respect of the systems of internal control and concurred with the disclosures made.

External audit effectiveness and reappointment

The Audit and Risk Committee undertakes an annual review of the qualification, expertise, resources and independence of the external auditors and the effectiveness of the external audit process by:

- reviewing Crowe Clark Whitehill LLP's (CCW) plans for the audit of the Group's financial statements, the terms of engagement for the audit and the proposed audit fee
- considering the views of management and the CCW engagement partner on CCW's independence, objectivity, integrity, audit strategy and its relationship with the Group, obtained by way of interview
- taking into account information provided by CCW on their independence and quality control.

The Audit and Risk Committee also took into account their tenure as auditors and considered whether there should be a full tender process. There were no contractual obligations restricting the Audit and Risk Committee's consideration of the choice of external auditors.

Financial reporting

CCW's external audit plan identified a number of potential risks and areas of judgement in the consolidated financial statements, which they judged to be significant. CCW explained to the Audit Risk Committee the programme of work they planned to undertake to address these risks and the other risks they had identified to make sure that they did not lead to a material misstatement of the financial statements.

Where they thought it would be effective to do so, CCW's work plan included the evaluation and testing of the Group's own internal controls and assessment of the work of the firm's internal audit function. They also explained where they planned to obtain direct external evidence.

The Audit and Risk Committee discussed the above matters with CCW on conclusion of their external audit of the financial statements for the year. CCW explained the work they had undertaken and conclusions they had drawn, including in relation to revenue recognition, including amounts that were unbilled at the year end; the carrying value of goodwill and intangibles arising from business combinations; the adequacy and appropriateness of provisions for client claims and property matters; the consistency and appropriateness of assumptions adopted in the valuations of the firm's defined benefit pension schemes for the purposes of financial reporting; management's assessment of the appropriateness of the going concern basis.

Following consideration of the matters presented to it and discussion with both management and CCW, the Audit and Risk Committee is satisfied with the judgements and financial reporting disclosures included within the financial statements.

Use of the external auditors for non-audit services

A policy is in place regarding the use of the firm's external auditors in providing non-audit services.

Statement of compliance with the Audit Firm Governance Code

The Executive Board has reviewed the provisions of the Audit Firm Governance Code together with details of how the firm is complying with those provisions and has concluded that, with the exception of the matter referred to below, as at 30 June 2011, PwC UK is in compliance with the provisions of the Audit Firm Governance Code.

The Governance Code (A.1.4) requires that the firm's governance structures and management team and their members should be subject to formal, rigorous and ongoing performance evaluation.

Although a performance evaluation process and methodology exists for the Executive Board and Supervisory Board, no such evaluation took place in the year ended 30 June 2011 with respect to the Public Interest Body (PIB) because the PIB had been established for less than a year. A performance evaluation of the PIB will take place when the PIB has had sufficient time to establish itself.

5. Internal control and internal quality control systems

Quality comes from more than adherence to standards and regulation, important though both are. Ultimately, it depends on our ability as a firm to recruit, train and motivate intelligent professionals who take personal responsibility to deliver high-quality work and that the firm provides the support and infrastructure necessary for them to operate effectively in the business environment. Quality not only delivers regulatory compliance, but it also enhances the experience for all of our clients and staff.

Introduction

PwC UK's quality control system is based on International Standard on Quality Control (UK and Ireland) 1 'Quality control for firms that perform audits and reviews of historical financial information and other assurance and related services engagements' (ISQC (UK&I) 1), issued by the Auditing Practices Board (APB).

ISQC (UK&I) 1 applies to firms that perform audits of financial statements, report in connection with investment circulars and provide other assurance services where they relate to activities that are reported in the public domain and are therefore in the public interest.

The objective of ISQC (UK&I) 1 is for the firm to establish and maintain a system of quality control to provide it with reasonable assurance that:

- the firm and its personnel comply with professional standards and applicable legal and regulatory requirements
- reports issued by the firm, or by engagement leaders are appropriate in the circumstances.

In addition, compliance with International Standards on Auditing (UK and Ireland) issued by the APB requires PwC UK to have a quality control system for the audits of financial statements.

The policies and procedures that form our internal quality control system have been documented, and there is a monitoring regime to enable the Executive Board to review the extent to which the policies and procedures are operating effectively.

The policies and procedures are embedded as part of the firm's day-to-day activities.

Although this Transparency Report is focused on our audit practice, many of our systems, policies and procedures operate firmwide across all parts of our business. Additionally, we have included those policies, procedures and practices that exist solely in respect of our audit practice.

Explanation of our system of internal control, including internal quality control system

Our internal control system is based on the six elements of quality control set out in ISQC (UK&I) 1, which are:

1. Leadership responsibilities for quality within the firm.
2. Relevant ethical requirements.
3. Acceptance and continuance of client relationships and specific engagements.
4. Human resources.
5. Engagement performance.
6. Monitoring.

In parts 1 to 6 below we set out how our internal control system and internal quality control system incorporate each of the above elements. Part 7 deals with factors outside of the control of auditors, effecting audit quality, and part 8 explains our belief of an additional key driver of audit quality in addition to those drivers identified by the Audit Quality Framework issued by the FRC in February 2008. Parts 9 and 10 explain the review of the firm's internal control system and our statement on the effectiveness of the firm's internal quality control system.

The firm's internal quality control system has been documented. The documentation is reviewed by the firm's regulators in addition to reviews conducted as part of the evaluation of PwC UK's compliance with the Network Risk Management Standards. Updates and changes to the firm's internal quality control system, as well as points needing reinforcement, are communicated to partners and staff via mandatory training and other technical communications. The information is also available at any time to partners and staff via PwCInform, our web-based technical repository.

1. Leadership responsibilities for quality within the firm

(a) Organisational structure

The Executive Board, under Ian Powell's chairmanship, is responsible for the firm's internal control system and internal quality control system.

Day-to-day responsibility for implementing these systems and for monitoring risk and the effectiveness of control is delegated to Compliance, Internal Firm Services and the Lines of Service, where appropriate.

The firm's leadership is committed to quality work and has established a culture of upholding the values of integrity, independence, professional ethics and professional competence.

Dedicated resources to establishing high standards in quality, independence and professional ethics are in place. Quality has been embedded throughout the firm and the detailed policies endorsed by the leadership team, including ethical, human resources and engagement performance, are discussed below.

Owen Jonathan is the member of the Executive Board responsible for risk management and quality control. In addition, each Line of Service has a partner responsible for risk management and quality control relative to the firm's client services.

Within Assurance, Deian Tecwyn, the Assurance Risk & Quality leader, is responsible to the Assurance Executive for risk and quality matters and is a member of the firm's Risk Council, which is chaired by Owen Jonathan. The Assurance Risk & Quality leader also chairs the following subcommittees of the Assurance Executive:

- the Risk Management Steering Group, whose purpose is to agree significant risk management policies and discuss current risk management issues
- the Audit Steering Committee, whose purpose is to discuss and agree audit methodology issues and policy, and provide input into the development of PwC Audit, the audit methodology and tools used by all member firms of the PwC Network
- the Accounting Steering Group, whose purpose is to discuss and respond to accounting developments and issues
- the Learning & Education Committee, whose purpose is to approve the form and content of technical training.

Additionally, our US Steering Group deals with audit methodology and accounting issues specific to audits conducted by PwC UK under auditing standards generally accepted in the US.

(b) Culture and tone at the top

We believe that audit quality begins with the tone set by the leadership of the firm. We have developed an overview of the culture and behaviours we expect in our firm, which we describe as 'who we are'. We will achieve our vision of building the iconic professional services firm by living and breathing a common set of behaviours – this comprises the following components:

(i) One firm

We are one firm, an extensively networked organisation that aims to bring the best of PwC UK to our clients, each and every time. We combine rigour with fun and relish the most complex challenges. We create a flow of people and ideas. We will:

- aim to deliver more value than our client expects
- be agile and flexible
- share knowledge and bring fresh insights
- act always in the interest of the whole firm.

(ii) Powerhouse

Our clients and people feel and benefit from the energy and power of the firm. We have talented, enterprising and intellectually curious people who will strive with our clients to achieve success. It is this purpose that enables us to attract, develop and excite the best people and inspire confidence in our clients. We will:

- be positive and energise others
- invest in personal relationships
- listen with interest and curiosity, encouraging diverse views
- have a thirst for learning and developing others.

(iii) Doing the right thing

We will deliver exceptional value with integrity, confidence and humility. We support one another and our communities. We have the courage to express our views, even when they may not be popular. We will:

- put ourselves in our clients' shoes
- never be satisfied with second best
- treat people in a way we would like to be treated

- always be brave enough to challenge the unacceptable
- act with integrity and enhance our reputation.

We must all accept personal responsibility to play our part in driving our firm and demonstrating these values and behaviours – opting out is not acceptable. Put simply, this is how we define success.

2. Relevant ethical requirements

We take compliance with ethical requirements seriously and seek to embrace the spirit and not just the letter of those requirements.

Bill Morgan is PwC UK's Ethics partner, a role defined by the Ethical Standards issued by the Auditing Practices Board. He is a senior partner within the firm, supported by a team of specialists to help the firm apply robust and consistent independence policies, procedures and tools. He reports directly to Owen Jonathan.

In addition, Tony Stewart-Jones, a partner within the firm, is PwC UK's chief compliance officer who, supported by a team of specialists, oversees the firm's adherence to ethical requirements. He also reports to Owen Jonathan.

All partners and staff undertake regular mandatory training and assessments so that they understand the ethical requirements under which we operate.

(a) Integrity and objectivity

The reputation and success of the firm depends on the professionalism and integrity of each and every partner and member of staff. Partners and staff uphold and comply with the standards developed by the PwC Network and PwC UK. The firm monitors compliance with these obligations.

On joining the firm, all staff and partners are provided with a copy of the PwC UK Code of Conduct (the Code) and must confirm annually that they are familiar with it. The Code, which can be found at www.pwc.co.uk/eng/aboutus/code-of-conduct.html, sets out what we stand for and is underpinned by the following overarching principles:

- acting professionally
- doing business with integrity
- upholding our and our clients' reputations
- treating people and the environment with respect
- acting in a socially responsible manner
- working together and thinking about the way we work
- considering the ethical dimensions of our actions.

(b) Independence

The firm has policies, procedures and practices relating to independence and these are explained in more detail in Section 6.

