The Effect of Independent Regulation on Audit Quality: Evidence from UK And Nigeria

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Ph.D. 2023

The Effect of Independent Regulation on Audit Quality: Evidence from UK And Nigeria

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A thesis submitted in partial fulfilment of the requirements of

Manchester Metropolitan University

for the degree of Doctor of Philosophy

Department Accounting, Finance and Banking
Manchester Metropolitan University

2023

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Word count: 81579

DECLARATION OF ORIGINALITY

I declare herewith that this research is my original work and that all sources of information have been duly cited.

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Date: October 2023.

ABSTRACT

This study assessed the effect of independent regulation on audit quality. The research data consisted of both primary and secondary. The primary data was obtained from structured interviews conducted with staff members of the Financial Reporting Council, UK, and the staff of the professional accounting bodies (PABs) in Nigeria. The analysis of data entailed the identification of themes and patterns, percentage analysis of the FRC audit inspection grades, and the textual analysis of the audit inspection reports and tribunal judgements using the NVivo 12 (Pro) qualitative data analysis software. The study found that the audit quality outlook in the UK improved during the review period. It was observed that the FRC conceptualised audit quality in terms of adherence of the Big4 audit firms to legislations, auditing and accounting standards, ethical standards, and their own internal operating policies and procedures, with compliance assessed using key audit indicators constituted into an Audit Quality Framework (AQF) in 2008. The study revealed a double-faced audit culture of the Big4 audit firms towards audit quality, wherein they recognise and commit to the pursuit of audit quality but adopted implementation strategies which ensured their interests were served at the expense of the public interest, thereby exhibiting the features of both the normative and abolitionist theoretical perspectives of the public interest theory. The study contributed to theory by providing evidence for the articulation of the public interest behaviour of audit firms in the UK and contributed to debates on the conceptualisation of audit quality. The use of qualitative research approach represented a departure from the common application of quantitative methods to practice based issues. It provided a guide for policy initiatives for the strengthening of audit regulation, especially in developing countries like Nigeria.

Keywords: Audit quality, Audit regulation, Financial Reporting Council, Public Interest.

ACKNOWLEDGMENTS

I am thankful to the Almighty God for the completion of a tortuous but successful PhD journey. An event, which started on an interesting note but filled with quite a lot of challenges that threatened the successful completion of the programme. To God be the glory for that which He has granted me to achieve today.

It would have been impossible to achieve this feat without the support of the chosen ones whom God has ordained to make a success of this endeavour for me. In this regard, I remain indebted to my doctoral supervisors, Dr Geofry Areneke (Principal Supervisor – 2023), Dr Russ Glennon, Dr Dimitrios Syrrakos (Supervisor- 2022), Professor Kevin Albertson (Director of Studies, 2013 – 2019), Dr Emmanuel Cleve, and Mr Graham Holt. I thank you sirs for your frank comments and useful guides throughout the long journey. I also appreciate all staff members of the Graduate School of the Faculty of Business and Law, as well as all academic staff members of the Department of Accounting, Banking and Finance of the Manchester Metropolitan University, Manchester. My examiners, Professor Frank Kwabi, Dr Earnest Ezeani, Dr Anna Samsonova-Taddei are worthy of appreciation for their insightful comments at the viva towards improving the quality of the thesis that has now earned me the PhD degree.

Next, my appreciation goes to the Vice-Chancellor, the Dean School of Management Technology, and the Head, Department of Accounting, of the Federal University of Technology, Akure (FUTA), Nigeria. The release and sponsorship provided by FUTA, my employers, were the reasons why I was able to embark on the journey overseas for this all-important achievement of my life. I thank you ma, and sirs. My gratitude also goes to my academic colleagues in FUTA who have had to cover my teaching responsibilities in my absence, with joy. Deserving of special mention are Professor Balogun, Professor Daramola (former Vice-Chancellors), Professor Okoko, Professor Obamuyi, and Professor Lawal (former Deans, SMAT/SLIT), Professor Olowolaju, Professor Ojo, and Professor Simeon-Oke (Dean, SLIT), Professor (Barrister) Olowokere, Dr Abayomi, Dr (Mrs.) Ajayi, Dr (Mrs.) Abosede, and Mrs Mogaji, for the special roles they played at various stages of my PhD programme. God bless you sirs, and mas.

The special ones in my life, and mothers to my children, Mrs Olufunke Akinduko, Mrs Oluwatoyin Akinduko, and Mrs Oluwabukolami Akinduko, children and friends are all deserving of special thanks for coping with my absence and providing the emotional and financial support required for the successful completion of the programme. I thank you all.

Finally, and more importantly, I glorify the holy name of the Almighty Jehovah God of Celestial, who had remained faithful to His promise in my life.

DEDICATION

I dedicate this thesis to my late parents Mr Vasco Akinrinleye Akinduko and Mrs Grace Akinduko who prepared me very well for the challenges of life and set my feet towards the fulfilment of my destiny. Unfortunately, both are not alive to witness this day of glory. I am convinced and I believe that this achievement will gladden your spirits.

It is further dedicated to all individuals and families that remain determined to make successes of their pursuits, despite being victims of environmental limitations because of inequitable national wealth distribution and lopsided political governance in their respective national environments.

The final and most important dedication goes to the Almighty God for keeping me alive and providing the strength and means for this achievement amid overwhelming challenges.

CHAPTER 1: INTRODUCTION

1.1 Introduction

"Audit and financial reporting quality are under intense scrutiny nationally and globally" (Beattie et al, 2015:15). The accounting profession is founded on a set of ideals or virtues which it ascribes to itself, and which distinguishes it from others. Carnegie and Napier (2010) refer to these ideals as "education, ethics and expertise". These opportune them to claim privileged rights to undertake certain activities, such as corporate audit (Lee, 1995). While accounting affords the managers of corporations to give account of their stewardship to the stakeholders in the form of financial statements, the audit function lends credibility to such statements, through an implied confirmation of the existence and reality of the assertions implied in the financial statements. Both functions fall within the purview of the accountancy profession, recognised by government, and socially endorsed by society through its perception of value adding (Bottom, 1998:378).

The spate of corporate collapses, particularly since the case of Enron Corporation of 2001 has exacerbated the concern about whether public interest is being served by the accounting profession as it professes. This calls to question the integrity, relevance and reliability of the accounting profession as represented by the audit function (Williams, 2004:994). Examples of such corporate collapses included, but not limited to Bank of Credit and Commerce International on 5 July 1991; Equitable Life Assurance Society on 8 December 2000; WorldCom on 21 July2001, Enron on 28 November 2001; Parmalat on 24 December 2003; Bayou Hedge Fund Group on 29 September 2005; Bear Sterns on 14 March 2008; Lehman Brothers on 15 September 2008; Royal Bank of Scotland Group on 13 October 2008; and more recently Dick Smith on 5 January 2016. Whether audit (or lack thereof) made things better or worse, remained inconclusive. Power (1997) observed: "However, it is difficult to disentangle particular facts about an audit process from particular facts about the company collapse. It is always logically possible that a 'good' audit was performed even though the company failed".

The development of the accountancy profession and its impact on the society has attained different levels under different national settings. While some countries are more developed and more responsive to public yearnings, some are still at transformative stages and grappling with the effect of peculiar limitations. The accountancy profession made efforts internally (self-regulation) to overcome the audit quality challenges, but the problem seems to defy successive solutions applied to it. Porter (1990) averred that the audit function may not be capable, by itself, of achieving accountability tenets. Consequent on the perceived self-regulatory failure of the accounting profession, governments in the developed economies (for example, the United States and the United Kingdom, among others), established oversight functions to ensure independent statutory regulation of the accounting profession to ensure the protection of public interest. These endeavours include, among others, the establishment of the Public Company Accounting Oversight Board (PCAOB) by the US Congress in 2002 (see About the PCAOB at https://pcaobus.org), and the Financial Reporting Council (FRC) by the UK in 1991. Even at that it does not appear that the investing public and other stakeholders are comfortable on the adequacy of the protection of their interests, because more corporate failures of equally high magnitude like the Enron case occurred in succession from 2001 reaching its climax during the credit crisis of 2007 to 2009. Examples include the bankruptcy of the WorldCom in the USA, HIH Insurance in Australia, Parmalat in Italy, Royal Ahold in the Netherlands, and Equitable Life Assurance Society in the UK (Carnegie & Napier, 2010:360), to mention a few.

The concept of audit quality has been described as nebulous (Francis, 2004), and therefore not capable of accurate measurement. However, in an act that appears like the first of its kind, the FRC (UK) developed the audit quality framework in 2006, for adoption in its supervision of the audit of listed public entities in the UK (Holm and Zaman, 2012). The compliance or otherwise of audit firms with this framework, has been the subject of annual inspection reports issued by the FRC from 2006 to date. These reports are communicated to the audit firms, the audit committees of affected companies and made public on the FRC website. The FRC (UK) also undertakes professional discipline of members of the accounting and actuarial professions through a tribunal which receives complaints from the public, and subjects erring accountants or audit firms to prosecution by the Executive Legal Counsel of the FRC. The judgements of the tribunals are also made public on the website of the FRC. The analysis of the inspection reports and tribunal reports revealed that although there might not be major reports of audit failures since the credit crisis, significant departures from laid down standards, ethics and the audit quality framework have been observed till present time. This always makes the subject matter of audit quality and regulation relevant for study, especially now.

The study found that the audit quality outlook in the UK improved during the review period, given an overall 67.0% of the total FRC audit inspection sample classified as Grade 1 (good quality), 26.1 % as Grade 2 (fair quality), and 6.9% as Grade 3 (low quality). The transparent and public disclosure policy of the FRC was identified as a major influence for attaining this level of audit quality. It was observed that the FRC conceptualised audit quality in terms of adherence of the Big4 audit firms to legislations, auditing and accounting standards, ethical standards, and their own internal operating policies and procedures, with compliance assessed using key audit indicators constituted into an Audit Quality Framework (AQF) in 2008. The study revealed a double-faced audit culture of the Big4 audit firms towards audit quality, wherein they recognise and commit to the pursuit of audit quality but adopted implementation strategies which ensured their interest being served at the expense of the public interest, thereby exhibiting the features of both the normative and abolitionist theoretical perspectives of the public interest theory.

1.2 Research problem and research gap

Concerns about the dwindling quality of audit quality and heightened public displeasure about the ineffectual handling of the activities of the large accounting firms by the professional accountancy bodies have led to the establishment of independent regulatory bodies in most countries, especially in the United Kingdom and Nigeria, which have the Financial Reporting Councils as their audit regulator. Duff (2009:2) indicated that prior to Enron failure, the audit profession in the UK has been affected by the globalisation of business in which businesses get transacted internationally usually under a group structure commonly known as multinationals, with complex accounting system and greater audit responsibility; commercialisation of practice in which auditors have become more interested in maximising their revenue from all sources with less attention to professionalism, and stakeholder dissatisfaction with the level of audit quality, consequent on the losses which arose from corporate collapses.

The conceptualisation of audit quality has largely been made from perceptions and elicited from quantitative analytical procedures, without regards to the lived everyday experience of the auditors and their regulators. In this regard, DeAngelo (1981:116) considered audit quality in terms of the auditor's ability to discover and report breaches in accounting regulations. Francis (2011:127) discussed audit quality in terms of the appropriateness of audit reporting. While Knechel et al (2013) measured audit quality as the occurrence or otherwise of litigations against the auditor; DeFond & Zhang (2014:276) evaluated audit quality as a component of financial reporting. In all of these, the professional practice of auditing as undertaken by the practitioners and the processes of regulating it have received little attention. Brown & Tarca (2007) observed that: "There has been limited research on the activities of enforcement bodies and different approaches to enforcement". In consequence, the impact on the practice and procedures employed in accountancy have not been emphasised by this approach. Humphrey (1997:26) expressed the need "to develop understanding of the practical activities of auditors, not from the basis of hypothetical laboratory experiments but from detailed studies of the lived experiences of auditors in real contexts". Similarly, Berg (2000) in Dabbler (2006) called for "future research to aim at obtaining a better understanding as to why and how regulatory decisions affect business performance". Yin (2009:9) stated that "how and why questions deal with operational links needing to be traced over time, rather than mere frequencies or incidence". a gap now filled by this study in the assessment of the impact of independent regulation, as typified in the Financial Reporting Council, UK, on the audit quality outlook of the UK.

In response to these identified conceptual and methodological gaps, this study employed the use of qualitative approach to allow for auditing practice to be studied in its rich natural context, aimed at improving the practice of the audit firms and audit quality, by examining the activities of the Big4 accounting firms as reflected in the inspection reports of the Financial Reporting Council (see Baker, 1993:77).

1.3 Aim and objectives of the study

The overall aim of the study is to determine the effect or impact, if any, which the introduction of independent regulation has had on audit quality in the United Kingdom, with a view to providing lessons for Nigeria, which has a similar regulatory structure which is younger in age and less developed.

The specific objectives are:

i. To investigate the various meanings ascribed to audit quality over time, with a view to finding commonalities in definitions or descriptions, for adoption in the conceptualisation of an audit quality framework.

ii. To examine the audit quality drivers that were observed to cause changes in audit quality, especially during the era of independent audit regulation in the UK and Nigeria.

iii. To investigate the effect of independent regulation on audit quality in the United Kingdom and Nigeria.

Resultantly, the following research questions arose for determination:

i. How is audit quality conceptualised, and what are the key drivers?

ii. What are the determinants of audit quality?

iii. What are the effects of independent audit regulation on audit quality?

1.4 Significance and motivation for the study

The study focused on the audit review activities of the Financial Reporting Councils of the United Kingdom and Nigeria. The study facilitated a better understanding of the quality of audit services in the capital market, identified the factors that contributed to the quality of audit services, and identified necessary remedial actions towards the narrowing of the audit expectations gap.

Only the audits of listed public limited companies and other public interest entities were considered in this study, with the large accounting firms that audited them as our units of analysis. This position was taken because of the public interest perspective of this study, which is also the focus of the FRC in its audit review.

The study is a cross country case study of the United Kingdom and Nigeria, with the structure and operations of the Financial Reporting Council of the UK contrasted to the Nigerian body with a view to providing a framework for lessons to be learnt by Nigeria, a less developed economy with a similar independent audit regulatory body called the Financial Reporting Council of Nigeria. While the FRC UK has existed from 1991 to date, the FRC Nigeria was established in 2011 from when it has been operating till date. The FRC Nigeria was established to meet the business regulatory needs of the Nigerian society. While not patterned specifically after the UK body, the objectives and structure appear similar, hence this study expected that some lessons could be learnt from the experiences of the longer existing FRC, UK.

1.5 Overview of the research methodology

The research design is a cross-country case study of the independent oversight activities of the Financial Reporting Councils in the United Kingdom and Nigeria. The research approach is qualitative and consisted of the examination of the auditing activities of the accounting firms as reported by the FRCs in the annual audit inspection exercises carried out on the firms. The Big-4 audit firms represented the unit of analysis due to their involvement as the main auditors of public interest entities.

The research data consisted of both primary and secondary. The primary data was obtained from interviews conducted with staff members of the Financial Reporting Council, and the professional accounting bodies (PABs). The secondary data were the audit inspection reports of the FRC, and the FRC Tribunal litigation reports from 2008 to 2016.

The samples were purposively chosen to reflect the focus of the study, hence only staff members of the FRC and PABs connected with audit inspection and case litigations were selected for interview. For the secondary data, all the reports issued within the study period were examined. There were five firms which were individually reported upon in addition to a summary report on all the firms combined. A total of forty-five (45) audit firm specific reports and nine (9) combined reports were analysed. Thirty-eight FRS Tribunal judgements were also analysed.

The analysis of data entailed the identification of themes and patterns for an understanding of the conceptualisation of audit quality, percentage analysis of the FRC audit inspection grades, and the textual analysis of the audit inspection reports and tribunal judgements using the NVivo 12 (Pro) qualitative data analysis software, for an assessment of the effect of the independent regulatory perspective on audit quality.

1.6 Research contributions

The study contributed to theory by providing evidence for the articulation of the public interest behaviour of audit firms in the UK. It contributed to debates on the conceptualisation of audit quality. The use of qualitative research approach, entailing the direct observation of the lived day to day experience of audit firms, represented a departure from the common application of quantitative methods to practice based issues. It provided a guide for policy initiatives for the strengthening of audit regulation, especially in developing countries like Nigeria.

1.7 Thesis structure

This study is divided into seven chapters including this introductory chapter. In chapter 2, the case narratives on the case study organisations (FRCs) from the case study countries (UK and Nigeria) were provided. The chapter provided information on the current issues and regulations affecting audit quality, among others, in both countries. Chapter 3 presented the theoretical and conceptual and empirical review of literature. In chapter 4, the research methodology was discussed, with focus on the ontological and epistemology underpinnings of the study. The design, approach, samples and sampling method, data structure, collection, analysis, and validity procedures were also covered. Chapters 5 and 6 are the empirical chapters. In chapter 5 the empirical study data were presented, both for the audit inspections and the tribunal litigation judgements, while in chapter 6 the results of the data analysis were presented in line with the study objectives. Chapter 7 is the concluding chapter in which the summaries of findings and conclusions, and the contributions to knowledge were presented. Recommendations for further research on the study were also suggested.

1.8 Summary

This chapter provided an introduction into the subject matter of the study, an outline of the aim and objectives of the study, and the resultant research questions. The sequence in which the study was carried out was explained, and an overview of the research methodology was explained. The research problem was discussed, and the research gap succinctly identified.

CHAPTER 2: INSTITUTIONAL BACKGROUND

2.1 Introduction

This chapter provided the case narratives on the case study organisations, the Financial Reporting Councils (FRCs) in both case study countries, the UK and Nigeria. The chapter provided an overview of regulatory issues in the accounting profession with a focus on the transformation from self-regulation to independent regulation in both case studies. The structure and operations of the FRC in both countries were outlined, and a comparative summary of the two bodies provided.

2.2 Overview of developments on the regulation of audit quality

Dellaportas & Davenport (2008:1091) observed that the image of the accounting profession is more projected through the audit function, as evidenced by the overwhelming attention accorded it in the professional codes of ethics, relative to provisions relating to accountants in business. Birch (2004:895) also observed that “The most significant role of an accountant in society is that of the auditor. Following this premise, the regulation of accounting is discussed with reference to how such regulatory perspective contributes to an increase or a decrease in the quality of the audit services offered in the capital market.

Professional practices have come to be affected by changes in technology, globalisation, and economic systems over the years. These changes have brought several challenges to the ways in which professional services are rendered and the extent to which public interests have been served. For instance, technological changes have led to the adoption of the Business Risk Audit (BRA) approach (Robson et al, 2007); while the economic capitalism has led to commercialism and the aggressive pursuit of profit, in conflict with professionalism (Freidson, 2001); and according to Sikka (2008:399): “Major accountancy firms are global enterprises with networks and operations in hundreds of countries. In common with capitalist enterprises, they are concerned with the trading environment in each jurisdiction and have shown willingness to deploy the necessary financial and political resources to secure conditions conducive to a smooth accumulation of profits”. All of these portend a shift in professional focus and a tendency to satisfy the personal commercial interests of accounting firms. Robson et al (2007) further observed that: … “the market for audit services is statutorily obligated and highly regulated", hence regulatory action is needed to protect professional services if society sees value in professions (Gendron, 2007). Regulation in the accountancy profession arose from the need to ensure that the auditors and indeed professional accountants perform their duties as prescribed by law and in the satisfaction of public interest. According to Humphrey (1997:21): The traditional theoretical justification for a regulatory system has been that it offers a valuable way of ensuring that auditors provide quality work and discourages the provision of substandard work through a system of active monitoring and the punishment of poor-quality work".

Regulation can be regarded as state intervention in private spheres of activity to realize public purposes (Dewing and Russell, 1997). The responsibility for economic regulation resides in national governments. Government has the option of engaging in direct regulation or delegating its powers to either a public agency or a private agency. In the United States of America (USA), such powers are exercised by Congress, while the Secretary of State holds forth in the United Kingdom (UK), with powers exercised through the Department of Trade and Industry (DTI). In Nigeria, regulatory powers are exercised by government through an agency created by law, with representatives of professional accounting bodies as members, the Financial Reporting Council of Nigeria.

Reasons for government delegation of powers for economic regulation, according to Mattli and Buthe (2005), include:

- Enhancing efficiency through specialisation or creating policy commitments or biases.
- Blame avoidance or shifting responsibility.

In the context of financial reporting and audit, Withington (1993) identified three forms of regulation, viz.:

- Self or private regulation, which is typically carried out by professional bodies in the interests of facilitating the work of their members.
- A broadly based self or private regulation which has greater independence from members of the group being regulated and involves representation of a broader range of interests; and

- Public sector regulation where a regulatory body is backed by the formal authority of law.

2.3 Self-regulation in the accounting profession

We discussed in the preceding section that the monopoly granted to the accounting profession in recognition of its expertise and public interest mandate, provided the basis for its self-regulation. The body of knowledge of the profession is such that it is difficult or less likely that a lay man can evaluate the quality of the professional services of the accountant, hence it behoves on the profession itself to regulate itself in a way as to check inappropriate behaviours and ensure due compliance with the ethical and professional standards by its members. Given the nature of professional services and its inherent difficulty to be evaluated or understood by users or consumers (Humphrey, 1997:22), coupled with the monopoly it enjoys, especially in the accountancy professions as it relates to the audit of corporate financial statements, it was believed that the professional accountancy bodies are better suited to monitor and control their members. Therefore, self-regulation was the first known mode of regulation worldwide in the accountancy profession.

How well was the public interest served under the self-regulatory approach? The spate of corporate failures culminating in the Enron debacle of 2001 exposed the weakness in the professional independence of the auditors and heightened public concerns more than usual. Baker (1993:70) observed: "Monopoly power in the hands of the self-regulated public accounting profession has produced welfare losses on the part of third-party consumers of audited financial statements". Dellaportas & Davenport (2008:1082) observed that: Members of the professions use their expertise and authority to abuse the trust that society has placed on them, most often to advance their own interest at the expense of those that they serve". Similarly, Grant et al (1996:7) opined that: "Accounting organizations in the pre-Enron period did not really engage in a reflexive examination of the notion of auditor independence. Criticisms addressed by policy makers and academics were typically downplayed". Efforts made by the profession in stemming the tide of the damages to the profession from the perceived audit failures have been described as mere impression management (Holm & Zaman, 2012) and largely ineffectual. Reactions from the professional bodies have been the introduction of new accounting and auditing standards and ethical guidelines, without punitive steps against offenders, who in the main consists of the large accounting firms. It is believed that the financial support of the large firms to the professional bodies was a dominant influence on its ability to enforce discipline on the firms. Humphrey (1997:22) observed further that "self-regulation is seen as a way of the profession protecting itself from external threat and of preserving the status quo". He identified the under listed features of the self-regulatory style:

- Closed nature of professional investigations into audit failure and the resulting lack of disciplinary action by professional regulators, particularly in cases involving large audit firms.
- The limited operational use of professional auditing standards and guidelines.
- Self-interested nature of changes to statements of professional ethics.
- Relative infrequency of regulatory visits to chartered accountant firms.
- Lack of impact in terms of improving large firms' audit practices, with most criticisms directed at small audit firms.
- Regulators are concerned with the existence (or lack) of appropriate procedures to ensure high quality audits, a sort of regulating compliance with audit regulations and not audit quality per se. (See Humphrey, 1997:22)

It is the view of Holm & Zaman (2012) that all the profession did was to keep the profession out of court cases through supposed remedial actions which do not promote audit quality, but an attempt to manage the impression the public has about the quality of audit practice. Humphrey (1997:23) further observed that what led to the public demand for external regulation of the accountancy profession arose from the conflict inherent in self-regulation, in which a professional body acts both as a regulator of audit practice and a trade association for its members.

2.4 The emergence of independent regulation

In reaction to the perceived inadequacy of the self-regulatory model, most nations have in the last decade moved from self-regulation to external regulation by establishing an independent body aimed at restoring public confidence in the accountancy profession and enhancement of audit quality for the smooth functioning of the capital market. External regulation in the form of independent regulation came about to correct the observed or perceived lapses in the self-regulatory perspectives. The national governments succumbed to public pressures and were no longer persuaded by the impression management tactics of the accountancy bodies, thereby allowing the emergence of independent regulatory bodies. For instance:

- In the UK until 1991, the setting of accounting standards and the licensing and monitoring of audit firms was the sole responsibility of the respective accountancy bodies. Under this regime, Griffith (1996) observed that: ‘Accounting standards were flexible and creative accounting was rife’, and there was no effective enforcement to compel compliance or punish auditors who lent their names to creative accounting (Fearnly & Hines, 2003). To restore credibility, the Financial Reporting Council (FRC) was set up in 1988 at the instance of the Department of Trade and Industry (DTI). Auditing standards are set in the UK by the Auditing Practices Board with membership of 40% auditors and 60% non-auditors since 1991.
- In the USA, the setting of accounting standards and the licensing of public accountants was delegated by the Securities and Exchange Commission (SEC) to the American Institute of Certified Public Accountants (AICPA), under which for about twenty-five years, audit firms were only subject to self-regulation under peer review (Lennox and Pittman, 2010). Following the Enron crisis and the resultant promulgation of the Sarbanes and Oxley Act 2002, the SEC was saddled with the responsibility for the regulation of the accounting and audit practice. The SEC set up the Public Company Accounting Oversight Board (PCAOB) to monitor audit firms.
- In Nigeria, the regulation of audit practice was the sole responsibility of the Institute of Chartered Accountants of Nigeria (ICAN), from 1965 until the last decade when the Association of National Accountants of Nigeria (ANAN) was established. Members of both bodies now provide audit services in Nigeria and are subject to the regulation of their respective professional bodies. The setting of standards was handled by the Nigerian Accounting Standards Board (NASB), a government agency, until 2011 when the Financial Reporting Council of Nigeria (FRC) was established to take over the

standard setting functions of the NASB in addition to ensuring compliance with set regulations (See s.8 of the FRC Act 2011).

In the UK, the independent regulator of audit is the FRC, UK. In Nigeria, it is the FRC Nigeria, while in the USA the independent body is the PCAOB. These bodies are established to take over the protection of public interest, in a manner better than what the professional bodies have done. In essence, ensuring a high quality of professional services, represented in the audit function, for the benefits of the public, becomes imperative. It is therefore important to explore an understanding of the conceptualisation of audit quality by these regulatory actors, and an evaluation of how the bodies are positioned towards efficiency in their operations. These are considered in the next section.

2.5 History of the financial reporting council, United Kingdom (FRC, UK)

The FRC, UK is a company limited by guarantee, which serves as the independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. Its scope of operations covers for the United Kingdom and Republic of Ireland. Its establishment was announced in 1990 by government and had since then been enlarged and expanded in terms of the roles performed and bodies placed under its supervision (ICAEW, Knowledge Guide). In 2004, the role of the FRC was extended to become the single independent regulator of the accounting and the auditing profession, issuance of accounting standards and the related enforcement actions. From 2006 the FRC also took on formal responsibility for actuarial oversight and standard setting. New reforms were carried out in July 2012 by the UK government, to enhance the independence of the FRC and to operate as a unified regulatory body. Consequently, all regulatory activities were put under the FRC Board.

2.5.1 Funding structure

The FRC, UK is funded by both government and industry. The core operating costs in relation to accounting, auditing and corporate governance are currently funded by an arrangement under which costs are met by the business community and the accountancy profession. The details of the funding and cost recovery arrangements as provided by FRC (2014:8) are stated below:

i. Core operating costs (Corporate governance, reporting, and audit)

Core operating activities cover all our activities in relation to corporate governance, reporting, and audit other than audit quality review, disciplinary cases, and Conduct Committee (corporate reporting review) case costs. The costs of our core operating activities, and any contribution to our general reserves, in relation to corporate governance, reporting and audit are currently met by three funding groups: the accountancy profession, preparers of accounts (through the preparers levy), and Government.

ii. Audit Quality Review costs

Audit Quality Review costs include only the specific and variable costs of the Audit Quality Review team and are met by the individual Recognised Supervisory Bodies with which the firms that are subject to inspection are registered.

iii. Accountancy Disciplinary Scheme case costs

Accountancy disciplinary scheme case costs include only the specific and variable costs of cases taken by FRC. Case costs are met by the individual participating accountancy bodies to which the members or firms that are the subject of each case belong. We collect these costs from the relevant body during the conduct of the case. Any fine income received, or legal costs awarded to the FRC in relation to disciplinary cases are returned to the participating bodies which met the related case costs.

iv. Conduct Committee Case Costs Fund

Conduct Committee case costs include only the specific and variable costs of cases which the Conduct Committee decides to take to Court or prepares to take to Court. The other costs of corporate reporting review (principally staff, office accommodation and shared IT systems) are included in core operating costs. Case costs are met in the first instance from the Conduct Committee case costs fund, which is then replenished in the following financial year on the same basis as the costs of the core operating activities (accounting, auditing, and corporate governance).

v. Actuarial standards and regulation

Our funding in relation to actuarial standards and regulation is different from that in relation to accounting, auditing, and corporate governance. A single arrangement applies to both core operating costs and actuarial disciplinary case costs. They are met from an annual contribution from the actuarial profession and levies on insurance companies and pension schemes.

vi. Core operating costs (Actuarial)

Core operating activities cover all our activities in relation to actuarial standards and regulation other than disciplinary case costs. They include a proportion of our overheads.

vii. Actuarial disciplinary case costs

Actuarial disciplinary case costs include only the specific and variable costs of actuarial cases. We maintain a fund to cover actuarial case costs. The level of the fund is kept under review in the light of experience of the number and size of cases. The contribution that is required to maintain the fund at an appropriate level is reviewed each year. Any fine income received, or legal costs awarded to the FRC in relation to disciplinary cases are used to replenish the fund. Should the fund exceed the target level, the excess is used to meet the FRC's actuarial operating costs, thereby reducing the costs to the funding groups.

viii. Reserves

We maintain reserves to meet unforeseen expenditure and in recognition of the fact that the FRC has entered several long-term financial commitments. Separate reserves are maintained in relation to our responsibilities for accounting, auditing and corporate governance and our responsibilities for actuarial standards and regulation.

