

Audit quality – Inspections and investigations on our audits

This forms part of our FY21 Transparency Report

Firmwide governance

Independence and ethics

People

Audit quality

- **Inspections and investigations on our audits**
- Our system of quality management
- Our programme to Enhance Audit Quality, and our Root Cause Analysis
- FRC Report on PwC UK's audit quality

Our Audit methodology

Finances and other disclosures



Audit quality

Inspections and investigations on our audits

Inspections and investigations

We operate in a highly regulated field, with many different laws and regulations that need to be followed. As a requirement of some of the registrations, PwC UK is subject to monitoring by a number of regulatory authorities.

External inspections – UK regulators

Each year, the Financial Reporting Council's (FRC) Audit Supervision team undertake inspections of the quality of the firm's work as statutory auditors of public interest entities and on a cyclical basis perform a review of aspects of the firm's policies and procedures supporting audit quality. The Quality Assurance Department (QAD) of the Institute of Chartered Accountants of England and Wales (ICAEW) undertakes annual inspection audits of entities that do not fall within the FRC's scope. The results of the inspections undertaken by the FRC and QAD are reported to the ICAEW's Audit Registration Committee (ARC). In addition, audit engagements have been subject to inspection by NHS Improvement (undertaken by the QAD) and the Public Company Accounting Oversight Board (PCAOB) during the year.

On 8 September 2021, the ARC considered the findings arising from the most recent FRC and QAD inspection reports and proposed that the firm's UK audit registration should be continued on the basis

of the firm's action plan to address the findings of the FRC's report and the actions the firm has already undertaken, and the undertakings given in response to the matters raised in the QAD report. The ARC also recommended that the firm's registrations as a recognised auditor in Jersey, Guernsey and the Isle of Man be continued.

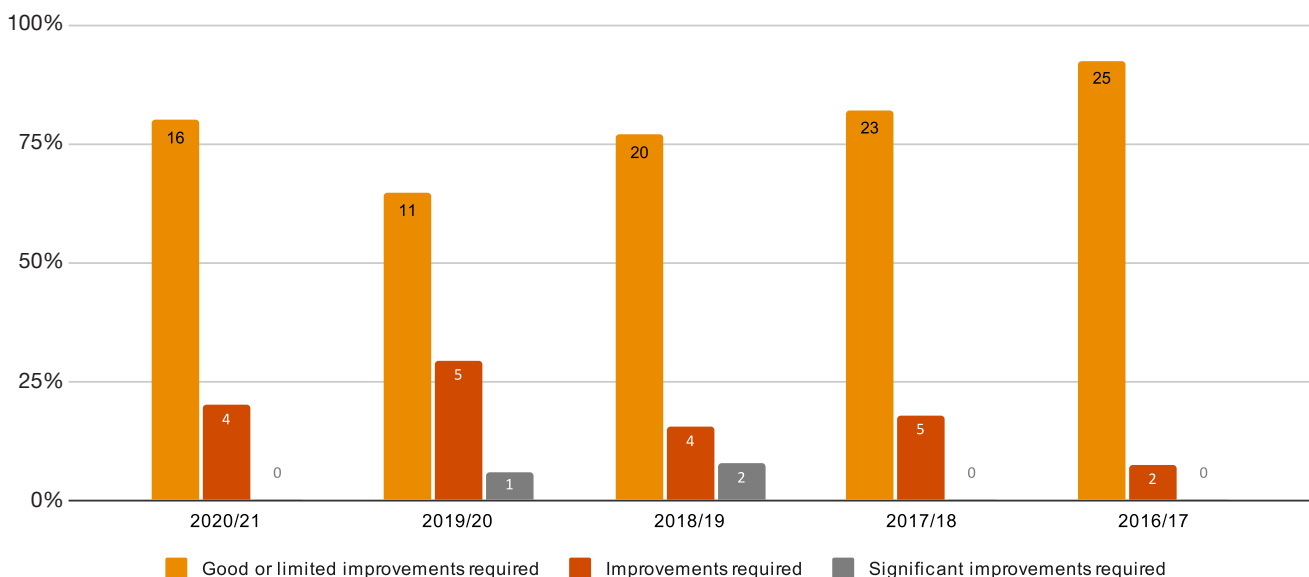
FRC – Audit Quality Inspection and Supervision Report

The FRC issued its 2020/21 Audit Quality Inspection and Supervision Report on PwC UK on 23 July 2021. Alongside the results of the FRC inspection, the report also included the firm's own 2020 internal quality monitoring results and those of the annual QAD inspection. The 2020/21 inspection comprised reviews of 20 (2019/20: 17) individual audit engagements relating to FTSE 100, FTSE 250 and other listed and major public interest entities.