(c) Whistle-blowing

The firm has a whistle-blowing helpline, which is available to any partner or member of staff who observes bad business conduct or unethical behaviour that cannot be resolved locally, or for which the normal consultation processes are not appropriate. In addition, third parties may also call the whistle-blowing helpline.

The whistle-blowing helpline number for partners, staff and third parties is 0800 169 3590.

The PwC UK Code of Conduct encourages partners and staff to report and express concerns in good faith, fairly, honestly and respectfully, and we are committed to dealing responsibly, openly and professionally with any genuine concerns raised about possible malpractice. If a genuine concern is raised, the individual raising the concern will be protected from losing their job, or suffering from any form of victimisation as a result. Provided that the individual acts in good faith, it does not matter if they are mistaken.

(d) Confidentiality and security

Confidentiality is a vital element of the firm's services. Misuse or loss of confidential client information or personal data may expose the firm to legal proceedings, and it may also impact our reputation.

The firm's chief financial officer, Keith Tilson, is the Executive Board member responsible for information security. In this role he is supported by the Security, Confidentiality & Privacy Governance Group that is responsible for providing oversight, policy and strategic direction for information security. Membership of the Security Confidentiality & Privacy Governance Group includes the firm's general counsel, Owen Jonathan, and comprises representatives from Risk & Quality, Information Technology and the Lines of Service.

As part of PwC UK's membership of the ICAEW, all partners and staff are required to comply with the ICAEW's fundamental principle of confidentiality. There are also other legal and regulatory obligations on partners and staff regarding handling of confidential information and personal data, and contractual terms govern the use and disclosure of information. The firm provides confidentiality and data protection training upon recruitment, together with update training for all partners and staff in respect of their information security obligations.

PwC UK operates an Information Security Management System which is certified as compliant with the requirements of ISO/IEC 27001:2005 for all client data that comes under its control or ownership.

PwC UK's information security policies and procedures aim to make sure that:

- information is protected from internal and external threats
- confidentiality, availability and integrity of information is maintained
- statutory, regulatory and contractual obligations are met
- access to information is granted only for justified business needs.

Our policies and procedures include:

- encryption of all laptops, PCs and memory sticks
- software restricting the use of removable media to approved and encrypted devices only
- access to engagement files – both electronic and hard copy paper files – which is controlled by those with a 'need to know'
- regular backup of data on individual laptops and PCs
- clear-desk policy, both in our offices and at client sites
- hard copy files not in use are secured
- remote access to our network is via a secure virtual private network, or equivalent technology
- policies in place on the transmission of data by email outside of the organisation
- access to operational areas of PwC UK and our buildings is restricted.

The firm's policies and standards are supported by ongoing compliance monitoring. Monitoring is carried out by PwC UK's Internal Audit and Compliance teams and is supplemented by checks by the PwC Network's global security organisation. The ISO/IEC 27001:2005 certification, achieved by PwC UK in June 2011, is subject to an annual external audit.

The firm has incident reporting and response procedures that seek to minimise the impact of any data loss. These procedures include notifying clients when it is known that their data is at risk and, where appropriate and feasible, taking corrective actions.

(e) Anti-bribery

We are opposed to bribery in any form. Our Code of Conduct makes it clear that it is unacceptable for our people to solicit, accept, offer, promise, or pay bribes.

Policies, training and procedures in respect of anti-bribery have been in place for some time. In preparation for the implementation of the Bribery Act 2010, we reassessed our policies and procedures and have taken appropriate actions to make sure bribery risk is adequately addressed.

3. Acceptance and continuance of client relationships and specific engagements

We have rigorous client and engagement acceptance and continuance procedures to help protect the firm and its reputation.

(a) Acceptance and continuance systems

Within Assurance, we now use two applications:

- Acceptance and Continuance (A&C) – A&C is used for all audits and, as of 30 June 2011, by some engagement teams for non-audit work.
- One-Firm Questionnaire (1FQ) – during the year ended 30 June 2011, we commenced the roll-out of the 1FQ across Advisory as well as the Risk Assurance and Government and Public Sector practices within Assurance. This roll-out in Assurance will complete in late 2011. The aim of the 1FQ is to simplify the acceptance process for all non-audit work across PwC UK into one standard process.

Both applications:

- enable engagement teams, business unit management and risk management specialists to determine whether the risks related to an existing or potential client are manageable, and whether or not PwC UK should be associated with a particular client and its management
- contain triggers that require consultation within business units and/or with the UK National Assurance Risk Management partner. This allows the right people to make the right decisions and also enables the firm to put in place safeguards to mitigate identified risks.

The applications also allow portfolios to be managed at an engagement leader, office and business unit level. In addition, the applications facilitate risks being properly assessed and policies being followed.

(b) Withdrawal from an engagement

Policies and procedures are in place for circumstances in which we determine that we should, or are required to, withdraw from an engagement. These policies include the need for appropriate consultations both within the firm and with those charged with governance (i.e. audit committees, clients' boards of directors, owner/managers and partners), ensuring compliance with legal and professional obligations.

The policies and procedures also deal with circumstances where we become aware of information after accepting the engagement which, had we been aware of that information earlier, would have led us to declining the engagement.

(c) Conflicts of interest

Before accepting an engagement, we perform checks to identify relevant relationships. These checks are performed by a dedicated relationship checking team within Compliance. The team works with risk management functions and the Ethics partner to put procedures in place to protect confidential information between teams, and to make sure that potential conflicts of interest are appropriately managed, including the use of restricted access rooms to work in.

New people joined up this year

2,482

1,091 were graduates

59 were school leavers

4. Human resources

Perhaps the most critical components of quality are the skills and personal qualities of our people. As a professional services firm, many of these skills and qualities are relevant to all our Lines of Service. As a consequence, our high-level strategy for recruitment, engagement, development, diversity and remuneration is consistent across the firm.

(a) Recruitment

PwC UK aims to recruit, train, develop and retain the best and the brightest staff, who share in the firm's strong sense of responsibility for delivering high-quality services. Across the firm, we took on over 2,400 new people, including nearly 1,100 graduates in the year ended 30 June 2011.

We have always believed that the best audits are performed by bright and intelligent people. Accordingly, we maintain a strategy of accepting graduates into our audit business and set a high academic threshold.

In addition to recruiting graduates, we invested heavily in a new intern programme. Over 290 student interns secured a place with us over summer 2011. They took part in a range of opportunities in Tax, Assurance and Advisory, including shadowing senior leaders over a six-week paid programme across 22 locations in the UK.

We launched our new Headstart programme during the year, which gave 59 school leavers the chance to join the firm after their A Levels to study for a professional accounting or tax qualification.

All recruits are required to submit an application form and are subject to two interviews – certain information such as qualifications is verified. Student recruits pass through an internal assessment centre before joining the firm.

(b) Performance evaluation

We continue to invest in equipping our partners and staff with the coaching and management skills needed to give honest feedback to continually improve performance. We expect feedback to be provided regularly by all staff and partners. This feedback then feeds into our annual appraisal process. Each member of staff assesses their own performance against their agreed objectives and against the Global Core Competencies we have defined for a person of that grade.

Technical competence and quality are components of the review and consideration is given not only to what an individual has achieved, but also how they achieved it. Based on this, individuals are assigned a performance rating that is benchmarked across the firm and which influences their salary and bonus as well as their progression.

(c) Capabilities and technical competence

Capabilities and technical competence are developed through work experience, coaching and training, and are regularly reviewed.

As part of our appraisal process, partners and staff assess their ongoing personal development needs and identify any necessary development activities, including in relation to quality. Unsatisfactory work results in reduced performance-related remuneration.

(i) Learning and education: Training and development is an ongoing process which starts when a person joins the firm and continues throughout his or her career. Our people participate in a variety of formal training courses and e-learning, and they are also trained through on-the-job coaching and supervision.

The overall aim of the training programmes is to provide training specific to the needs of the individual, based on their experience, grade and role, and which:

- make sure that they have the professional skills and knowledge to deliver a high-quality service
- supports the strategy of the firm.

On joining the firm, all partners and staff are required to complete induction training, which focuses on skills training, professional development, compliance, independence and ethical rules, as well as our culture and values. A tailored pathway has been created for all joiners to the firm, whether they are school leavers, graduates, or experienced hires, and is based on the individual's experience and grade.

For existing staff and partners, there are a number of mandatory and optional training courses on auditing, accounting, risk management and ethical issues. In addition, niche training is developed as required.

In the year ended 30 June 2011, our training programme in Assurance has included:

- Summer School and quarterly Quality-in-Practice webcasts for all professional audit staff from year five through to, and including, partners. This is being replaced in the current year with the multi-component 'Time to Learn' programme where the training is delivered throughout the year on a just-in-time basis. The combination of remote access and classroom training integrates knowledge transfer and practical application. Both programmes include training on areas of change or required reinforcement in relation to regulatory findings, risk management, audit methodology and accounting

- core training for students in years 1 to 4 equipping them with the skills and knowledge to undertake the work assigned to them and develop their professional competencies
- milestone training events supporting the transition of those stepping up in role or grade, for example the New Manager Experience.

We also have a national non-mandatory training programme and run additional training sessions within offices, as and when required. Additionally, our industry groups operate specialist training programmes relevant to their sectors.

Completion of mandatory training is monitored. Failure to complete mandatory training by set deadlines results in disciplinary procedures being taken against the individual, which can ultimately lead to dismissal from the firm. The curriculum content and delivery are reviewed for compliance with PwC Network training policies and the effectiveness is assessed through a number of feedback mechanisms. We seek to deliver training that is consistent and high quality through the use of appropriately senior and experienced tutors across our programmes, with the use of a high-quality tutor pool, who deliver multiple events and are recognised as being effective tutors.

The firm maintains online reference databases and materials that cover all aspects of policy, procedure and methodology, as well as a complete library of UK and international accounting, auditing and ethical standards. To support and keep theoretical knowledge up to date, partners and staff receive regular communications on technical and regulatory topics as they arise. The Assurance Risk & Quality group provides support to partners and staff on auditing, accounting and regulatory requirements through a fortnightly technical update email.

Compliance with continuing professional development requirements and the completion of mandatory training programmes make sure that our services are delivered by individuals who have the right experience for the job. This includes legislative and other qualifications, and accreditation policies for certain types of work, such as pensions and charities audits, capital market transactions and due diligence work.