2.5.2 Governance and structure

The FRC, UK is governed by a board which is made up of executive and non-executive directors, with responsibilities for providing strategic leadership for the long-term success of the company.

The Chairman and Deputy Chairman are appointed by the Secretary of State for Business, Innovation and Skills.

Members of the governing board are required to be independent of the profession regulated by the FRC. To this end, no office holder of an accountancy or actuarial body is eligible for appointment to the board or as a director. Similarly, practising auditors are not eligible for appointment to the board (IFIAR, 2016). However, other than the governing body, members of the profession are involved as part of FRC staff engaged in management and inspection functions, but such members while they can retain their membership of such professions, cannot be involved in the governance of the professional body, nor can they carry out any work for professional accountancy firms.

The board which now operates on a committee system classified under three divisions, previously operated using six operating bodies, including the Professional Oversight Board (POB), which is relevant to this study.

The POB is a part of the FRC. It provides oversight on the professional accountancy bodies in the setting of standards and enforcement of discipline among their members. The board's supervisory powers are limited to a mere review of the procedures and actions taken by the professional bodies. It does not have power to direct as to how the professional bodies go about their disciplinary functions or overturn decisions reached by them (Accountancy Age, 13 May 2011). The POB also operated an Audit Inspection Unit (AIU) which oversees auditing organisations and makes recommendations for appropriate regulatory actions by governments and professional bodies. The board was known as the Professional Oversight Board for Accountancy until May 2006, when the name was changed to reflect its wider coverage of the actuarial profession alongside the accountancy profession.

2.5.3 Regulatory approach

The FRC, UK believes that market participants and their professional advisers, encouraged by the investor community, have the primary responsibility for achieving the primary responsibility for achieving high standards of governance and reporting. Consequently, the broad approach adopted is that of *facilitation rather than dictation, and on principles rather than rules.* It believes that no system of regulation can ever eliminate the possibility of corporate reporting or governance failures, and that the pursuit of zero failure would stifle rather than facilitate growth. Where failures are identified, the FRC, UK aims at facilitating rectification and learning by experience, with the pursuit of culpable failures for which there are evidence.

The following principles guide the discharge of the regulatory responsibilities of the FRC, UK:

Operating with the support of the government and other stakeholders, but independently of those whose activities the FRC regulates; Focusing on issues of material significance to investors and users of the capital markets in relation to the quality of corporate governance and reporting; Taking decisions on actions to take based on evidence, fairness, and proportionality; Making open reports of their activities and reasons for them; Observance of the principles of good regulation as statutorily enshrined in the UK, which include transparency, accountability, proportionality, consistency, and targets; Audit monitoring policies and procedures; and Reporting. A transparent reporting method is adopted by the FRC, UK, in which reports are made to government, through the Secretary of State for Business, Innovations and Skills, to the inspected firms, the chair of the client audit committee, and to other stakeholders and the public, through the FRC website.

The reports issued include Audit quality thematic reports; Annual audit quality review reports; Audit firm specific audit reports; and Professional oversight board's annual report to the Secretary of State for Business, Innovation and Skills.

2.5.4 Impact of FRC regulatory activities on audit quality in the UK

Brown & Tarca (2007:456) highlighted the inherent difficulty or near impossibility for the outside observer to measure the effectiveness of an enforcement body. They opined that for an assessment of the impact of the activities of a regulatory body, regards must be given to the extent to which the body attains its objectives. The efficiency and effectiveness of the regulatory process towards the attainment of such stated objectives should therefore be of interest. In the specific case of the FRC which regulates corporate governance, financial reporting and audit and actuarial practices in the UK, it becomes necessary to ascertain the appropriateness and effectiveness of the regulatory policies, procedures, inspections, and enforcement actions on the one hand, and to evaluate the outcomes of the regulatory process in terms of how well the objectives set out to achieve have been met. In doing this, this study outlined the objectives of the FRC, the philosophical principles underlying its governance process, formulation of policies and checks to ensure internal quality in the execution of its tasks. This includes a consideration of the effect and application of the Hampton review rules for better regulation in the UK. With regards to the outcome of the FRC regulatory works, the study is limited to two main areas which concern audit quality, the subject matter of this study, the inspection reports on the accounting firms (auditors) that audited accounts of public interest entities, and the outlook of the disciplinary processes taken against audit professionals who are considered as being in breach of their rules of engagement. Perceptions of a wide range of stakeholders were also considered as part of the evaluative process of the regulatory efficiency and effectiveness of the FRC.

The broad mission of the FRC is Promoting high quality corporate governance and reporting to foster investment, and this the FRC aims to be accomplished by:

i. Maintaining the UK's corporate governance and stewardship codes which foster trust in the way companies are run.
ii. Implementing and monitoring standards for corporate reporting that promote reports that are fair, balanced, and understandable as well as being clear and concise.
iii. Developing standards and behaviours to enhance confidence in the value and quality of audit. overseeing standards which underpin high quality actuarial practice, and the integrity, competence, and transparency of the actuarial profession.
iv. Operating effective, proportionate, and independent investigative, monitoring, and disciplinary procedures which safeguard the integrity of auditors, accountants, and actuaries.
v. Influencing key developments in issues that affect stakeholders in the UK and internationally.
vi. Engaging continuously with stakeholders at every stage of the process to ensure we are responsive to their needs.

vii. Operating a Financial Reporting Lab that brings together companies and investors to collaborate on improvements and innovations to reporting.

(See FRC: What we do and Who we are).

2.6 The financial reporting council of Nigeria (FRCN) and audit regulation

2.6.1 Establishment

The Financial Reporting Council of Nigeria (FRCN) was established in 2011 by an act of parliament as government parastatal under the supervision of the Federal Ministry of Industry, Trade, and Investment.

The FRC replaced the Nigeria Accounting Standards Board (NASB). The Nation (March 02, 2014) reported that "The NASB was established in 1982 as a private sector initiative closely associated with the Institute of Chartered Accountants of Nigeria (ICAN). However, NASB became a government agency in 1992, reporting to the Federal Minister of Commerce. The Nigerian Accounting Standards Board Act of 2003 thus provided the legal framework under which NASB set accounting standards. Membership includes representatives of government and other interest groups".

Thus, the sole purpose of the NASB as of then was the setting of accounting standards, for which the institutional membership was appropriate. However, the FRCN does not only set standards now, but also ensures compliance with the set standards, as well as having regulatory supervision on the professional accounting bodies and the audit firms and individuals licensed by the respective professional accountancy bodies. The change in mandate and enlargement of functions has not attracted a change in the composition of the board.

2.6.2 Main Objects of the Council

Section 11 of the FRCN Act 2011 prescribes the main objects of the FRCN as including the under listed:

(*i*) protect investors and other stakeholders' interest.

(ii) give guidance on issues relating to financial reporting and corporate governance to bodies listed in sections 2 (2) (*b*), (*c*) and (*d*) of this Act.

(*iii*) ensure good corporate governance practices in the public and private sectors of the Nigerian economy.

(*iv*) ensure accuracy and reliability of financial reports and corporate disclosures, pursuant to the various laws and regulations currently in existences, and

(*v*) harmonize activities of relevant professional and regulatory bodies as relating to Corporate Governance and Financial Reporting.

In consequence of the above, the FRCN has the vision: “To be the conscience of regulatory assurance in financial reporting and corporate governance in Nigeria”, and a mission: “To bring utmost confidence to investors, reputation to oversight and ensure quality in accounting, auditing, actuarial, valuation and corporate governance standards and non-financial reporting issues” (FRCN, Vision and Mission).

2.6.3 Governance and Structure

The FRCN is governed by a board of nineteen institutional members as listed below:

i. Association of National Accountants of Nigeria.

ii. Institute of Chartered Accountants of Nigeria.

iii. Office of the Accountant General of the Federation.

iv. Office of the Auditor General for the Federation.

v. Central Bank of Nigeria.

vi. Chartered Institute of Stockbrokers.

vii. Chartered Institute of Taxation of Nigeria.

viii. Corporate Affairs Commission.

ix. Federal Inland Revenue Service.

x. Federal Ministry of Trades and Investment.

xi. Federal Ministry of Finance.

xii. Nigerian Accounting Association.

xiii. Nigerian Association of Chambers of Commerce, Industries, Mines and Agriculture.

xiv. Nigerian Deposit Insurance Corporation.

xv. Nigerian Institute of Estate Surveyors and Valuers.

xvi. Securities and Exchange Commission.

xvii. National Insurance Commission.

xviii. Nigerian Stock Exchange, and

xix. National Pension Commission.

xx. The Executive Secretary of the Financial Reporting Council.

2.6.4 Functions of the board of FRC Nigeria

The main functions of the board of the FRCN as stated in S.8 of the FRC Act, 2011

(*i*) develop and publish accounting and financial reporting standards to be observed in the preparation of financial statement of public interest entities.

(ii) review, promote and enforce compliance with the accounting and financial reporting standards adopted by the Council.

(*iii*) receive notices of non-compliance with approved standards from preparers, users, other third parties or auditors of financial statements.

(*iv*) receive copies of annual reports and financial statements of public interest entities from preparers within 60 days of the approval of the Board.

(*v*) advise the Federal Government on matters relating to accounting and financial reporting standards.

(*vi*) maintain a register of professional accountants and other professionals engaged in the financial reporting process.

(*vii*) monitor compliance with the reporting requirements specified in the adopted code of corporate governance.

(*viii*) promote compliance with the adopted standards issued by the International Federation of Accountants and International Accounting Standards Board.

(*ix*) monitor and promote education, research, and training in the fields of accounting, auditing, financial reporting, and corporate governance.

2.6.5 Operational arms of the Financial Reporting Council, Nigeria

The FRCN Act (S.23) prescribes seven directorates to serve as the operational arm of the FRCN. These consist of:

i. Directorate of Accounting Standards – Private Sector
ii. Directorate of Accounting Standards – Public Sector
iii. Directorate of Auditing Practice Standards
iv. Directorate of Actuarial Standards
v. Directorate of Valuation Standards
vi. Directorate of Inspection and Monitoring
vii. Directorate of Corporate Governance.

The detailed responsibilities of the directorate of inspection and monitoring, which is the focus of this study are specified in sections 24 to 29 of the FRCN Act of 2011, as highlighted below:

(I) monitor compliance with auditing, accounting, actuarial and valuation standards, and guidelines reviewed and adopted by the Council.

(ii) recommend through the Technical and Oversight Committee, sanctions as may be necessary for the Council's approval; and

(*iii*) implement sanctions and fines as approved by the Council in subsection (1) (*b*) of this section.

(2) The Council shall appoint such number of inspectors as it may deem fit under the circumstances.

(3) In exercise of its powers under sub-section (1) (*a*) of this section, the Council may appoint consultants.

(4) Any inspector appointed under sub-section (2) of this section shall have powers to:

(*a*) make such examinations and inquiry as may be necessary to ascertain whether the provisions of this Act or any rule or regulation made thereunder are complied with; and

(*b*) by notice in writing require any person to furnish in such form as may be directed any information on such matters as may be specified in the notice and such person shall comply.

2.6.6 Funding structure

The Council shall establish and maintain a fund into which shall be paid all incomes accruing from annual levies charged from—

(a) every registered professional, not less than N5,000.00 annually.

(b) every publicly quoted company, an amount based on its market capitalization, annually as follows:

(i) an amount equal to 0.1% of market capitalization or N250,000.00 whichever is lower, where the market capitalization of a company is not more than N1 billion.

(ii) an amount equal to 0.04% of market capitalization or N2,000,000.00 whichever is lower, where the market capitalization of a company is greater than N1.00 billion but not more than N500 billion; and

(iii) N5,000,000.00 only, where the market capitalization of a company is greater than N500 billion.

(c) every public interest entity other than those covered by paragraph (b), an amount based on its annual turnover as follows:

(i) N5,000.00, where the annual turnover of the entity is not less than N25 million but not more than N50 million.

(ii) N20,000.00, where the annual turnover of the entity is greater than N50 million but not more than N500 million.

(iii) N50,000.00, where the annual turnover of the entity is greater than N500million but not more than N1 billion.

(iv) N100,000.00, where the annual turnover of the entity is greater than N1.00 billion but not more than N10 billion; and

(v) N1,000,000.00, where the annual turnover of an entity is greater than N10 billion.

(d) budgetary allocations and subventions from the Federal Government.

(e) fines and penalties imposed by the Council.

(f) fees charged for services rendered by the Council.

(g) rents, fees, and other internally generated revenues from services provided by the Council.

(*h*) gift, loans, grant-in-aid from national, bilateral, and multilateral organizations and agencies; and

(*i*) all other sums accruing to the Council from time-to-time.

(2) Where a person fails to pay the levy charged in accordance with sub-section (1) as and when due, the person shall:

(*a*) pay a penalty equivalent to 10% of the amount due for every month of default cumulatively for up to ten months.

(*b*) thereafter, if still in default, the defaulting person shall be prosecuted and if convicted shall be liable to a fine of not more than 3 times the amount due plus all accrued penalties for default charged by the Council; and

(*c*) in addition, in the case of a company, the chief executive officer of the company shall be liable to a fine of not more than N500,000.00 or imprisonment for a term not exceeding 6 months.

2.6.7 Regulatory approach

The process for the conduct of the regulatory functions and exercise of powers are contained in the "Financial Reporting Council of Nigeria, Directorate of Inspections and Monitoring Guidelines/Regulations 2014" (hereinafter referred to as the Guidelines).

Monitoring and inspection exercises do not appear to be a routine exercise, nor are criteria specified for the choice of entities to be inspected in each year. The focus of inspection relates to determining if there are inappropriate accounting treatments in a set of financial statements, and to impose sanctions (see section 10 of the Guidelines).

2.6.8 Audit monitoring policies and procedures

a. According to section 3 of the Guidelines, matters are brought to the attention of the Council in any of the following ways:

(*i*) a review of financial statements, accounts, financial reports, returns, and other documents selected for that purpose by the Inspectors, an officer or agent of the Council.

(*ii*) a complaint from individual, entity, regulator, or otherwise; any breach of the code of conduct and ethics by a registered professional.

(*iii*) any material irregularity notified to it.

(*iv*) a qualified report.

(*v*) public comments (such as press commentary); and

(*vi*) any other matter on financial reporting and corporate governance that may come to the attention of the Council.

b. Such matters are received by the secretariat and assigned to the directorate of monitoring and inspection.

c. A team of inspectors is constituted to meet with the entity for necessary briefing to determine if a breach has occurred, and to assess and impose sanctions as appropriate. Where the briefing looks inadequate to ascertain the depth of the breaches, an on-site investigation may be arranged to hold at the premises of the entity. Fees are charged either per hour or per day for such inspection services at prescribed rates contained in the Guidelines.

d. At the end of the inspection and/or investigation, reports are issued to the entity and penalties and sanctions are imposed by the directorate of inspections in accordance with sections 16 and 20 of the Guidelines, giving due consideration to the nature and materiality of the contravention. Material but not misleading contraventions also attract penalties and sanctions to the entity, the audit firm and engagement partner and other relevant professionals within the entity.

e. Appeals may be made to the Technical and Oversight Committee (TOC) of the FRC board by aggrieved entities. However, a prescribed non-refundable application fee must be paid to institute such appeal. Where the entity has not appealed, and it has not complied with the stipulated penalties and other actions required by the FRCN, a legal action may be instituted against such entity by the FRCN.

f. In limited circumstances, the FRCN may grant consultations to auditors or entities seeking clarifications in respect of clarifications on certain aspects and application of the rules and standards set by the FRCN. However, such consultations attract payment of both an appointment fee and management time fee charged on hourly basis for the duration of the consultation.

2.6.9 Reporting

The FRCN as a parastatal of government reports to the Minister in the Federal Ministry of Trade and Industries. However, the format and frequency of such reports is neither contained in the Act establishing the FRCN, nor in any of the guidelines issued by it. There are two reports on two companies found on the website, but not a report or review of national audit outlook or quality assessment as would be expected.

2.7. Comparison of the structure and operations of the FRC in the United Kingdom and Nigeria

Table 2.1 below provided a comparative summary of the structure and operations of the independent regulatory bodies (FRC) in the two case study countries, Nigeria, and the United Kingdom.

2.8. Summary

The chapter provided the case narratives on the two case study organisations, the Financial Reporting Councils in the UK, and Nigeria. An overview of audit quality considerations under the self-regulatory perspective of the professional accounting bodies was provided, which was largely believed to consist more of impression management than deterring the errant behaviours of audit firms and their staff. Consequently, the events leading to the clamouring and emergence of the independent regulatory perspective were highlighted. The transitional and legal processes that gave effect to the birth of the Financial Reporting Councils in Nigeria and the UK were illustrated. A review of how effective and efficient the public oversight bodies are undertaken, towards determining how and if the objectives of independent regulation was achieved. The structure, operations, and regulatory approaches of the two organisations were examined for an assessment of their independence of the audit firms and professional bodies regulated by them, especially that part of the funds used by the FRC come from the audit firms and professional bodies. A peep was made to the composition of the board for a check against the possible conflict of interest that may result from having some of the persons and professional bodies being regulated, as part of the regulatory board. Finally, a table was provided to compare the two FRCs on criteria relating to audit regulation.

Table 2.1 Comparison of structure and operations of the FRC UK and Nigeria

		FINANCIAL REPORTING COUNCIL, UK	FINANCIAL REPORTING COUNCIL, NIGERIA	OBSERVATIONS	IMPLICATIONS
1	Establishment	Established in 1990 and became the sole regulator of audit in the UK from 2014.	Established in 2011 and it is the sole regulator of audit in Nigeria.	Both oversight bodies are creation of law and enjoy state support.	This makes for independent regulation.
2	Vision		To be the conscience of regulatory assurance in financial reporting and corporate governance in Nigeria.	Supports quality in financial reporting.	Increases investors' confidence.
3	Mission	To promote high quality corporate governance and reporting to foster investment.	To bring utmost confidence to investors, reputation to oversight and ensure quality in accounting, auditing, actuarial, valuation and corporate governance standards and non-financial reporting issues.	Supports quality in financial reporting and audit.	Supports capital market operations.

		FINANCIAL REPORTING COUNCIL, UK	FINANCIAL REPORTING COUNCIL, NIGERIA	OBSERVATIONS	IMPLICATIONS
4	Funding	Funded by the UK government and the business community. Costs are met by the business community and the accountancy professional bodies.	Funded through government budgetary allocations and subventions, and levies and fines imposed on individual registered professionals and public companies, fees received from services provided to audit firms and corporate bodies.	The UK funding is structured to reflect the benefits to the providers of the funds. The FRC Nigeria relies on compulsory payment of fines and levies, the recoveries of which may involve litigations.	For regulatory effectiveness, the focus should not be on commercialisation.
5	Governance	Governed by a board, whose chairman and deputy chairman are appointed by the UK government (Secretary of State for Business, Innovation and Skills). Other members consist of executive and non-	Governed by a board of nineteen institutional members which include the two main professional accountancy bodies in Nigeria (ICAN and ANAN). The chairman of the board is rotationally picked from the	The FRC UK board are free from the profession that they regulate. The members of the regulated profession play leading role in the activities of the FRC board in Nigeria.	The independence of the board may be affected, and the pursuit of audit quality jeopardised when the accounting professional bodies are represented on the board of their independent regulatory body.

		FINANCIAL REPORTING COUNCIL, UK	FINANCIAL REPORTING COUNCIL, NIGERIA	OBSERVATIONS	IMPLICATIONS
		executive directors who are required to be independent of the professions being regulated and must not engage in accountancy practice.	two professional accounting bodies.		
6	Regulatory approach	Regulatory approach based 'as far as possible on facilitation rather than dictation, and on principles rather than rules' (FRC, 2014:3).	The Financial Reporting Council of Nigeria, Directorate of Inspections and Monitoring Guidelines/Regulations 2014 is applied. The focus of inspection relates to determining if there are inappropriate accounting treatments in a set of financial statements, and to impose sanctions, usually monetary, as	It will appear that the FRC Nigeria is high-handed in its approach to audit regulation and looks more focused on revenue generation than the attainment of high quality of financial reporting and audit. The FRC, UK, sees the attainment of audit quality as a collective endeavour.	A cordial relationship with all stakeholders is a pre-requisite to the attainment of good quality of audit and financial reporting.

		FINANCIAL REPORTING COUNCIL, UK	FINANCIAL REPORTING COUNCIL, NIGERIA	OBSERVATIONS	IMPLICATIONS
			prescribed in the 2014 Guidelines (see section 10)		
7	Approach to failures	To facilitate rectification and learning by experience, but culpable failures for which evidence are available are pursued.	Sanctions are imposed by way of fines and / or penalties.	The FRC Nigeria does not seem to leave room for learning from mistakes, especially when they are not culpable errors.	Regulatory objectives might become commercial instead of pursuit of quality if too much emphasis is placed on fines and levies.
8	Guiding principles on regulatory responsibilities	Focused on issues of material significance to investors and users of the capital market; decisions taken based on evidence, fairness, and proportionality; making open reports on activities and reasons for them; observance of the	No formal principles are enunciated. However, the board is supervised by the Nigerian government, through the Minister of Trade and Commerce.	The basis for decisions should be determined and made public to allow for transparency in regulation, and for the assessment of efficiency.	The lack of agreed and known basis of decision making may allow for abuse of office by regulatory inspectors, thereby resulting in frequent disputes and litigations.

		FINANCIAL REPORTING COUNCIL, UK	FINANCIAL REPORTING COUNCIL, NIGERIA	OBSERVATIONS	IMPLICATIONS
		principles of good regulation as prescribed by the UK government.			
9	Audit monitoring policies and procedures	An audit quality framework is adopted made public; annual inspections are conducted on selected audit samples; inspection outcomes are discussed with audit firms and action plans are agreed towards improvement in practice;	Audit monitoring takes place based on complaints received against companies or auditors. Inspection teams are assigned to the investigation for which fees are charged. A report is issued to the company or auditor at the end of the investigation and sanctions are imposed by the investigation team in line with the Guidelines of 2014.	The FRC Nigeria does not seem to have a work plan in respect of audit regulation yet. The latest attempt was the formation of a committee to advise on its mode of audit regulation. Formal reporting has yet to be embraced, since no reviews have taken place and made public.	The absence of set goals and the planning of the methodology for its achievement may limit the attainment of the promotion of audit quality.
10	Reporting	Transparent reporting method is adopted. All reports are made public	The FRC Nigeria reports to the Federal Minister in the Federal Ministry of Trade and	The activities of regulatory bodies should be opened to the public, to earn public	Transparency enhances audit quality as the auditors reported upon

		FINANCIAL REPORTING COUNCIL, UK	FINANCIAL REPORTING COUNCIL, NIGERIA	OBSERVATIONS	IMPLICATIONS
		and made to the UK government (through the Secretary of State for Business, Innovations and Skills); Audit quality inspection reports are issued to audit firms, audit committees of client companies, and audit engagement partners.	Industries. The content, frequency and format of the reports are not stated in the Act establishing the FRC, and these are not made public. There are two reports on the FRCN website on two companies, but these are not reports or reviews of national audit outlook as would be expected.	trust and support towards the realisation of its objectives.	are conscious of their reputation, hence won't want negative reports published on them
11	Consultations	The FRC, UK responds to external consultations that fall within its remit. Responses will generally be published a day after they have been submitted by the FRC.	In limited circumstances, the FRC, Nigeria may grant consultations to auditors or entities seeking clarifications on the application of the rules and standards set by the FRCN. However, such consultations	Regulatory actions should be more directed towards the education of the regulated entities on matters of financial reporting, audit, and corporate governance, for	It is not ideal in representative democracies to commercialise the activities of a regulatory body.

		FINANCIAL REPORTING COUNCIL, UK	FINANCIAL REPORTING COUNCIL, NIGERIA	OBSERVATIONS	IMPLICATIONS
			attract payment of both an appointment fee and management time fee charged on hourly basis for the duration of the consultation.	the asking. Fees charging presents a different relationship outlook.	

CHAPTER 3: LITERATURE REVIEW

3.1 Introduction

In this chapter, the background to the subject matter of the study was provided, in respect of the acclaimed public interest mandate by the accountancy profession and the growing public distrust in the accountancy profession concerning its commitment to public interest. Following this was the theoretical framework underlying the study, wherein the theory of public interest was explored in relation to the auditing function. Since public interest service formed the crux of professionalism, the study reviewed the understanding of the public interest mandate by the accounting profession, and identified the appropriate theoretical perspectives that best captures the behaviour of the audit firms in their quest for public interest service. This was followed by the empirical literature under which the main research objectives were discussed in sequence.

3.2 Theoretical literature

3.2.1 Introduction

Accounting, like most professions, consist of members considered to have requisite skills and competences which qualify them to engage in the functions of their occupation. Such expertise, among other considerations, formed the basis for state endorsement and grant of monopoly, in most countries, especially in the UK. Following such recognition, occupational groups then become professions and are expected to act selflessly by considering the interest of the public over and above their personal interests. How well and long, that professions commit themselves to the public interest mandate has been the subject of debate as it relates to the accounting profession in recent times. Consequently, the tenets of the public interest theory were considered for use in explaining the operations of the audit stakeholders (the regulator and the regulated – FRC and the audit firms) and explained using the findings from the analysis of the audit inspection reports of the FRC.

3.2.2 The theory of public interest

It was discussed in the preceding section that the public interest mandate forms the crux on which professionalism is grounded, especially as claimed by the accounting profession.

However, issues have arisen, in the light of recurring corporate scandals and failures, as to whether or how well the public interest is being served by the accounting profession. More importantly, the definition or description of what constitutes public interest, appears blurred and incapable of universal description (Baker, 2005:690). Who constitutes the public and what are the interests of the public, have also been observed as necessary to be understood before a proper evaluation of whether a profession conducts its business in the interest of the public can be made. While Dellaportas & Davenport (2008:1082) observed that “the term public interest lacks precise definition”, O’Regan (2010) opined that the lack of precise definition of public interest “has sometimes been helpful to the accountancy profession and government regulators who can each invoke quite fluid and ambiguous public interest claims to support their respective viewpoints”.

Claims to serve the public interest has been a feature of the development of the accounting profession across different nationalities. Baker (2005:693) cited Article II of Section 53 of the 2004 Code of Professional Conduct of the American Institute of Certified Public Accountants (AICPA) as containing a provision that explains its public interest mandate, who are the public, and what public interest is as follows:

“Members should accept the obligation to act in a way that will serve the public interest, honour the public trust, and demonstrate commitment to professionalism.” The AICPA (2004) identifies the public as “…. consisting of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce.”

“The AICPA (2004) defines the public interest specifically as: the collective well-being of the community of people and institutions the profession serves.”

(See Baker, 2005:693).

In the UK, Paisey and Paisey (2018:2) reported that: “The Institute of Chartered Accountants Scotland (ICAS) has a long history throughout which the relevance of the ICAS Charter has endured to shape the purpose of ICAS in a modern context. ICAS exists to serve its stakeholders in the public interest.”

Apart from the professional accountancy bodies, the accounting regulatory bodies responsible for the issuance of accounting standards, such as the Financial Accounting Standards Board (FASB) and the International Federation of Accountants (IFAC) also lay claim to the public interest mandate (Baker, 2005:696; Ardelean, 2013:57).

Lee (1995:61) described the accountant's pursuit of public interest as self-serving and lacking in commitment, a phenomenon which he noted was common to both the US and UK professional bodies. Paisey & Paisey (2018:4) observed that a "contradiction between the accountancy profession's references to its role in protecting the public interest, compared with its actions which often prioritise self-interest, has received considerable attention." While Sikka (2009:428) stated that: "The claims of professionalism are routinely problematized by the recurring crisis of capitalism, frequently given visibility by unexpected corporate collapses, frauds, and economic crisis. Such events often give visibility to ethical lapses and anti-social practices crafted by accountants and pose renewed questions about their claims of professionalism." Ways in which accounting claims to serve public interest include:

i. Statutory registration of suitably qualified individuals to be admitted as accounting practitioners. The essence of this was to exclude persons considered to be of sub-standard knowledge from working as accountants, thereby safeguarding the public from the consequence of sub-standard services (see Lee, 1995:53).

ii. Exercising control over the accounting standard setting process, with a view to providing relevant guidance to members of the accounting profession towards the provision of high-quality financial reporting which in turn will assist the public in taking informed decisions from the use of such financial reports (see Lee, 1995:61).

iii. Setting up a professional code of ethics for the regulation of the conduct of members of the accounting profession. Ardelean (2013:57) reported that the establishment of ethics principles by IFAC as well as FEE was a way of ensuring auditor's accountability towards the public interest.

iv. Paisey & Paisey (2018:3) also identified the conduct of continuing professional development (CPD) programmes by member bodies of the accounting profession as a means of developing and maintaining the professional competence of

> members, in the public interest, to provide high quality services to meet the needs of clients, employers, and other stakeholders (IAESB, 2014, para. 9). The IAESB (2014, para. A29) stipulates that "a professional accountant's wilful failure to develop and maintain professional competence is a violation of a professional duty that justifies disciplinary action, in that it diminishes the ability to act in the public interest". Consequently, the IAESB makes CPD a requirement for all IFAC member bodies.

For an understanding of what 'the public' and 'public interest' represent to the accounting profession, this study follows the Cochran (1974) typology, as espoused by Dellaportas & Davenport (2008:1086). In this typology, Cochran reviewed three theoretical perspectives of public and public interest and the ways in which the accounting profession purports to act in their satisfaction. Cochran alluded to a continuum theory of public interest, reflecting elements of the three theoretical perspectives. The Cochran (1974) theoretical perspectives are summarised below (see Dellapotars & Davenport (2008:1083-1086):

Cochran does not believe in a single meaning or approach to defining public interest, but rather canvasses a variety of approaches. Public interest theories were classified into four, viz: Normative, Consensual, Process, and Abolitionist, discussed below:

3.2.2.1 Normative theory of public interest

"The normative view of the public interest, also referred to as the traditionalist view, is primarily concerned with the good of the community (Sturm, 1978, p. 20). Therefore, according to the normative perspective, a policy or action is in the public interest if it advances the collective welfare of the public" (Dellapotars & Davenport, 2008:1084). He explained that the normative approach takes cognisance of the impossibility of serving the interests of all members of the community, but the interest of the majority members will be served, hence raising the question of 'injustice' arising from the clash of the interests of the many with the interests of the few. The notion of the higher good therefore requires that the interest of the few or private interests be subordinated to public interest.