Of the 20 audits reviewed in the 2020/21 cycle, the AQR assessed that:

- 16 audits (11 in 2019/20) were graded 'good or limited improvements required',
- 4 audits (5 in 2019/20) were graded as 'improvements required', and
- No audits (one in 2019/20) had 'significant improvements required'

FRC Inspection Results 2016/17 – 2020/21 PWC – All Reviews



The FRC's report highlighted the following key findings in respect of their individual file reviews, and concluded that PwC should:

- improve the challenge of short-term cash flow forecast growth assumptions in relation to impairment reviews and going concern assessments;
- enhance the audit work performed for the valuation of Pooled Investment Vehicle (PIV) pension assets; and
- enhance the audit work performed over the residual journal population once risk criteria were identified and the sample tested down to an immaterial balance.

We are encouraged by the improved inspection results for audits selected by the FRC as part of the 2020/21 inspection cycle. Whilst we continue to focus on achieving consistent high quality, particularly in respect of the evaluation of management's impairment and going concern assessments which was the main finding in this year's FRC inspection, we are pleased that other previous recurring findings, in respect of long term contract auditing, and the audit of groups, were not identified. We also welcome the broader range of good practice examples identified during the inspections. We remain focused on identifying and addressing risk factors which have contributed to the lower rated inspections and, more broadly, on continuous improvement to achieve consistently high quality audits.

The FRC also reported on their cyclical inspection of policies and procedures to support audit quality. The following areas were reviewed with key findings and areas of good practice reported:

- **Methodology and training programmes** – The FRC reviewed a wide range of our methodology and training programmes, including the firm's response to new auditing and accounting standards and with a focus on banking audit methodology. There were no key findings included in the report in respect of this inspection cycle, and a number of good practices highlights;
- **Audit quality initiatives during 2019/20** – The FRC reviewed the PEAQ programme and concluded that the firm needs to develop an Audit Quality Plan (AQP) to follow the three year PEAQ programme. A successor AQP would help operationalise the audit strategy, ensure audit quality remains a top priority beyond PEAQ and capture key audit

quality initiatives to be regularly reported on to the firm's Audit Oversight Board. Good practices were identified being the governance of the PEAQ and the benefits realisation framework used to assess the effectiveness of actions within PEAQ; and

- **Root Cause Analysis (RCA) for the 2019/20 inspection results** – The AQR concluded that the firm's RCA is responsive to recurring findings as it includes a number effective techniques. However they noted that further RCA and an action effectiveness assessment still needs to be undertaken given certain recurring findings identified during the course of their 2020/21 inspection cycle. A number of good practice examples were included within the report, including the establishment of the Continuous Improvement team.

We welcome the number of examples of good practice that were identified during the firmwide review cycles, including on PEAQ, RCA, methodology and training and within the feedback received on the 2020/21 thematic review cycles, including going concern. We continue to focus on supporting our engagement teams and appreciate the observations in respect of our audit quality plan and root cause analysis. Our designated methodology and training teams are focused on providing high quality updates, training and guidance to our audit practice.

A copy of the report on PwC can be found at www.frc.org.uk.

Other FRC activity

Thematic reviews focus on specific topics or aspects of processes across all the major audit firms. In November 2020, the FRC issued the findings from its 'Climate Thematic', producing separate reports for boards on governance, companies on reporting, for auditors on assessing and responding to climate related risks, for regulators relating to professional oversight and for investors.

During 2020, and in response to the challenges of Covid-19, the AQR also completed a review of each firm's policies and procedures, and the application thereof on individual audits, relating to the audit of going concern. The AQR published their findings in a letter to the Heads of Audit during November 2020.

The firm has considered the findings and examples of best practice within each of these documents, and determined actions where appropriate. A copy of the reports can be found at www.frc.org.uk.



ICAEW – QAD inspection

The standard-scope QAD audit engagement 2020 inspection results were published within the AQR's monitoring and supervision report on the firm on 23 July 2021. They will also be included within the ICAEW's 2021 Audit Monitoring report, to be released in October 2021.