(ii) Work experience and coaching: Each engagement leader is responsible for staffing engagements with partners and staff who have the professional competence and experience required in the circumstances. Each engagement leader is ultimately responsible for determining the extent of direction, supervision and review of the work of more junior staff to whom work is delegated. This process is consultative and forms part of a culture that embraces coaching in all we do and at all levels within the firm.

(d) Career development

We seek to provide an optimal mix of on-the-job experience, coaching and training programmes, and expect this mix to be in the proportions of 70:20:10 (i.e. 70% as on-the-job experience). This is supported by additional development opportunities, such as international assignments, community partnerships and voluntary programmes.

Each member of staff has a People Manager assigned to them, who is responsible for their performance management, coaching and well-being. The People Managers work with individuals to understand their strengths and development areas, and assess what opportunities are available to help them to acquire necessary skills.

(e) Promotion

Any promotion in the firm is based on an individual's performance, their skills and the business case. In the case of promotion to director or admission to partnership, the process is particularly thorough and involves the Line of Service leadership teams. All potential admissions to partnership are considered by the Partner Admissions Committee, a subcommittee of the Supervisory Board, and are put to the full partnership for consideration.

Within Assurance, the process for promotion to director and admission to partnership involves a formal assessment of the quality of the individual's work and their adherence to ethical requirements and professional standards. We take this process seriously and will not promote an individual to director or admit an individual to the partnership if we have concerns about the quality of their work.

(f) Remuneration

In determining remuneration for our staff, we carefully balance several complex elements: including the economic climate; recognition of people's hard work including the quality of the work they deliver; the performance of the Line of Service and the firm, and investment for the future. PwC UK has a 'one firm' approach to bonuses and performance ratings to provide clarity and consistency across all Lines of Service.

(g) Assignment of engagement teams

Partners and staff are assigned to engagement teams based on the individuals' experience, competencies and grade.

In addition, for certain types of work we specify levels of experience and/or specific additional training to make sure that the individuals are competent to undertake that type of work. In some areas, formal accreditation is needed, for example only accredited individuals can lead and/or undertake certain types of work such as pensions and charities audits, capital market transactions and due diligence work.

5. Engagement performance

The quality, effectiveness and efficiency of our audit service is critical to maintaining our registration with the ICAEW. We therefore invest heavily in the effectiveness of our audits, in the skills of our people (as noted above) and in our underlying audit methodology, as well as in making the right amount of time and resources available. We pay close attention to what our audit clients require from us, what they tell us we need to improve and to the findings of our regulatory inspections on the quality of our work. The findings from the most recent regulatory findings can be found in Section 7. Just as important are the internal indicators and processes that routinely monitor the effectiveness of our risk and quality processes.

(a) Methodology and tools

Member firms of PwC International use a common audit methodology and process (PwC Audit), supplemented by local regulatory requirements, for their audit engagements. This common methodology allows us to respond quickly to the changing environment in which member firms, and their clients, operate. The PwC UK audit approach adheres to International Standards on Auditing and laws and regulations in the UK, and we continuously seek to improve the model.

PwC Audit includes specific policies and procedures with regards to the audits of groups, including multi-locational and cross-border groups. Those policies and procedures include the use of, and reliance on, other auditors, whether they are part of the PwC Network or not, and the signing of group audit reports. PwC Audit is compliant with ISA (UK&I) 600, which sets out the requirements for the conduct of group audits with many of those requirements having been adopted by PwC two years in advance of their implementation date.

The roll-out of our latest electronic tool, Aura, which commenced in 2008, was completed in the UK in late 2010 and is expected to complete across the PwC Network in 2012. Aura supports teams in applying our methodology more effectively by creating greater transparency of the linkage between risks and the work done to address those risks, as well as providing enhanced project management capabilities. The effect is that the quality of our audits improves as teams are able to focus their efforts on areas of risk.

We have continued to roll out our non-audit engagement tool, MAP, to our Assurance practice through 2010 and 2011. MAP has been used for some years in our Advisory practice and brings the benefits of enhancing compliance with our policies and the quality of our documentation across the wide range of non-audit services now offered within the Assurance practice. The roll-out of MAP in Assurance will complete in the latter half of 2011.

(b) Comprehensive policies and procedures

The firm has policies and procedures governing UK accounting and auditing practice. These are regularly updated to reflect new professional developments, changes in our operating environment and emerging external issues, as well as the needs and concerns of the practice. These policies cover both professional and regulatory standards and also reflect the guidance that PwC UK provides to its professionals on how best to implement them. They are available in electronic files and databases, and are accessible to our people remotely at any time.

(c) Assurance delivery centres

We appreciate and share our clients' concerns around continuous improvement, audit quality and cost containment. Therefore, we have made investments focused on further enhancing audit quality through standardisation, optimisation and increased flexibility.

A key element of this investment is a sourcing model that is designed to reallocate certain administrative and common audit procedures to overseas delivery centres. Allocating certain tasks, which do not require auditor judgement, to a centralised location achieves the following benefits:

- enhanced quality through standardisation
- improved efficiency and speed through scale
- improved flexibility in delivery
- controlled cost of audit delivery.

The use of delivery centres allows professional staff in the UK to focus on applying their judgement and professional scepticism in the audit process as well as spending more face-to-face time with the client.

The majority of the work performed to date by our delivery centres in Kolkata, India and Katowice, Poland, has been in the casting, cross-referencing and internal consistency checking of financial statements.

Other activities currently being performed by the delivery centres include managing confirmation processes, coordination of group deliverables, audit file set-up, roll-forward and maintenance, and setting up templates ready for audit teams to use.

In addition, we have started to use the delivery centres to assist audit teams with certain aspects of manual controls and substantive testing. This is restricted to selecting items for testing, based on the clear instructions of the audit team, which the delivery centre documents in a template ready for the audit team to perform the test at the client's site.

To maintain confidentiality and security of information, we have implemented strict data security controls, and work is performed solely by PwC employees.

In the areas where the delivery centres have been involved to date, we consider the quality of the work has improved.

(d) Consultation and support

Consultation is a key element of quality control. The firm has policies setting out the circumstances under which consultation is mandatory. The firm's technical experts track new developments in relevant areas and provide updates to the appropriate professional staff.

Our consultative culture means that our engagement teams regularly consult with each other on an informal basis as well as experts and others often in situations where consultation is not formally required.

Within Assurance, a tool, IGLO, has been specifically designed to aid the enquiry and consultation process and, in respect of consultations, it provides an agreed documentation of consultations with the Assurance Risk and Quality group (ARQ), in accordance with professional standards. During the year ended 30 June 2011, a total of 376 consultations were submitted on IGLO and 5,647 enquiries covering audit, accounting and risk management queries. In addition, during the year ended 30 June 2011, 44 (2010:59) technical panels took place on audit clients of which 28 (2010: 41) included going concern issues.

ARQ supports audit and non-audit engagement teams within Assurance to help them function in line with professional standards, and regulatory and legal requirements. ARQ's remit is to establish the technical risk and quality framework in which the Assurance practice operates and to provide advice and support to client teams, and clients in some instances, when the need arises.

- **Audit methodology** – the PwC Network completed a major programme to enhance its audit methodology, audit tools and audit documentation during 2010, which also involved a complete update of templates and documentation for the adoption of the new clarity International Standards on Auditing (UK and Ireland) for periods ending on or after 15 December 2010 (clarity ISAs).
- **Risk management** – market conditions have resulted in a significant increase over recent years in the number of client-related issues that have required risk management input. This has resulted in a large increase in the guidance given to the practice through notes, webcasts and briefings.
- **Accounting consulting services** – the level of technical support given to the practice over the past year has been significant. The group continues to be busy with engagement teams and clients on financial reporting requirements through technical update seminars and through work to improve the electronic delivery of IFRS and UK GAAP knowledge and materials.
- **Technical learning and education** – the team maintains and develops an ongoing curriculum of online and classroom solutions that build core skills in audit, accounting and risk management. Areas of focus include anticipating changes in external requirements and equipping engagement teams to respond; recognising remediation needs and providing pragmatic solutions; and making sure the training available is given in a timely flexible manner that meets the needs of the practice.

(e) Supervision and review

The engagement leader and audit manager supervise the audit, review the work done, coach the team and maintain audit quality. Our audit software, Aura, is designed to help audit team members track the progress of the engagement and therefore make sure that all work has been completed, that work is reviewed by the relevant individual including the engagement leader and, where relevant, the Quality Review Partner, and that all matters arising have been appropriately addressed.

The engagement leader is expected to:

- lead the performance of the audit and its documentation by being proactively and sufficiently involved throughout the audit, including being satisfied that risks have been assessed and responded to appropriately
- drive a cultural mindset that strives for continuous quality improvement, challenges engagement team members to think, analyse, question and be rigorous in their approach and embody the client and people experience in how the team delivers the audit and applies professional scepticism
- foster an integrated coaching culture and demonstrate a willingness to learn and to coach others
- be responsible for the engagement team undertaking appropriate consultation on difficult or contentious matters, initiating those consultations where necessary
- have an ongoing involvement in assessing the progress of the audit, and in making key judgements
- be satisfied that the review, supervision and quality control procedures in place are adequate and effective
- have an overall responsibility for reviewing and assessing the quality of the work done, its proper and timely documentation and the conclusions reached.

The audit team manager supports the engagement leader by:

- setting an example in the performance of the audit and its documentation by being involved throughout the audit, including identifying the risks and being satisfied that they are responded to appropriately

- striving for continuous quality improvement, challenging engagement team members and applying rigour to the audit process
- fostering an integrated coaching culture and demonstrating a willingness to learn and coach others
- together with the engagement leader, putting in place arrangements for timely reviews of audit work and documentation, and, taking into account the nature, extent and level of reviews already performed by other members of the team, satisfying himself or herself that the work performed and documentation is consistent with the understanding of the engagement
- reviewing work done and the record of the audit, including considering the quality of the audit process and the results of the work and the documentation of conclusions.

In addition to reviews by the engagement leader and audit team manager, all staff are expected to critically self-review their own work to make sure that it meets the relevant requirements.

(f) Engagement Quality Control Review

We appoint a Quality Review Partner (QRP) to conduct engagement quality control reviews of the audits of listed clients, other public interest entities and clients identified as high risk. QRPs are experienced partners who are independent of the core engagement team; they receive training when appointed as a QRP. QRPs are appointed to an engagement, based on their experience and expertise and, in the case of QRPs on FTSE 350 audit clients, their appointment is approved by a national panel of senior partners. A QRP forum was established in the year to provide QRPs with a mechanism to discuss common issues, share experiences as to how they discharge their obligations and provide technical updates and training as needs arise.