3.2.2.2 Abolitionist theory

Cochran explained that “the public interest theories based on abolitionist notions do not recognise the public or community other than the aggregation of individuals and special interest groups that they form (Cochran 1974, p. 328). Each group reaches for power and influence over other groups to protect their own interest and to gain advantages over others for resources and goods of human life” (see Dellapotars & Davenport, 2008:1085).

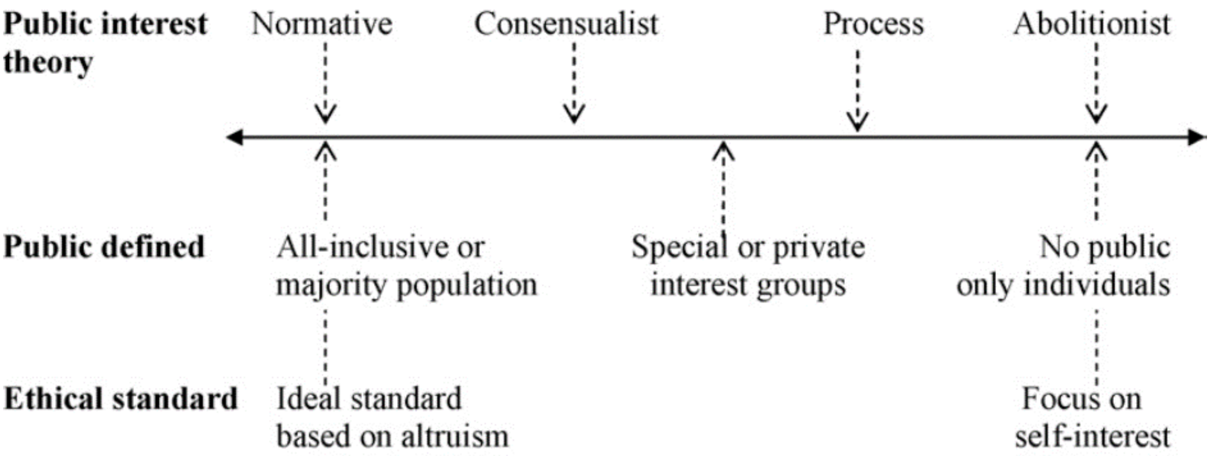
3.2.2.3 Process theories

Process theory of public interest is concerned with the processes by which conflicts of interests are resolved within the community. It does not recognise any category of public and their associated interests, rather it concerns itself with the trade-offs and compromise arrangements between competing interest groups in a community and the process through which agreements were reached. Dellaportas & Davenport (2008:1085) stated that: “According to this view, achieving the public interest requires mechanisms to provide a process of accommodation and compromise between competing interest groups. Such mechanisms provide a reconciliation of interests that allow people to decide the interests that are to be served.”

3.2.2.4 Consensual theory of public interest

The consensual theory considers that public interest is not capable of clear definition, and broader than what can be described in a few words. It is yet to adopt any consensual description of public interest but holds the ideology that what should be regarded of being of public interest should be those that are placed above special private interests. Special private interests being “interests possessed by more than one individual, usually a relatively large number of people but not possessed by the entire society” and considers “morals, principles, community values and ethical standards as well peoples’ interests in a broader context than immediate self-interests.” (See Dellaportas & Davenport (2008:1085).

FIGURE 3.1 COCHRAN (1974) TYPOLOGY OF PUBLIC INTEREST THEORIES – A CONTINUUM



Source: Dellaportas & Davenport (2008:1086)

Cochran typology was explained as classifying the public interest theories into two extreme groups, using the identification of what constitutes the public, and the extent of adoption of ethics and promotion of shared values reflective of majority interests in the community. In so doing, the normative and consensual theories were grouped together, while the Process and abolitionist theories formed the other group.

Accounting associations' use codes of ethics to create expectations of professional behaviour that are ostensibly aimed at benefiting third parties. Definitions of the public interest and members' obligation to serve the public interest appear in the respective codes of ethics of the jurisdictions to which the code relate (Dellaportas & Davenport, 2008:1087). The normative group identified the public as the stakeholders, as the interest sought to protect is higher than the individual interest of any of the groups which make up the stakeholders. The accounting profession's view of the public and public interest appears more associated with the normative view of public interest theory. The ethical codes of the accounting bodies require accountants in their personal and professional behaviours to live above the selfish interest of themselves and their clients and employers in the interest of the stakeholders. Considering the impossibility of the accountant meeting the needs of all the stakeholders, the consensual view comes to the rescue, in that it views the public as the majority and not all members of the community. Applying this theory to the accounting profession, the public therefore is limited to the primary users of accounting information and not the wider public as claimed in their various code of ethics. In contrast, the process and abolition theories do not believe in the public as a whole or majority, instead, they identified individual groups seeking to serve their interests, and the processes adopted to resolve conflicts in interest among the various groups.

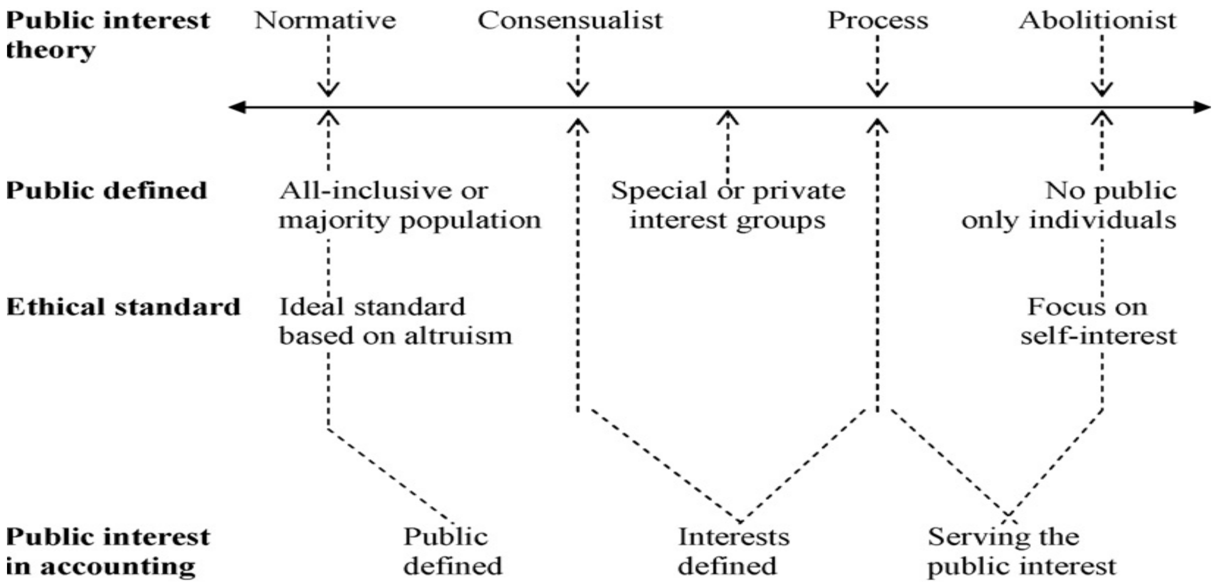
Not much explanations is contained in the Cochran typology about public interest, Dellaportas & Davenport (2008:1089) relying on the description of public interest in political science stated that "interests are asserted if the benefit in question can plausibly be connected to the individuals to whom the definition relates", and in relation to accounting, such connection can be established "when financial reporting serves the economic interests of direct user groups." These are direct users of financial reports. Again, with regards to public interest, the code of ethics portrays the interest of a wider public whereas all it could offer in the financial reports are monetary or quantitative matters on which investment decisions are based. The stakeholders' interest is numerous and varied and beyond the accounting profession to meet. Consequently, the accounting approach reflects the consensual theory and not the normative outlook contained in the code of ethics. Process theories of the public interest are generally concerned with the processes by which conflicts are transformed into policies or actions in the public interest. In accounting, due process is observed when members 'serve the public interest' according to a set of defined criteria even if the outcomes are less than desirable for all interested parties. The setting of standards which members of the profession are expected to comply with is a major feature of the process theory. The abolitionist theory contends that professions like individual groups in a community engage in self-service as a means of protecting public interest.

Elaborating further, Dellaportas & Davenport (2008:1091) discussed how the public interest is served by the accounting profession. This was done at two levels, namely, individual professional judgement, and institutional processes. At individual level, the observance of ethical guidelines and professional standards, align with public interest service. However, conflicts abound in the ethical requirements, especially as regards the accountant's duty of confidentiality. Accountants owe their clients and employers a duty of confidentiality and are also required to make relevant disclosures in public interest. Where conflicts arise, it is traditional of the accounting profession to accord priority to the duty of confidentiality. A second issue relates to the structure of the ethical codes, which seem to be more concerned with auditors to the detriment of accountants in business. Dellaportas & Davenport

(2008:1091) stated: “The auditor’s duty to serve the public interest dominates codes of ethics, yet the obligation to serve the public interest rests on all members of the accounting profession, including accountants in business not just auditors.”

At institutional level, public interest is served when accounting institutions such as IFAC or FASB issues good quality standards with a view to improving the quality of services rendered by members of the accounting profession. Such high quality of service is then expected to elicit public trust and confidence in the profession. Complimentary to a good set of standards is an effective disciplinary process. However, it was observed that the accounting profession has not been transparent in its disciplinary processes, being conducted in secret without public input, and the sanctions applied considered a token or too low for a deterrence of inappropriate behaviours. Furthermore, the inclusion of public interest service in the codes of ethics by the accounting profession was described as ‘mere window-dressing’ to win public confidence, and such inclusions, most times were reactionary to criticisms (see Dellaportas & Davenport, 2008:1092-1093). Here, the accounting profession demonstrates features of the abolitionist theory which holds that individual groups engage in the pursuit of self-interest as a means of pursuing the public interest. According to Lee (1995), the accounting profession has historically relied on the public interest as a means of protecting the profession’s economic self-interest. In this sense, advocating the public interest gives pretext of responsibility when none may exist (Dellaportas & Davenport, 2008:1093). Dellaportas & Davenport argued further that a profession’s pursuit of self-interest can either enhance or worsen the public interest service, depending on the level of pursuit. They advised that self-interest is desirable but should not be pursued at the expense of public interest service to the stakeholders. They revised the Cochran typology of public interest theories, to reflect the public interest service by the accounting profession, as shown below:

FIG. 3.2 THE PUBLIC INTEREST IN ACCOUNTING



Source: Dellaportas & Davenport (2008:1094)

3.3 Empirical literature

3.3.1 Introduction

This section provided a detailed understanding of the description and understanding of audit quality. Descriptions of audit quality from various perspectives were explored and considered for the conceptualisation of an audit quality framework.

3.3.2 The need for audit quality

Greater concerns about audit quality have arisen in recent times more than before. The discussion centres round several factors which concern the usefulness and the expectations about the audit function. From the capital market perspective, investors and other stakeholders rely on audited financial information, among others, for their decision making. However, the spate of corporate failures, some coming after audit certifications, has been a source of worry to market participants. According to Kirkham (1992:292): “Current concerns regarding the audit function have centred upon a series of major scandals both in the UK, the US and internationally (e.g., Maxwell Communications Corporation (MCC), Savings and Loans Association (S&Ls), Bank of Credit and Commerce International (BCCI)). These scandals have revived a questioning of the independence, integrity, and expertise of auditors in relation to several aspects of the audit function, including the absence of qualified audit opinions despite apparent evidence of problems and the adequacy of the collection and evaluation of audit evidence". The need for reliability of information has therefore necessitated the need for greater audit quality. From professional standpoint, the auditing function is regarded as the image of the accounting profession. The auditing function in the UK, like in other countries, enjoys government support and legal monopoly over the audits of corporate bodies. Consequent on this, society has come to regard the auditor as the objective and independent observer on, and attester to, corporate financial statements. Auditing was conceptualised as a service to the society and is supposed to be impartial and devoid of excessive commercialisation. However, current events seem to portray auditors as self-serving and compromising, not committed to the public interest mandate, and highly engrossed in fraternising with those they are supposed to superintend on, to secure increased revenue and profitability, to the disadvantage of the shareowners and other stakeholders. Against this background, concerns about audit quality becomes imperative, and calls for the social context of accounting has become louder, in preference to the traditional or technical approach to accounting. This will allow for a better understanding of the practice of accounting as manifested in the audit function and an examination of the quality of service provided to the society. Concerning the public character of accounting information, Burchell et al (1985:383) argued that: "The consequent search by the accounting profession for ways to improve the accuracy and utility of published financial statements resulted in, among other things, the creation of institutions for accounting standardization and regulation, themselves a significant new part of the accounting environment".

What translates to improved or higher audit quality has been the subject of historical and continuous debates, lending credence to the topicality and relevance of the subject always. Christensen et al (2016:1649) observed that: "Despite the importance of audit quality to the stability of the capital markets, and the large body of research investigating the topic, regulators, investors, and researchers continue to debate the definition, composition, and understanding of audit quality". The need to understand the concept of audit quality and the development of a framework for understanding changes in it as time changes has become much more important now than ever, due to the self-enlargement of the range of services offered by the large accounting firms and the continued reliance on certifications and opinions rendered by them by the audit stakeholders in recognition of the expertise ascribed to the accountancy profession as typified in the auditing function, and the state endorsement through legislations which confer monopoly on the accountancy profession for the provision of auditing services.

What is audit quality seeming to be growing from the state of little-known described by Francis (2004), to the emergence of further descriptions and frameworks for a better understanding, pursuit, and regulation of audit quality. The concerns for ensuring the understanding of audit quality drivers and the sustenance of practices to enhance its development has transcended professional accountancy bodies, professional accounting firms, academic accounting researchers, national and international regulatory bodies, and investors to mention but a few, all of whom constitute the audit stakeholders. Different perspectives abound in the perception of audit quality by the different audit stakeholders. It is pertinent to mention that the lens from which quality is discussed in most cases is the public interest entities (which include public listed companies and government parastatals, among others) and activities of the large and international accounting firms which provide auditing and other advisory services to them.

Defining audit quality in specific terms is an onerous task, which has defiled solution for a long time. Knechel et al (2013:387) indicated that: “The problem of audit quality being in the ‘‘eye of the beholder’’ is reflected in the broad range of diverse, and sometimes divergent, definitions that have been offered by numerous authorities and individuals over the past 20 years”. Kilgore et al (2014:778) observed that: “Although there is a vast body of literature relating to audit quality, there is no single generally accepted definition or measure of audit quality.” Similarly, While Smith (2012:18) considered that: “actual audit quality is an unobservable state”, Knechel et al (2013:385) remarked that: “Audit quality is much debated, but little understood. Despite more than two decades of research, there remains little consensus about how to define, let alone measure, audit quality”. Duff (2009:401) also added that: “Audit quality does not have a consistent definition and operationalization across studies. It has troubled theorists for many years. Audit quality is particularly problematic intrinsically, and for external users, as its characteristics are often unobservable”. The professional and regulatory bodies do not agree less with the academics, as the American CPA also shared this view. The IAASB (2014), a body of international accounting and audit regulator highlighted that: "The term "audit quality" is frequently used in debates among stakeholders, in communications of regulators, standard setters, audit firms and others, and in research and policy setting. Audit quality is a complex subject and there is no definition or analysis of it that has achieved universal recognition." A similar view was expressed by the Financial Reporting Council, UK (FRC, 2006:16) which stated that ''there is no single agreed definition of audit quality that can be used as a 'standard' against which actual performance can be assessed.'' In all of these, concerns arose as to the approaches to understanding audit quality, given its nebulous nature (Francis, 2004).

3.3.3 The conceptualisation of audit quality

The academic literature has adopted various approaches to explaining the concept of audit quality. DeAngelo (1981:186) described the quality of audit services as "the market-assessed joint probability that a given auditor will both (a) discover a breach in the client's accounting system, and (b) report the breach." She considered the technical competence of the auditor as a requirement for being able to detect a breach, if any, that exists in the client's accounting system. She considered the reporting of the breach, where found, as a function of the independence or objectivity of the auditor. Francis (2004) observed, with regards to research conducted in the USA, that audit quality would appear to have recovered from the damaging level of the 1990s, he posited that "we do not know from research the optimal level of audit quality and therefore whether we currently have 'too little' or 'too much' auditing". Francis (2004:346) conceptualised audit quality as a theoretical continuum which ranges from low to high, with low quality or audit failures occurring at the lower end of the continuum. He recommends that audit quality should be discussed in terms of the failure rates. He sees audit failure from the twin perspectives of the auditor's ineffective enforcement of client compliance with relevant accounting standards and principles, on one hand, and the issuance of inappropriate audit report with regards to the circumstance of the client. To DeFond and Zhang (2014:276) "…… audit quality is a component of financial reporting quality", consequently, sees "higher audit quality as greater assurance of high financial reporting quality". Francis (2011:127) discussed the legal view of audit quality as: "…. a simple dichotomy of failure or no failure", with failure occurring when the auditor is not independent in fact, or issues inappropriate report because of insufficient and incompetent audit evidence. Good audit occurs when the auditor complies with auditing standards and issues correct audit report. Knechel et al. (2013:388) considered litigations against the auditor as part of output measures of audit quality. It was suggested that single factors are inadequate to describe audit quality, but rather by a combination of related factors (DeFond & Zhang, 2014:276), in the form of a framework.

Using the framework approach, Duff (2009:404) referred to the two factors in the DeAngelo definition as being technical qualities. He expressed the need for the inclusion of service qualities in the definition of audit quality, thereby adopting a framework approach for the definition of audit quality. Duff proposed a framework of four parts comprising of nine factors, viz, reputation, capability, assurance, independence, expertise, experience, responsiveness, empathy, and non-audit services. The FRC UK developed a framework in 2006, which became operational in 2008, as the basis for conducting its inspection of the audits of public interest entities for which the Big4 firms served as auditors (FRC, 2008:3). The framework was designed to support effective communication between auditors, audit committees, preparers, investors, and other stakeholders on audit quality. The framework has five parts as follows:

i. The culture of the audit firm

This concerns the way the firm impacts on the belief and performance of its partners and staff in the handling of audit responsibilities with the public interest as a major concern. It requires the firm to create an environment which rewards staff commitment to quality audit and encourages them develop personal characteristics in this regard. The need for independence, objectivity, and ethical compliance in the acceptance of new engagements were also emphasised.

ii. The skills and personal qualities of the audit partners and staff

This concerns the extent to which partners and staff understand the businesses of the audited clients, and their adherence to auditing and ethical standards; The exhibition of professional scepticism in judgments made by staff and partners and the extent of robustness and consultation in the treatment of difficult issues arising from the audit engagement. The need for sufficient training and staff mentorship by the more experienced partners were also highlighted.

iii. The effectiveness of the audit process

The key areas of attention here are the firm’s audit methodology, which is expected to be provide for proper audit planning, inclusiveness of relevant personnel at all stages of the audit, appropriate audit documentation and sufficiency of audit evidence, with a clear understanding of audit procedures by all partners and staff involved in specific audit engagements. Other issues are the provision of technical support to audit staff when needed, and a consciousness of the negative impact of financial pressures on audit quality.

iv. The reliability and usefulness of audit reporting

It is expected that the observance of the yardsticks highlighted in the previous elements of the audit quality framework will facilitate the issuance of an appropriate audit report which reflects the true position of the affairs of the client company. It is also expected that the auditor communicates with the audit committees as timely and detailed as possible on matters which include the scope of the audit, threats to auditor’s objectivity, key risks identified and judgements made in reaching their audit opinion, and other factors which in the views of the auditor will assist in promoting audit quality in the client company.

v. Factors outside the control of auditors

These concern matters which are external to the auditor and hence outside of his control. They involve the client’s approach to corporate governance, the state of the audit committee’s effectiveness and efficiency, and the regulatory environment in the applicable country.

Holm & Zaman (2012:59) reviewed the audit quality framework of the FRC UK and opined that it was inadequate to evaluate the quality of audit work conducted by the audit firms. They suggested that: “…. issues related to the expertise and professionalism of auditors, commercialization of audit, and the transparency of the audit process as well as that of audit firms have not received much regulatory attention.” Similarly, Francis (2011:125,126) provided a multi-dimensional framework for evaluating audit quality. Francis contended that though audit quality appears non-observable, it has outcomes which are observable, and these are: The audit report, and the client's financial statements. Using the audit report as a proxy for audit quality requires that the auditor is examined or measured on his ability to exercise the attribute of independence, by correctly reporting on the client's affairs. He argued that a less independent auditor will not disclose the financial wrongs of the client even when the audit evidence obtained disclosed such. Using the client's financial statements, requires that earnings quality be used as proxy for audit quality. Low quality earnings reduce the informative use of earnings for investors in predicting future performance (see p.131). Consequently, he proposed a six-part audit quality framework as follows: Audit Inputs (Audit tests, and Engagement team personnel), Audit Processes (Implementation of audit tests by engagement team personnel), Accounting Firms (Engagement teams work in accounting firms, and Accounting firms hire, train, and compensate auditors, and develop audit guidance (testing procedures), and Audit reports are issued in name of accounting firms), Audit Industry and Audit Markets (Accounting firms constitute an industry, and Industry structure affects markets and economic behaviour), Institutions (Institutions affect auditing and incentives for quality, e.g., State Boards of Accountancy, the AICPA, FASB, SEC, and PCAOB, as well as the broader legal system), Economic Consequences of Audit Outcomes (Audit outcomes affect clients and users of audited accounting information). Furthermore, the International Auditing and Assurance Standards Board (IAASB) also produced an audit quality framework. The IAASB framework for audit quality was introduced for discussion in May 2013, and approved for application in February 2014. The framework is the latest from a regulatory body, coming after the FRC 2008 audit quality framework, regarded as the first audit quality framework from a regulatory body (Holms and Zaman, 2012; Hu, 2015). The IAASB audit quality framework has the under-listed elements: Inputs factors, Process factors, Output factors, Key interactions within the financial reporting supply chain, and Contextual factors. All the five elements were discussed at three levels which are the engagement level, the firms' level, and the national level. It prescribed what indicators that should be in place for the attainment of good quality audit at each of these levels. The key provisions are summarised below:

i. <u>Input factors</u>:

The input factors centres on the partners and staff of the audit firm. Audit quality indicators considered relevant included values, ethics, and attitude, as well as the knowledge, skills, and experience of the partners and the engagement team staff. Here too, the culture and ethical tone of the firm and how these impact on the partners and staff are of importance. Principles were laid down for ensuring the compliance of partners and engagement staff with the requirements for independence, objectivity, ethics, and sound judgment in the discharge of the audit assignment.

ii. Process factors:

This involves the application of rigorous audit procedures with substantial compliance with laws, regulations, and standards. While the engagement team needs to be encouraged in the appropriate use of information technology and imbibing the culture of due interaction with other members in problems solution and decisions, the audit firm is expected to develop a methodology which provides clear direction and complies with all applicable laws and standards. The firm's ethical tone and methodology is regarded as the directive guide to the engagement team.

iii. Output factors:

The output from the audit process is expected to be useful to the different categories of stakeholders. Other than the standard audit report, many other reports are generated at the end of the audit exercise. These include management letter or domestic report to clients' management, reports to audit committees, reports to financial and prudential regulators, and transparency reports, among others. The firm also issues report in reaction to the observations of professional and independent regulators. These reports are expected to be informative and assist in the evaluation of the audit quality stance of the firm and its staff. The reports are also expected to be adequate in contents and timely. Necessary guidelines were prescribed in the framework for the evaluation of these attributes.

iv. Key interactions within the financial reporting supply chain

It is the considered view of the International Federation of Accountants (IFAC) that the attainment of high-quality audit cannot be achieved in isolation, as it takes all that are connected within the financial reporting supply chain to be of 'high quality' and 'closely connected'. The parties connected in these interactions were identified as including Management, Auditors, Users, Regulators, and those charged with governance. Of immediate relevance to this study is the interactions between the auditor and management, and between the auditor and those charged with governance, as well as regulatory authorities:

- In the auditor's interaction with the management of the client company, discussions and reports are prescribed to include possible improvements to the company's financial reporting practices and inter control systems, new financial reporting requirements, perspectives on new industry issues, and observations on legal and regulatory matters.
- In the auditor's communication with those charged with governance, especially the audit committee, where one is in place, matters relating to the planning of the audit and the significant findings from the audit exercise should receive attention. Those charged with governance will then be assisted to provide an enabling environment for the independence and objectivity of the auditor.
- In interactions with audit regulators, the audit firm should include detailed responses and plans to deal with improvements required in respect of observations raised on the audits inspected by regulators. These may include observations in respect of breaches of the law and/or standards.

v. <u>Contextual factors</u>:

The framework identified several environmental and contextual factors which are precedent or contributory to the achievement of high-quality audits. The level of development and effectiveness of these factors are expected to vary from country to country with consequent effect on the performance of audit firms operating in such environments. The factors include, but not limited to:

- Applicable financial reporting framework
- Corporate governance
- Information systems
- Broader cultural factors
- Financial reporting timetable
- Attracting talent

- Litigation environment
- Audit regulation
- Business practices and commercial law
- Laws and regulations relating to financial reporting.

From the various perspectives of audit quality descriptions and frameworks in the foregoing, the underlisted key drivers were extracted, and these were adopted for the discussion of the determinants of audit quality:

TABLE 3.1 FRC UK AUDIT QUALITY DRIVERS AND UNITS OF ANALYSIS

S/N	Drivers of audit quality	Indicators of audit quality	Units of analysis
1	The culture of the firm	The audit firm is expected to promote audit quality in the public interest by ensuring adherence to policies on acceptance of engagements, making sure that decisions are not heavily influenced by financial considerations, rewarding staff based on commitment to quality, and monitoring of audit quality amongst staff.	Audit quality monitoring.
			Client acceptance and continuation
			Financial consideration
			Investment and reward
			Consultations
			Staff reward system
2	The skills and personal qualities of the audit partners and staff	Audit partners and staff are required to understand the client's business, adhere to auditing and ethical standards, exhibit professional scepticism, have adequate training and experience, and partners mentoring other staff members.	Adherence to audit and ethical standards
			Mentoring and on the job training.
			Professional scepticism
			Specialist training
3	The effectiveness of the audit process	Application of well-structured audit methodology and tools. Obtaining sufficient appropriate audit evidence. Effective review of audit work and provision of technical support to audit staff. Avoiding the effect of financial pressures on the sufficiency of audit evidence.	Audit evidence
			Audit methodology
			Integrity, objectivity, and independence
			Quality technical support

S/N	Drivers of audit quality	Indicators of audit quality	Units of analysis
4	The reliability and usefulness of audit reporting	Clear and unambiguous wording of audit reports on the financial statements. Reaching proper conclusion on the truth and fairness of financial statements. Communications with audit committees on the scope of the audit, threats to objectivity, key risks identified, and judgements made in reaching audit opinion, and qualitative aspects of the client's accounting and reporting.	Audit reports Communications with audit committees Proper audit conclusion – truth and fairness
5	Factors outside the control of auditors	Adequacy of client's corporate governance for effectiveness towards financial reporting and auditing. Effectiveness and professionalism of audit committees. Adequacy of support from shareholders. Effect of reporting deadlines on quantum of audit work performed. Arrangements for limitation of auditor's liability. Effect of audit regulatory environment on audit quality.	Client's corporate governance structure Effectiveness of audit committees Shareholders' support for auditors in facilitating positive change in the behaviour of management Agreed arrangements for the limitation of auditor's liability on the audit Effectiveness of audit regulatory actors and environment

3.3.4 Determinants of audit quality

3.3.4.1 Introduction

The relevance of the audit function to the credibility of corporate financial information and smooth operation of the capital market has made the quality of the audit service of significant concern to stakeholders in the capital market. The seeming lack of trust in the auditors and the growing non-reliability of the audit opinion, as evidenced in the avoidable or preventable corporate failures in the UK over the years have stimulated discussions and evaluation of factors which impact on the auditors' ability to live up to expectation, in exchange for the public confidence reposed in, and governmental support enjoyed by them. These factors have been the subject of claims and counter claims between the accountancy profession and the stakeholders, especially the investors, who bear the major loss arising from the failure in the auditors' exercise of the duty of care. Opinions have been divided among academic and professional researchers on the impact of these factors, usually because of the variations in the context of research and cultures of the research environments, among others. Significant factors which were identified as material to the key drivers contained in the audit quality framework of the FRC are hereunder discussed. These key drivers, which formed the basis for the analysis of qualitative data in the later part of this study are highlighted below.

3.3.4.2 Independence and ethics

The auditor is expected to be a professional required to carry out his duties as neutrally and sincerely as possible. He is not only required to be objective, but should be seen to be so, to earn the confidence of his employers and other users of his audit output who rely on the value of his expertise. The International Standards on Auditing (UK and Ireland) 200, paragraph 14 requires that: "The auditor shall comply with relevant ethical requirements, including those pertaining to independence relating to financial statement audit engagement". Dart (2011:173) observed that: "If the owners of organisations doubt the auditor's independence, financial statements will lack credibility, which could lead to the abrupt and arbitrary withdrawal of capital from suspect businesses". DeAngelo (1981:116) considered that: "An auditor is independent when on discovering a breach of accounting regulations the auditor reports the breach".

3.3.4.3 Economic dependence

Dart (2011) examined three auditor-client relationships which have been considered as capable of affecting the independence of the auditor, viz: Economic dependence; Provision of non-audit services; and tenure of the auditor's engagement.