The 2020 QAD inspection comprised reviews of 10 (2019: 10) individual audit engagements, of which:

- Nine audits (Seven in 2019) were assessed as 'satisfactory/acceptable',
- One audits (Two in 2019) were graded as 'improvement required', and
- None of the audits (One in 2019) had 'significant improvement required'.

The QAD concluded that overall, the audit work reviewed was of a good standard, with one audit requiring improvement, which was an improvement on the prior year.

For the audit requiring improvement, the QAD concluded there was insufficient challenge of management in relation to the revenue recognition policy originally adopted in prior years, and a lack of evidence on the audit file of the audit team's continued consideration of the basis on which management recognised revenue.

Whilst there were no broader themes reported, the QAD noted isolated gaps in documentation of key audit work and judgements across a number of audit areas on the generally acceptable graded audits.

As with the AQR 2020/21 inspection, we are pleased with the improved outcome of the 2020 QAD inspection. The QAD's findings have been incorporated into our RCA processes and responsive actions identified.

Local Audit monitoring

During 2020/1, the third year of monitoring under the Local Audit and Accountability Act 2014, the firm had four Local Audit clients subject to monitoring under the scope of the LAAA, all of which were health bodies. As part of the inspection cycle, the firm provided an update to the FRC on actions agreed in response to the 2019/20 inspection cycle. No audit inspection was undertaken by the AQR team for the 2020/21 cycle.

NHS Improvement

Annually NHS Improvement, the regulator of NHS Foundation Trusts, requests that the QAD review

a sample of audits of NHS Foundation Trusts. The QAD reports the results of its reviews privately to NHS Improvement. NHS Improvement writes to each audit engagement leader reviewed to inform him/her of the outcome. NHS Improvement also writes to the NHS Foundation Trust to inform it of the outcome and it requests that the Chair of the Board ensures the results are shared with the Council of Governors, as the body responsible for appointing the external auditor. One audit of an NHS foundation trust was reviewed for the year ended 31 March 2020 inspection cycle. NHS Improvement advised the audit engagement leader and the Trust that there were no significant issues arising from the review that it wished to raise.

Other UK regulatory bodies with which we have interactions

As statutory auditors we engage in ongoing dialogue with regulators of our clients. For example, many audit engagement teams meet with the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) on a regular basis. We also have a duty, for example, to report to the PRA and FCA in respect of matters set out in the Financial Services and Markets Act 2000 (communications by Auditors) Regulations 2001 and to report to the Charity Commission for England and Wales, the Office of the Scottish Charity Regulator (OSCR) and the Charity Commission for Northern Ireland matters required by applicable charities legislation. We also engage with the PRA and FCA through other roles including reporting as a skilled person under s166 of the Financial Services and Markets Act 2000 and Client Asset/Client Money reporting, as set out in the FCA's Supervision Manual. Additionally, PwC LLP is authorised and regulated by the FCA for designated investment business and consumer credit related activity; details of our status can be viewed on the FCA website under firm reference number 221411. We also work with our clients to enable them to assist the Corporate Reporting Review team of the FRC in their work monitoring public company reporting.

Overseas regulatory bodies with which we have interactions

PwC UK is also registered with a number of overseas regulators or oversight bodies. A complete list of all these registrations is included in the PwC UK audit registrations download within the Finance module. Below is a summary of the bodies that have inspected PwC UK in the year.



Public Company Accounting Oversight Board

The Public Company Accounting Oversight Board ('PCAOB') is the regulator for the audits of public companies with securities listed in the US. Engagements covered by the scope of the PCAOB inspection include any US registrant including Domestic Filers and Foreign Private Issuers ('FPIs') as well as UK components of groups listed in the US.

The PCAOB commenced its most recent triennial inspection of PwC UK in September 2020. The inspection covered two FPI engagements and one UK component of a US listed company. The final inspection report has not yet been issued by the PCAOB. However, we are not aware of any inspection comments on the three engagements inspected. We will report the results of the inspection when available.

The Crown Dependencies

Under arrangements with the relevant regulatory authorities in the Crown Dependencies, the FRC undertakes the review of relevant audits performed by PwC UK of the financial statements of certain entities registered in the Crown Dependencies. In their 2020/21 inspection of PwC UK, no such audits were reviewed by the FRC.

Canadian Public Accountability Board

The Canadian Public Accountability Board (CPAB) is the regulator for the audits of reporting issuers in Canada. CPAB inspected audit work performed by PwC UK as component auditor as part of a Canadian group audit inspection. No report is provided to PwC UK by CPAB as part of this process.