The QRP is responsible for reviewing key aspects of the audit, including independence, significant risks and their responses, judgements, uncorrected misstatements, documentation of work done in the areas reviewed, the financial statements, communications with those charged with governance and the appropriateness of the audit report to be issued. QRPs are involved throughout the audit process so that their input is timely. The QRP will seek to challenge the audit team in the judgements they have made and work done. Their review is completed and any matters raised are resolved to the QRP's satisfaction in advance of the audit report date.

Second partners are required to be appointed to certain types of non-audit work and fulfil a role similar to that of a QRP on an audit.

(g) Differences of opinion

Policies exist to resolve the situations where a difference of opinion arises between the engagement leader and either the QRP, another Assurance partner or central function such as ARQ or Compliance. These include the use of technical panels consisting of partners independent of the engagement and/or Business Unit.

(h) Engagement documentation

At the end of an engagement, teams are required to assemble the hard copy paper file and then archive both this and the electronic file within set periods laid down by professional standards and/or law.

In the case of the electronic audit file, automated processes exist to make sure that the file is archived on time and the act of archiving prevents any further amendments being made to the file. Backups exist of all audit and non-audit electronic engagement files.

The hard copy paper file is archived using an electronic system that logs the files. The hard copy file is then retained in a secure locked filing system to which engagement teams have no direct access – files have to be requested and are then delivered to the individual.

Both the electronic and hard copy paper files are accessible only by members of the engagement team until they are destroyed. All engagement files are destroyed after periods specified by law or professional standards, which in the case of audits is generally eight years after the balance sheet date.

(i) Reliability and usefulness of audit reporting

We are acutely aware that the effectiveness of our work as auditors is directly linked to the effectiveness of our reporting, whether to Audit Committees or boards of directors or in the role we play in external reporting.

Reporting to audit committees

When reporting to audit committees, and those charged with governance in other organisations where no audit committee exists, we place particular emphasis on communicating the scope and audit approach together with our assessment of audit risk. During the course of the audit we communicate any threats to auditor objectivity, including independence, identify the significant risks and judgements that impact the reported financial performance and position, and the manner in which the information is presented in the annual report. In part, this presentation of significant judgements includes highlighting to the audit committee the judgements that have been made by management in preparing the financial statements that we believe are important to an understanding of the performance being presented. It is important as auditors that we recognise that the nature of accounting and the judgements that are applied mean that there is often not a precise answer.

It is also our role to inform the board whether we can conclude that what is reported externally is both true and fair within established norms of materiality, including considering both qualitative and quantitative aspects of accounting and reporting.

In addition, we have been discussing the issue of the transparency of our discussions with audit committees with a view to improving disclosures in their annual reports of those discussions. As a result, a number of our FTSE 100 clients made changes to their audit committee reports to reflect these discussions and improve the transparency of discussions we had with them.

External reporting

We are conscious that our audit reports should be clear and unambiguous. The form and content of our audit opinions are laid down by UK legislation and the APB for UK entities. Engagement leaders only conclude on the truth and fairness of the financial statements and sign an audit opinion following appropriate review of the work performed by the audit team, resolution of issues identified, clarification of any uncertainties and an assessment of uncorrected misstatements, both quantitative and qualitative, identified in respect of the financial statements. Consultation procedures are in place where a modified opinion or an emphasis of matter is proposed. The consultation process assists in conveying matters raised clearly and unambiguously.

In addition to the audit opinion, in certain situations we also have reporting obligations to regulators and to other organisations specified by UK law such as the Financial Services Authority.

Corporate reporting

The past 12 months has seen a significant amount of activity in the reporting space. In the UK there is a stated desire from government and the FRC to make sure that reporting remains an effective communication vehicle for information that is strategically important and material to a user's understanding of the business and its future sustainability. This interest reflects a widespread concern that reporting is become increasingly voluminous and difficult for users 'to see the wood for the trees'. Here, work is being undertaken to consider how the 'clutter' of current reporting can be minimised, including an assessment of how company websites can be used to report standing data (which does not change from year to year) and less material compliance information. We believe this work is of critical importance to the sustainable value of audit, given that the relevance, accessibility and timeliness of the information reported is the bedrock on which it is based.

Another important development is the growing interest in the concept of 'integrated reporting'. This model of reporting is being developed and promoted by the International Integrated Reporting Committee ('IIRC'). It reflects the growing market need for a mainstream reporting model, which presents an integrated picture of business performance, capturing all the resources used and consumed across a company's value chain, and one that provides a joined-up picture of business activity from strategy to remuneration. This approach reflects how many companies are shifting their thinking and is starting to influence regulators and standard setters around the world. The implications of this model are profound for the audit profession, both in providing the context in which to consider how the scope of audit can develop, but critically in providing a challenge as to the skills, knowledge and education programmes needed in the future.

Recently, the firm together with Tomorrow's Company and CIMA have issued a report entitled 'Tomorrow's Corporate Reporting – a critical system at risk'. This report is based on a research study looking at the reporting system and the barriers and enablers of change. The report highlights that few see corporate reporting as a system separate from the financial reporting system and process, largely because of the way it has evolved and the historic legacy of narrow institutional mandates. Furthermore, the system itself is seen as a barrier to change, due to friction brought about by structural and behavioural norms. We believe this report has a significant role to play in illuminating the issues that need to be addressed, if meaningful change in reporting and audit are to occur to meet the change dynamic of business in the current century.

Accordingly, we firmly believe that the time has now come for the audit profession to embrace a more progressive agenda, focused on potential changes to its mandate, which will make sure that audit quality, relevance and value can become synonymous with each other. We believe this debate needs to be pushed productively and that in large part the future audit must be framed around developments to the information framework, the channels used to disseminate information and its timeliness to the market.

Stewardship

The new UK corporate governance and stewardship codes continue to bed down. Work is ongoing to consider the practical implications of the stewardship code, which is complementary to the Governance Code, and focuses on enhancing the quality of engagement between institutional investors and companies in order to improve overall corporate governance and in so doing to improve long-term returns to shareholders.

This code has implications for the development of reporting and the audit over time, particularly because auditors have little or no direct engagement with shareholders to whom collectively they formally report. Although our interaction with shareholders is limited, and in practice confined to the activities of the Annual General Meeting, we commit time and effort to engage with investor groups on matters such as audit quality and the development of the reporting model, where their views are particularly sought by the standard setters.

(j) Independent senior partner review

PwC UK operates a programme of obtaining direct feedback from our clients via face-to-face interviews, undertaken by senior partners independent of the engagement teams, as well as client satisfaction surveys.

We use this feedback to make sure that we continue to provide high-quality services and address any service issues promptly.

6. Monitoring

Monitoring of our internal quality control systems comprises internal and external monitoring. External monitoring is undertaken by the firm's regulators and is dealt with in Section 7.

Quality monitoring is an integral part of the firm's continuous improvement programme. The firm constantly seeks to improve policies, procedures and the consistency of the quality of our work. Instances of failure to meet defined performance standards are treated seriously and the engagement leader responsible will be counselled to improve performance. In addition, under the firm's accountability framework, an engagement leader's remuneration can be impacted by quality failings.

Each Line of Service runs an annual quality assurance programme, in which independent teams of partners and staff review completed engagements to assess compliance with our quality standards and regulatory requirements. Details of the assurance programme are set out below.

(a) ISQC (UK&I) 1 and the Audit Compliance Review (ACR)

In accordance with the Audit Regulations of the ICAEW, we undertake an annual ACR, which includes reviews of a sample of audit engagements (see 'Engagement Compliance Review' below) and tests on the effectiveness of the firm's controls in functional areas such as recruitment, training and independence.

The work on the ACR provides testing of compliance with many of the policies and procedures established to comply with ISQC (UK&I) 1. But as the ACR is narrower in scope, additional testing on the requirements of ISQC (UK&I) 1 is undertaken to cover areas not covered in the ACR. Any issues identified are followed up and an action plan is developed and implemented.

(b) Global Assurance Quality Review Programme

The PwC Network has established a review programme for the Assurance practice, which includes a risk-based planning phase, followed by an assessment of controls over quality at the firm level (the Quality Management Review QMR), which in turn drives the nature, timing and extent of detailed testing by way of Engagement Compliance Reviews (ECR).

(i) Quality Management Review

The QMR assesses the effectiveness of a member firm's internal quality control systems, including compliance with professional standards such as ISQC 1. A QMR is performed every three years with an update being performed in the intervening years. The aim of the update is to monitor progress on the remediation of any control issues and assess the impact of any new developments on the internal quality control systems. Control issues identified during the QMR are specified as either 'meriting attention' or 'requiring immediate action'. The QMR is often led and resourced from outside of the member firm, subject to the QMR.

PwC UK was subject to a QMR in late 2010. The QMR team identified three control issues. They did not believe that any of the control issues created exposure whereby an engagement or multiple other engagements would not be compliant with applicable professional standards.

(ii) Engagement Compliance Review

Within Assurance, PwC UK carries out independent reviews at the individual engagement level known as the ECR. The key features of the ECR are as follows:

- a cold review of completed audit engagements of individuals in the firm who sign audit reports (known as Responsible Individuals)
- the ECR covers non-audit engagements performed as well as audit engagements
- all Responsible Individuals are subject to review of their audit work at least once every three years in accordance with the ICAEW Audit Regulations, but such reviews may be more frequent due to the nature of the clients being reviewed (e.g. certain high-profile or high-risk clients are reviewed more frequently)
- engagement leaders who perform non-audit work are subject to review at least once every five years but, depending on the nature of the non-audit work performed, the engagement leader may be reviewed more frequently
- the programme is conducted annually
- reviews are conducted by experienced partners supported by directors and managers who are independent from the office and business unit that performs the work, as well as the engagement leader being reviewed
- follow-up reviews take place in the intervening years if deficiencies have been identified in the prior year
- adverse findings are taken into consideration in determining the reward and promotion of Responsible Individuals and of engagement leaders of non-audit engagements
- the results are reported to the Assurance Executive and Executive Board of PwC UK.