Economic dependence was considered with regards to the amount and method by which audit fees are paid to audit firms. Here it was argued that the dominance of the revenue base of an audit firm by the fees derivable from a client or a set of connected clients, may constitute a major threat to the independence of the auditor. Haber (2005:12) reported that in the case of the celebrated Enron debacle, the fees received from Enron by the local Andersen office that audited its accounts, represented a substantial proportion of the audit revenue of the office, even when the fees from non-audit services have been excluded. This was considered to have partly accounted for the impairment in the audit judgement on matters that came to light during the audit, but which remained unreported, until Enron went into bankruptcy. Corroboratively, Khurana and Raman (2006), as informed in Dart (2011) found that: "investors perceived client dependence negatively, because in his regression analysis, a positive association between auditor fees and cost of equity capital was established".

3.3.4.4 Non audit services

This factor has been of major concern for a very long time and has attracted diverse opinions from researchers and practitioners. Opinions have been divided and somehow inconclusive on whether the auditor's provision of non-audit services to their audit clients may impact negatively on their independence and objectivity (see Ashbaugh, 2004; Brandon et al., 2004; Reynolds et al., 2004; and DeFond et al., 2002).

Proponents of the usefulness or appropriateness of the auditor's involvement in the provision of non-audit services to audit clients have argued in the following directions:

- Antle et al. (1997) suggested that the provision of non-audit services to audit clients will lead to an improvement in audit quality.
- Wallman (1996) argued that the auditor's knowledge of the client company will be increased while providing non-audit services, with resultant increase in independence and objectivity.

- Arunnada (1999:169) found that the provision of non-audit services by the client company auditor will lead to a reduction in the overall cost of all services to the company.

Several researchers have confirmed the indifference or preference of the client company for the provision of non-audit services by their own auditors. Palmrose (1988) informed that majority of clients prefer to source non-audit services from their auditors (see also Glezen & Millar, 1985; Hussey (1999) also suggested that UK finance directors are not opposed to the continued engagement of company auditors for non-audit services.

However, quite a few others do opine that the engagement of company auditors for non-audit engagements will impair independence and objectivity:

- Some findings indicated that it would amount to engaging in self-audit with the resultant threat of self-audit risk (see Brandon, et al., 2004; Frankel et al., 2002; and Raghunandan, 2003).
- Canning & Gwillian (1999) reported that such an engagement will increase the power and influence of management on the auditor, due to the auditor's reliance on the extra fees received from non-audit engagements awarded by management; and
- Flint (1988:82) opined that: "It may influence their mental attitude, impartiality and objectivity, and independence of thought and action".
- In Dart (2011:179) it was reported that investors expressed concern over the provision of non-audit services by auditors. They considered those services as impairing on the independence of the auditor.

A call for a modification in the mode of rendering non-audit services have also been suggested. Whereas Swanger & Chweing (2001) opined that the audit firm could provide non-audit services to their audit clients but using different personnel other than the audit engagement team personnel. Rasmussen (2005) however rejected this position.

The issue of auditor's independence and objectivity in relation to non-audit services, among others, is covered in the Revised International Standards on Auditing, UK 200 (ISA, UK, 200). In reference to this, the FRC Revised Ethical Standards (2016), section 5.6 clarifies what can be regarded as audit related non-audit engagements as follows:

"In the context of an audit engagement, if additional work on financial information49 and/or financial controls is authorised by those charged with governance, but the objective of that work is not to enable the auditor to provide an audit opinion on the entity's financial statements, it will be considered as an 'audit related service' (see paragraph 5.40) for the purpose of this Ethical Standard provided that it:

- is integrated with the work performed in the audit and performed largely by the existing audit team; and
- is performed on the same principal terms and conditions as the audit. Because of these factors, any threats to auditor independence arising from the performance of such additional work are clearly insignificant."

Section 5.7 of the Ethical Standard described non-audit services which are not related to the audit as:

"For entities audited by the firm, other additional work that:

- does not relate to financial information and/or financial controls; or
- is not integrated with the work performed in the audit, or is not performed largely by the existing audit team, or
- is not on the same principal terms and conditions as the audit; will be regarded as an 'other non-audit service' for the purpose of this Ethical Standard".

It further defined what constitutes non-audit engagement in section 5.8 as follows:

"'Non-audit services' comprise any engagement in which a firm, or a member of its network, provides professional services to:

- an audited entity.
- an audited entity's affiliates; or
- another entity where the subject matter of the engagement includes the audited entity and/or its significant affiliates.
- other than the audit of financial statements of the audited entity".

The Ethical Standards provided in section 5.16 for the identification of significant risks to independence and objectivity from the provision of non-audit engagements and the required plan of action to provide the necessary safeguards, as follows:

“For an engagement other than an investment circular reporting engagement, before the firm accepts to provide a non-audit / additional service to an entity relevant to the engagement, the engagement partner shall:

(a) identify and assess the significance of any related threats to the integrity or objectivity of the firm and covered persons, including whether independence would be compromised; and

(b) identify and assess the effectiveness of the available safeguards to eliminate the threats or reduce them to a level where independence would not be compromised; and

(c) consider whether it is probable that an objective, reasonable and informed third party, having regard to the threats and safeguards, would conclude that that the proposed non-audit / additional service would not impair integrity or objectivity and compromise the independence of the firm or covered persons.”

3.3.4.5 Auditor tenure

Blandon & Bosch (2013) observed that: “The length of the auditor-client relationship constitutes a major issue in the auditor conflict of interest, because long auditor-client relationships may cause auditor complacency about management decisions regarding the firm’s financial statements”. Findings are varied on the effects of tenure on auditor independence. Using the likelihood of the auditor issuing a qualified opinion on the accounts of a client as a proxy for audit quality, Blandon & Bosch (2013) found that: “the likelihood of receiving a qualified audit report decreases with tenure”, possibly due to the auditor’s complacency, lack of innovation, less rigorous audit procedures, and a learned confidence in the client in long term engagements (see Shockley, 1982). The further alluded that audit qualifications are less likely during the earlier years of engagement, but more likely in subsequent periods of the auditor’s tenure. However, Dart (2011:181) reported the lack of support by investors concerning the length of the auditor’s appointment impairing on his independence. He explained that the respondents expressed support for the practice of rotating partners on audit engagements, every five years, as being sufficient to ensure the preservation of the independence of the auditors and indeed the audit firm.

3.3.4.6 Audit committee

In the UK, audit committee came into the corporate governance process following the observed or perceived ineffectiveness of the external audit process in superintending on the directors' stewardship as much as desired by the shareowners and the stakeholders. Consequently, the audit committee has become an issue to be considered in assessing both the quality of financial reporting and the quality of audit work performed thereon. Usman et al., (2022) reported that the financial expertise of audit committee members has been observed to constrain the classification shifting of expenses, hence contributing to the improvement of audit quality. Komal et al., (2023) also reported that "age diversity influences earnings management, and younger audit committee female executives reduce earnings management more than their old counterparts".

Following the template developed by Turley and Zaman (2004) on the assessment of the effectiveness of audit committees in corporate management, four main factors were identified within the framework formulated, which include:

- Structural incentives, concerning factors which are associated with the adoption of audit committees and possible reduction in agency costs.

- Audit function, consisting of four factors, which are: Selection and remuneration of the external auditor; Independence of the external auditor; The external audit process and audit communications; and monitoring of internal control and internal audit.

- Financial reporting quality, giving regards to errors and irregularities, defective reporting, audit qualifications, and the adoption of accounting standards and accounting policy choices.

- Corporate performance, emphasising the impact of the adoption of audit committees on share prices and wealth creation.

The adequacy of audit committees as a control tool has equally been the subject of doubt, given the incidence of corporate failures which had arisen since its introduction (See Turley and Zaman, 2004:306). DeZoort (1997) considered the adoption of audit committees as merely symbolic, and any attributable benefits seen as more rhetorical than substantive.

For the assessment of the impact of audit committees on audit quality, this study has been restricted to the "Audit function" element of the four-part framework of Turley and Zaman. This is to keep the study in focus. The major observations as obtained from Turley and Zaman (2004) are as provided below:

i. <u>Selection and remuneration of the external auditor</u>

The mode of appointment, remuneration and removal of the auditor may impact on his independence and by extension on the quality of audit work. It is expected that the involvement of the audit committee in the process, as opposed to being left in the hands of executive management, who themselves are the subject of audit, may enhance the quality of audit work.

- There is a positive but not significant association of audit committees with the selection of external auditors. Presence of audit committees have led to the selection of top firms, especially within the big four firms. (See Turley and Zaman, 2004:313).
- Where the objective of the audit committee is to enhance audit quality, the remuneration of the auditor is usually higher, and when the objective is to strengthen internal control, the auditor's remuneration is usually lower. (See Turley and Zaman, 2004:315).

ii. <u>Auditor's independence</u>

The independence of the auditor is of major importance to the objectivity of the audit exercise and the credibility of the resultant audit judgement and opinion, and the reliability of the financial statement. Quite a few factors are easily associated with the independence of the auditor, and the presence and activities of the audit committee is of importance among such factors.

- "The presence of audit committees has been found to create a perception of enhanced auditor independence and more reliable financial reporting among financial statement users", (See Turley and Zaman, 2004:315).
- In terms of the behaviour of the audit committees in matters of dispute resolution between the external auditors and management, Turley, and Zaman (2004:316) reported Knapp (1987) as having reported that: "The results suggested that audit committee members, on average, tended to support the auditors, rather than management….".

iii. <u>Audit process and auditor communications</u>

- Cohen et al (2002) was reported in Turley and Zaman (2004:316) as having reported a one-way auditor communication with the audit committee, in which reports on significant issues were merely given at meetings, rather than a two-way exchange or pro-active process on the part of the audit committee. In the same report, the auditors were observed to believe that audit committees are not effective and powerful enough to resolve contentious matters with management.

3.3.4.7 Audit firm size

The size of an audit firm is considered as a determinant of audit quality.

Palmrose (1988) observed that the large audit firms are wealthier than the small firms and able to invest extensively in their reputation, and that the incentive to protect their reputation and minimize litigation risk, will make them provide high quality audits. This view was supported by Abughazaleh et al. (2015) who predicted that large auditors would provide the highest quality audit because they have greater litigation risk and more reputation at stake. They warned however that: "this does not insinuate that every Big-4 firm provides better audit quality for every audit", especially with the recurrence of large audit failures too often. Salem et al (2023) found that the use of joint auditors or the engagement of Big4 audit firms by banks are more likely to restrain managers' opportunistic behaviours.

3.3.4.8 Auditor’s fees and commercialisation

Audit firms operate in a competitive market for different classes of clients. For the multi-national entities which are classified as public interest entities, they are audited predominantly by the Big-4 firms who have the capacity to handle such size of entities.

The amount of audit fees accruable to a firm is deemed to be a function of the audit effort and the expertise provided (Palmrose, 1986). This is supposed to be common to firms in the same category of size. However, in some cases, audit firms have charged fees above what their efforts and expertise would normally justify, and some companies are willing to pay such fees, even when they are aware of cheaper legal alternatives (Francis, 2004). It was explained by Willenborg (1999) that the existence of high information gap between the management and investors of an entity may necessitate the appointment of a high-quality auditor to reduce the information asymmetry and provide the needed information on the entity’s financial condition. For the audit firms, it is important to ascertain if the extra fee charged by a firm is due to additional audit efforts with a view to improve audit quality through the reduction of earnings management by clients, or it is simply a risk premium provided towards possible litigation costs, which does not contribute towards audit quality (Zhang et al., 2023). DeFond & Zhang (2014) suggested that the charging of risk premium by an auditor is a measure to counter the litigation threat. Venkataraman et al. (2008) also noted that audit fees are higher in a higher-litigation regime.

Another aspect of the auditor’s fees requiring attention is the commercialization of audit services. Audit firms have been observed to be more commercially inclined, thereby pursuing revenue drive to the neglect of their traditional public interest responsibilities. Broberg et al (2018) explored the auditors’ professional and organizational identities as drivers of commercialization. They described professional identity as the auditors’ affiliation with, and commitment to the profession, by their independence and ethical compliance as espoused by the profession. By organisational identity, the auditor is described as exhibiting loyalty and commitment to the goals of the audit firm to which he belongs. They explained that an auditor with a strong professional identity has a greater propensity to be more independent and ethically compliant, than an auditor with a strong organisational identity who commits to the audit firm’s goals and aspirations, especially when these conflict with professional ethics and audit standards, hence abdicating their public interest responsibility. Three aspects of commercialization were highlighted, viz: market orientation, customer orientation, and firm process orientation. Market orientation refer to “auditors building and maintaining a close, or even intimate, relationship with auditees” to be familiar with customers and their activities thereby getting involved in activities such as communication, marketing, public relations, and networking, often seen as aspects of customer orientation (Kohli and Jaworski, 1990) but considered by Sweeney and McGarry (2011) as “leaning toward becoming more commercial and thus less professional”. Broberg et al (2018) see customer orientation as a consideration of the customers in terms of the managers and representatives of the entity, rather than as the client denoted traditionally as the shareholders of the entity; and the firm process orientation as “the firm’s socialization process as well as the efficiency and effectiveness of business processes within a firm”. Broberg et al (2018) found that both the professional and organizational identities were found to be associated with commercialization. They proffered the inclination of auditors to put a greater focus on his employer by helping to ensure and contribute to the firm’s survival, especially fuelled by pressure on the auditor by the firm, through incentives provided as compensation for such efforts. Fogarty & Rigsby (2010) described these tendencies as “attempt to convert that which had been designed as a social good into one more aligned with a commercial logic” and a “departure from classic professionalism.”

3.3.4.9 Auditor litigation and legal regimes

The risk of litigation in respect of audits that fall short of required quality and the legal environment in which the audit firms operate have come under scrutiny regarding how these determine the quality of audits performed by auditors. Two aspects of this factor will be explored. First is the reaction of the auditor to the likelihood of litigations from clients and third parties in respect of audits in which the auditor may be negligent, and second, is the auditor’s behavioural response to the legal environment in which it operates.

Concerning the relevance of litigations to audit quality, Venkataraman et al (2008) identified the diminished legal threat to auditors as one of the culprits to blame for accounting scandals. Similarly, Frantz (1999) considered "an auditor's equilibrium litigation and quality choices as a function of his level of skill, trial awards, litigation costs, and auditing standards. These presupposed that the auditor is incentivised to opt for low- or high-quality audits in consonance with his assessment of the likely consequences which may arise from litigations, among other factors. The relevant issues concern the possibility of reputation loss or litigation cost (see DeAngelo, 1981), just as Abughazaleh (2015) reported that "Big Four auditors are more conservative towards a client's financial reports as a response to high litigation risk caused by stricter investor protection".

The second part focuses on the association between audit quality and the legal environment in which the auditor operates. A weak legal system does not exert pressures on the auditor and may allow for auditor complacency with regards to audit quality. In contrast, a strong legal system with regulatory provisions imposing punishments on auditors for lapses or creating enabling environment for litigations to take place will put the auditor on his toes and necessitate a more critical approach to the audit to achieve high quality. In Francis & Wang (2008), three different legal environments identified within Europe were: English common law, German civil law, and French civil law. They posited that the audit quality is assumed to differ between these countries because of the levels of investor protection and litigation risk offered by their legal systems. La Porta et al. (1997) investigated investor protection in different legal environments and found that investors in civil law countries have weaker legal rights than investors in common law countries.

3.3.4.10 Corporate governance mechanism of the client company

The corporate governance mechanism of the client entity has been found to be one of the key determinants of audit quality. Usman et al., (2022) observed that: "Weaker corporate governance encourages managers to engage in various financial malpractices, including earnings management, profit smoothing, impression management, and aggressive accounting. Usman et al., (2022) also informed that "misclassification of revenue items may constrain auditors and regulators' monitoring". Areneke et al., (2022) noted the prevalence of weak institutional environment in emerging economies, such as Nigeria, while Areneke et al., (2019) observed in the case of countries like Cameroon, Pakistan, and Kenya that corporate governance compliance is driven by regulatory requirements instead of national identities, hence a low impact usually results. However, Areneke et al., (2022) noted that "weak institutional environments can be strengthened by transfer from the host countries by foreign investors, although such transfers could be inhibited by cultural differences. Similarly, Areneke & Tunyi (2022) reported that "foreign CEOs has been identified as contributing positively to corporate governance mobility across economic environments". Corporate governance models vary in legal and economic perspectives in different economic settings. While the Anglo-Saxon model reflects the shareholders' interests (market-based), the stakeholders' model is adopted by Japan, Germany, and France, among others (see Ezeani et al., 2022). It has been reported that in both shareholders oriented and stakeholders-oriented models of corporate governance, board composition mitigates agency conflict (Ezeani et al., 2023). Areneke (2015) reported that "board's roles affect the performance of firms, and that boards that are majority shareholder oriented are prone to decisions that are detrimental to the firm's survival". According to Usman et al., (2022) the supervisory board has a greater responsibility to monitor the performance of the firms and detect any earnings manipulation to reduce agency costs, and that board meeting helps companies to reduce earnings manipulation, as the meetings provide the opportunity for discussion on issues that enhance the monitoring process.

3.3.5 Effect of Independent regulation on audit quality

The clamour for a change in regulatory perspective in the accountancy profession became more pronounced after yet another financial crisis in 2008, which led to the challenge of the independence and objectivity of auditors and calls for regulatory actions to mitigate the risk of further collapses (Sikka, 2009). Williams (2007) acknowledged the developments in the audit process, following the Enron scandal, but also noted the subsistence of other issues that impact confidence in the audit process, enumerated as including: "complexity of financial reporting which is increasingly reliant on estimates and valuations; The possibility that audits will not detect management fraud; The relationship between executive management and auditors; A lack of transparency of the work of auditors and the judgements they make; and The effect of an increasingly prescriptive approach to audit." In response, a few countries have adopted public oversight, using independent regulatory bodies, to replace the self-regulatory practice in the accounting profession (Knechel, 2016). In the UK and Nigeria, the independent regulatory bodies are the Financial Reporting Councils discussed in chapter two. As observed by Eldaly & Abdel-Kader (2016): "one of the main strategies of the independent regulators is to improve the quality of the audit process. Intensive inspections have been conducted to assure an acceptable level of quality within audit firms."

Yuan et al (2020) observed that: "The study of the consequences of public inspection of the audit profession was carried out by researchers," mainly based on USA data, and challenged the need for similar studies in other national settings, like in the UK and Nigeria. A review of the literature on the consequences of the regulatory activities of the FRC UK on audit quality is summarised below:

3.3.5.1 Identification of areas of improvement

The risk-based approach and depth of audit inspections conducted by the FRC enabled the discovery of areas of improvement in each of the audit firms subjected to inspection. These are communicated to the audit firms and the chair of the audit committees. The identified areas are reviewed in subsequent inspection years to check against recurrence. Eldaly & Abdel-Kader (2016) observed that such findings constitute valuable feedback to the regulator to facilitate periodic revision of their regulations and standards.

3.3.5.2 Improved audit quality practices

The direct observation and inspection of the planning and execution of audits by the regulatory audit inspectors would appear to overcome the difficulty in the assessment of audit quality performance of audit firms, hitherto adjudged to be non-observable. Access to and scrutiny of the inputs, processes, and outputs of audit engagements by regulators has led to changes in the ways audit firms operate and conduct their engagements, as hereunder observed:

- Lin & Yen (2016) reported that firms will need to retrain their audit team members to meet the skills requirement of the new regulatory regime, and this may have huge financial implications.

- Auditors become more conservative and follow more rigid procedures in client acceptance and continuation decisions (Patterson & Smith, 2007).
- Audit firms have been made to improve in their audit documentations. This is aimed at helping auditors to justify their audit judgments to the public (Eldaly & Abdel-Kader, 2016).
- Yuan et al (2020) reported that the disclosure of individual inspection reports may alter the auditors' reporting behaviour, thereby making them more likely to issue qualified audit opinions to clients. Their study provided evidence that: The FRC disclosure regime has changed auditors' reporting behaviours and has contributed to tightening governance mechanisms through auditors' oversight."
- Audit firms affected by FRC's disclosure of individual reports were observed to be more cautious and efficient, resulting in audit report lags, and a greater likelihood of clients receiving qualified audit opinions (Yuan et al, 2020).

3.3.5.3 Enhancing corporate governance.

The corporate governance practices in both the audit firms and client entities should benefit from the regulatory reports of the FRC. How well the board carries out its oversight function on the management, and how well the audit committee of the board works with the auditors, are factors considered relevant to the attainment of higher audit quality. Ezeani et al (2021:3288) considered corporate governance as a mechanism for resolving agency conflicts by involving various stakeholders in the monitoring process. In the UK, the shareholder oriented corporate governance model is practiced, with the independent board dominated by outsiders, which Ezeani et al (2022:479) considered that "it ensures that manager's interest is aligned with that of shareholders.

3.3.5.4 Increased transparency and public disclosure of information

The depth of disclosure of inspection findings varies among regulators. Whereas in the USA, the regulatory oversight body, PCAOB, defers the release of adverse findings of audit inspections for one year, the FRC UK publicly disclose all areas of the audit firm's performance in the year of discovery (see Eldaly & Abdel-Kader, 2016).

3.3.5.5 Increased audit risk and audit efforts

Regulatory changes were found to increase the audit risk and consequently audit efforts of audit firms. As a result, auditors require skill transformation and must reach appropriate judgments (Abdumalik & Che-Ahmad, 2020).

3.3.5.6 Public interest perspective

Suddaby et al, (2007) reported that: “public interests have been intensively considered by independent regulators and audit firms when compared with the self-regulated stage”.

3.3.5.7 Impact on financial reporting quality

Yuan et al (2020) provided evidence that: “The regulation of the audit profession has a positive impact on financial reporting quality and due diligence”. Auditors become conservative in issuing audit opinions and committed increased audit efforts and time into reporting decisions, after being found with audit deficiencies.

3.3.5.8 Information for public decision-making

The strategy of the FRC UK in providing public information on the outcome of the audit inspections is considered beneficial to the investing public and audit clients. Eldaly & Abdel-Kader (2016) concluded that: “The FRC’s efforts successfully offer more information for public about the audit market. Extra information has been available to help: - public to know more about audit firm’s governance structures; -mid-size firms to know more about competition’s drivers in the market; and – audit clients to compare potential auditors”. Yuan et al (2020) added that: “These reports provide inspection results for individual audit firms, enabling clients to distinguish between high – and low-quality firms.

3.4 Summary

The chapter provided the theoretical and empirical literature underpinning the study. The public interest theory was explored in relation to its adaptation by the accountancy profession. More importantly, the normative and abolitionist perspectives were peculiar to the behaviour of auditors and the audit firms. The normative theory saw the public in terms of the stakeholders that are the primary users of accounting information, to which auditors commit to serve, whereas the abolitionist perspective is the service of the public in a self-serving way. This theoretical framework was discussed in relation to the conceptual framework of audit quality, for which the conceptualisation, and determinants were examined. In the empirical section, the descriptions of audit quality were explored and the conceptualisation by the FRC was determined therefrom. Factors which determine changes in audit quality were discussed. The chapter concluded with an examination of the effects of the independent regulatory perspective on audit quality.

CHAPTER 4: RESEARCH METHODOLOGY

4.1 Introduction

This chapter provided an insight into the philosophical perspectives from which the study is conducted, together with an indication and justification of the research design and methods. The chapter also contained information about the researcher's positionality and participants (sample), as well as considerations relating to ethics.

4.2 Philosophical assumptions

Philosophical assumptions are the beliefs and values of a researcher. The alternative views as identified by Cresswell & Cresswell (2023) include: Postpositivist, Constructivist, Transformative, and Pragmatic.

This study adopted the constructivist worldview or social constructivist, combined with interpretivism. This philosophical view holds that:

- Individuals seek understanding of the world in which they live and work.
- Individuals develop subjective meanings of their experiences.
- The goal of the research relies as much as possible on the participants' views of the situation.
- The researcher's intent is to make sense of (or interpret) the meanings others have about the world.

The subject matter of this study, audit quality, was sought to be understood within the meanings ascribed to it by the participants in the study, the audit practitioners, and their independent regulator, with the researcher making sense or interpreting those views towards contributing to knowledge.

The choice of this approach was to facilitate the study of audit practice in terms of the changes, which evolve on its perception and in line with cultural changes over the years of the study. The ontology of auditing was viewed in terms of the observed behaviour of the large audit firms in the United Kingdom (Big-Four or Big4), by the Financial Reporting Council (FRC), UK, as contained in the annual inspection reports and audit firm-specific inspection reports for the years 2008 to 2016 covered in this study. Both the FRC, UK and the Big4 UK audit firms form the units of analysis for this study. Humphrey (1997:26) expressed the need “to develop understanding of the practical activities of auditors, not from the basis of hypothetical laboratory experiments, but from detailed studies of the lived experiences of auditors in real context”.

4.3 Research approach, design, and methods

The conduct of research involves the intersection of philosophy, research design, and the specific research methods (Cresswell & Cresswell, 2023). The choice of a research design is expected to be in consonance with the philosophical assumptions related thereto, and in the same vein, the methods to be used in a study should normally relate the appropriate research design. The application of this principle in this study is amplified as follows:

4.3.1 Research approach

Following from the philosophical position espoused above, the study adopted a qualitative research approach.

Cresswell & Cresswell (2023:193) described the characteristics of qualitative research as including the followings, among others:

- Participants’ meaning: Meanings are as expressed by the participants, and not brought in by the researcher.
- Natural setting: Research data is collected in the natural setting of the participants, and not in a contrived situation like a lab.
- Researcher as key instrument: The instrument for the collection of data is the researcher, through the examination of documents, observing the actions and / or interviewing the participants. The researcher also interprets the data. He does not use or rely on questionnaires or other instruments.
- Multiple sources of data: The researcher does not rely on a single source of data. Multiple sources of data are usually explored, such as interviews, observations, documents, audio-visuals etc.
- Inductive and deductive data analysis: The process involves both inductive and deductive analysis. Themes and patterns are inductively built from available data,

while themes are deductively reviewed back to the data in the search of additional information.

- Reflexivity: The researcher is required to reflect on the possible effect of his background, culture, and experience on his interpretation of the data.

The above characteristics accord with the tenets of the social constructivist philosophical school of thought that guide the conduct of this study. Information about the participants, sources and methods of data collection were provided later in this chapter, for an assessment of their fit into the qualitative research approach. The researcher is a professional accountant also engaged in accounting practice in one of the case study countries chosen for this study. This background provided the needed understanding of the subject matter of the study and meaningful interaction with the views provided by participants as well those obtained from documents that were examined. The possibility of bias in the interpretation of data was significantly curtailed by the checks provided by the supervisory team with similar background, professional qualifications and understanding of the subject matter. It is pertinent to inform that the goal of the research was the main driving force, as the researcher was indifferent to outcomes obtained from the analysis of data.

4.3.2 Research design

Cresswell & Cresswell (2023:195), identified two research design approaches for qualitative studies, viz. descriptive methods, and analytic framework. While descriptive studies require the researcher to stay close to the data, use limited frameworks and interpretation for explaining the data, and catalogue the data into themes; The analytic framework consist of procedures used interpreting data, that fit into a predetermined structure. The popular variants of the analytic framework design include narrative research, phenomenology, grounded theory, ethnography, and case studies.

This study adopted the case study research design, which according to Stake (1995), involve a detailed description of the setting or individuals, followed by data analysis for themes or issues. Chapter two of this study provided detailed description of the case study organisations, the Financial Reporting Council, in the two case study countries, Nigeria and the United Kingdom. This was followed in chapters five and six with the presentation of the data collected from interviews conducted on the staff members of the Financial Reporting Council, examination of the audit inspection reports of the FRC on the Big-4 accounting firms, examination of the judgements of the FRC Tribunals on professional accountants and audit firms whose audit performance were alleged to be substandard, and the consideration of other literature related to the subject of audit quality and its regulation. The analysis was conducted around the drivers of audit quality contained in the FRC, UK, audit quality framework of 2006, applied for the inspection of audits of public interest entities from 2008 to date. These drivers formed the themes around which patterns were observed and analysed.

4.3.3 Sources and methods of data Collection

Both primary and secondary data were used.

Primary data consisted of face-to-face interviews conducted on four members of the FRC UK, made up of two members of the audit inspectorate team, the Legal Counsel of the FRC, and the Executive Secretary of the FRC. Five members of the practice and inspectorate division of the professional accounting bodies in Nigeria (ICAN and ANAN) were also interviewed. Concerning the adequacy or otherwise of the sample size, Creswell & Poth (2018) opined that sample size depends on the research design adopted and not specific, but however four to five cases was recommended for case studies.

Secondary data were made up of the publications, reports, policies, processes, procedures etc. of the units of analysis in printed and electronic forms, as were obtained from the websites of the FRC, and contained in relevant literature. Specifically, the audit inspection reports, and tribunal reports of the FRC from 2008, when the audit quality framework was initiated by the FRC in the UK, to 2016 formed the focus of attention. The reports were issued annually for all firms combined, and specifically for each of the four firms selected for sampling. The audit firms Deloitte LLP, Ernst & Young LLP, KPMG LLP, and PwC LLP were chosen because they have complete inspection reports for the entire study period, 2008 to 2016. A total of thirty-six audit firm-specific inspection reports and nine combined inspection reports were examined in this study. Furthermore, thirty-eight decided cases at the FRC Tribunal were examined for analysis. The cases chosen were those in respect of which judgements were given during the study period.

4.4 Sampling and recruitment

The case study countries and sources of data were purposively chosen to recruit the best participants and/or materials that will best assist the researcher to understand the research problem. The independent regulator of audit in the UK and Nigeria is the Financial Reporting Councils of both countries. The actors or participants interviewed in this study were staff members of the FRC engaged in audit inspections, FRC tribunal case counsels, FRC management staff involved in policy. The recruitment process involved writing to the FRC, London for approval to use the organisation as a research site and to seek permission to interview identified key members of the organisation. Approval was granted in 2015, as per letter included as an appendix to this study. Thereafter, the consent of the participants was obtained by consent forms completed by them and attached as an appendix. This process was mandated by the Ethics Board of the Manchester Metropolitan University which gave approval for the conduct of the study. The incentive for securing the permission and consent of the FRC and the staff participants was mainly the commitment to quality and the prospect of the study contributing towards the improvement of the operations of the FRC. While this process was smooth in the case of the FRC UK, permission was not granted by the FRC Nigeria. The staff members of the practice and inspectorate division of the professional accountancy bodies in Nigeria (the Institute of Chartered Accountants of Nigeria, and the Association of National Accountants of Nigeria). Staff members of the FRC Nigeria were interacted with unofficially and information relating to audit inspections and other matters were elicited.