Internal monitoring

Quality monitoring is an integral part of the firm's continuous improvement programme. We constantly seek 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 our accountability framework, financial penalties can be imposed on engagement leaders in case of adverse quality findings. Similarly, engagement leaders on any files that are considered 'exceptional' will have their reward positively impacted.

Engagement Compliance Review (ECR)

The Audit engagement compliance review (ECR) programme considers the full population of audits performed and is designed to cover both the firm's Responsible Individuals ("RIs") and specific categories

of audit clients, such as Higher Profile Clients. The ECR programme involves a post-signing cold review of an audit engagement for each RI at least once every three years, and twice in any six-year period for audits identified by the firm as having a high public profile. ECRs are led by experienced partners and are supported by teams of partners, directors and senior managers who are independent of the audit and RI under review. The outcome of each review is evaluated using a standard set of principles set by the PwC Network to assess whether relevant auditing, accounting and professional standards have been complied with. A moderation panel, composed of the review team, the firm's UK Audit Quality Review Leader and a member of the firm's Global Inspections team, forms an overall engagement assessment considering the nature and severity of the individual findings in each review.

PwC UK's monitoring programme is also designed to meet the requirements of ISQC (UK) 1, the ICAEW Audit Regulations and requirements of our other registrations including the Crown Dependencies' Audit Rules and PCAOB regulations and include the requirement to undertake an annual Audit Compliance Review (ACR).

This monitoring programme comprises of two parts:

1. the ECR programme is used to assess whether engagements are performed in accordance with relevant standards; and
2. whole firm review of policies and procedures adopted by PwC UK in respect of audit quality and ISQC (UK) 1 compliance. The firm conducts its own review of its compliance with policies and procedures each year as part of its Quality Management for Service Excellence (QMSE) review programme. This process is reviewed annually by the firm's regulators, and also by a PwC Network team independent of PwC UK as part of the Quality Management Review (QMR) programme. Partners and employees of our firm are informed on a timely basis about the review results and the actions taken to enable them to draw the necessary conclusions for the performance of engagements. In addition, the Global Assurance Quality – Risk Leader informs engagement leaders of our firm who are responsible for group audits involving cross-border work about relevant quality review findings in other PwC firms which enables our partners to consider these findings in planning and performing their audit work and take action if needed to mitigate any quality issues identified in either the firm or individual engagement leader.



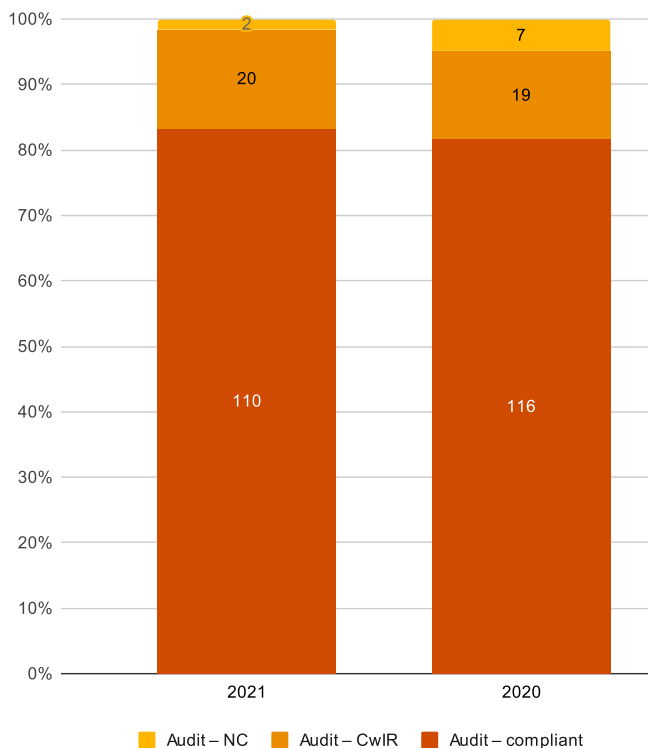
Details of the coverage and results of the 2021 ECR are as follows:

- 132 audit engagements (FY20: 142) were reviewed in FY21, covering 39% (FY20: 43%) of the firm’s Responsible Individuals. 21 non-audit assurance engagements (FY20: 28) were also reviewed
- 110 audit engagements (FY20: 116), representing 83% (FY20: 82%) of the audit engagements reviewed were classified as ‘compliant’. 20 audit engagements (FY20: 19), representing 15% (FY20: 13%) of the audit engagements reviewed were classified as ‘compliant with improvement required’, and 2 (FY20: 7) were classified as ‘non-compliant’