One hundred and sixty-three audit engagements (2010: 148 audit engagements) were reviewed in 2011, covering 46% (2009: 42%) of the firm's Responsible Individuals. Seventy-five non-audit engagements (2010: 60 non-audit engagements) were also reviewed. Each engagement reviewed is classified as either 'compliant', 'compliant with review issues', or 'non-compliant':

- 'compliant' – relevant GAAS, GAAP and PwC Audit requirements have been complied with in all material respects

- 'compliant with review issues' – circumstances such as the following will lead to this conclusion:
  - required audit procedures not performed and/or not documented relating to a significant account balance, or area, and/or
  - procedures not substantially performed in accordance with professional standards, and/or
  - audit procedures that failed to detect a material GAAP departure, and/or
  - the audit report did not conform to professional standards.

But in all these cases, sufficient other work has been performed.

- 'Non-compliant' – relevant GAAS and PwC Audit requirements and/or relevant GAAP requirements and/or documentation requirements were not complied with in respect of a material matter. In 2011, all of the audit opinions on engagements classified as 'non-compliant' were considered appropriate.

In 2011, 155 audit engagements (2010: 163), representing 95.1% (2010: 96%) of the audit engagements reviewed, were classified as either 'compliant', or 'compliant with review issues' and 72 non-audit engagements (2010: 60), representing 96% (2010: 100%) of the non-audit engagements reviewed, were classified as either 'compliant', or 'compliant with review issues'.

An action plan is developed to respond to significant matters arising from the ECR. A number of the matters arising from the 2011 ECR have already been incorporated into the summer 2011 mandatory training programme. Specific individuals have been made responsible for implementing the action plan within agreed time frames. The action plan is also being monitored to make sure actions are implemented.

In addition to the above, significant matters identified and consistent themes are also fed back to the practice through quarterly Quality-in-Practice webcasts, together with additional or revised guidance to assist teams. Any additional guidance is generally issued though the fortnightly technical update email, the 'ARQ Technical Update', and is reinforced within Business Units by specifically designated partners and champions through a variety of mechanisms, including webcasts, breakfast briefings, group meetings and voicemails.

(iii) The Member Firm Report

A Member Firm Report is prepared by the International Team leader assigned to PwC UK by the Global Assurance Risk & Quality leader and covers the results of both the QMR and ECR for that year. The Member Firm Report also includes a conclusion with respect to the PwC UK's quality control systems.

In 2010, PwC UK's internal quality control systems were classified as 'providing reasonable assurance with exceptions'. This means that the internal quality control systems provide reasonable assurance of performing and reporting on assurance engagements in compliance with relevant laws and regulations with certain exceptions, while not being significant, merited being brought to the attention of the Assurance leadership.

PwC UK has responded to the points raised within the Member Firm Report and an action plan to address the exceptions noted has been developed. These actions have been assigned to specific individuals.

(c) Quality key performance indicators

Quality key performance indicators (KPIs) are set each year and are aimed at creating behavioural change in areas where improvement in quality is considered necessary. The quality KPIs are updated annually to take account of matters arising from regulatory reviews and the ECR, so that they focus on those aspects of an audit where need for improvement has been identified.

In the year to 30 June 2011, 13 audit quality KPIs were assessed, covering various aspects of the audit from planning to completion and 8 non-audit quality KPIs were assessed, covering various aspects of non-audit engagements.

The KPIs are assessed quarterly through the 'hot review' of files by partners and staff who are independent of the engagement under review. The results are moderated firstly by business units and then centrally.

Issues identified are communicated to the practice through webcasts, briefings and additional guidance, and are also incorporated into core training events. Where additional guidance is required, this is developed by ARQ. The overall quality KPI scores feed into the firm's balanced scorecard and are taken into consideration when determining the bonus pool for staff in each business unit.

(d) Complaints and allegations

If clients are not satisfied with the services we have delivered, or have suggestions for how we can improve, they may contact either the engagement leader or Owen Jonathan, the Executive Board member responsible for Risk and Quality. We will look carefully and promptly at any complaint we receive. Clients may also contact the ICAEW.

(e) Learning lessons

Our reputation for quality is high. Inevitably, given the size of our business, we do on occasion fall short of the standards we set ourselves. When this happens, we seek to discuss and resolve the issues with the client or other concerned party. We also review the matter independently for lessons learned and communicate those lessons to the relevant part of our business.

7. Factors outside the control of auditors effecting audit quality

In addition to our processes, systems and controls that are outlined above, there are a number of other factors that effect audit quality that are outside of our control.

Regulatory and political environment

The changing regulatory and political environments pose challenges to us and often have a direct impact on audit quality.

It is clear that since the Audit Inspection Unit was established and started reporting publicly, audit quality has improved. We continually seek to improve the quality of what we do and we value the relationship we have with all of our regulators. Regulators identify those aspects of the audit and our processes that we need to improve and this feedback enables us to further enhance the quality of our work. We will therefore continue to act on any feedback we receive from our regulators.

In the political arena, the role of the audit and the audit market are under more scrutiny than ever. Since the financial crisis, numerous consultations, inquiries and reports have been instigated, including those undertaken by the House of Lords' Economic Committee, the Office of Fair Trading, the Financial Reporting Council, various governmental bodies and departments, as well as the Public Company Accounting Oversight Board.

In the UK, the Office of Fair Trading has provisionally concluded that there are competition issues that need to be addressed in the audit market, based on a number of factors viewed as potentially preventing, or distorting competition. In their view, there is a reasonable chance that appropriate measures are available to address the identified issues.

In Europe, the October 2010 EU green paper received an unprecedented level of over 700 responses from a range of stakeholders. Arising from the responses, the EU have indicated that they are looking at three policy areas being the independence of the profession, opening up of the audit market and the creation of an integrated European market and reinforcement of supervision.

Politically led solutions can pose a threat to audit quality. Remedies identified need to be based on the evidence and be proportionate, but critically, they should be market-based and led, not restrict market choice and preferably enhance, but certainly not detract from audit quality. Some of the proposed remedies will undoubtedly enhance market choice and audit quality, and are to be welcomed and supported. However, other proposed remedies such as mandatory joint audits, rotation or retendering, and prohibition of the provision of non-audit services to audit clients will have cost implications for companies, restrict companies' choice of professional advisers and damage audit quality.

We have been actively involved in responding to the various consultations and enquiries as well as meeting with all of those involved in discussing the future role and responsibilities of the auditor and will continue to do so. As part of this process, we also need to actively explain what we do and how we perform our role, so all involved have an understanding of the audit process. This will enable those involved in the process to make decisions from a knowledgeable position, based on evidence.

It is not sufficient for us to assume that people have the relevant knowledge to make decisions about the future of the audit and our role – knowledge which we take for granted.

There are actions we can take and in fact are taking now. Richard Sexton outlined a number of these actions in his message on pages 8 to 10 of this report. The Progressive Agenda, launched in October 2010 before many of the consultations and inquiries commenced, outlined what we see as the priority areas for reform and action.

It is right that our role and responsibilities are examined and consideration given to what changes can be made, but these need to lead to improved choice in the audit market and further enhance audit quality rather than detracting from it. We will certainly be at the forefront of making the changes that are needed.

Corporate governance

In addition to the regulatory and political environment, corporate governance, whether good or bad, impacts audit quality.

Corporate governance often features as a key aspect in corporate failure, as the core reasons are normally strategic, business model-related, or behavioural. The financial crisis highlighted the importance of effective corporate governance in running a business and its interactions with its external stakeholders.

Our routine interaction with audit committees, and others charged with governance, is critical. We place significant effort in ensuring that our audit committee reports, and other reports to those charged with governance, focus on the material issues and professional judgements that are critical to our audit opinion. Importantly, when the need arises, we will intervene outside the normal audit routine, for example if we believe that non-executive directors are missing an issue, or if we feel they are being misled.

However, the audit committee also provides a challenge to us in what we do and how we do it – they want to know our views and professional opinions on the matters raised by us, but they also seek to challenge us on our views and also whether what we plan to do, or have done, is actually sufficient. This can only enhance audit quality.

Developing the role of the audit committee would enhance audit quality as would increased transparency of the discussions they have with us, especially in the area of critical audit judgements. This is something we have already discussed with a number of Audit Committee chairs in the last year. These discussions led to a number of our clients, and a number of other companies, disclosing more information on these discussions on a voluntary basis. We will continue these discussions and push more of our clients to improve transparency in this area.

8. Additional key driver of audit quality

The Audit Quality Framework, issued by the FRC in February 2008, identified five key drivers of audit quality. These are: the culture within an audit firm, the skills and personal qualities of audit partners and staff, the effectiveness of the audit process, the reliability and usefulness of audit reporting, and factors outside the control of auditors. The ways in which we have applied these drivers have been incorporated into this report already.

In addition to the five key drivers of audit quality identified by the FRC above, we believe there's a sixth critical driver and that is the financial success of the audit practice. The quality of our audit work is largely dependent on the quality and skills of our people in what remains a highly competitive market. Our ability to recruit the best graduates, staff and partners depends on our ability to offer market-competitive salaries and world-class professional training. In addition, we make significant investments in both our audit methodology and supporting technologies and tools. Without financial success, our ability to invest in our people, methodology and tools would be jeopardised.

PwC UK has, like every other business, continued to focus on costs and potential efficiency savings over the past year. However, we are absolutely clear that no financial consideration will be at the expense of audit quality.

9. Review of the firm's internal control system

The Audit Firm Governance Code requires the firm to conduct, at least annually, a review of the effectiveness of the firm's internal control system, covering material controls such as financial, operational and compliance controls, and risk management systems. In maintaining a sound system of internal control and risk management, and in reviewing its effectiveness, we have used the 'Internal Control: Guidance for Directors on the Combined Code' (the Turnbull guidance), issued in October 2005 by the Financial Reporting Council.

The Executive Board has overall responsibility for PwC UK's internal control system and for reviewing its effectiveness. It has reviewed the systems of internal control in operation effectiveness throughout the year ended 30 June 2011, and up to the date of approval of this Transparency Report, using a process that involves:

- written reports and/or confirmations from relevant senior partners, committees, the Risk Council and functions concerning the operation of those elements of the system for which they are responsible
- reports of periodic reviews of the UK firm's performance and quality, which have been carried out independently by the PwC network
- internal audit work carried out by the Internal Audit function, which reports to the Audit and Risk Committee
- reports from the firm's regulators
- reports from the external auditors.

Our internal control systems are designed to manage, rather than eliminate, the risk of failure to achieve business objectives or, in the case of financial controls, the risk of material misstatement in our financial statements. Accordingly, they provide only reasonable and not absolute assurance against such failure, or material misstatement in our financial statements.