4.5 Methods of data analysis

The methods of data analysis were discussed under each research question below:

Research Question 1 (RQ1): How is audit quality conceptualised, and what are the key drivers?

This is concerned with the conceptual meaning of audit quality. Procedures adopted included:

- Themes and patterns were identified for an understanding across the different sources of literature, publications and reports in which opinions were expressed about the definition, description or understanding of the concept of audit quality. The applied sources are academic literature, publications of professional and regulatory bodies, legislations, and directives.
- The elements or components of the FRC's 2008 audit quality framework were compared to the different perspectives proposed by academic researchers and international regulatory bodies, especially, the 2011 audit quality framework of the International Auditing and Assurance Standards Board (IAASB). The comparison was done for an assessment of coverage and adequacy, as a basis for audit inspections.
- The extracts from the above steps were related to the views of audit quality expressed by the Audit Quality Review Team (AQRT) of the FRC as respondents (R2 and R3) in the interview conducted at the FRC UK office in April 2015 and the actual approach adopted by the FRC for the inspection work.

Research Question 2 (RQ2): What are the determinants of audit quality under the independent regulatory perspective?

This entails the textual analysis of the inspection reports of the FRC, both aggregate and audit firm specific, and textual analysis of the tribunal reports of the Financial Reporting Council, UK, with a view to identifying which drivers in the audit quality framework (AQF), developed from RQ1, that are subject of attention, both positively and negatively.

The textual analyses of documents, reports and information obtained from websites of our units of analyses is consistent with Canning and O'Dwyer (2013) who used a modified form of content analysis focusing on the examination of both the manifest (literal meaning) and latent (deep structural meaning) content of evidence. The initial reading of the evidence was done with a focus on the identification of key drivers on which the audit firms fell short of FRC audit quality framework. We proceeded from this stage to an in-depth discussion of the emerging conceptual framework.

The FRC selected different aspects of the FRC 2008 Audit Quality Framework for the review of the inspection sample of audited accounts of public interest entities for each year. In addition to the audit quality grades assigned to the reviewed financial statements, the FRC offered comments on the performance of the related auditing firm concerning specific audit quality factors or indicators that underlie the grading of the accounts. The factors which emerged were examined for recurrence and predictive effect on changes in audit quality in the UK. These factors were summarised and discussed.

The textual analysis was carried out with the aid of the NVivo (version 12) qualitative data analysis software. The software makes easy, the assemblage of themes and patterns from many sources.

In using this software, the following procedures were applied:

i. A programme file was created on NVivo named as FRC Audit Inspection Report Textual Analysis.

ii. The FRC annual audit firm specific inspection files for 2008/2009 to 2016/2017 were uploaded into the programme file created in 'i' above. The process is known as 'file import'. Ten files for each of the four audit firms, totalling forty were uploaded.

iii. Five nodes were created in respect of the themes chosen for the analysis of the data. Nodes are places where contents of similar nature within the files are deposited. For this analysis, the study adopted the five main areas of the FRC 2008 Audit Quality Framework as Nodes. These are: The culture within the firm; Skills and personal qualities of the audit partners and staff; Reliability and usefulness of audit reporting; Audit process; and Factors outside the control of the audit firms.

iv. The uploaded files are manually read on the software and extracts of portions relating to the chosen themes are made and kept in the nodes. This process was undertaken for each of the forty files.

v. The output from the nodes is downloaded in pdf format and copied into the project file for further analysis and/or discussion.

vi. The downloaded report for this study, presented below as Figure 5, is arranged on theme basis, wherein the extracts on 'Audit Process' for instance, were put together for the four firms in alphabetical order of Deloitte, EY, KPMG, and PwC, before going to another theme. This was done for all the five themes mentioned in iii above.

vi. The audit firms and the reporting years are clearly identified on the output reports from the nodes.

Research Question 3 (RQ3): What are the effects of independent regulation on audit quality in the UK?

For an assessment of the effect of independent regulation on audit quality, which is the subject of RQ3, the grades assigned in scoring the audits inspected by the FRC were subjected to both empirical and interpretational analyses, both from the standpoint of the researcher (subject) and the researched (object), for a determination of changes which have occurred in the process of moving towards the ideal state of audit quality (i.e. public expectations), and in effect, a measure of the extent to which the audit expectations gap has been further bridged, consequent on the regulatory efforts of the FRC.

Specifically, the following steps were undertaken in respect of the empirical analysis:

- Grade classifications for the inspection ratings assigned by FRC to the aggregate audits conducted by all auditors of public interest entities from 2008/2009 to 2016/2017.
- Bar chart representation of the inspection grades above for annual and longitudinal comparisons.
- The inspection grades and codes assigned are: Good Audits (Grade 1), Audits Requiring Improvements (Grade 2), and Audits Requiring Significant Improvements (Grade 3).
- While the above steps represent the national outlook, the steps were repeated using the audit firm specific inspection reports of the FRC, on individual firm basis, and with the same objectives, now peculiar to each firm being inspected.
- Analyses were conducted for all the four auditing firms individually and in summary using aggregate data from the firms. The study analysed the individual performance of each firm and the national outlook from the combination of results from the auditing firms as a group.
- For an assessment of the effectiveness and effectiveness of the regulatory process, the study conducted an analysis of the structure and operations of the FRC. The outcome of the analyses was compared to expectations drawn from the law setting

up the FRC, UK government guidance to regulatory bodies, and opinions of academia, the UK press, users of auditing services and the public.

The empirical analysis was followed by the interpretational analysis, using the latent approach, being the second part of the Canning & O'Dwyer (2013), applied in RQ2. The latent approach involves an interpretative content analysis of the data with a view to understanding and explaining the data in the context of the central characteristics of the regulatory impact. In this regard, the factors which emerged from RQ2 were used to explain the changes reflected in the empirical analysis in the preceding step.

The interpretative content analysis was further extended to determine how much of public interest is served by the accounting firms. To this end the Cochran typology of public interest was adopted as yardstick.

The study sought to ascertain the overall effect of audit inspection or regulation on changes in audit quality through an interview conducted on key personnel of the unit of analysis, the FRC, UK.

Finally, following Humphrey & Wood (2009) the study engaged in the analysis of key policy initiatives and debates on a progressive time basis, using resources from the interviews conducted at FRC and the professional accountancy bodies, to engage with outcomes from the interpretational analysis which arose from the textual analysis of the documents examined.

4.6 Validity of data

Qualitative validity requires that the researcher checks for the accuracy of the findings by employing certain procedures (Creswell 2014:201). This entails the use of deductive approach which relates the themes obtained from data analysis to the raw data, for an evaluation of the adequacy of the evidence available to support the themes (Cresswell & Cresswell, 2023:194).

The following are some of the procedures were used for validating the qualitative findings in this study:

i. The researcher’s interpretation of the interview transcripts was referred to the interviewees for concurrence or amendment.

ii. The evidence obtained from the various sources of data, viz, interview data and examination of inspection reports were used to build a coherent argument for the validity of the study.

iii. The researcher provided a reflectivity of how his background and experience has impacted or shaped the interpretation of the findings in this study.

iv. Detailed descriptions of the settings of the research were provided to enhance the richness and thickness of the research findings, thereby adding to the validity.

4.7 Summary

This chapter covered the philosophical background to the study and an articulation of the research approach adopted for the study. The epistemology and ontology underpinnings of the study was explored in terms of the constructivist worldview or social constructivist, combined with interpretivism, reflective of the qualitative research design. The methods adopted for the collection and analysis of the primary and secondary data used in the study were highlighted. The details of the respondents interviewed for the collection of primary data was provided, and the procedures used for the NVivo software coding of qualitative data was explained. A sequential description of the methods of analysis applicable to the research questions of the study was provided. The study concluded with the procedures by which the research data was validated.

CHAPTER 5: PRESENTATION OF RESEARCH DATA

5.1 Introduction

This section presents the data collected and used in this study, while the discursive analysis followed in the next chapter. The data sets consisted of both primary and secondary data, mainly from the Financial Reporting Councils (FRC) in the United Kingdom and Nigeria, which are the case study organizations responsible for independent audit regulation in those countries. The audit inspection reports of the FRC on the audits of public interest entities in the UK form the main unit of analysis.

The table below presents the details of the research data and the insightful links with the research questions:

Table 5.1: Research data and insights

S/N	Source of Data	Type of Data	Related Research Question (RQ)	Insights
1	Secondary data	Academic literature on public interest and audit quality.	RQ1 – How is audit quality conceptualized?	It provided an understanding of the conceptual meaning ascribed to audit quality, especially for the purpose of identifying the determinants of audit quality.
2	Secondary data	Academic literature on audit quality, and the FRC (2008) audit quality framework.	RQ2 – What are the determinants of audit quality in the in the UK and Nigeria?	It provided an insight into the key drivers of audit quality which could form the bases for the evaluation of changes therein.

S/N	Source of Data	Type of Data	Related Research Question (RQ)	Insights
3	Secondary data	Audit firm specific audit inspection reports for the big4 audit firms, and the combined audit inspection reports for all inspected UK firms from 2008/2009 to 2016/2017, a total of fifty reports.	RQ3 – What are the effects or consequences of independent regulation (represented by the FRC) on audit quality?	The findings of the audit quality inspectors and the responses from the audit firms, provided empirical data for ascertaining the changes in audit quality and allowed for an extraction of factors which were more frequently breached amongst the drivers in the audit quality framework. Further explanations on these were obtained at the interview sessions.
4	Primary data	Structured face to face interview with four (4) staff members of the FRC, UK (including the Executive Secretary, Legal Counsel, and two Audit Quality Inspectors)	RQ1, RQ2, and RQ3.	
5	Primary data	Structured face to face interview with two staff members of the audit quality monitoring departments of The Institute of Chartered	RQ4 – How do the FRCs in the UK and Nigeria compare in their structure and operations towards the achievement of	A comparative review of the organizational structure, strategies, and procedures of the FRC in both case study countries, the UK and Nigeria, as related to the efficient and effective

S/N	Source of Data	Type of Data	Related Research Question (RQ)	Insights
		Accountants of Nigeria (ICAN) and three staff members of the Association of National Accountants of Nigeria (ANAN).	their regulatory objectives?	attainment of their regulatory objectives.
6	Secondary data	Legislations, Newspaper reports, Journal articles, and informal interviews with staff members of the FRC Nigeria.		

Source: Field studies (2016).

The research data are presented in the following sequence:

i. Tabular presentation of the sample of audit inspections and their audit quality gradings, and the textual data extracted from the FRC UK audit firm specific inspection reports from 2008/2009 to 2016/2017.

ii. Tabular presentation of decided cases from the litigations against UK auditors at the FRC tribunal from 2006 to 2016.

The interview transcript is attached as an appendix to this thesis. The analysis will form part of the next chapter on the analysis of data.

5.2 Presentation of audit quality grades extracted from the FRC UK audit firm specific inspection reports.

5.2.1 Introduction

The FRC UK conducted annual inspections of selected audited accounts of public interest entities in the United Kingdom and issued reports to the firms concerned, copies of which were published for public use. The reports for the period from 2008/2009 to 2016/2017 were considered in this section of the study.

The FRC scored the inspected audited accounts by assigning grades to them to reflect their assessment of the quality of audit work performed by the audit firms on the financial statements. This was followed up with detailed reports of the extent of compliance exhibited by the audit engagement teams in relation to selected audit quality drivers, which were varied from year to year, in line with the needs of the capital market and the UK economy. The reports, among others, explained the basis for the grades assigned to the inspected audits. The audit quality inspection grades for 2007/2008 were not public available, hence no grades have been included for 2007/2008, even though it was the first year of the application of the FRC UK audit quality framework for adopted for the conduct of inspections.

The summary of the selected samples of inspected audits will be presented first and followed by the textual data extracted from the inspection reports.

5.2.2 Presentation of samples of inspected audits and audit quality gradings of the UK Big4 firms

5.2.2.1 Classification of audit quality grades

The grades assigned to the audits examined in each of the audit firms for the years 2008/2009 to 2016/2017, extracted from the respective audit inspection reports for each firm are presented below:

Grade 1 – Good Audits

This represents good audits, which implies that the audit work was performed to good standard or requiring limited improvements. The deciding factor here is not about the appropriateness of the audit report issued or the true and fair state of the financial statements. It is about the sufficiency of audit evidence and the appropriateness of the audit process and judgements.

Grade 2A – Audits requiring limited improvements.

This represents audits which were conducted appropriately and with sufficient audit evidence and appropriate audit judgement but requiring minor areas of improvement. In our analysis, the grade 2A audits have been merged with grade 1 audits and classified as Good Audits (GA). Both groups were merged in the FRC inspection reports for 2008/2009 to 2012/2013. The split into grades 1 and 2A started from the 2014/2015 report. We have retained the old grades 1 to 3 as adjusted for 2014/2015 to 2016/2017, for consistency of our analysis.

Grade 2B – Audits requiring improvements.

This category of audits consists of those audits where a high but non-significant level of deficiencies have been observed with regards to appropriateness of audit judgements, sufficiency of audit evidence and quality of the audit process in general.

Grade 3 – Audits requiring significant improvements.

On this category of audits, the FRC (2015:6) stated: "An audit is given a grade 3 (assessed as requiring significant improvements) if we have significant concerns in relation to the sufficiency or quality of audit evidence, or the appropriateness of significant audit judgments or the implications of other matters are considered to be individually or collectively significant."

In the analyses that follow, grades 1 and 2A are classified as Good Audits (Grade 1), grade 2B as Audits Requiring Improvements (Grade 2), and grade 3 as Audits Requiring Significant Improvements (Grade 3). The total audit sample size for each year was described as Total Audits Inspected (TAI), and the total public interest entity clients of the audit firms, from which the inspection sample was selected for each year was described as Total Public Interest Entity Clients (TPIEC).

The data in respect of the audit quality grades attached to the inspection samples are presented in alphabetical order for the four big audit firms below as follow.

5.2.2.2 Deloitte LLP: Audit quality inspection grades

Table 5.2 below provides the summary of the grades assigned to the audit inspections conducted by the FRC on the selected sample size from the public interest entity clients of Deloitte LLP. The grades were provided as part of the audit firm-specific report issued on the firm from 2008/2009 to 2016/2017. The report for each year is in respect of audits of clients which the firm carried out in the preceding year. This implies that the report for 2008/2009 relates to audits performed in 2008 while that of 2016/2017 are in respect of audits performed by the firm in 2016.

TABLE 5.2: DELOITTE LLP – SUMMARY OF FRC AUDIT QUALITY INSPECTION GRADES FROM 2008/2009 TO 2016/2017

YEAR	GRADE 1	GRADE 2	GRADE 3	TAI	TPIEC
2008/2009	9	1	1	11	380
2009/2010	10	2	2	14	301
2010/2011	9	3	1	13	342
2011/2012	6	7	1	14	334
2012/2013	11	2	1	14	343
2013/2014	12	4	1	17	367
2014/2015	15	5	0	20	361
2015/2016	18	4	0	22	388
2016/2017	18	3	2	23	366
Total	108	31	9	148	3182

Source: FRC audit firm-specific inspection reports on Deloitte LLP for 2008/2009 to 2016/2017

5.2.2.3 ERNST AND YOUNG LLP: Summary of FRC audit quality inspection grades

Table 5.3 below provides the summary of the grades assigned to the audit inspections conducted by the FRC on the selected sample size from the public interest entity clients of Ernst and Young LLP. The grades were provided as part of the audit firm-specific reports issued on the firm from 2008/2009 to 2016/2017. The report for each year is in respect of audits of clients which the firm carried out in the preceding year. This implies that the report for 2008/2009 relates to audits performed in 2008 while that of 2016/2017 are in respect of audits performed by the firm in 2016.

TABLE 5.3: ERNST & YOUNG LLP – SUMMARY OF FRC AUDIT QUALITY INSPECTION GRADES FROM 2008/2009 TO 2016/2017

YEAR	GRADE 1	GRADE 2	GRADE 3	TAI	TPIEC
2008/2009	5	5	1	11	318
2009/2010	7	6	0	13	236
2010/2011	5	7	1	13	295
2011/2012	6	3	2	11	269

YEAR	GRADE 1	GRADE 2	GRADE 3	TAI	TPIEC
2012/2013	10	1	1	12	288
2013/2014	6	6	4	16	321
2014/2015	8	6	2	16	399
2015/2016	17	3	0	20	327
2016/2017	15	2	0	17	
TOTAL	79	39	11	129	2453

Source: FRC audit firm-specific inspection report on Ernst and Young for 2008/2009 to 2016/2017.

5.2.2.4 KPMG LLP - Summary of FRC audit quality inspection grades

Table 5.4 below provides the summary of the grades assigned to the audit inspections conducted by the FRC on the selected sample size from the public interest entity clients of Ernst and Young LLP. The grades were provided as part of the audit firm-specific reports issued on the firm from 2008/2009 to 2016/2017. The report for each year is in respect of audits of clients which the firm carried out in the preceding year. This implies that the report for 2008/2009 relates to audits performed in 2008 while that of 2016/2017 are in respect of audits performed by the firm in 2016.

TABLE 5.4: KPMG LLP – SUMMARY OF FRC AUDIT QUALITY INSPECTION GRADES FROM 2008/2009 TO 2016/2017

YEAR	GRADE 1	GRADE 2	GRADE 3	TAI	TPIEC
2008/2009	5	6	1	12	444
2009/2010	10	3	2	15	355
2010/2011	10	2	2	14	413
2011/2012	6	7	1	14	415
2012/2013	7	6	0	13	436
2013/2014	10	4	2	16	469
2014/2015	15	4	1	20	512
2015/2016	14	6	2	22	504
2016/2017	15	6	2	23	466

YEAR	GRADE 1	GRADE 2	GRADE 3	TAI	TPIEC
TOTAL	92	44	13	149	4014

Source: FRC audit firm-specific inspection report on Ernst and Young for 2008/2009 to 2016/2017.

5.2.2.5 PwC LLP – Summary of FRC Audit Quality Inspection Grades

Table 5.5 below provides the summary of the grades assigned to the audit inspections conducted by the FRC on the selected sample size from the public interest entity clients of PWC LLP. The grades were provided as part of the audit firm-specific reports issued on the firm from 2008/2009 to 2016/2017. The report for each year is in respect of audits of clients which the firm carried out in the preceding year. This implies that the report for 2008/2009 relates to audits performed in 2008 while that of 2016/2017 are in respect of audits performed by the firm in 2016.

TABLE 5.5: PWC LLP – SUMMARY OF FRC AUDIT QUALITY INSPECTION GRADES FROM 2008/2009 TO 2016/2017

YEAR	GRADE 1	GRADE 2	GRADE 3	TAI	TPIEC
2008/2009	7	5	2	14	520
2009/2010	7	10	1	18	433
2010/2011	7	7	1	15	488
2011/2012	8	5	1	14	458
2012/2013	11	2	1	14	488
2013/2014	17	2	0	19	576
2014/2015	16	4	2	22	559
2015/2016	21	4	0	25	540
2016/2017	25	2	0	27	472
TOTAL	119	41	8	168	4534

Source: FRC audit firm-specific inspection report on PwC LLP for 2008/2009 to 2016/2017.

5.2.2.6 Big4 UK audit firm combined summary of FRC Audit Quality Inspection Grades

The combined summary of the audit quality inspection grades for all Big4 UK audit firms are presented in Table 5.6 below. The table shows the overall outlook for the big four firms combined. The study is focused on the overall audit quality outlook in the UK and not necessarily concerned with the comparative performance of the firms. The table is a summary of the Tables 5.2 to Table 5.5 for each of the Big4 firms shown above.

TABLE 5.6: BIG-4 FIRMS: COMBINED SUMMARY OF FRC AUDIT QUALITY INSPECTION GRADES FROM 2008/2009 TO 2016/2017

YEAR	GRADE 1	GRADE 2	GRADE 3	TAI	TPIEC
2008/2009	26	17	5	48	1662
2009/2010	34	21	5	60	1325
2010/2011	31	19	5	55	1538
2011/2012	26	22	5	53	1476
2012/2013	39	11	3	53	1555
2013/2014	45	16	7	68	1733
2014/2015	54	19	5	78	1831
2015/2016	70	17	2	89	1759
2016/2017	73	13	4	90	1304
Total	398	155	41	594	14183

Source: Tables 5.2, 5.3, 5.4, and 5.5

5.3 Presentation of textual data extracted from the FRC UK audit inspection reports on Big4 audit firms in the UK.

Figure 5.1 below presents the textual analysis of the FRC audit firm specific inspection reports on all the big-four UK audit firms from 2008/2009 to 2016/2017 reporting years. The report for 2008/2009 represents the report of work done on 2008 accounting year while that of 2016/2017 is for 2016 accounting year.

The textual analysis was carried out with the aid of the NVivo (version 12) qualitative data analysis software. The software makes easy, the assemblage of themes and patterns from many sources.

In using this software, the following procedures were applied:

i. A programme file was created on NVivo named as FRC Audit Inspection Report Textual Analysis.

ii. The FRC annual audit firm specific inspection files for 2007/2008 to 2016/2017 were uploaded into the programme file created in 'I' above. The process is known as 'file import'. Ten files for each of the four audit firms, totalling forty were uploaded.

iii. Five nodes were created in respect of the themes chosen for the analysis of the data. Nodes are places where contents of similar nature within the files are deposited. For this analysis, the study adopted the five main areas of the FRC 2008 Audit Quality Framework as Nodes. These are: The culture within the firm; Skills and personal qualities of the audit partners and staff; Reliability and usefulness of audit reporting; Audit process; and Factors outside the control of the audit firms.

iv. The uploaded files are manually read on the software and extracts of portions relating to the chosen themes are made and kept in the nodes. This process was undertaken for each of the forty files.

v. The output from the nodes was downloaded in pdf format and copied into the project file for further analysis and/or discussion.

vi. The downloaded report for this study, presented below as Figure 5.1, is arranged on theme basis, wherein the extracts on 'Audit Process' for instance, were put together for the four firms in alphabetical order of Deloitte, EY, KPMG, and PwC, before going to another theme. This was done for all the five themes mentioned in iii above.

vi. The audit firms and the reporting years are clearly identified on the output reports from the nodes.

Figure 5.1: <u>NVivo coding of textual data from FRC UK audit firm specific audit inspection reports on each of the Big4 UK audit firms from 2008/2009 to 2016/2017</u>

A. <u>DELOITTE UK LLP</u>

<u>Name: Nodes\\Audit process\Audit evidence</u>

<Files\\Deloitte Public Report 2007 - 2008> - § 2 references coded [1.09% Coverage]

1. Auditing Standards require the auditor to make enquiries of management regarding their process for identifying and responding to the risks of fraud. They also require the engagement team to discuss the susceptibility of the entity's financial statements to material misstatement due to fraud. In many of the audits we reviewed, these requirements were applied. However, in a minority of the audits we reviewed, there were weaknesses in the application of the requirements concerning audit teams' fraud risk discussions and the review of Board oversight of managements' processes for identifying and responding to the risks of fraud.

2. We reviewed several significant audit judgments and, following discussion with the relevant audit teams, we were generally satisfied that audit evidence on which they were based was sufficient and the judgments were reasonable. However, there were certain areas in several audits we reviewed in which there was, in our view, insufficient evidence on file, as noted below.

<Files\\Deloitte Public Report 2008 - 2009> - § 2 references coded [1.07% Coverage]

3. In most of the audits we reviewed, audit teams had applied the guidance and followed the required procedures. However, in a minority of the audits we reviewed, in our view, the application and evidencing of certain aspects of the firm's procedures concerning the evaluation of controls required improvement.

4. In a small minority of the audits we reviewed, there was, in our view, insufficient evidence on the audit files to demonstrate that audit teams had considered disclosures. In one case, in our view, the audit team did not consider the need for the disclosure in the financial statements of a related party transaction. In two other cases, there was, in our view, insufficient evidence on the audit files that audit teams

had reviewed financial information in a directors' report and a trustees' report for consistency with the financial statements.

<Files\\Deloitte Public Report 2009 - 2010> - § 2 references coded [1.51% Coverage]

5. We were generally satisfied with the audit evidence obtained to support the significant audit judgments and the appropriateness of the judgments themselves. However, in some of the audits we reviewed, we identified weaknesses in the audit evidence obtained or in the appropriateness of the judgments.

6. Audit work on impairment testing was generally performed to an acceptable standard. However, two audits we reviewed required significant improvement. In one, we identified an error in the client's goodwill impairment testing model which had the effect of overstating the available headroom by a significant amount. In our view, if this error had been identified by the audit team and more appropriate assumptions been adopted for the purposes of the sensitivity analysis, further work would have been needed to establish whether an impairment charge was required.

<Files\\Deloitte Public Report 2011 - 2012> - § 2 references coded [1.16% Coverage]

7. However, we continued to identify issues in relation to the sufficiency of evidence or challenge in relation to the discount rate, growth rate or other key assumptions (five audits) and in relation to the audit of related disclosures (eight audits).

8. On nine audits, sample sizes for one or more areas of substantive testing were determined on a judgmental basis. These included areas of significant risk, or where no reliance was placed on internal controls, and the sample sizes were often relatively small. The firm's audit manual includes guidance on statistical sample sizes; however, there is no guidance on judgmental sample sizes, which audit teams often used as a substitute for the firm's formal sampling methodology.

<Files\\Deloitte Public Report 2012 - 2013> - § 2 references coded [0.95% Coverage]

9. We identified issues in relation to the sufficiency of evidence or challenge in relation to the discount rate or other key assumptions used to support the carrying value of

goodwill and other assets and in relation to the audit of the related disclosures (four audits).

10. On ten audits, substantive testing sample sizes for one or more areas of the audit were not adequately justified. These included areas of significant risk, or where no reliance was placed on internal controls. The use of judgmental sampling for substantive testing purposes may not adequately consider the significance of the identified risks, the materiality levels, or the extent of reliance on controls. The firm should ensure audit teams make greater use of the firm's methodology for statistical sampling.

<Files\\Deloitte Public Report 2014 - 2015> - § 4 references coded [1.66% Coverage]

11. In the following cases, which had been identified as significant risks by the relevant audit teams, there were weaknesses relating to the quality of audit evidence and/or the evidence of challenge of management:

    - Valuation models for assets — On one audit, certain assumptions used in the valuation models were tested by agreement to management information, without adequate testing of that information.

12. Audit teams often place reliance on management's reports and spreadsheets, where the information has been generated by the IT system. On ten of the 20 audits we reviewed, there was insufficient testing of aspects of certain reports or spreadsheets relied on for audit purposes, mainly relating to revenue, inventory valuations or bad debt provisions.

13. We reviewed the audit of supplier rebates on one retail audit. There was insufficient evidence that adequate procedures had been performed to understand the supplier rebate arrangements and to assess the related risks. In addition, most of the accrued rebate income tested was agreed to e-mails, rather than being re-calculated or independently confirmed by the auditors.

14. Stock-count procedures

    On two out of the three retail audits we reviewed, all with multiple locations, the extent of attendance at stock counts was not adequately justified. On one of these audits, six out of over 300 stores were visited and, on the other audit, five out of over 500 stores were visited, to observe and

<Files\\Deloitte Public Report 2015 - 2016> - § 2 references coded [1.49% Coverage]

15. Revenue recognition was identified as a significant risk area for all audits we reviewed. However, we identified instances where there was insufficient justification of why the risk was assessed as limited to only a small portion of revenue or an individual revenue assertion.

    We also noted cases where insufficient procedures were performed relating to the accuracy of the classification of revenue streams; there was insufficient challenge of the adequacy of related disclosures in the financial statements to enable investors to make informed decisions; or there was insufficient evidence to support the conclusion that revenue was being recognized in the correct accounting period.

16. The principal issues resulting in four audits being assessed as requiring more than limited improvements in 2015/16 included the following (further details of which are set out in section 2):

    - Insufficient challenge of the process management undertook to assess impairment and asset valuations generally, including the key assumptions used.
    - Insufficient audit evidence in relation to revenue and inventory.

Name: Nodes\\Audit process\Audit methodology

<Files\\Deloitte Public Report 2007 - 2008> - § 2 references coded [0.63% Coverage]

17. The firm's technical department reviews a significant volume of auditing, accounting, legal and regulatory material each year. The flexibility of the firm's electronic audit support system and related technical databases enables the firm to introduce enhancements and new requirements into audit procedures usually within 24 hours. We consider this to be a particular strength.

18. In our view, Deloitte's audit methodology addresses the requirements of auditing standards in the UK appropriately and the firm's audit support system enables engagement teams to demonstrate compliance with them.

<Files\\Deloitte Public Report 2012 - 2013> - § 3 references coded [1.49% Coverage]

19. We identified weaknesses in relation to the audit of revenue on nine audits, particularly in relation to the substantive analytical procedures performed, such as the basis of the expectations set, or the corroboration of explanations obtained from management. In one of these audits, in our view, the testing performed was not adequately responsive to the identified significant risks relating to revenue.

20. In two audits, the extent of testing of journals was not adequately justified. On one of these audits, while the IT experts had selected a sample of journals for testing, the audit team only tested some of these journals and did not test those journals identified by the IT experts as demonstrating characteristics of fraud. In addition, for most of the journals selected, there was no supporting documentation or evidence of management's review, and this was not challenged by the audit team.

21. In two audits, there was no evidence that the audit team had requested that unadjusted audit differences be adjusted, as required by Auditing Standards. The firm's Audit Committee report template did not include a request that unadjusted misstatements be adjusted, and the firm subsequently amended the template when this was highlighted by us.

<Files\\Deloitte Public Report 2013 - 2014> - § 7 references coded [2.74% Coverage]

22. There were weaknesses in the testing of the loan impairment models and assumptions, used as the basis for the collective provisions, and in the testing of the property valuations used in determining the individual provisions.