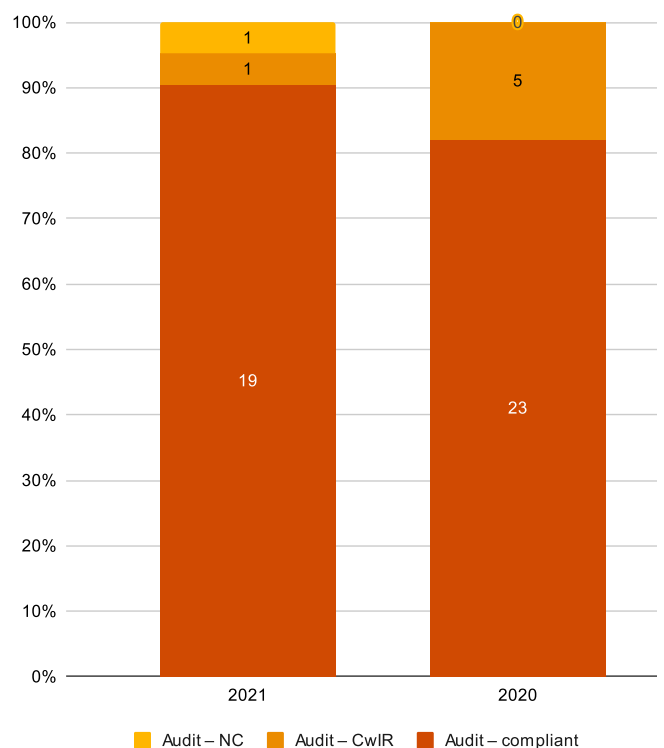
- 19 non-audit assurance engagements (FY20: 23), representing 90% (FY20: 82%) of the 21 non-audit assurance engagements reviewed were classified as ‘compliant’. 1 non-audit assurance engagement (FY20: 5) representing 5% (FY20: 18%) of those reviewed was classified as ‘compliant with improvement required’. 1 non-audit assurance engagement (FY20: 0) was classified as ‘non-compliant’
- In addition, a further 19 audit engagements (FY20: 17) were subject to limited scope, targeted reviews of a specific aspect of the overall audit engagement. 18 engagements were classified as ‘compliant’ (FY20: 17) and 1 was classified ‘compliant with improvement required’ (FY20: 0). 4 non-audit assurance engagements (FY20: 2) were also subject to limited scope, targeted reviews. All 4 were found ‘compliant’ (FY20: 2)

132 Audit engagements were reviewed in FY21
 (FY20: 142) **Covering 39%** of the firm’s Responsible Individuals
 (FY20: 43%) **21** Non-audit assurance engagements were also reviewed
 (FY20: 28)

Audit ECR results



Non-audit ECR results



Audit Compliance Measures (ACMs)

The Audit Compliance Measures (ACMs), previously called the Quality Key Performance Indicators (KPIs), are set each year to take account of matters arising from regulatory reviews and the previous year's ECR findings, in order to ensure that they focus on those aspects of our work where behavioural change and improvements in quality are considered necessary.

In the year to 30 June 2021, 14 ACMs were assessed, covering various aspects of the audit from planning to execution and completion. These metrics are assessed quarterly through the review of files by partners and staff who are independent of the engagement under review. The results are moderated at both a business unit and a national level. The overall metrics for the Audit line of service are reported to the Executive Board.

The overall ACM score for the year ended 30 June 2021 was 92.5% (FY20: 93.5%).

These results are analysed by specific question as well as by business unit, and form the basis of amendments to policies, procedures and training materials.

The slight decrease in the compliance rate in FY21 was primarily driven by the new measures that weren't assessed in FY20. As in previous years, we made changes to the ACMs for the year to 30 June 2021 to help deliver further improvements in key areas of the audit process.

Audit Quality Indicators (AQIs)

Throughout the year to 30 June 2021, we also monitored 18 separate Audit Quality Indicators ('AQIs') ranging from engagement management to people metrics, on a quarterly basis to identify trends in audit quality. Separately to this, the Policy and Reputation Group (PRG) previously identified three people-related areas which could contribute to audit quality, the measurement of which is intended to be done through staff feedback surveys. The suggested survey questions are:

1. I am encouraged to perform a high quality audit;
2. I receive enough training and development to enable me to deliver quality audits; and
3. The teams I work with have sufficient resources to enable them to deliver quality services.