10. Statement on the effectiveness of the firm's internal quality control system

PwC UK's internal quality control system is a subset of the firm's internal control system and is outlined in this section. On the basis of the reviews performed as outlined in part 9 above, the Executive Board is satisfied that PwC UK's internal quality control system is operating effectively. Any matters identified through the various monitoring and review processes are actioned and changes implemented as appropriate.

6. Independence policies and practices

Organisation

Bill Morgan is PwC UK's Ethics partner. He is a senior partner within the firm and is responsible for providing appropriate support and processes such that PwC UK partners and staff are knowledgeable about independence matters and that they take the actions required of them by the firm's independence policies and supporting guidance. He is supported by a team of independence specialists. He is a member of the PwC Network's independence leadership team and reports directly to Owen Jonathan, the Executive Board member responsible for Risk and Quality.

Policies and guidance

The PwC Network Independence Policy, which is based on the International Ethics Standards Board for Accountants (IESBA) Code of Ethics for Professional Accountants contains minimum standards with which member firms of PwC International have agreed to comply, including processes that are to be followed to maintain independence from clients where necessary.

The independence requirements of the The US Securities and Exchange Commission (SEC) and those of the Public Company Accounting Oversight Board of the US ('PCAOB') are in certain instances more restrictive than the firm's policy. Given the reach of these requirements, and their impact on the PwC Network, the policy identifies key areas where these requirements are more restrictive. Provisions that are specifically identified as applicable to SEC restricted entities must be followed in addition to, or instead of, the firm's policy.

The UK firm also supplements PwC Network Independence Policy as required by UK professional bodies and regulations.

The firm's independence policy covers, among others, the following areas:

- personal and firm independence, including policies and guidance on the holding of financial interests and other financial arrangements, e.g. bank accounts and loans by partners, staff, the firm and its pension schemes
- non-audit services and fee arrangements. The policy is supported by Statements of Permitted Services (SOPS), which provide practical guidance on the application of the policy in respect of non-audit services to assurance clients
- business relationships, including policies and guidance on joint business relationships (such as joint ventures and joint marketing) and purchasing goods and services acquired in the normal course of business.

Independence systems

The PwC Network has a number of global systems that assist PwC UK and their personnel comply with its independence policies and procedures. These systems include:

- the Central Entity Service (CES), contains information about corporate entities including public interest audit clients and SEC-restricted clients and their related securities. CES assists in determining the independence status of clients of the firm before entering into a new non-audit engagement, or business relationship. This system also feeds GPS
- the Global Portfolio System (GPS), which facilitates the pre-clearance of publicly traded securities by all member firm partners, directors and practice managers before acquisition and records their subsequent purchases and disposals. Where a member firm wins a new audit client, this system automatically informs those holding securities in this client of the requirement to sell the security where required
- Authorisation for Services (AFS), is a global system that facilitates communication between a non-audit services engagement leader and the audit engagement leader, documenting the potential independence threats of the service and proposed safeguards, and acts as a record of the audit engagement leader's conclusion on the acceptability of the service.

PwC UK also has a number of UK-specific systems, including:

- a rotation-tracking system that monitors compliance with the firm's audit rotation policies for engagement leaders, other key audit partners and senior staff involved in an audit
- a database that records significant approved business relationships entered into by the firm (excluding those carried out in the normal course of business). These relationships are reviewed periodically each year to assess their ongoing permissibility.

Training and confirmations

Annually, all partners and staff receive mandatory computer-based training on the firm's independence policies and related topics. Completion is monitored and non-completion may lead to disciplinary action being taken.

Additionally, face-to-face training is delivered to members of the practice on an as-needed basis by the firm's independence specialists and risk and quality teams.

PwC UK requires all partners and staff, upon joining the firm and at least annually thereafter, to confirm their compliance with all aspects of the firm's independence policy, including their own personal independence. In addition, all partners and directors must confirm that all non-audit services and business relationships for which they are responsible, comply with policy, and that the firm's processes have been followed in accepting these engagements and relationships. These confirmations serve two primary purposes: to identify any threats to independence that may have arisen and as a periodic reminder of the firm's independence policies and procedures. These annual confirmations are supplemented by periodic engagement-level confirmations for the firm's larger financial services clients.

Disciplinary policy

PwC member firms are required to have disciplinary mechanisms to promote compliance with independence policies and processes, and to report and address any violations of independence requirements.

In PwC UK, a partner or staff member may be subject to a fine or other disciplinary action, including dismissal, for a violation of personal independence policies.

Internal reviews of independence procedures and practices

Our independence procedures and practices are subject to review on an ongoing basis. This is achieved through a monitoring and testing programme, which includes the following:

- quality control engagement reviews to confirm compliance with risk management processes, including independence
- personal independence audits of a random selection of partners, directors and managers
- compliance testing of independence controls and processes
- central monitoring of independence KPIs, including the quality of AFSs
- annual assessment of the firm's adherence with the PwC Network's independence risk management standards.

In addition, policies and guidance are reviewed and revised when changes arise such as updates to laws and regulations (including the APB's Ethical Standards), when PwC Network policies and guidance change or as a result of the above reviews and of our monitoring and testing programme.

Following revisions to Ethical Standards in December 2010, the UK Independence Policy, the SOPS, our training programmes and supplementary guidance were updated. The changes to our policy and guidance were approved by the UK Ethics partner, and were communicated to all partners and staff in each Line of Service. To make sure that any changes would be understood and acted upon, any significant changes were discussed with the Lines of Service and each Line of Service reviewed and approved the communications issued – in the case of Assurance, this was done by the Audit Steering Committee and Risk Management Steering Group.

The results of the firm's monitoring and testing are reported to the Executive Board on a regular basis with a summary reported to them on an annual basis.

The investigation of any identified policy violations further serve to identify any need for improvement in the firm's systems and processes, and for additional guidance and training.

Confirmation of an internal review of independence practices

Based on the reviews outlined above, we confirm that we have conducted an internal review of independence practices during the year ended 30 June 2011.

7. External monitoring

(a) Regulators in the UK

The firm is authorised to undertake statutory audit work by the Institute of Chartered Accountants in England and Wales (ICAEW), which is a recognised supervisory body for auditors under the Companies Act 2006.

Each year, as part of the ICAEW's monitoring responsibilities, the Audit Inspection Unit (AIU) of the Professional Oversight Board (part of the Financial Reporting Council) and the Quality Assurance Department (QAD) of the ICAEW each undertake an inspection of the quality of the firm's work as statutory auditors.

The remit of the QAD is to monitor the quality of individual audits at all audit firms, but they do not review the audits of fully listed clients and others designated as major public interest clients, as they fall within the AIU scope. The full scope of the independent inspections of the AIU can be found at www.frc.org.uk/pob/audit/scope.cfm.

(i) AIU – timeline from review to public reporting

The AIU completed its public reporting cycle in respect of its 2010/11 inspections on 26 July 2011 with the issuance of its public report on PwC UK. The AIU issued its draft private report, which contains detailed findings arising from its reviews, to us in March 2011. This was finalised in May 2011 and included agreement of our action plan in response to their findings.

Our key training season occurs in the summer of each year and incorporates feedback and actions arising from regulatory reviews, which can include the communication of new policies and guidance. In addition, as themes emerge from the regulatory reviews during the year, we communicate the points to the practice via the Quarterly in Practice webcasts and other technical communications. However, due to the timing of some of the reviews and the reporting of some of the findings to us, it is not always possible to address points raised by the AIU, and QAD, before the following year's audits have been completed. This may therefore mean that the same point is raised by the AIU, or QAD, in subsequent periods.

(ii) AIU – Overview

While it is impractical to reproduce the content of the entire report, we set out below the key points raised in respect of the review of audit engagements in part (iii) and the review of the firm's policies and procedures in part (iv). Part (vi) discusses how we respond to the matters raised by the AIU and also the QAD.

To fully understand the matters included below and all other matters raised by the AIU and their context, the full report should be read and is available on the FRC's website at www.frc.org.uk/pob/audit/firmreports1011.cfm.

The 2010/11 inspection covered a review of the firm's policies and procedures supporting audit quality and reviews of FTSE 100, FTSE 250 and other major public interest entities with financial year ends up to June 2010, the majority of which were December 2009 or later.

The report commented that:

- the firm places considerable emphasis on its overall systems of quality control
- in the view of the AIU, the firm has appropriate policies and procedures in place for its size and the nature of its client base in the relevant areas, which are subject to review.

The AIU identified certain areas where improvements are required.

The AIU's key messages were that we should pay particular attention to the following areas to enhance audit quality:

- make sure teams pay more attention to the assessment of goodwill impairment, in particular the appropriateness of key assumptions and the adequacy of related disclosures
- enhance the firm's procedures to encourage further the exercise of professional scepticism and make sure that audit teams demonstrate this in practice
- make sure audit teams pay more attention to planning the audit of revenue in an effective manner
- provide further guidance and training to audit teams regarding the use of internal experts
- monitor the effectiveness of actions taken to address recurring findings from one year to the next.

The first four areas have been dealt with as part of the 2011 mandatory training programme, with additional guidance and also being issued to teams. The monitoring of the effectiveness of our actions is dealt with in part (v) below.

(iii) AIU review of audit engagements

The AIU:

- undertook two follow-up reviews of audits reviewed in the prior year and commented that the issues previously raised had been addressed resulting in an improvement in audit quality in the relevant areas
- reviewed selected aspects of 15 (2009/10: 18) audits of which:
  - seven (2009/10: seven) audits were determined by the AIU to have been performed to a good standard with limited improvements required

– seven (2009/10: ten) audits were determined to have been performed to an acceptable standard, but with improvements required

– one (2009/10: one) audit was determined as requiring significant improvement in relation to the sufficiency of audit evidence for several key aspects of the audit.

Where the AIU assesses an audit as requiring significant improvement, the AIU has significant concerns in relation to the sufficiency or quality of audit evidence or the appropriateness of judgements in one or more key audit areas, or the implications of concerns relating to other areas are considered to be individually or collectively significant. This assessment does not necessarily imply that an inappropriate audit opinion was issued. As the AIU also notes in its report, due to the small size of the samples involved, changes in performance from one year to the next are not necessarily indicative of any overall change in audit quality.