23. The firm's guidance on journal testing does not adequately cover the selection of journals based on fraud risk, for example whether journals with multiple fraud risk characteristics should be selected for testing.

24. We reviewed the audit of revenue on 15 audits. We identified weaknesses on nine of these audits, relating to risk assessment (five audits), substantive analytical review (five audits) and other substantive procedures (six audits).

25. We reviewed the audit of the stock count procedures on four audits. On all four audits there were weaknesses in relation to the extent of attendance at stock counts, or the audit procedures performed, where the stock was held at multiple locations or where management was undertaking perpetual counts.

26. The firm's methodology allows account balances, classes of transactions and disclosures higher than overall materiality, if assessed as low risk, to be excluded from audit testing. In 2012, the firm issued some guidance on limiting the extent of this and required these situations to be communicated to Audit Committees. In 2013, the firm added a requirement for the Engagement Quality Control Reviewer (EQCR) to review the rationale for such situations. However, we continue to believe that this aspect of the firm's methodology is inconsistent with the requirements of UK Auditing Standards.

27. We reviewed the audit of three letterbox companies, which took place before the abovementioned communications. On one of these audits, the audit engagement partner did not visit the country of the entity's head office at the planning stage of the audit. While we were informed that he was involved in planning the audit, there was limited evidence of this. In another audit, the group audit team did not audit the group consolidation, as required by Auditing Standards, as the procedures were performed by the overseas component audit team, with their work reviewed by the group audit team.

28. The firm's methodology does not specifically cover determining samples sizes for provisions. On four audits we reviewed, the sample sizes for the substantive testing of certain provisions were based on the size of the provision. Therefore, a reduction in the provision would have resulted in a smaller sample size, even though the objectives of the testing included assessing the completeness of the provision.

<Files\\Deloitte Public Report 2014 - 2015> - § 2 references coded [1.13% Coverage]

29. On five audits, some of the sampling for controls testing purposes was not in accordance with the firm's methodology.

On five audits, the firm’s IT specialists had identified weaknesses in the IT controls, and it was not clear how the audit procedures performed addressed those weaknesses.

30. Audit quality monitoring — practice review of component audits

Deloitte’s annual audit quality monitoring process is described within the firm as its “practice review”. Significant UK component audits are still not consistently covered in the scope of the practice review of group audits. The AQR review of one audit, which was also reviewed as part of the practice review, identified findings concerning the audit of revenue and journals in certain UK components of a UK listed group, where the UK components accounted for 45% of group revenue. The practice review of this group audit did not identify these matters, as it had not included the UK component audits in the scope of the review.

<Files\\Deloitte Public Report 2015 - 2016> - § 1 reference coded [0.97% Coverage]

31. We identified several concerns on audits where we reviewed the work performed relating to defined benefit pension scheme balances and disclosures. Our concerns related to:

- Insufficient evidence of procedures performed in relation to the accuracy and completeness of membership data or to verify employer contributions.
- Insufficient evidence that an appropriate assessment had been undertaken of the risks associated with a new investment strategy and whether these risks were adequately disclosed in the financial statements.
- The level of control exercised over the custodian confirmation process, such as asking the entity to request the confirmation rather than doing so directly.

<Files\\DELOITTE Public Report 2016 - 2017> - § 2 references coded [1.64% Coverage]

32. The principal issues resulting in two audits being assessed as requiring significant improvements in 2016/17 included the following (where relevant, further details for our key findings are set out in section 2):

— Insufficient challenge of the adequacy of management's impairment model, which was too high level, and insufficient challenge of management's key assumptions relating to revenues and costs, contingencies, and perpetuity growth rates.

— Insufficient procedures performed over revenue and accrued income, and an insufficient audit response to IT control weaknesses.

33. — On a group audit where substantive analytical review procedures were used to obtain audit evidence for approximately 40% of group revenues, differences identified between expected and actual revenue figures were not always fully investigated and management explanations not fully corroborated to supporting evidence.

— Insufficient audit procedures in relation to accrued income and in response to identified IT control weaknesses.

— Appropriate audit evidence was not obtained over the completeness and accuracy of the underlying data used in the audit testing of unbilled revenue.

— Insufficient testing of key assumptions underlying certain contractual revenue streams.

Name: Nodes\\Audit process\Ethical compliance - Integrity, objectivity, and independence

<Files\\Deloitte Public Report 2007 - 2008> - § 3 references coded [0.86% Coverage]

34. We considered the application of these requirements in all the audits we reviewed and noted that in most cases these requirements had been applied. However, we considered there was insufficient evidence on file in a small minority of the audits we reviewed to demonstrate that proper consideration had been given to the possible threats to the firm’s independence and objectivity arising from the provision of non-audit services and the adequacy of the safeguards that had been put in place.

35. No audit engagement partner was found to have exceeded the maximum period allowed without first having an extension of time properly authorized in accordance with the firm's policies and procedures.

36. Based on our review, we consider the firm to have effective rotation policies and procedures. <Files\\Deloitte Public Report 2008 - 2009> - § 3 references coded [0.86% Coverage]

37. As indicated in Section 2.2.2, we identified that, contrary to the firm's policies and Ethical Standards, several audit directors and managers referred in their performance evaluations to cross-selling non-audit services to their audit clients.

38. Subject to the above matter, we considered the firm's rotation policies and monitoring procedures to be appropriate.

39. Engagement partners are required to document the reasoning for their decisions to provide non-audit services and explain the safeguards adopted. In a minority of the audits we reviewed, we considered that audit teams failed to identify threats to the firm's objectivity and independence and apply appropriate safeguards when deciding to provide non-audit services.

<Files\\Deloitte Public Report 2009 - 2010> - § 2 references coded [1.17% Coverage]

40. In six audits we reviewed, audit teams did not document adequately consideration of their assessment of the nature of the threats to the firm's independence and objectivity arising from the provision of non-audit services to audit clients and so did not consider the appropriateness of the safeguards that were adopted to mitigate them.

41. Based on our review of audit engagements and of the firm's consultations log and related material, we identified two instances in which it appeared that non-audit services Audit Inspection Unit 9 provided by the firm may in substance have strayed over the boundary of what the Ethical Standards permit.

<Files\\Deloitte Public Report 2012 - 2013> - § 2 references coded [0.77% Coverage]

42. In four audits, there was an inadequate assessment of the specific independence threats and safeguards relating to non-audit services provided.

43. On one of these audits, the report to the Audit Committee identified the non-audit services provided as including “other relevant services such as sustainability and information technology services” and the identified threats to independence focused on the information technology services. However, no sustainability or information technology services had been provided. This illustrated a lack of attention by the audit team to independence threats arising and the related safeguards applied.

<Files\\Deloitte Public Report 2013 - 2014> - § 2 references coded [0.95% Coverage]

44. These additional services may create independence threats. While the firm’s intranet includes some guidance on the potential independence threats, this is brief. The firm should expand its guidance to audit teams, including distinguishing between audit related services, as defined in the Ethical Standards, and other assurance services, for which appropriate safeguards need to be applied. The guidance should also explain the independence implications for audit personnel introducing these services to audited entities.

45. The Ethical Standards require an assessment as to whether informed management exists where there is a potential management threat. The firm’s standard audit work programme for consideration of independence matters does not specifically cover this requirement.

    In addition, there was little or no evidence of this assessment, where relevant, for the audits we reviewed.

<Files\\Deloitte Public Report 2014 - 2015> - § 1 reference coded [0.43% Coverage]

46. Independence — non-audit services

    Ethical Standards require an assessment as to whether informed management exists where there is a potential management threat arising from the provision of non-audit services to audited entities. There was little or no evidence of such an assessment, where relevant, for 11 audits, in relation to areas such as the provision of tax advice.

<Files\\Deloitte Public Report 2015 - 2016> - § 1 reference coded [0.13% Coverage]

47. Insufficient communication of threats arising from non-audit services and related safeguards.

Name: Nodes\\Audit process\Quality technical support

<Files\\Deloitte Public Report 2007 - 2008> - § 1 reference coded [0.43% Coverage]

48. Following the turmoil in financial markets which began in late summer 2007, the firm provided extensive and timely information to audit partners and staff. The firm recognized the credit crunch as a global issue and its IFRS Centre of excellence played a leading role in developing DTT's response for member firms, the aim of which was to heighten awareness, rather than change established procedures.

<Files\\Deloitte Public Report 2008 - 2009> - § 1 reference coded [0.19% Coverage]

49. We met certain partners and staff from the technical department and reviewed some of the firm's audit training material and concluded that it was satisfactory.

<Files\\Deloitte Public Report 2013 - 2014> - § 2 references coded [0.82% Coverage]

50. We identified weaknesses on 10 of these audits relating to the reliance on management's reports or spreadsheets or the testing of IT controls. Auditors often place reliance on management's reports and spreadsheets, where the information has been generated by the
IT system, for example to calculate stock valuations or bad debt provisions. On 10 audits there
was insufficient testing of those reports or spreadsheets. In addition, on five audits, weaknesses were identified in the audit testing of certain IT general and/ or application controls.

51. The annual practice review process, which monitors the quality of audits, was improved. There was an enhancement of the review of the firmwide procedures, with all areas reviewed every year, rather than on a rotational basis.

<Files\\Deloitte Public Report 2014 - 2015> - § 1 reference coded [0.62% Coverage]

52. Audit quality monitoring — reviews of partners with audits graded non-compliant.

    The DTTL practice review manual requires audit engagement partners receiving a noncompliant (i.e., the lowest) grade in the practice review to be reviewed in the subsequent cycle.

    While the firm considers the extent of recurring findings in prior years for those partners with a non-compliant graded audit, the firm no longer reviews another audit for each relevant partner in the current year to identify whether there are any similar findings on those audits.

Name: Nodes\\Reliability and usefulness of audit reporting\Audit reports

<Files\\Deloitte Public Report 2007 - 2008> - § 1 reference coded [0.22% Coverage]

53. We reviewed the involvement of the Professional Standards Review department in all the individual audit engagements we reviewed and considered the department provided a valuable role in quality assurance.

<Files\\Deloitte Public Report 2008 - 2009> - § 2 references coded [0.75% Coverage]

54. In our view, the scope of the pre-issuance reviews undertaken by the department is a particular strength of the firm's review procedures. However, we were unable to assess the quality of these reviews as the output is not retained on the audit files.

55. We reviewed several significant audit judgments, including such matters as the rationale for accounting treatments, the reasonableness of assumptions in valuations and estimates and judgments concerning the extent of audit work performed. We were generally satisfied, subject to our comments below and in Section 2.4.5, with the basis on which significant audit judgments were made.

<Files\\Deloitte Public Report 2014 - 2015> - § 1 reference coded [0.60% Coverage]

56. Of the audits we reviewed, 16 were affected by these new requirements. On five audits, there were inaccurate or unclear descriptions in the auditor's report of certain audit procedures performed in response to the identified risks. On one of these audits,

the auditor's report was factually incorrect by referring to certain audit procedures relating to inventory provisions that had not been performed. On three of these audits, the auditor's report did not sufficiently describe certain aspects of the scoping of the audit.

Name: Nodes\\Reliability and usefulness of audit reporting\Communication with audit committees

<Files\\Deloitte Public Report 2007 - 2008> - § 1 reference coded [0.41% Coverage]

57. We reviewed the firm's communications with Audit Committees for all the audits we reviewed. In our view, they were timely and addressed the key issues in a balanced and informative manner. However, in a small minority of the audits we reviewed, we noted that uncorrected misstatements other than those considered 'clearly trivial' had not been reported to Audit Committees as required.

<Files\\Deloitte Public Report 2008 - 2009> - § 1 reference coded [0.47% Coverage]

58. We considered the firm's communications with Audit Committees for all the audits we reviewed. In our view, they were generally timely and addressed the key issues in a balanced and informative manner. However, in a small minority of the audits we reviewed, there was, in our view, insufficient reporting of errors identified or independence threats arising from the provision of non-audit services.

<Files\\Deloitte Public Report 2011 - 2012> - § 2 references coded [1.18% Coverage]

59. However, on two audits, several outstanding matters were set out in the final report to the Audit Committee, but there was no evidence of any further communications on those areas. In addition, on eight audits, the communication of threats and safeguards for non-audit services was either incomplete or insufficiently detailed.

60. Auditing Standards require the auditor to communicate significant deficiencies in internal controls identified during the audit on a timely basis. In two audits, not all the identified significant control deficiencies were communicated to the Audit Committee until well after the approval of the financial statements (nearly three months later in one case, and five months later in the other case).

<Files\\Deloitte Public Report 2014 - 2015> - § 1 reference coded [0.96% Coverage]

61. We reviewed the reports issued by the auditors to the Audit Committees on all 20 audits. In most respects, these reports were of a good standard. The firm's standard template was used on all audits we reviewed, which helped ensure consistency of the reporting to Audit Committees. One of the standard matters reported are the procedures planned to respond to the identified areas of significant risk. While these were generally in line with the actual procedures performed, on seven audits there were inaccurate communications relating to certain audit procedures performed for one or more areas of significant risk.

    On six audits, the audit plan was not communicated on a timely basis, generally after the audit work had commenced. On one of these audits, there was no meeting with the Audit Committee to discuss the planning report.

<Files\\Deloitte Public Report 2015 - 2016> - § 1 reference coded [0.56% Coverage]

62. We saw examples of good quality communications on several of the audits we reviewed. We also identified cases, however, where the communications with Audit Committees required improvement.

    These included:

    Inadequate communication of changes in the audit strategy and audit procedures performed, or of the reasons for changes, compared to the planning information previously communicated to the Audit Committee.

<Files\\DELOITTE Public Report 2016 - 2017> - § 1 reference coded [1.03% Coverage]

63. We reported last year on the need to improve the quality of communications with Audit Committees on certain audits; but also, that we had seen several examples of good quality communications on other audits. We again saw both examples of good quality communications and cases where improvements were needed in this area.

    We refer in the overview section of this report to high quality reporting in relation to property valuations.

    Issues arising on one or more audits included:

— The sufficiency of reporting on key areas of judgment, in relation to impairment assessments and pension balances.

— The adequacy of the reporting on internal control deficiencies, including the audit response.

—A lack of clarity regarding the reporting on the audit approach to revenue.

Name: Nodes\\Reliability and usefulness of audit reporting\Proper audit conclusion - Truth and fairness

<Files\\Deloitte Public Report 2007 - 2008> - § 2 references coded [0.87% Coverage]

64. In many of the audits we reviewed, audit teams had applied the guidance and followed the required procedures. However, in a minority of the audits we reviewed, there was, in our view, room for improvement in the identification of significant risks and the evaluation of the design and implementation of the related controls.

65. We reviewed the firm's audit finalization procedures in all the audits we reviewed and found they were generally performed to a good standard. However, in a minority of the audits we reviewed, there was room for improvement either in the application or in the evidencing of the firm's procedures in relation to one or more of the following: subsequent events, going concern, obtaining representations from those charged with governance or the archiving of completed audit files.

<Files\\Deloitte Public Report 2008 - 2009> - § 1 reference coded [0.45% Coverage]

66. We considered the involvement of independent review partners in all the individual audit engagements we reviewed. We considered that they generally performed their reviews in accordance with the firm's policies and procedures. However, in a minority of the audits we reviewed, there was, in our view, insufficient evidence on the audit files of their involvement on a timely basis.

<Files\\Deloitte Public Report 2011 - 2012> - § 2 references coded [1.21% Coverage]

67. Component materiality is required to be set at a level lower than materiality for the group financial statements as a whole. The basis of the calculation of component

materiality was not adequately Justified by the group audit team in seven audits and, in one case, the level of component materiality was the same as group materiality.

68. We identified weaknesses in relation to the audit of revenue on eight audits. On four of these audits, the significant risk identified relating to revenue recognition was narrowly defined as applying to cut off only. In two of these audits, where there was a high level of deferred revenue, there were weaknesses in the audit procedures performed to ensure that revenue was recognized in the correct accounting period.

<Files\\Deloitte Public Report 2013 - 2014> - § 1 reference coded [0.23% Coverage]

69. On one audit we reviewed, we identified errors in the cash flow statement and in certain notes to the financial statements, which had not been identified by the audit team, nor by the firm's quality control reviews.

<u>Name: Nodes\\Skills and personal qualities of audit personnel\Adherence to audit and ethical standards</u>

<Files\\Deloitte Public Report 2007 - 2008> - § 4 references coded [1.35% Coverage]

70. We reviewed the firm's ethical policies and procedures and considered them to be comprehensive.

71. In our view, the practice of including staff from clients' internal audit departments in external audit teams may be inconsistent with the underlying principles of the Ethical Standards, because it is not possible for such staff to be independent of their employers. We believe the firm should review the appropriateness of this practice and what safeguards should be applied to deal with such threats to independence.

72. We reviewed the firm's procedures in respect of the year ended 31 May 2007 and noted that by 31 July 2007 compliance confirmations had been received from all partners. The firm's own monitoring procedures identified two instances of non-compliance with the requirements of Ethical Standards concerning the holding of investments in restricted entities which have since been disposed of.

73. In many of the audits we reviewed, the requirements had been applied. However, in a small minority of the audits we reviewed, certain analytical procedures that were

carried out as risk assessment procedures did not, in our view, give rise to an increased understanding of the entity or its environment for the purposes of engagement planning.

<Files\\Deloitte Public Report 2008 - 2009> - § 3 references coded [0.55% Coverage]

74. We reviewed the firm's mapping of the revised Standards to the Ethics and Independence section of the Deloitte Policies Manual with no issues arising.

75. We reviewed the firm's systems for recording consultations on ethical matters and considered them to be operating in accordance with the firm's policies.

76. We considered the firm's independence and ethical policies and procedures to be comprehensive and, subject to the above matter, to have been communicated appropriately. <Files\\Deloitte Public Report 2011 - 2012> - § 1 reference coded [0.23% Coverage]

77. On the group audits reviewed by us, the written instructions from the group auditor to the component auditors were generally of a good standard.

<Files\\Deloitte Public Report 2013 - 2014> - § 1 reference coded [0.27% Coverage]

78. The firm implemented detailed guidance to respond to the requirements of the revised Auditing Standard on audit reports (ISA UK & I 700) and was the first firm to issue an enhanced audit report, incorporating a more detailed commentary about the audit.

<Files\\Deloitte Public Report 2014 - 2015> - § 1 reference coded [0.27% Coverage]

79. The firm requires omitted disclosures and other financial reporting deficiencies identified in the PSR reviews to be noted in the audit file. However, we continue to see little or no evidence that this policy is being applied in practice.

Name: Nodes\\Skills and personal qualities of audit personnel\Mentoring and on the job training

<Files\\Deloitte Public Report 2012 - 2013> - § 1 reference coded [0.42% Coverage]

80. The firm's practice review identified through interviews with certain audit personnel that, while there was generally a good awareness of Deloitte's ethical principles, this was not the case in one of the business units. The firm was planning to take action to increase the awareness of these principles across the firm at the time of our inspection.

<Files\\Deloitte Public Report 2013 - 2014> - § 1 reference coded [0.18% Coverage]

81. The firm has no guidance on the extent of audit testing required for multiple stock locations or for perpetual counts. Such guidance should be developed by the firm.

Name: Nodes\\Skills and personal qualities of audit personnel\Professional scepticism

<Files\\Deloitte Public Report 2011 - 2012> - § 1 reference coded [0.37% Coverage]

82. The firm issued several communications to audit personnel on the importance of professional scepticism, including the subject in its mandatory audit training and encouraged its consideration in the performance evaluation process.

<Files\\DELOITTE Public Report 2016 - 2017> - § 1 reference coded [1.60% Coverage]

83. The audit of this area was still a major contributing factor to audit quality assessments on eight audits, including four where we assessed that more than limited improvements were required to the quality of the audit work. We identified the following concerns in relation to the extent of challenge of management by audit teams, or evidence thereof, on one or more audits:

— Insufficient evidence of challenge of management's assumptions over forecast cash flows supporting goodwill impairment reviews and intangible assets arising on acquisition. This related to key assumptions over market share, pricing initiatives and operational improvements, discount rates, new business development and growth rates. Also, in one case there was insufficient challenge of management over the adequacy of an impairment model which contained a high level of contingencies; and in another an insufficient audit response to known historical budgeting inaccuracies.

— On the same audits, we had concerns over the adequacy of the auditors' consideration of sensitivity analysis for key assumptions.

— Insufficient audit procedures to assess the carrying value of certain intangible assets, particularly customer relationships.

Name: Nodes\\Skills and personal qualities of audit personnel\Specialist training

<Files\\Deloitte Public Report 2007 - 2008> - § 2 references coded [0.51% Coverage]

84. It was clear from these that the firm attaches appropriate importance to technical competence and audit quality.

85. The firm was prompt in including in its audit training the findings from its Practice Review and AIU's prior year inspection and ensured that all audit partners and staff who were required to attend such training did so. However, we noted that not all partners and staff who were required to attend the firm's mandatory IFRS Technical Excellence training did so.

<Files\\Deloitte Public Report 2011 - 2012> - § 1 reference coded [0.97% Coverage]

86. In most of the audits reviewed by us, experts were not used to assist the audit teams in their assessment of goodwill impairment, as the audit teams considered that they had sufficient expertise in that area. However, we were not convinced that this was always the case. We believe that there is a need for further training in this area, as those performing the audit procedures do not always appear to understand all the relevant accounting and financial reporting requirements, for example in relation to the determination of appropriate discount rates and the required disclosures for impairment reviews.

<Files\\Deloitte Public Report 2012 - 2013> - § 3 references coded [1.23% Coverage]

87. The mandatory audit training in the year on revenue primarily focused on risk assessment, and did not cover the approach to auditing revenue, including the use of substantive analytical procedures. We still consider that further guidance and training is needed to improve the quality of auditing in this area.

88. Audit teams generally used internal experts to assist them in several key areas, such as property valuations, tax, and pensions. On six audits, there were inadequate details of the audit work performed or evidence obtained to support the conclusions of the internal experts used, tax experts. The firm is currently in the process of strengthening its procedures relating to the interaction between audit teams and tax experts.

89. The firm should also clarify its guidance in relation to which individuals should be regarded as having expertise in a specialized area of accounting or auditing, as opposed to expertise in other areas, as this affects how their work is to be treated for audit purposes.

<u>Name: Nodes\\The culture of the firm\Audit quality monitoring</u>

Deloitte Public Report 2007 - 2008> - § 2 references coded [0.76% Coverage]

90. Based on our review of the Practice Review guidance, the work steps themselves, the results arising and the firm's actions in respect of them, we considered the UK Practice Review to have been well planned and executed and that appropriate steps were taken based on the findings.

91. In our view, the practice of including staff from clients' internal audit departments in external audit teams may be inconsistent with the underlying principles of the Ethical Standards, because it is not possible for such staff to be independent of their employers. We believe the firm should review the appropriateness of this practice and what safeguards should be applied to deal with such threats to independence.

<Files\\Deloitte Public Report 2009 - 2010> - § 1 reference coded [0.77% Coverage]

92. The firm's annual audit quality monitoring procedure comprises a review of the quality of a sample of completed audit engagements and an assessment of compliance at office or business unit level with certain firm-wide procedures relating to audit quality. Three audits we reviewed were also reviewed as part of the firm's audit quality monitoring procedure. In each case, the firm's findings were broadly consistent with the AIU's findings.

<Files\\Deloitte Public Report 2015 - 2016> - § 1 reference coded [1.01% Coverage]

93. We have the following concerns regarding these arrangements:

- The firm adopts a team approach to the conduct of EQCR reviews for listed entities, with elements of the review being conducted by members of staff in the firm's PSR team. However, the output of the EQCR and PSR reviews is not retained. On several audits reviewed, there was, therefore, insufficient evidence of appropriate challenge of audit teams.

- There is no requirement for PSR reviewers to confirm that they are independent of the audit team.

- The pre-issuance reviews of the financial statements of the firm's highest profile audits are undertaken by the PSR team with no involvement of the firm's accounting technical specialists (National Accounting and Audit).

<u>Name: Nodes\\The culture of the firm\Client acceptance and continuation</u>

<Files\\Deloitte Public Report 2007 - 2008> - § 1 reference coded [0.21% Coverage]

94. We reviewed the acceptance procedures and related documentation in respect of a sample of new audit clients won during the year and found they were completed properly in all material respects.

<Files\\Deloitte Public Report 2008 - 2009> - § 2 references coded [0.46% Coverage]

95. We reviewed the acceptance procedures and related documentation for a sample of new audit clients won during the year and the continuance procedures for the individual audits we reviewed.

96. We considered the firm's acceptance and continuance policies and procedures to be comprehensive and concluded that, in each case we reviewed, they were completed in accordance with the firm's policies.

<Files\\Deloitte Public Report 2009 - 2010> - § 1 reference coded [1.01% Coverage]

97. The firm's client take-on procedures are designed to ensure appropriate consideration is given to the suitability of new clients to be accepted as audit clients of the firm. In

one audit we reviewed, the firm's take-on procedures were fully signed off before several key information gathering steps were carried out. We were informed that the sign-off was an ‘in principle’ agreement and was still subject to the satisfactory resolution of outstanding matters. The firm should clarify the extent to which the take-on procedures must be completed before they are signed off.

<Files\\Deloitte Public Report 2012 - 2013> - § 1 reference coded [0.75% Coverage]

98. A sample of audit proposal documents reviewed by us all stated that the firm had completed its client acceptance procedures, even though they had not been completed in all respects. For example, on one of these proposals, the former auditor stated, shortly after the proposal, that it had resigned due to a serious disagreement with the directors in relation to the appropriateness of an accounting Financial Reporting Council 9 treatment. This required further consideration before the firm could accept the audit, including further internal approval following an increase in the firm’s risk rating of this entity.

Name: Nodes\\The culture of the firm\Financial consideration

<Files\\Deloitte Public Report 2010 - 2011> - § 1 reference coded [0.39% Coverage]

99. Given that the firm’s overall strategy emphasizes the importance of increasing revenues, the firm should ensure that this is not at the expense of its focus on achieving improvements in audit quality.

<Files\\Deloitte Public Report 2011 - 2012> - § 1 reference coded [0.66% Coverage]

100. There is a risk that the quality of future audits may be impacted by these fee pressures and the resulting initiatives to improve efficiency. The firm should ensure that it continues to focus on audit quality and give particular attention to its audit policies and guidance in areas where the extent of audit procedures performed are dependent on judgments relating to materiality, scoping or sample sizes.

Name: Nodes\\The culture of the firm\Investment and reward

<Files\\Deloitte Public Report 2007 - 2008> - § 1 reference coded [0.23% Coverage]

101. In our view, the appraisal process for audit partners and staff was conducted to a good standard in all the cases we reviewed apart from one case in which there was no evidence of input from the appraising partner.

<Files\\Deloitte Public Report 2008 - 2009> - § 1 reference coded [0.14% Coverage]

102. The appraisals we reviewed demonstrated that there was close linkage between audit quality and partner remuneration.

<u>Name: Nodes\\The culture of the firm\Consultations</u>

Deloitte Public Report 2007 - 2008> - § 1 reference coded [0.21% Coverage]

103. We reviewed the involvement of the independent review partners in all the individual audit engagements we reviewed and found they evidenced their work in line with the firm's policies and procedures.

<Files\\Deloitte Public Report 2008 - 2009> - § 1 reference coded [0.38% Coverage]

104. The firm continued to make a panel of partners available to engagement partners for consultation. In addition, representatives from the firm's audit groups and technical department held fortnightly meetings to ensure the firm was taking an appropriate and consistent approach to emerging issues.

<u>Name: Nodes\\The culture of the firm\Staff reward system</u>

<Files\\Deloitte Public Report 2007 - 2008> - § 1 reference coded [0.12% Coverage]

105. The appraisals we reviewed demonstrated that there was close linkage between audit quality and remuneration.

<Files\\Deloitte Public Report 2008 - 2009> - § 3 references coded [0.82% Coverage]

106. We reviewed the appraisals for a sample of audit partners and found that they were completed in accordance with the firm's policy and gave appropriate weight to audit quality considerations.

107. However, in a minority of the appraisals we reviewed, we identified that, contrary to the firm's policies and Ethical Standards, audit directors and managers referred to cross selling non-audit services to their audit clients.

108. We reviewed the partner promotion process and the portfolios of evidence for each partner candidate put forward by the Audit service line. In our view, the process was thorough and well executed and the portfolios of evidence considered audit quality matters.

<Files\\Deloitte Public Report 2011 - 2012> - § 3 references coded [1.24% Coverage]

109. Despite the firm's guidance in this area, nearly all the staff appraisal forms we reviewed did not include specific objectives and commentary relating to audit quality or technical related competencies.

110. However, it was not clear that the performance evaluation and remuneration of the partner responsible for the audit graded by the AIU as "significant improvements required" in the prior year was impacted by this finding. In addition, adverse findings on the quality dashboard for two other partners were not referred to in their appraisal forms.

111. We identified two partner promotion candidates who had referred to non-audit services provided to audited entities in a manner that could be interpreted as seeking credit for success in selling non-audit services.

<Files\\Deloitte Public Report 2012 - 2013> - § 2 references coded [1.15% Coverage]

112. The firm's performance evaluation system includes consideration of several audit quality metrics and requires consideration of performance against audit quality in the partner appraisal forms. The firm's guidance states that a negative contribution to audit quality will adversely impact remuneration.

Unlike revenue generation, a positive contribution to audit quality is not included as one of the criteria that influences the performance rating.

113. While the partner appraisals reviewed by us included consideration of audit quality, a third of them did not include audit quality related objectives, as required by

the firm. In addition, some partners indicated that the objective set for maintaining audit quality had been met or exceeded, when our own findings on their audits indicated otherwise. The setting of quality related objectives is important in ensuring that audit quality is adequately considered in the performance evaluation process.

<Files\\Deloitte Public Report 2013 - 2014> - § 3 references coded [1.33% Coverage]

114. In addition to this, the firm's policies require further action to be taken for partners with the lowest grades in the firm's internal practice review, such as a review of the partner's portfolio. However, this policy does not apply to partners with the lowest grades arising from external reviews, including any audit partners with recurring adverse findings from AQR reviews.