Respondents were able to score on a scale of 1-5 where 1= strongly disagree; 2=disagree; 3=neither agree nor disagree; 4=agree; and 5= strongly agree. Results are reported on a percent favourable basis which is the percent of responses that are a 4 or 5 (Agree and Strongly Agree) – the higher the value, the more favourable the result. Responses in relation to the question 'the teams I work with have sufficient resources to enable them to deliver quality services' include both favourable and neutral responses 60%. In our previous year we asked for responses in relation to a different statement, "I have sufficient time and resource to deliver quality audits". Under the aforementioned methodology of including both favourable and neutral responses, the score for this statement was 55%. Using our 2020 methodology of including only favourable responses, the score for this statement was 31%.



We take the workloads of our partners and staff very seriously and recognise the issues highlighted by the responses to the question in relation to sufficiency of time and resources.

Responding to matters raised by our Regulators

Investigations

The Audit Risk & Quality Investigations Team works alongside PwC's Office of General Counsel (OGC) to resolve Troublesome Practice Matters (TPMs) which arise on completed audits. TPMs include FRC regulatory enquiries and enforcement actions, ICAEW enquiries and, in some cases, matters raised by clients and litigation. The team sits within Audit Risk & Quality and acts as internal experts who review and assess the quality of audit work under enquiry/investigation. The OGC litigation team provides legal advice relating to TPMs.

Having an established Investigations Team within the Audit line of service is part of our recognition that we do not always get things right. We actively work with stakeholders, learn lessons, put in place remedial actions and, where necessary, defend our work by being clear about what we do, why we do things and how we comply with our obligations under international auditing standards.

We recognise and accept any identified shortcomings in our audit work, and acknowledge whenever our work falls below the professional standards expected of us and that we demand of ourselves.

FRC Investigations

The FRC is the 'competent authority' for audit under the UK Audit Regulation and Audit Directive. The FRC deals with cases that appear to raise important issues affecting the public interest in the UK, and investigates whether there is evidence of misconduct (under the Accountancy Scheme) or breach of a relevant requirement (under the Audit Enforcement Procedure) by an accountant or accountancy firm. In the year to 30 June 2021, there have been no cases (2020: nil) found against the firm by the Enforcement division of the FRC. We have four ongoing FRC investigations which are in the public domain. These are in respect of the audit of the financial statements of BT Group plc for the years ended 31 March 2015 to 2017, Eddie Stobart Logistics plc for the year ended 30 November 2018, London Capital & Finance plc for the year ended 30 April 2016 and Wyelands Bank plc for the year ended 30 April 2019. There are other ongoing FRC investigations which are confidential and to which the firm is responding.

FRC Case Examination and Enquiries ("CEE")

The Constructive Engagement process, handled by the CEE team, seeks to resolve cases where the FRC considers that any audit quality concerns identified are able to be appropriately and satisfactorily addressed without full enforcement action. A key part of resolving Constructive Engagement enquiries is for the CEE team to agree appropriate remedial actions with the audit firm. Throughout the year, we have successfully resolved enquiries from the CEE team by promptly responding to enquiries and putting in place the necessary remedial actions to prevent similar matters from reoccurring. These actions have included, for example, providing additional training to the audit practice in specific areas, updating Aura file work papers, issuing additional guidance in the form of the firm's "InBriefs" technical updates to the audit practice and updates to the PwC Audit Guide. As part of resolving enquiries, we provide evidence to CEE that the actions have been completed.

We also have open enquiries and are committed to working with the CEE team to constructively resolve these, and to proactively take the steps we need to, to improve audit quality.

Further details of the constructive engagement process, Accountancy Scheme and Audit Enforcement Procedures can be found on the FRC's website at www.frc.org.uk

ICAEW

In the year to 30 June 2021 there was one (2020: nil) audit case found against the firm by the Audit Registration Committee of the ICAEW. This resulted in a fine and reprimand for the firm. We have ongoing enquiries with the ICAEW which we are committed to continuing to work with the ICAEW in resolving. Further details of the ICAEW's disciplinary process can be found at www.icaew.co.uk

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 Alison Statham, the firm's General Counsel and Chief Risk Officer, who is located at our registered office. We look carefully and promptly at any complaints or allegations we receive. The Institute of Chartered Accountants in England and Wales (ICAEW) or the institute of which the individual PwC UK partner or member of staff is a member, may also be contacted directly.