In addition to the matters identified as 'key messages' above, the AIU saw some improvement, following positive steps taken by the firm, in respect of fraud risks relating to revenue recognition, the testing of journals and the consistency between the planned and actual audit approach. However, continued effort is required to achieve further improvements. These matters were specifically addressed in core mandatory training in summer 2010. The results of the 2011 ECR indicate that these actions have been effective in improving quality in these areas.

The AIU commented that although audit finalisation procedures were generally performed to an acceptable standard, there were instances when areas relating to significant risks and judgements were not included as significant matters for engagement leader and QRP review. We changed our policy in this area in 2010.

The AIU further commented that in one instance an Audit Committee report did not refer to our views or conclusions on areas of audit judgement. This point has been reinforced to all audit teams in mandatory training in summer 2011.

On a complex audit of a subsidiary company, the AIU found that significant improvement was required in relation to the sufficiency of audit evidence over the extent of reliance on management's testing of controls and the extent of substantive audit evidence obtained and recorded. The audit was complex as reliance needed to be placed on certain group functions audited by other PwC Network firms. Due to the timing of the findings, the matters were addressed as far as possible as part of the 2010 audit and any residual points will be acted upon as part of the 2011 audit.

(iv) AIU review of the firm's policies and procedures

The AIU reviewed the firm's policies and procedures. The report commented that PwC UK puts significant resources into its central support functions, such as HR, risk management, audit and accounting technical, independence and compliance, in addition to the regular monitoring of quality key performance indicators on audits.

The AIU's review involves the review of documentation, which given the size of our business inevitably means that instances of non-compliance, while relatively few in number in many cases, are identified. The areas identified by the AIU, together with the actions that have been undertaken to date, are set out below.

The AIU found:

- that we should document policies and procedures covering the consultation on ethical matters. This is in progress and is expected to be completed in late 2011
- instances where the assessment of independence threats relating to non-audit services was not adequately performed and that safeguards in place to mitigate threats to independence were not always communicated to Audit Committees. These points have been reinforced to all staff via mandatory training in summer 2011
- that no formal disciplinary procedure exists in respect of non-personal independence breaches. Formal guidance was issued to partners during 2011 as to how to reflect this in an engagement leader's performance appraisal and reward
- one instance of partner admission papers included references to the selling of non-audit services to audit clients, which is contrary to Ethical Standards. While this did not influence that person's admission to the partnership, the matter has been, and will continue to be, reinforced to all partner and director candidates as well as to staff across all Lines of Service in respect of objective setting and reward
- the firm should formalise the process for considering the impact of unsatisfactory ECR failings on the remuneration and promotion of directors. This process was in place for the 2011 ECR
- quality was identified by the firm as being less consistent on audits led by audit directors compared with audits led by partners. As a result of our findings in 2010, we had already established a 'buddy' system for all directors together with Responsible Individual training to assist with the transition to a signing engagement leader and quarterly file reviews to further support and develop them
- the firm's 2010 Transparency Report was a significant improvement on the 2009 Transparency Report. However, the Report did not confirm that an internal review of independence practices had taken place. This confirmation has now been made at the end of Section 6 of this report.

While the AIU found no evidence that audit quality had been effected during the course of their inspection, the AIU commented that continued care is needed that:

- the continued emphasis on achieving efficiency on audits does not adversely effect audit quality
- that audit teams are not pressurised to meet the forecast hours for work to be performed by offshore 'delivery centres'.

We continue to reinforce the above points to audit teams through mandatory training and other communications and are committed to ensuring that audit quality is not effected by these points.

In addition, the AIU identified a few areas where, while no issues were identified in the course of their inspection, following policy changes implemented in the year ended 30 June 2011, the AIU intend to review and assess whether there has been any impact on quality. These areas included a change in policy with respect to:

- the use of disclosure checklists
- the use of specialists and internal experts.

(v) QAD findings

The QAD issue us with a copy of a private report which they prepare for the Audit Registration Committee of the ICAEW. The report is therefore not published, or publicly available.

The key findings of the QAD from their reviews of a sample of audit files which fall within the QAD remit are set out below, together with the actions we have taken.

The QAD commented that the issues identified from the review of files were mainly of a documentation nature rather than concerns about the quality of the underlying work. The detailed findings were as follows:

- the extent of documentation was not sufficient to demonstrate that fraud matters had been fully covered, although engagement teams were able to explain the matters that had been considered. We have already reinforced this issue through the 2011 mandatory training programme
- documentation weaknesses identified with regards to the rationale for non-attendance at stock-counts and for the alternative procedures performed providing sufficient audit evidence. We have reinforced the need for documentation in these circumstances through the April 2011 Quality-in-Practice webcast
- on one audit file, detailed working papers for stocktake attendance work at a principal location had been mislaid
- documentation should include cumulative knowledge from prior years and where knowledge has been brought forward, this should be updated. We have reinforced both of these points in the 2011 mandatory training programme for staff at all levels and have added further guidance to the audit guide
- documentation of the results of analytical review needed greater detail.

As noted previously, we have changed our policy with regards to the use of disclosure checklists for accounts. The QAD will consider the impact of this change in policy as part of their inspection, which commences in late 2011.

(vi) Responding to matters raised by our regulators

We are committed to working constructively with, and take seriously the findings identified by, all of the firm's regulators in relation to the firm's audit work. We have established an action plan to address those findings together with a clear time frame for their resolution and make specific individuals responsible for ensuring that those actions are achieved.

The action plan, which has been agreed with the AIU and the QAD, often consists of creating new policies and procedures as well as including the matters raised in core mandatory training events.

In addition to monitoring that the actions are achieved, we consider whether the actions have been effective in addressing the concerns raised by the AIU and other regulators. We have historically monitored the effectiveness of actions through the Engagement Compliance Review and Quality Key Performance Indicators programme. In order to strengthen this monitoring process further, we have established a group to meet monthly and whose remit is to review the progress on all actions within the action plan. This review will also involve the selection of specific actions for a deeper review through examining evidence gathered on changes to the firm's performance resulting from the action. Progress against the action plan will be reported quarterly to the Assurance Executive. The committee consists of the Head of Assurance (James Chalmers), the Assurance Risk & Quality Leader (Deian Tecwyn) and the partners responsible for the regulatory process within the firm (Chris Taylor and Tony Hemus).

The AIU's review of engagements and policies and procedures in 2011/12 will assess the effectiveness of our responses. They will report their findings privately to us in March 2012 and publicly in summer 2012. The QAD will report to us privately in February/March 2012, following the completion of their reviews.

(vii) Other regulatory bodies with which we have interactions

Under various regulations, we also have reporting responsibilities to regulators of our clients such as the Financial Services Authority.

In addition, we work with our clients to enable them to assist the Financial Reporting Review Panel (also part of the Financial Reporting Council) in their work monitoring public company reporting.

(b) Overseas regulators

PwC UK is registered in the following territories in order to meet local requirements in relation to the audits of certain entities:

- USA
- Japan
- Canada
- the Crown Dependencies of Jersey, Guernsey and the Isle of Man.

As a requirement of these registrations, PwC UK is subject to monitoring by the relevant regulatory bodies.

Following the Statement of Protocol between the Professional Oversight Board and the Public Company Accounting Oversight Board (PCAOB) dated 10 January 2011, the PCAOB commenced an inspection of PwC UK in May 2011. That inspection is not expected to report its findings publicly until 2012 at the earliest.

In addition, the AIU are undertaking inspections on behalf of the regulator of the Crown Dependency of Jersey in 2011 and we understand that they may also be conducting similar inspections on behalf of the Crown Dependencies of Guernsey and the Isle of Man in 2012.

No other regulatory inspections by overseas regulators have taken place or are currently planned.

(viii) Our audit registration

In June 2011, the ICAEW's Audit Registration Committee considered the outcome of the 2010/11 inspections undertaken by the AIU and QAD and confirmed the continuance of the firm's audit registration.

8. Financial information

Consolidated financial information

The following information is extracted from the consolidated financial statements of PricewaterhouseCoopers LLP for the year ended 30 June 2011:

- consolidated profit for the financial year before members' profit share was £656m (2010: £642m)
- consolidated profit available for division among members of £622m (2010: £622m).

Relative importance of statutory audit work

An analysis of the UK and total consolidated turnover of PricewaterhouseCoopers LLP for the financial year ending 30 June 2011, which shows the relative importance of UK-related statutory audit work, is shown below:

	2011 £m	2010 £m
Statutory audits and directly related services for audit clients	547	548
Non-audit services to audit clients	363	358
Services to audit clients	910	906
Services to clients we do not audit	1,371	1,287
UK firm turnover	2,281	2,193
Turnover from non-UK subsidiary undertakings	180	138
Consolidated turnover	2,461	2,331
Revenues from statutory audits and directly related services for audit clients as a percentage of UK firm turnover	24%	25%

Audit profitability

The Consultative Committee of Accountancy Bodies (CCAB) issued the Voluntary Code of Practice on Disclosures of Audit Profitability in March 2009 (the Audit Profitability Code). The Audit Profitability Code sets out recommended disclosures in respect of the profitability of statutory audits and directly related services (the 'reportable segment').

Turnover and operating profit of the reportable segment, calculated in accordance with the requirements of the Audit Profitability Code, are:

	2011 £m	2010 £m
Turnover	547	548
Operating profit	79	108

Turnover, direct costs and overheads for the reportable segment are recognised and measured on a consistent basis with the firm's consolidated financial statements:

- turnover represents amounts recoverable from clients for statutory audits and directly related services provided during the year, excluding Value Added Tax, and reflects the fair value of the services provided on each client assignment, including expenses and disbursements, based on the stage of completion of each assignment as at the balance sheet date
- operating profit for the reportable segment is calculated based on direct costs, including staff costs, recorded on engagements falling within the segment, together with the allocation of overheads, such as property and IT costs. These costs have been allocated on a pro rata basis, based primarily on headcount, or revenues. No cost is included for the remuneration of members of PricewaterhouseCoopers LLP, consistent with the treatment of partners' remuneration in the firm's consolidated financial statements.

9. Remuneration of partners

Partners are remunerated solely out of the profits of PwC UK and are personally responsible for funding their pensions and other benefits.

Audit partners and audit staff, which includes staff from other Lines of Service contributing to the audit with effect from 30 April 2011, are not permitted to be, nor are they incentivised to be, evaluated or remunerated for the selling of non-audit services to their audit clients.

In addition, the Assurance Risk Management Partner participates in the remuneration discussions for audit partners, providing input on their performance in respect of risk and quality matters, and to make sure that the process complies with the firm's policies.