115. The staff appraisal forms focus on the achievement of individual objectives. In our sample of staff appraisals, the objectives in relation to audit quality were often unclear, there was no reference to situations where adverse quality ratings had been given, and most did not refer to other audit quality metrics, such as attendance at mandatory training. The appraisal forms should better facilitate an evaluation of overall performance in relation to audit quality.

116. We reviewed the level of bonuses for a sample of staff. This included four individuals who had been involved on audits where adverse AQR findings had been communicated during the appraisal period.

Three of these individuals had received an increase in their bonus compared with the prior year. It was not possible to determine if, or how, the level of bonuses was affected by audit quality considerations.

B. <u>ERNST & YOUNG LLP</u>

<u>Name: Nodes\\Audit process/Audit evidence</u>

<Files\\Ernst Young Public Report 2007 - 2008> - § 3 references coded [0.95% Coverage]

117. However, we considered there was insufficient evidence on file for one of the audits we reviewed to demonstrate that proper consideration had been given

to the possible threats to the firm's independence and objectivity arising from a tax audit partner who also provided tax advice to his audit client.

118. In one audit, due to the dearth of evidence on file of the firm’s planned approach or how the work performed contributed to the audit of revenue, it was unclear to us on what basis the audit team had concluded that sufficient appropriate audit evidence had been obtained in this area.

119. In another audit, there was, in our view, insufficient evidence on file to support an audit judgment relating to the disclosure of certain tax matters in the entity's financial statements.

Ernst Young Public Report 2008 - 2009> - § 2 references coded [1.04% Coverage]

120. In our view, one of the audits we reviewed, relating to a listed entity, required significant improvements in relation to the audit evidence on the group audit files to support the firm’s audit opinion on the group financial statements. In this case key audit working papers relating to the group audit prepared by another EYG member firm outside the UK were not on the group audit files made available to us.

121. The firm’s audit methodology provides guidance on the identification of significant risks and on the evaluation of the design and implementation of the related management controls. However, in a large majority of the audits we reviewed we identified weaknesses in one or more of the following areas: the identification of significant risks; the evidencing of the evaluation of the design and implementation of the related controls; and the communication of significant risks to subsidiary auditors.

<Files\\Ernst Young Public Report 2009 - 2010> - § 2 references coded [1.11% Coverage]

122. Impairment of goodwill and other assets

In four audits we reviewed, the audit files did not contain sufficient evidence of the work performed by the audit teams in assessing the reasonableness of the growth rates and other assumptions used by management in assessing the potential for impairment of goodwill and other assets.

123. In several of the audits we reviewed, there was insufficient evidence on the files of the assessment of the competence, experience, and objectivity of external experts. In other cases, involving the use of internal EY experts, there was insufficient evidence on the files to indicate either the detail of the work performed by the specialists or how all the matters raised by them had been followed up by the audit team.

<Files\\Ernst Young Public Report 2010 - 2011> - § 6 references coded [3.61% Coverage]

124. Impairment of goodwill and other assets on four audits, the files did not contain sufficient audit evidence of audit teams having either assessed the reasonableness of the growth rates or other assumptions used or reviewed source data and methodologies used by management in their projections to assess the potential for impairment of goodwill.

On two audits, there was insufficient evidence of the audit team's consideration of intangible assets including those deemed to have indefinite lives.

125. Impairment of loans and advances on one audit of a financial institution, there was insufficient evidence that the audit team had challenged key assumptions and judgments made by management,

126. Revenue recognition and fraud risks: In two of the audits, we reviewed there was insufficient evidence to support the contract revenue recognized in the current year. In one of these cases there appeared to be no explicit testing undertaken to confirm the accuracy of the underlying data used by management to calculate revenue recognized on long term contracts or to challenge management's explanations in relation to certain accounting judgments.

127. External confirmations

Auditing Standards state that audit evidence is more reliable when it is obtained from independent sources external to the entity. In one of the audits we reviewed, insufficient audit work in relation to the confirmation of material balances was performed or evidenced. Whilst we had fewer findings than last year, the firm should maintain its efforts to obtain direct confirmations where possible.

128. Significant risks: We identified continuing problems relating to insufficient linkage within the working papers to the evaluation of the design and implementation of controls over significant risks (5 audits) and no detailed evidence of fraud risk discussions (2 audits). The firm has, however, continued to place emphasis on this area in audit training and we found some further improvement this year.

129. Audit quality monitoring

On one of the groups audits we reviewed, which was also the subject of an AQR review, we identified that the AQR questionnaire did not include specific procedures to consider whether the work of component auditors was adequately reviewed cases where substantially all the audit procedures were performed by them.

<Files\\Ernst Young Public Report 2011 - 2012> - § 2 references coded [0.86% Coverage]

130. Audit sampling

In six of the audits we reviewed, we identified issues relating to the basis on which samples were selected for testing, including insufficient evidence to justify the sample selected in four audits.

131. Risk assessment procedures

In five audits we identified issues relating to risk assessment procedures, including insufficient consideration of certain areas of risk and related audit responses; and insufficient consideration of potential indicators of management bias in an area of key accounting judgment.

<Files\\Ernst Young Public Report 2012 - 2013> - § 1 reference coded [1.16% Coverage]

132. Group audit considerations

We assessed the quality of the firm's audit work in this area on the ten audits in our sample where group audit considerations were applicable. In six audits, we identified issues with either the sufficiency of the group audit team's involvement in component auditors' risk assessments or the extent of their review of component auditors' work. Further, in one of these audits the group audit team's assessment of the extent of audit work required in relation to each component was based on profits at the half year stage and not updated for the full year results. The scoping for this audit should also have considered other key financial data including revenue and assets and whether a component otherwise gave rise to a significant risk of material misstatement.

<Files\\Ernst Young Public Report 2013 - 2014> - § 9 references coded [5.01% Coverage]

133. Revenue recognition

The audit of revenue was reviewed on eight audits. We identified issues on six audits including insufficient testing of controls over assertions relating to revenue on four audits. In two of the six audits, insufficient audit procedures were performed, and insufficient evidence obtained to substantiate whether revenue had been recorded in the correct period.

134. Group audit considerations

We reviewed group audit considerations on nine audits. In four audits, we identified issues with either the sufficiency of the group audit team's involvement in component auditors' risk assessments or the extent of their review of component auditors' work. In three audits we identified issues surrounding the scoping of the group audit. In one of these audits, the group team did not set the materiality level for the audit of a component; this was instead set by the component auditors, who selected a materiality level equal to overall group materiality, which we considered to be inappropriate.

135. As a result of these issues, certain aspects of audit evidence were not included on the audit files and were therefore not subject to the firm's full quality control review procedures.

136. Goodwill and other intangible assets

We reviewed the audit of goodwill or other intangible assets in seven of the audits we selected. On three audits issues were identified with the procedures performed to test impairment. In two of these audits, there was insufficient evidence of assessment of the reasonableness of the growth rates or other assumptions used, the reliability of the source data and the appropriateness of the methodologies adopted by management in their impairment review.

137. Use of the work of Internal Audit

In two of the audits reviewed, the audit team obtained direct assistance from members of the entity's internal audit function. In one of these audits, the group audit team provided insufficient direct supervision of the work performed by the internal audit staff and relevant findings were reported through the head of internal audit, rather than directly to the EY group audit team. In both these audits, the group audit team did not appropriately confirm with the Audit Committee the relevant responsibilities of the internal audit staff and those of the external auditor.

138. In two audits, both in the insurance sector, there was insufficient evidence of the approach and audit testing performed by the audit team's actuarial specialists, including the testing of actuarial models. In addition, in one of these audits there was insufficient evidence supporting the actuaries' assessment of both the individual and cumulative impact of the issues they identified during their review.

In two audits we identified issues in relation to the audit work performed on the fair valuation of derivative financial instruments. In one of these audits, we considered that the audit team had performed insufficient testing of the most complex financial instruments where a significant input to fair value is not based on observable market data. In addition, the audit team had not conducted their work in this area in accordance with planned procedures. In the other audit, there was insufficient evidence that procedures performed at an interim date had been adequately updated to the balance sheet date.

In three other audits we identified issues in the audit of non-derivative financial assets and liabilities. In one of these audits, there was insufficient evidence that audit procedures performed at an interim date relating to cash balances were adequately updated to the balance sheet date. Further, controls identified and relied upon by the audit team did not address the relevant financial statement assertions relating to the cash balances.

139. Independence — non-audit services

In one audit, part of the fee arrangements agreed for non-audit services involved what was, in substance, a contingent fee. There was insufficient consideration of the threats arising from this arrangement or assessment of whether these could be reduced to an acceptable level. In a second audit, where non-audit fees exceeded the audit fee for the year, the audit engagement partner did not discuss the circumstances with the firm's Ethics Partner as required by Ethical Standards.

140. Assessment of IT risk and complexity

Audit teams are required to assess how IT affects the audit strategy and consider the complexity of the IT environment each year. This is, however, not necessarily performed by an IT specialist even if the IT environment is expected to be complex. Accordingly, there is a risk that audit teams do not fully understand the nature and/or extent of any planned IT changes at the application or infrastructure level. The firm should revisit the requirements for interaction between the audit team and IT specialists for complex IT environments to ensure that the guidance to related IT audit strategy is considered appropriately.

The firm's audit methodology provides several approaches and testing techniques to assess the reliability of system generated information. Although relevant training was provided in the year, there is insufficient guidance explaining how procedures, including sample sizes, may vary with the complexity of such information. The firm should expand its guidance to ensure a more consistent approach to testing system generated information, including sample sizes and the distinction between standard and bespoke reports.

The firm's audit methodology requires IT audit teams to determine any follow-up procedures required at the year-end where controls testing has been performed at an interim date. However, there are no standard procedures clarifying the extent of additional audit evidence required to update interim testing to the balance sheet date.

<Files\\Ernst Young Public Report 2014 - 2015> - § 7 references coded [4.56% Coverage]

141. Audit of revenue

The audit of revenue was reviewed on 12 audits. We identified issues on three audits. We concluded that one of these audits required significant improvements in all the areas set out below.

Analytical review procedures were frequently used to obtain substantive evidence in the audit of revenue. Weaknesses were identified in the application of substantive analytical procedures in all three audits, including a lack of adequate corroboration of management explanations and a failure to set expectations either at all or with sufficient precision.

On all three audits, insufficient testing was performed in respect of certain revenue streams to assess whether revenue had been recorded in the correct period.

We identified weaknesses in assessing the risks relating to revenue recognition on all three audits. On two of these audits there was insufficient evidence that the risk of fraud in revenue recognition had been appropriately identified and the audit approach in this respect lacked clarity. On the other audit, the basis for the conclusion that certain revenue streams did not give rise to a significant risk (for which there is a rebuttable presumption in Auditing Standards) was unsupported.

In two of the three audits, there was insufficient evidence of testing controls over revenue, where the audit team were relying on the operating effectiveness of these controls, and a lack of substantive testing of certain revenue streams.

Involvement of group auditors

Of the eight audits where we reviewed group audit considerations, we identified issues on four audits, in addition to the group audit scoping issues noted above.

On two audits, for audit work completed by the firm's internal experts that should have been under the direction, supervision, and review of the group audit team, it was not appropriate to rely on reviews performed by component audit teams. This work should have been included in the group audit files and been subject to review, as necessary, by the group audit partner and group engagement quality control reviewer.

On two audits, there was insufficient evidence of the group audit team's direction and review of certain aspects of the audit. On one of these audits, a letterbox3 company, there was insufficient detail of the work performed on the consolidation and the group financial statement disclosures.

142. Audit of loan loss provisions

There was a lack of understanding and review by the audit team of the procedures performed on their behalf by the group audit team and the conclusions reached.

For most key controls over loan loss provisions, the audit team retested items already selected by internal audit and performed no other testing. Furthermore, in several instances, controls testing focused on whether management had performed the control rather than testing its underlying operating effectiveness.

We also identified weaknesses in substantive testing including insufficient evidence that balances had been agreed to source systems, failure to identify inconsistencies between the underlying evidence and the conclusions reached and no evidence that the accuracy of certain provision calculations had been tested.

143. Journals testing

We considered the appropriateness of the audit of journals in all the audits we reviewed. On six audits, we found that the audit approach to the testing of journals was inappropriate, and that insufficient testing was performed as a result.

On five audits, generic risk criteria were used to select journals for testing with insufficient evidence that the fraud risks specific to the audit had been considered. On four of these audits, there was no explanation why the number of journals tested was sufficient. On three of the four audits, insufficient or no corroborative evidence had been obtained for the journals tested.

144. Impairment

On one audit which required significant improvements, the audit team should have considered whether there was a significant risk in relation to the carrying value of non-current assets, given that other related non-current assets had been impaired, and planned sufficient appropriate procedures to address this risk. In addition, insufficient audit procedures were performed to challenge management's cash flow projections in relation to this assessment of impairment.

145. There is no central oversight or monitoring of the nature of the work that is performed by offshore staff. The firm also allows review of offshore work to be undertaken by more senior offshore staff in certain circumstances. A second review should always be performed by a member of the core UK team.

<Files\\Ernst Young Public Report 2015 - 2016> - § 7 references coded [6.07% Coverage]

146. Given the level of audit risk and the potential impact on the financial statements, we reviewed the audit of valuations and estimates on nearly all the audits that we inspected. The audit of this area was a contributing factor for all three audits where we assessed that more than limited improvements were required to the quality of the audit work.

147. The main findings related to:

- The extent to which certain key assumptions in impairment reviews had been adequately considered and challenged. On one audit there was insufficient challenge of the entity's forecast improvement in its profitability, which was the basis for not impairing its non-current assets. In addition, there was insufficient evidence that the audit team had adequately considered the potential problems that could have influenced the forecasts.

- The audit of certain provisions, where the audit team had not sufficiently assessed and challenged management's judgments in cases where there was estimation uncertainty. On one audit the audit team did not adequately consider or challenge the method management had used to estimate a provision and did not adequately involve the firm's internal experts to assess the reasonableness of the provision. In addition, the audit team had not sufficiently considered whether the related disclosures were adequate. On another audit, the audit team did not sufficiently test the data management had used to support the assumptions applied to calculate the provision.

148. Sufficiency of testing of controls: on one audit the controls testing did not cover all types of transactions and on another audit the suitability of the nature and extent of the approach to testing individual controls was not explained. On a third audit there was insufficient evidence that the design and implementation of controls for a significant risk had been evaluated.

- Adequacy of the substantive analytical review: on the audits reviewed, the audit teams often used analytical procedures to predict the expected amounts and compare them to the actual revenue. In two audits the expected amounts had not been determined appropriately and therefore were not a suitable basis for comparison to actual revenue.

We also identified instances where the differences between actual and expected amounts were not adequately investigated or corroborated.

149. Justification of the sample sizes used in testing: on some audits, there was insufficient justification for the sample sizes used and insufficient supporting evidence for the sample of items selected for testing revenue.

150. Reliance on reports generated from IT systems: on one audit there was insufficient evidence that the completeness of revenue reports had been adequately tested.

151. A need for improvements to the firm's monitoring of its independence policies and procedures was identified in the following areas:

- Monitoring of holdings in prohibited financial interests: the firm was not monitoring on a timely basis prohibited financial interests held by partners and staff in audited entities. It is now doing so daily to ensure the prompt disposal of such holdings.

- Delays by the Independence team in notifying the relevant audit partner of independence breaches:

the firm identified cases where holdings of prohibited financial interests in audited entities by other partners were not notified to the relevant audit engagement partners on a timely basis and, consequently, there were also delays in notifying Audit Committees. New procedures were implemented in the year.

- Monitoring of partners leaving the firm: until recently, the firm did not have adequate procedures in place to monitor roles subsequently taken on by partners who leave the firm, such as joining audited entities.

- Monitoring of completion of independence training: the firm's procedures to ensure that mandatory training was completed by the required deadline were not sufficiently timely and robust at the time of our review. New monitoring and follow up procedures were subsequently implemented for the 2015 mandatory training.

152. We also identified independence issues on certain audits:

- The firm provided non-audit services to an entity without adequately assessing whether the safeguards in place to reduce or eliminate potential threats to independence were likely to be effective.

- Audit teams for two investment trust entities did not adequately consider whether entities within the same group of companies were connected parties, and the implications for the independence of the firm.

<Files\\Ernst Young Public Report 2016 - 2017> - § 2 references coded [2.00% Coverage]

153. We identified findings on several of these audits, relating to whether the audit team's challenge of management was sufficiently rigorous or evidenced, including the following on one or more audits:

—In relation to the assessment of goodwill and other assets for impairment, there was insufficient challenge of whether management's cash flow forecasts appropriately reflected the expected timing and duration of important contracts and whether short term growth rates could be achieved.

—In relation to the valuations of investments, there was insufficient evidence of challenge of whether management had the appropriate information to support the more subjective valuation of certain investments.

154. On some audits, however, we still identified findings on aspects of the audit approach, including the following on one or more audits:

— Use of data analytics where the audit of revenue was dependent on a high correlation between revenue and cash. Data analytics were used to establish how much revenue was generated from cash and non-cash items. Insufficient testing was, however, planned and performed over key cash reconciliations upon which the data analytics relied.

— Insufficient testing of the completeness of certain revenue transactions recognized during the year (for example, where the audit approach was designed to focus primarily on revenue deferred at the year-end, rather than revenue recorded in the year).

Insufficient sample sizes were used to audit revenue (for example, where the samples did not reflect all relevant risk factors such as deficiencies in IT and other controls).

Name: Nodes\\Factors Outside Auditor's Control

<Files\\Ernst Young Public Report 2013 - 2014> - § 1 reference coded [0.48% Coverage]

155. Going concern assessment

We assessed the quality of the firm's audit work in relation to the assessment of going concern on eight audits in our sample. In five audits, we identified issues in one or more of the following areas:

insufficient assessment by the audit team of management's consideration of the going concern assumption; insufficient evidence of the consideration of key factors relevant to the assessment of going concern; inconsistencies with assumptions used by management in other areas, and inadequate disclosures in the financial statements.

Name: Nodes\\Audit reporting

<Files\\Ernst Young Public Report 2007 - 2008> - § 1 reference coded [0.44% Coverage]

156. However, in a small minority of the audits we reviewed, we noted inconsistencies between what was communicated to those charged with governance and the execution of the audit engagement itself. In one case, we noted that uncorrected misstatements affecting earnings more than the 'clearly trivial' threshold had not been reported to an Audit Committee.

<Files\\Ernst Young Public Report 2008 - 2009> - § 2 references coded [0.92% Coverage]

157. Audit working papers.

In one of the audits we reviewed, key working papers relating to the group audit prepared by another EYG member firm outside the UK were not on the group audit files made available to us. The audit files, therefore, did not demonstrate that the firm had obtained sufficient appropriate audit evidence supporting its opinion on the group financial statements of a listed entity.

158. In one audit we reviewed, the firm reported its audit findings to the Audit Committee indirectly through a report ('the Management Report') which also included material prepared by management. In our view, given the separate responsibilities of management and the auditors, the firm should have communicated its audit findings to the Audit Committee directly and not through the Management Report.

<Files\\Ernst Young Public Report 2009 - 2010> - § 1 reference coded [0.35% Coverage]

159. Communicating with the Audit Committee

The reporting to audit committees was generally of a satisfactory standard. However, on half the files we reviewed, we found that independence threats and safeguards were not adequately reported.

<Files\\Ernst Young Public Report 2010 - 2011> - § 3 references coded [1.39% Coverage]

160. Communicating with the Audit Committee On five audits we reviewed, we found that independence threats and identified safeguards adopted, particularly regarding the provision of non-audit services, were not adequately reported to audit committees. In addition, on four audits we reviewed, we identified other weaknesses in communication, including significant audit findings not having been adequately reported or, in some cases, evidenced as having been reported.

161. Signing and dating of audit reports.

On two audits the auditor's report was signed prior to the completion or evidencing of all necessary review procedures.

162. Audit finalization We found weaknesses in connection with audit finalization procedures on seven of the audits we reviewed. Most of these weaknesses related to undetected clerical drafting errors in the accounts including, in one case, an error in the disclosed.

<Files\\Ernst Young Public Report 2011 - 2012> - § 2 references coded [1.22% Coverage]

163. Reporting to the Audit Committee

In two of the audits we reviewed, significant findings were not adequately reported to the Audit Committee. In one case the audit team should have communicated in writing the fact that the draft accounts presented for audit were not of an appropriate standard, due to the large number of errors identified by the firm's technical review.

164. Quality control and audit finalization

The firm's quality control and audit finalization procedures were generally performed to an acceptable standard. In two audits, however, there was insufficient evidence of review by the engagement partner or independent review partner. In a further two audits there were weaknesses in the assembly or archiving of audit files.

<Files\\Ernst Young Public Report 2012 - 2013> - § 1 reference coded [0.96% Coverage]

165. Reporting to Audit Committees

We included this area in the review of all audits in our sample. Although there was no common theme, we identified significant matters that had not been adequately reported to the Audit Committee in three audits. These were the lack of communication in writing of the audit team's planned involvement in the work of component auditors; the fact that the audit team had not relied on IT general controls due to control weaknesses previously identified and the audit findings in this area; and the lack of communication of non-audit services provided during the period and details of the specific threats and safeguards in place.

<Files\\Ernst Young Public Report 2013 - 2014> - § 1 reference coded [0.34% Coverage]

166. In three letterbox company audits there was insufficient consideration of the UK fit and proper requirements in relation to personnel from overseas EY network offices performing audit procedures directly for the UK firm. In two letterbox company audits we identified that the firm had not adequately reported to the Audit Committee information concerning audit team structures and personnel.

<Files\\Ernst Young Public Report 2014 - 2015> - § 3 references coded [1.92% Coverage]

167. On two of the four audits, the scoping section of the auditor's report was liable to misinterpretation as the reported percentages related to the total amounts at the principal locations rather than the balances that were subject to audit procedures.

On two of the four audits, there was no evidence to support statements made in the auditor's report relating to audit procedures performed. On one of these audits, the auditor's report did not explain that materiality was based on an adjusted profit figure.

On one of the four audits, given the magnitude of an identified prior year error, the auditor's report should have provided an understanding of the qualitative factors considered in determining whether the error required disclosure or correction.

Where an extended auditor's report was not required, in one case the auditor's report was issued under incorrect auditing standards as the audit was not conducted in accordance with the standards specified under applicable audit regulations.

168. Communications with the Audit Committee

We assessed the reporting to the Audit Committee in all the audits we reviewed. This was generally of a good standard, but we identified weaknesses in five audits. In three cases the written reporting provided insufficient detail or inaccurate information to the Audit Committee. For example, on one audit there was no detailed reporting to the Audit Committee on a significant item. In another case, certain misstatements required to be reported to the Audit Committee were omitted.

169. Evidence for conclusions

In several cases reviewers had not recorded the basis for their conclusions on specific findings arising in reviews and had not justified why mitigating factors presented by audit teams were appropriate. Furthermore, the reason for the overall grading of a review was not explicit as the final conclusions were generic and not tailored to reflect the relevant findings.

<Files\\Ernst Young Public Report 2015 - 2016> - § 1 reference coded [0.99% Coverage]

170. We reviewed communications with Audit Committees on all audits we inspected. Our main findings in this area related to insufficient evidence of reporting to Audit Committees of the audit findings in areas involving key judgments or estimates, including how the audit team had concluded that management's key judgments and estimates were considered appropriate.

For example, in three audits the reporting to the Audit Committee did not adequately explain the auditor's conclusions on methodologies and key assumptions used to estimate certain liabilities. On another audit, the reporting to the Audit Committee did not sufficiently explain how the audit team concluded that management's valuations of certain investments were appropriate.

<Files\\Ernst Young Public Report 2016 - 2017> - § 2 references coded [2.70% Coverage]

171. We reviewed communications with Audit Committees on all audits we inspected. On some of these audits, insufficient detail was reported to Audit Committees on certain significant findings, including the following on one or more audits:

The reporting to the Audit Committee did not include the impact of management's assumptions for certain contracts on the goodwill impairment assessment and the recognition of deferred tax assets.

Reproducing the risks section of the auditor's report in the written communications to the Audit Committee was not an appropriate substitute for reporting the auditor's findings on significant risks. Insufficient detail was provided to the Audit Committee on the rationale for, and effect of, valuing investments using assumptions that were more conservative than those used by similar third parties.

172. We reviewed a sample of staff appraisals completed in 2015 which were the most recent available at the time our work was undertaken (in early 2016). Based on this review the firm should improve the effectiveness of its staff appraisal processes by:

— Strengthening the link between the assessment of audit quality and overall performance for staff. In the sample of staff appraisals we reviewed, audit quality did not appear to have a direct impact on the staff appraisal process. This could be improved by taking account of the results of internal and external quality reviews on staff performance and having a clearer linkage between the overall appraisal rating, the achievement of quality objectives and remuneration.

— Enhancing controls over the completion of staff objectives. A significant number of staff had not completed their objectives three months after the firm's deadline and, in the sample, we reviewed, several audit quality objectives set by staff were either too brief or not specific.

Improving the quality of information on staff appraisal forms. We identified that key information was not always included on staff appraisal forms, such as comments from appraisers, a detailed self-assessment, and relevant references to adverse internal and external inspection quality ratings.

Name: Nodes\\Skills and personal qualities of Audit Engagement Team

Files\\Ernst Young Public Report 2008 - 2009> - § 2 references coded [1.26% Coverage]

173. The Ethical Standards require firms to establish policies and procedures to ensure that the objectives of audit personnel do not include the selling of non-audit services to their audit clients. While the firm had prepared guidance addressing this matter, it did not form part of the firm's independence policies and had not, in our view, been adequately communicated to partners and staff.

174. In a small minority of the audits we reviewed, there was, in our view, insufficient evidence on the audit files that the client's use of hedge accounting was appropriate.

In one audit reviewed, there was, in our view, insufficient evidence on the audit file of the basis for an audit judgment relating to the carrying value of an asset.

In one audit reviewed, there was, in our view, insufficient evidence on the audit file to support the averaging of certain costs over the lifetime of a long-term contract.

In one audit reviewed, the audit team did not identify a third-party entity as a service organization. As a result, it did not, in our view, perform sufficient audit procedures in this area.

<Files\\Ernst Young Public Report 2009 - 2010> - § 2 references coded [0.97% Coverage]

175. Our review of a sample of non-audit services approval forms ('NASAF') identified one audit where some of the NASAF forms had been completed without sufficient evidence that threats and safeguards had been properly considered.

176. We noted two cases where partners had taken credit within their appraisal documentation for "broadening the firm's service line penetration" to their audit clients. Whilst the two partners concerned did not quantify the non-audit

services involved, we believe that EY should reiterate that it is not appropriate to take any credit in appraisal documentation in connection with the selling of non-audit services to audit clients.

<Files\\Ernst Young Public Report 2010 - 2011> - § 4 references coded [2.73% Coverage]

177. determining whether specific impairment provisions were required for two out of a sample of 40 loans and advances to customers reviewed.

- Group audits: On four of the audits we reviewed, we identified weaknesses in either the content or timing of the referral instructions issued to component auditors, or in the information received from the overseas component audit teams and how this was addressed on the group audit files.

178. In three of the audits we reviewed, there was insufficient evidence of the audit team's consideration of the application of IFRS 8 to the identification of operating segments.

179. Substantive analytical review We have reported in previous years that there was a need for improvement in the performance of analytical procedures to obtain substantive audit evidence. In two of the audits, we reviewed this year the differences between the recorded amounts and expectations were calculated using prior year figures as the expectations. This did not provide sufficient substantive evidence for certain categories of cost on these two audits. Whilst the number of findings has again reduced in the current year, the firm needs to continue to focus on achieving improvements in this area.

180. We also noted one case where a partner had taken credit within his annual appraisal documentation for "account relationship development progressing strongly with increased tax and Transaction Advisory Services participation on three audit clients". Whilst the partner concerned did not quantify the value of any non-audit services involved, in our view the wording used implies that credit is being sought for the potential sale of non-audit services contrary to the underlying principles of the Ethical Standards and the firm's policy in this area.

<Files\\Ernst Young Public Report 2011 - 2012> - § 6 references coded [5.30% Coverage]

181. Impairment of goodwill and other assets

In response to issues identified in prior years, the firm emphasized the requirements in this area in its training and communications to the audit practice. However, on six audits, there was insufficient evidence of the work performed by the audit teams in assessing either the reasonableness of the growth rates or of the other assumptions, source data and methodologies used by management in their projections to assess the potential for impairment of goodwill. In three of these audits the audit teams did not apply sufficient professional scepticism in reaching their conclusion in this area.

182. Revenue recognition

In six of the audits we reviewed, we identified issues in relation to the audit of revenue.

In one case, revenue recognition should, in our view, have been identified as a significant risk and further testing performed. In addition, on the same audit, insufficient evidence was obtained to support the conclusion that related internal controls were operating effectively. In both this audit and a further two audits, weaknesses were identified in relation to aspects of substantive analytical procedures, such as expectations not being set or not being sufficiently granular and explanations obtained from management not being corroborated.

183. In one audit the group audit team's involvement in component auditors' risk assessments and planned audit responses was insufficient. In another the audit team's evaluation of the sufficiency and appropriateness of the audit evidence obtained by the component auditors for group audit purposes required improvement.

184. Partner performance evaluations and remuneration

While the assessment of a separate quality rating for each partner under the oversight of the firm's Quality & Risk Management function (Q&RM) is a positive feature of EY's performance evaluation procedures, the finalization of each partner's quality rating is insufficiently rigorous. As an example, based on the evidence we reviewed, good feedback from an audited entity has a positive impact on the overall quality rating even when such feedback may not be specifically related to quality, but to the strength of the relationship with that entity. As a result, it is not clear that evidence of poor-quality audit work, such as a low grade arising from an independent quality review, is always adequately reflected in partner remuneration.

Further, three partners in our small sample sought credit within their annual appraisal forms for selling non-audit services and/or developing potential opportunities for selling other services to entities that they audit.