The final allocation and distribution of profit to individual partners is made by the Executive Board, once their performance has been assessed and the annual financial statements have been approved. The Supervisory Board approves the process and oversees its application.

Each partner's profit share comprises three interrelated profit-dependent components:

- **responsibility income** – reflecting the partner's sustained contribution and responsibilities
- **performance income** – reflecting how a partner and their team(s) has performed
- **equity unit income** – reflecting the overall profitability of the firm.

Given the diverse roles and responsibilities each partner undertakes, the weighting given to each of the above criteria varies, depending upon those roles and responsibilities.

Each member's performance income, which in the year ended 30 June 2011 represented on average, approximately 37% of their profit share (2010: 37%), is determined by assessing achievements against an individually tailored balanced scorecard of objectives, based on the member's role. These objectives include ensuring that we deliver quality services and maintain our independence and integrity.

Quality failings identified either through regulatory reviews, or other external and/ or internal quality reviews impact the remuneration of audit partners, and other audit and non-audit engagement leaders in Assurance, through an accountability framework.

There is transparency among the partners over the total income allocated to each individual.

Drawings

The overall policy for members' drawings is to distribute a proportion of the profit during the financial year, taking into account the need to maintain sufficient funds to settle members' income tax liabilities and to finance the working capital and other needs of the business. The Executive Board, with the approval of the Supervisory Board, sets the level of members' monthly drawings, based on a percentage of their individual responsibility income.

10. Public interest entities

A list of the public interest entities for whom we issued an audit opinion between 1 July 2010 and 30 June 2011, who have issued transferable securities on a regulated market (as defined in the Statutory Auditors (Transparency) Instrument 2008) can be found at www.pwc.co.uk/annualreport.

Appendices

Appendix 1: Biographies

1. The Executive Board

(a) Members of the Executive Board in office during the year ended 30 June 2011

Ian Powell, Chairman and Senior Partner, joined the UK firm's Executive Board in 2006 and he was elected chairman and senior partner in 2008. He joined the UK firm as a graduate trainee in 1977 with a degree in economics from Wolverhampton Polytechnic and is a qualified chartered accountant (ICAEW). He became a partner in 1991. Before becoming chairman he was head of Advisory. He has an honorary Doctor of Business Administration awarded by the University of Wolverhampton Business School.

Richard Collier-Keywood is responsible for the overall management and performance of the business as well as our sustainability and community affairs programme. He read law at Warwick University and was called to the Bar in 1983. He joined the firm in 1987, became a partner in 1992 and joined the Executive Board in 2003. He was previously head of our Tax practice.

James Chalmers graduated from Oxford University with an engineering degree and he joined the firm in 1985. He became a partner in 1997. Before joining the Executive Board in 2008 as head of Strategy and Talent, he was a member of the Assurance leadership team. During his time in Assurance he has worked with multinational clients and has been on long-term secondments to clients in the banking and healthcare sector.

Kevin Ellis graduated in industrial economics from Nottingham University, joined the firm in 1984 and he became a partner in 1996. Before he joined the Executive Board in 2008 he headed up our Business Recovery Services. During his time with the firm Kevin has been on two secondments, one with an overseas bank and the other with a major UK financial institution.

Owen Jonathan is responsible for the Office of General Counsel and Enterprise Risk, including compliance and independence. He read law at the University of Bristol. Before joining the firm as a partner in 2000, he was a partner at City law firm Norton Rose and later CEO of South China Morning Post (Holdings) Limited of Hong Kong. He joined the Executive Board in 2002.

Barry Marshall has an MBA from Warwick University. Barry joined the firm in 1980 and became a partner in 1988. Barry's international experience includes acting as the global leader of our international tax structuring network.

Kevin Nicholson joined the Executive Board in 2008 as head of Regions after spending four years leading the Entrepreneurs and Private Clients' market on the Tax Leadership team. He graduated from Newcastle Upon Tyne Polytechnic, joined the firm in 1991 and became a partner in 2000. Over this period he worked in the North East, the Midlands, London and Hong Kong, and also spent two years working with the Global Tax leadership in New York.

Paul Rawlinson is responsible for driving revenues across our top-tier client base and put in place the industry and segment programmes, which will make sure the effective cascade of learning and credentials from our brand-defining clients. He has a history degree from Cambridge University, joined the firm in 1982 and became a partner in 1994. Paul has extensive experience as a transaction services partner in the private equity and corporate markets.

Richard Sexton graduated from Southampton University with a degree in mathematics and business finance. He joined the firm in 1980 and he became a partner in 1992. He has spent time in New York and Hong Kong. Before joining the Executive Board in 2006 as head of Assurance he led our London Assurance practice.

Keith Tilson is in charge of Finance and Operations. He read economics at Cambridge University. After joining the firm in 1976, he spent four years in Sydney and became a partner in 1988. Before taking up his current role, he was managing partner Operations and Finance and before that, head of Advisory. He joined the Executive Board in 1998.

(b) New members of the Executive Board who took office on 1 July 2011

Gaenor Bagley graduated from Cambridge University with a mathematics and management degree. She trained in audit and spent three years in an investment bank corporate finance team. In 1992 she joined the Tax practice where she has continued to work in M&A, specialising in private equity as a partner. She joined the Executive Board in 2011.

Stephanie Hyde graduated from Brunel University with a mathematics and management degree. She joined the firm in 1995 and became a partner in 2006. Before joining the Executive Board in 2011 she led our Assurance practice in Reading and our Mid-Cap market in the South East.

Richard Oldfield graduated from the University of York with an economics degree. He joined the firm in 1992 and became a partner in 2003. Before joining the Executive Board in 2011 he led our Banking & Capital Markets business within Assurance. He has worked in London, Zurich, Paris, New York and most recently, Sydney, on both audit and non-audit clients.

2. The Supervisory Board

Duncan Skailes (Supervisory Board chair from January 2010) is an Advisory partner in the corporate finance practice in London and leads the UK private equity team. He joined the firm in 1987 and was admitted as a partner in 1999.

John Dowty is an Advisory partner and the leader of the Global Delivering Deal Value business. He joined the firm in 1980 and was admitted as a partner in 1992. He chairs the Strategy and Governance Committee of the Supervisory Board.

Colin Brereton is an Assurance partner in the London top-tier business unit, focusing primarily on the telecoms sector, and is the Global Communications Industry sector leader. He joined the firm in 1982 and became a partner in 1995.

Pauline Campbell is an Assurance partner in the South East business unit, leads our Uxbridge office, and has dealt with the spectrum of market segments from private client to top tier. She joined the firm in 1985 and became a partner in 1996.

Paul Clarke is an Assurance partner within the London Insurance and Investment Management business unit. He joined the firm in 1985 and became a partner in 1994.

Katherine Finn is an Assurance partner in the West & Wales business unit. She joined the firm in 1991 and became a partner in 2006.

Roy Hodson is an Assurance partner in the London top-tier Assurance business unit. He joined the firm in 1976 and became a partner in 1988. He chairs the Audit and Risk Committee of the Supervisory Board.

Rob Hunt is an Advisory partner in the Business Recovery Services team in Birmingham. He joined the firm in 1984 and became a partner in 1996.

Pam Jackson is a Tax partner in London, specialising in mergers and acquisitions. She joined the firm in 1983 and became a partner in 1990. She chairs the Senior Partner Remuneration Committee of the Supervisory Board and is also a member of the board of PwC Middle East.

Mike Karp is a Tax partner in London and acts as global relationship partner for a number of clients. He joined the firm in 1979 and became a partner in 1990.

Roger Marsh is an Advisory partner in Leeds and leads the Government and Public Sector practice in the North. He joined the firm in 1976 and became a partner in 1988.

Pat Newberry is an Advisory partner in the Financial Services practice in Consulting. He joined the firm in 1977 and became a partner in 1988.

Ian Rankin is an Assurance partner in the Scotland business unit and is based in our Edinburgh office, dealing predominantly with financial services clients. He joined the firm in 1978 and became a partner in 1989.

Matthew Thorogood is a Tax partner in Human Resources Services part of the Tax practice in London. He joined the firm in 1986 and became a partner in 2001.

Graham Williams is an Assurance partner leading the Risk Assurance practice for the Government and Public Sector practice within Assurance. He joined the firm in 1980 and became a partner in 1991. He chairs the Partner Affairs Committee of the Supervisory Board.

Gerry Lagerberg is an Advisory partner in Forensic Services in London. He joined the firm in 1983 and became a partner in 1995. He is a member of the Global Board, the body responsible for the governance of the PwC Network, and a member of the board of PwC Middle East.

Murray Legg is an Assurance partner in the London top-tier business unit. He joined the firm in 1978 and became a partner in 1989. Since 2005 he has been a member of the Global Board, the body responsible for the governance of the PwC Network.

Appendix 2: Glossary

AIU – Audit Inspection Unit

APB – Auditing Practices Board

The Board – the Global Board

The Code – the PwC UK Code of Conduct

FRC – the Financial Reporting Council

FRRP – Financial Reporting Review Panel

Governance Code – the Audit Firm Governance Code

Group – PwC UK and its subsidiary undertakings in the UK, Channel Islands and Middle East as set out on page [X].

ICAEW – Institute of Chartered Accountants in England and Wales

IFAC – International Federation of Accountants

IFRSs – International Financial Reporting Standards

The Instrument – Statutory Auditors (Transparency) Instrument 2008

ISAs (UK&I) – International Standards on Auditing (UK and Ireland)

ISQC (UKI&I) 1 – International Standards on Quality Control (UK and Ireland) 1: 'Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Related Services Engagements'

NET – Network Executive Team

NLT – the Network Leadership Team

PCAOB – Public Company Accounting Oversight Board

PIB – the Public Interest Body

POB – Public Oversight Board

PricewaterhouseCoopers – the network of member firms of PwC International

PwC – the network of member firms of PwC International

PwC International – PricewaterhouseCoopers International Limited

PwC Network – the network of member firms of PwC International

PwC UK – PricewaterhouseCoopers LLP, a limited liability partnership incorporated in England and Wales

QAD – Quality Assurance Department of the ICAEW

RIs – 'Responsible Individuals' are individuals in the firm who sign audit reports

SEC – Securities and Exchange Commission of the United States of America

'us' – PricewaterhouseCoopers LLP, a limited liability partnership incorporated in England and Wales

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