185. Partner promotions

One partner candidate obtained feedback from audited entities to support the case for promotion to partner. While we recognize that the firm may wish to seek feedback from audited entities in relation to partner candidates, allowing the candidates themselves to seek such feedback gives rise to a potential threat to their independence and objectivity.

186. Approval of non-audit services

We noted several cases of approved non-audit services where threats to auditor independence and the safeguards applied by the firm had not been adequately considered.

<Files\\Ernst Young Public Report 2012 - 2013> - § 6 references coded [4.29% Coverage]

187. Revenue recognition

The audit of revenue was reviewed on all audits in the sample we selected. In six audits we identified issues in this area including, in two of them, issues regarding the recognition of revenue from long-term contracts. In one of these audits, no justification was given for the sample size and why it was considered adequate. Also, the sample of contracts was selected from ten months' rather than a full year's information. Further, in two audits insufficient audit procedures were performed and evidence obtained in relation to deferred revenue.

188. Impairment of goodwill

We reviewed the impairment of goodwill in eight of the audits we selected. On three audits issues were identified with the procedures performed in this area. In two of these audits there was insufficient evidence of assessment of the reasonableness of the growth rates or other assumptions, the reliability of the source data and appropriateness of the methodologies used by management in their impairment review. In one of these audits the audit team did not exercise appropriate professional scepticism in reaching their conclusion in this area.

Testing of internal controls

189. We considered aspects of the audit team’s work on internal controls in most audits selected and in two audits we specifically selected IT general controls for review. In these two audits, we identified issues relating to the testing of internal controls. In the first of these audits, it was not clear whether appropriate levels of testing had been performed in each area or whether all controls identified as responding to areas of significant risk had been tested appropriately.

190. One partner in our sample referred to non-statutory assurance services provided to two entities audited by him in assessing his achievements. Therefore, evidence remains that some partners continue to seek credit for the sale of non-audit services to entities that they audit.

191. Independence and ethics - error in the independence policy

The EY Global independence policy permits extended audit services if they have been authorized by the audited entity's management. However, Ethical Standards require authorization by those charged with governance. We raised this issue in our prior year report but noted during our inspection this year that the error remained in the current version of the firm’s policy.

192. Materiality for specific accounts/disclosures

The firm’s audit methodology, which is developed and updated by EY Global, requires audit teams to consider whether there are any accounts or disclosures where the occurrence of misstatements of a lesser amount than the materiality level set for the financial statements could reasonably be expected to influence the users of the financial statements. However, Auditing Standards also require audit teams to determine a materiality level for such items and this was not reflected in the firm’s methodology.

<Files\\Ernst Young Public Report 2013 - 2014> - § 8 references coded [3.37% Coverage]

193. Analytical review procedures are frequently used to obtain substantive evidence in the audit of revenue. Weaknesses were identified in relation to aspects of the application of substantive analytical procedures in four of the six audits, including expectations either not being set or not being set with sufficient precision and without adequate corroboration of management explanations.

194. In another of these audits, we identified several instances where the sample sizes chosen for testing controls differed from the planned testing portfolio and it was unclear that an appropriate strategy had been in place from the outset.

195. IT controls testing

We reviewed the audit of IT controls on four audits and identified issues in this area in each case. In two audits, testing one item was not sufficient to conclude as to whether certain access rights were appropriately segregated. In a further audit, there was insufficient evidence as to how the group audit team mitigated audit risks arising from the identification of inappropriate password controls and segregation of duties.

196. In a second audit, there was insufficient evidence of audit work being performed on an underwriting agreement for a rights issue fundamental to the going concern assessment. Furthermore, insufficient procedures were

performed regarding the appropriateness of the disclosures in the financial statements of this entity relating to the going concern assumption.

197. Journals testing

In three audits, there was insufficient justification for the number of journals tested. In one of these audits, there was a lack of evidence that the audit team had appropriately identified and tested higher risk journals.

In a fourth audit, journal testing was performed by another network firm and there was no evidence of the group audit team's involvement in, or oversight of, this work.

198. Consideration of accounting policies

In two audits which we reviewed we identified issues in relation to the consideration of accounting policies adopted in the financial statements.

199. Independence and ethics financial interest in an audited entity

We were informed by the firm that there was a breach of the firm's ethical policies, relating to an equity partner's financial interests in one of the firm's audited entities. This related to a senior partner, who purchased shares in an investment fund which was audited by the firm. In November 2013, in the circumstances of this case, the FRC launched an Accountancy Scheme investigation into the conduct of the firm in this matter.

200. Non-audit services and fees

We noted one case where the approval for a non-audit service provided to an audited entity was obtained retrospectively. In addition, an engagement letter was not sent until after the work was complete. We note also that the firm undertook its own monitoring in this area and identified three other instances where engagements had commenced prior to obtaining the necessary approval to provide the service.

Our review also identified instances where non-audit services were approved with insufficient evidence that threats to auditor independence and appropriate safeguards had been adequately considered by the audit team. Although all teams are required to complete the firm's standard process for approving non-audit services, this is not consistently followed.

Certain procedures adopted in practice do not ensure evidence that independence threats arise, and the related safeguards applied have been considered and addressed appropriately. The standard approval process should be followed for all audited entities and evidence of proper consideration of threats and safeguards should be required.

Furthermore, the firm cannot readily identify total non-audit fees for an audited entity without requesting the data from each audit team. This results in an increased risk that audit teams may not be able to monitor such fees effectively.

<Files\\Ernst Young Public Report 2014 - 2015> - § 3 references coded [1.35% Coverage]

201. Independence — non-audit services We identified issues related to non-audit services in four audits. On one audit, where non-audit fees were expected to exceed the audit fee for the year, the audit partner did not discuss the matter with the firm's Ethics Partner, as required by Ethical Standards. On the same audit, there were errors in the analysis of audit and non-audit fees within the Annual Report that were not brought to the attention of the Audit Committee.

On two audits, both large and complex groups with significant overseas operations, there was insufficient evidence that the group audit team had consistently followed the non-audit services approval process.

202. Assessment of adequacy of EQCR

Engagement quality control reviewers are appointed on certain engagements. AQM reviewers are asked to consider the sufficiency and appropriateness of the involvement of the EQCR. However, the EQCR's performance appraisal does not reflect the findings, even if his or her involvement is deemed to be less than satisfactory.

203. As part of the thematic review, we reviewed the policies and procedures applied by the firm in conducting bank and building society audits. The firm

does not have procedures in place to ensure that all banking audit personnel attend all relevant industry training courses and should take appropriate action to address this weakness.

<u>Name: Nodes\\The culture of the firm</u>

<Files\\Ernst Young Public Report 2007 - 2008> - § 1 reference coded [0.12% Coverage]

204. We reviewed the firm's ethical policies and procedures and considered them to be comprehensive.

<Files\\Ernst Young Public Report 2008 - 2009> - § 2 references coded [0.63% Coverage]

205. In a small minority of cases, we noted that audit directors received high overall performance grades and received performance bonuses despite having been responsible for an audit assessed by the firm in its Audit Quality Review as having 'significant room for improvement'.

206. Most of the appraisal forms for audit managers we reviewed had been appropriately completed. However, in some cases audit quality issues had not been adequately addressed on the appraisal forms and consequently the overall performance rating was not adequately supported.

<Files\\Ernst Young Public Report 2009 - 2010> - § 1 reference coded [0.49% Coverage]

207. Ethical Standards include a prohibition on the linking of objectives, remuneration and promotion of audit team members to success in selling non-audit services to an audit client. We identified a few partner candidate files which contained inappropriate references to the selling of non-audit services to their audit clients.

<Files\\Ernst Young Public Report 2010 - 2011> - § 2 references coded [0.97% Coverage]

208. Reflecting the results of AIU and AQR reviews in annual appraisals

We found that internal and external quality review findings are not currently reflected in a consistent manner in the annual performance review documentation prepared to support the evaluation of an individual's performance.

209. Client continuance assessments

We found two instances where there was no evidence of formal approval of client continuance for FTSE 100 clients until a few days before their respective audit reports were signed. We were informed that continuance risk was considered by the audit teams during the audit process in both cases.

<Files\\Ernst Young Public Report 2011 - 2012> - § 2 references coded [1.56% Coverage]

210. Staff performance evaluations

The current annual staff appraisal process does not require an individual's performance in relation to audit quality to be separately rated. Only an overall rating is required, rather than a rating for each scorecard area. The annual staff appraisal process should be enhanced by including a specific assessment relating to audit quality. We were informed that from the next appraisal year the firm is moving to a system whereby audit managers will have a separate rating for the firm’s four scorecard areas.

211. Audit quality monitoring

The firm has a well-developed audit quality monitoring process for individual audits. There was limited evidence, however, of testing being performed in certain areas as part of its practice level reviews (for example, aspects of the review of learning and the assignment of personnel). The firm should develop a more comprehensive testing programmed for all practice level reviews.

<Files\\Ernst Young Public Report 2012 - 2013> - § 3 references coded [2.17% Coverage]

212. Audit acceptance procedures

For one new audit, there was no evidence that the audit team had made appropriate enquiries of the previous auditors. There was evidence of a disagreement between management and the previous auditors regarding a proposed accounting treatment and this matter had not been appropriately considered by the audit team in accordance with the firm’s audit acceptance procedures.

213. Partner performance evaluations and remuneration

Partner appraisals are not conducted or evidenced on a consistent basis and a variety of templates and formats are used. Although the self-assessment is generally completed in sufficient, relevant detail and we noted improvements in this area this year, the assessment by the reviewing partner or partners did not in a few cases give a clear, comprehensive, and balanced account of the partner's performance.

214. Since the UK firm is part of EY Europe, reviewing partners may be based in a firm outside the UK. In one appraisal within our sample, a reviewing partner from elsewhere in Europe encouraged the partner being assessed to improve non-audit/audit fee ratios at audited entities for which he was responsible.

While this was identified by the partner being appraised as not being in accordance with Ethical Standards and reported to the management team, the firm must ensure that reviewing partners based outside the UK are made aware of UK ethical requirements in this area and the need to comply with them.

<Files\\Ernst Young Public Report 2013 - 2014> - § 5 references coded [2.70% Coverage]

215. Partner performance evaluation and remuneration

In general, partner appraisals were conducted and evidenced on a more consistent basis this year.

However, the support for Quality Ratings still requires improvement. Objective assessments of quality arise from internal and external quality reviews, including our own reviews. Partner appraisals should consistently record whether the partner was subject to any of these processes, the stage that the review has reached at the time of the appraisal process and the expected.

216. Personal independence monitoring

The firm requires investments held by partners and staff, together with those held by immediate family members, to be registered promptly on the Global Monitoring System (GMS). When individuals are identified as holding prohibited investments GMS requires their disposal. There was, however, until recently, no formal escalation process if such investments were not promptly disposed of by the individuals concerned. In addition, because the updating of GMS and related systems depends on certain manual processes which are not sufficiently monitored, there is a risk that prohibited investments and exceptions are not being identified on a timely basis.

217. Retired partner joining an audited entity.

Ethical Standards require the firm to resign as auditor if a partner leaves the firm and is appointed as a director or to a key management position with an audited entity, having previously acted as the audit engagement partner, engagement quality control reviewer, a key partner, or a partner in the chain of command at any time in the two years prior to this appointment. The firm does not always retain the information supporting the decision as to whether EY should resign as auditor in situations where retired partners join an audited entity within two years of leaving the firm.

218. Audit pricing

The firm has issued recent guidance which indicated that if the firm could not achieve the required fee increases for an audited entity, then it could agree to various 'concessions' instead including asking for "more work (e.g., specialist work resulting from regulatory change)". This is contrary to the Ethical Standards which require the audit engagement partner to ensure that audit fees are not influenced or determined by the provision of non-audit services to the audited entity. Other suggestions in the guidance include the partner and audit team spending less time in meetings with the audited entity and having fewer of them, and the audit team being on site for less time. There was no corresponding guidance provided that suggested how this could be achieved without having a detrimental impact on audit quality.

219. File reviews

EQCRs are not formally notified of the outcome of AQM reviews of audits in their portfolios. Given that their role is specifically focused on audit quality, EQCRs should always be informed of the relevant results.

Three offices received significantly fewer audits, graded 1 in the firm's AQM process compared to the firm's overall results. However, there was no impact on the quality ratings of the partners in charge of audit quality for these offices.

<Files\\Ernst Young Public Report 2014 - 2015> - § 4 references coded [2.10% Coverage]

220. A few of the findings below indicate that the firm may not have sufficient staff in place, with clear roles and responsibilities, to address independence matters. The firm should consider strengthening resources in this area.

221. Personal independence monitoring

Each year the firm carries out an independence confirmation process for all partners and professional staff and tests the accuracy of recorded financial interests for a sample of partners and managers. Any omissions or errors by partners, including those that resulted in a failure to dispose of holdings in prohibited entities, are generally subject to small financial penalties. The findings from the confirmation process and testing are not formally reported to the Board. Whilst an individual's performance manager is informed of the results, the firm does not take this into account as part of the annual performance review given the small financial penalties.

222. Financial interests in other partnerships and business arrangements

Partners and staff do not inform the firm consistently about investments in business arrangements (for example, partnerships and other similar business relationships). The firm's communications are not sufficiently clear on when and how such arrangements should be reported.

In one case five partners and one director had not reported their investment in a land partnership with several other individuals, many with previous connections to the firm. One of the other individuals recently became a non-executive director of an audited entity which created a prohibited business relationship under the firm's policies. As the land partnership had not been reported to the firm, this relationship was not identified until several months after it occurred.

223. Audit teams are required to separately search the database of audited entities as it does not automatically interface with GTAC. For 2014 this resulted in numerous instances where audited entities had not been identified and consequently the audit partner's approval was not obtained in advance of providing non-audit services, including nine such cases for listed entities.

C. KPMG LLP

Name: Nodes\\Audit Process

<Files\\KPMG Public Report 2007-2008> - § 5 references coded [2.44% Coverage]

224. Long association and key audit partners

While the firm's rotation policy requires audit teams to consider whether "advisory" partners such as those who provide tax and IT support should be classified as KAPs, it is rare for such a partner to be so classified since the firm's view is that the audit engagement partner would normally make the key audit judgments in those areas. However, we saw little evidence on the files we reviewed that audit engagement partners had considered whether the relevant advisory partners or partners responsible for key subsidiaries or divisions should be identified as KAPs or, if not, whether they should be classified as other partners and staff in senior positions.

225. Appropriate guidance on preliminary analytical procedures is included in the firm's audit methodology and the additional guidance provided by the firm during the year resulted in an improved approach.

However, in nearly half of the files reviewed there was a lack of evidence that appropriate preliminary analytical procedures had been performed.

226. However, one of the main recurring themes continued to be the lack of evidence on files that all relevant data, procedures and thought processes underpinning key audit judgments had been effectively analysed and evaluated and appropriate conclusions reached. The quality of audit evidence on file did not always reflect the extent of partner involvement in the resolution of key audit issues or the thoroughness with which these matters were addressed.

227. We identified examples of the use of experts in relation to the audit of pension assets and liabilities, IT controls, billing systems and stock. On nearly half of the audits reviewed we found that the requirements of Auditing Standards had not been fully complied with in relation to the competence and independence of

the experts and/ or the scope of their work, the verification of source data and/ or follow-up of the results of the experts' work.

228. Internal audit: We noted only two instances of reliance on the work of internal audit, but the relevant audit teams had not complied fully with certain requirements of Auditing Standards. They had not conducted an annual assessment of the competence and reliability of internal audit including re-performing a sample of their work.

<Files\\KPMG Public Report 2008-2009> - § 3 references coded [0.99% Coverage]

229. At the beginning of 2008 there was one ethical standard breach logged in the ethics register for a partner who is an RI. Another two breaches were reported and logged in the register during 2008 for partners who are not Rls. All three cases related to the holding of securities in a UK audit client. None of the individuals provided services to any of the entities in question. We were informed that in each case the breach was inadvertent and rectified as soon as it was identified.

230. However, on the files of one audit there was, in our view, insufficient evidence of the team's consideration and assessment of the appropriateness of a change in a key assumption used in determining loan loss provisioning levels. This had a material impact on the ultimate level of provisions, which decreased compared with the prior year.

231. However, we noted some instances of unexplained erroneous disclosures and/or insufficient consideration of the adequacy of accounts disclosures on half the audits reviewed.

<Files\\KPMG Public Report 2010-2011> - § 4 references coded [6.74% Coverage]

232. Impairment of loans Improvements were required in the audit of loan impairment in three audits we reviewed. Collective provisions were established in each case for impairments incurred by the end of the year but not yet reported. In each case we raised issues on the sufficiency of audit evidence supporting certain aspects of the techniques adopted by

management to assess the level of collective provision required. Also, in one case, there was insufficient review of the work performed by overseas audit teams in relation to significant specific loan impairments incurred during the year.

233. Revenue and profit recognition: On one audit significant improvement was required in relation to the sufficiency of audit evidence for revenue and profit recognition. The audit approach adopted in relation to long-term contracts included reviewing management's contract summaries for salient features. We consider this review to be a key component of the audit. However, the process adopted by management for compiling the contract summaries had not been evaluated or tested in the current year and it was not evident when it was last subject to audit testing. On the same audit, the accounting for profit on long term contracts included contingency provisions in respect of future costs. While we were informed that these contingencies were consistent with prior years, there was no evidence that the audit team had assessed whether this remained appropriate.

- Segmental reporting: On five audits we identified areas for improvements in the audit of segmental reporting disclosures. In one of these cases, we noted an apparent inconsistency between the identification of reporting segments in the financial statements and the disclosures provided elsewhere in the Annual Report. The audit team had not explained the basis for their judgment that this apparent inconsistency was acceptable.

234. Recurring findings from one year to the next Areas where there has been no improvement compared with last year.

At the time of the relevant audits, the action taken by the firm did not appear to have been sufficiently effective in addressing the recurring findings related to substantive analytical review procedures and the long involvement of Other Partners and Staff in Senior roles as detailed below. Both areas continue to be covered in the firm’s training programmes. We will continue to monitor these areas and expect the firm to have dealt with our recurring findings effectively.

- Substantive analytical review

On four audits we identified weaknesses in the substantive analytical review procedures performed in respect of the income statement. In three cases the analytical review procedures were not, in our view, performed in sufficient depth. In addition, in one case, most of the audit evidence relating to supplier incentives, rebates and discounts was obtained from substantive analytical procedures which involved discussions with buyers. While there was evidence that these discussions had taken place, notes of these discussions were not retained. Since these audits took place, the firm has required the use of the firm's substantive.

235. Long involvement of Other Partners and Staff in Senior roles: On four audits the audit teams did not evidence the identification and consideration of threats to independence for all Other Partners and Staff involved in the audit in Senior roles. In one of these cases the IT specialist partner had been involved for nine to ten years and, in our view, his role constituted a senior position as envisaged under the Ethical Standards. In the three other cases we identified shortcomings in the audit teams' records of Other Partners and Staff involved in Senior roles but none of them had been involved in the audit for longer than seven years.

236. IT general controls

On one audit where the control environment had a significant impact on the audit approach there was insufficient consideration of weaknesses identified in relation to IT general controls. In our view, there was insufficient evidence to support the conclusion that the weaknesses had no impact on the planned audit approach. The audit team should have explicitly evidenced their assessment of the cumulative effect of weaknesses in relation to interrelated or complementary controls on the level of audit risk.

<Files\\KPMG Public Report 2012 - 2013> - § 6 references coded [3.61% Coverage]

237. Loan impairment provisions

We reviewed three audits of financial services entities and, in each case had concerns in relation to the audit of loan loss provisioning.

238. Furthermore, insufficient audit evidence was obtained to show that all forbearance arrangements in place for commercial and retail loans had been identified for disclosure and provisioning purposes.

239. Audit of goodwill and other intangible assets

We reviewed the firm's audit of goodwill and other intangible assets in eight audits, including six FTSE 350 entities. In one audit, there was insufficient evidence of the auditor's assessment of the revenue and operating expense growth rates and the long-term growth rate assumed in the terminal value. In a second audit, the auditors had not identified deficiencies in the disclosure of growth rate assumptions in the goodwill note in the financial statements.

We also identified cases of insufficient challenge of the useful economic lives of other intangible assets on three audits. On a further audit, there was insufficient work performed to support the valuation attributed to acquired intangible assets.

240. General IT controls We found deficiencies in the testing of general IT controls on two audits.

On one audit, there was insufficient evaluation of the implications of three controls being found to be ineffective and the auditors had not tested certain authorization controls.

On a second audit, we identified a few concerns over the testing of general IT controls. This included insufficient assessment and testing of the effectiveness of new controls intended to address significant control weaknesses identified in the prior year and instances where the audit team concluded that there were no control deficiencies when deficiencies had in fact been identified by their IT specialist. Inadequate audit procedures were, therefore, performed to conclude on the effectiveness of general IT controls. As a result, the testing of automated application controls using a sample of one item was not sufficient.

241. Financial interest in an audited entity

On re-joining the firm as a partner, a former executive of an audited entity had a significant shareholding in that entity. Ethical Standards do not permit partners of the firm to hold any direct financial interest in an audited entity. The individual did not dispose of the shareholding upon joining the firm and it was some months before this was done. We were informed that senior personnel with responsibility for the firm's ethical compliance arrangements were not aware of this issue until it was drawn to their attention because of our inspection. We were advised that the firm has subsequently penalized the relevant partner and established that no financial benefit was obtained from the delay in disposal.

242. On one file review, non-audit fees exceeded audit fees, but it was not clear to what extent the matter had been discussed with the Ethics Partner. Issues relating to the financial interest in an audited entity noted above should have been identified and reported to the Ethics Partner on a timely basis.

<Files\\KPMG Public Report 2013 - 2014> - § 1 reference coded [0.78% Coverage]

243. Audit of loan loss provisions We reviewed the audit of loan loss provisions for five financial services entities.

In all five audits we identified issues relating to the extent of audit evidence to support the level of specific provisions and, in four cases, collective provisions. We continue to find cases where further audit evidence should have been obtained or there was a lack of appropriate challenge of management by the audit team.

On two of the audits, insufficient audit evidence was obtained that all forbearance arrangements in place had been identified for disclosure and provisioning purposes.

<Files\\KPMG Public Report 2014-2015> - § 7 references coded [5.97% Coverage]

244. Audit of goodwill and other non-current assets

We reviewed the audit of goodwill and other intangible assets on eleven audits. In four audits there was insufficient testing of the reliability of forecast cash flows used within the impairment assessment of goodwill or the capitalization of development costs. In one of those audits and one further audit, we identified related financial statement disclosures that were erroneous or potentially misleading. In another audit, we considered the level of challenge regarding the allocation of brand assets to cash generating units to be insufficient.

In one of those audits, there was also insufficient challenge of the assumptions used by management in the impairment assessment of investment property, including insufficient involvement of the firm's property specialists in assessing the appropriateness of the land valuation. In another audit there was insufficient evidence of scepticism in the assessment of whether a loan receivable was recoverable.

245. Inventories The audit of inventory was reviewed on five audits.

On all five audits we identified issues regarding the extent of the procedures performed relating to the valuation of inventory. On two of those audits, the issues related to the adequacy of analytical review procedures where the audit teams had either set no expectation for the outcome of the procedure or, in setting an expectation, had not obtained evidence to corroborate assumptions used therein. In two audits there was insufficient evaluation, by the audit team or through use of the firm's internal specialists, of work performed by management experts on which reliance was placed by the audit team. On the fifth audit, there was insufficient challenge of management's basis for determining a key estimate.

246. Audit of revenue We assessed the quality of the firm's audit work in relation to revenue on fifteen audits.

On four audits, insufficient substantive testing of contract revenues had been performed. On two of those audits, there was also inadequate evidence to support the appropriateness of certain accounting policies.

247. On two audits, our review of the evidence obtained relating to loan loss provisions for a sample of loans identified that there was insufficient challenge of management or insufficient audit evidence in relation to certain key inputs and assumptions used. We also identified some issues on all three audits

related to the sufficiency of testing of certain controls identified as relevant to the audit.

248. On five audits performed prior to these enhancements, there was insufficient evidence that the audit team had responded appropriately to IT deficiencies identified. On three of those audits the lead IT specialist was insufficiently senior given the planned reliance on IT controls and the complexity of the systems. On one further audit, reliance had been placed on certain IT application controls when the operating effectiveness of general IT controls had not been tested in the current year.

In one audit, there was inadequate analysis and testing of mitigating controls identified in relation to potential segregation of duties issues. Management's actions in response to those potential issues were also not adequately evaluated.

249. Independence and ethics - non-audit services

On two audits there was insufficient evidence that the audit team had considered independence threats, and related safeguards, arising from the provision of non-audit services. There was insufficient written communication to the Audit Committee of independence threats and the related safeguards applied on these audits and a further four audits.

On three audits, it was unclear why certain engagement partners responsible for the audit of significant components or certain specialist partners had not been identified as key partners involved in the audit for partner rotation purposes. One of these partners had been involved in the audit for longer than seven years, thereby increasing the risk of an actual or perceived loss of independence.

250. Audit quality monitoring — Review of financial services engagements

The firm has a senior UK partner as the financial services team leader for internal quality monitoring reviews. While all financial services reviews are undertaken by reviewers with relevant experience, this individual does not have a financial services background and, therefore, may not have appropriate experience to undertake all aspects of the role effectively.

Audit quality monitoring — Scope of review

Significant UK component audits were not consistently covered in the scope of the internal monitoring of group audits. Our review of one audit, which had also been reviewed as part of the firm's practice review, identified findings concerning the audit of contract revenues and related claims in relation to significant components (overseas and UK) of the group. The firm's review of this group audit did not identify these matters as it did not cover those significant components.

<Files\\KPMG Public Report 2015 - 2016> - § 4 references coded [1.79% Coverage]

251. Other findings in this area, on a further four audits, included applying insufficient safeguards to mitigate threats to independence; and ineffective or unclear consultations with the Ethics Partner.

252. Tests of controls were performed on a few of the audits we inspected, and the following issues were identified:

- In some cases, we identified weaknesses in the testing of IT system controls and/ or general IT environment on which audit teams had placed reliance.
- Insufficient follow-ups work once deficiencies in controls had been identified and a lack of testing of certain controls which were relied upon (including controls at service organizations).
- In some cases, reliance was placed on system outputs where audit teams had not tested those systems.
- On one audit there was a change of systems and third-party IT provider and on another there was a system upgrade. The audit teams did not design and perform procedures to obtain sufficient appropriate audit evidence in response to the migration risk or the system upgrade.

- On two retailer audits, where controls over inventory counts were relied upon, too few stores were visited to provide evidence that the controls were operating effectively.

253. The firm's actuaries were used on two insurance audits reviewed:

- On one of these audits the actuarial team did not sufficiently test the completeness and accuracy of data, key controls and reports used for substantive procedures, in relation to policyholder liabilities.

- On the other, there was insufficient evidence of the specific procedures performed by the firm's actuaries in relation to key balances and disclosures in the financial statements.

<Files\\KPMG Public Report 2016 - 2017> - § 1 reference coded [1.25% Coverage]

254. The market value of assets within defined benefit schemes is usually significant and the management of pension funds by independent custodians can present challenges for auditors. Audit procedures should provide sufficient assurance over asset valuation and ownership. We identified a few concerns where we reviewed the work performed relating to defined benefit pension scheme balances. Our concerns related to:

— Insufficient evidence of procedures performed in relation to the accuracy and completeness of membership data.

— The level of work performed over the valuation and ownership of scheme assets was inconsistent. Our concerns included: failure to obtain confirmations directly from the custodian; sole reliance on confirmations; not obtaining control reports from custodians or investment managers and a lack of independent testing of asset values.

We recommend that the firm considers improving the clarity of its methodology in this area. <Files\\KPMG Public-Report 2011-2012> - § 7 references coded [4.21% Coverage]

255. Impairment of goodwill and other assets: On three audits we had concerns relating to the adequacy of audit work in connection with the carrying value of goodwill. This included insufficient consideration of the reasonableness of the

growth rates and other assumptions, source data and methodologies used by management in considering the potential for impairment of goodwill and other assets. Additional sensitivity analysis should have been considered in some of these cases and a greater level of scepticism applied to the growth rate assumptions used.

256. External confirmations: On six audits, insufficient audit work in relation to external confirmation of material balances was performed or evidenced. On two of these audits, external confirmations were either not sought for material balance or were sought only for a sample of material balances. On three audits, confirmations were either received after the date of the auditor’s report (although alternative procedures had been performed) or there was no evidence they were received directly by the auditors.

In one case the auditors had not established the authenticity of confirmations which they received by e-mail.

257. Related parties Accounting Standards require the existence of related parties and transactions with such parties to be disclosed in the financial statements. On four audits we identified deficiencies relating to the audit of relationships and transactions.

258. Revenue recognition: On two audits, improvement was required in relation to the sufficiency of audit evidence, challenge and corroboration for revenue and profit recognition. On the first of these audits, more extensive corroboration of management's explanations in relation to the contracts selected for review should have been obtained to confirm the appropriateness of the revenues recognized. On the other audit, there was insufficient evidence of consideration of potential loss-making contracts and the audit team did not review the continued appropriateness of recognition policies for long-term contracts.

259. Consideration of independence threats and safeguards: On seven audits, there was insufficient evidence that the audit team had considered the specific

independence threats arising from the provision of non-audit services and the related safeguards required.

260. We identified weaknesses in the substantive analytical review procedures performed on four audits which were undertaken prior to the new policy taking effect. We will monitor the effectiveness of this change during future inspections.

<Files\\KPMG-LLP Report 2009-2010> - § 3 references coded [1.85% Coverage]

261. Confirmation letters: On five audits reviewed, banks or custodians were not circularized to obtain audit evidence supporting the existence of assets or liabilities. In each case alternative audit evidence was obtained and the main reason for not using circularization procedures was stated to be the difficulty in obtaining reliable responses. However, we were of the view that in these audits it should have been possible to circularize banks or custodians and obtain reliable responses, providing independent audit evidence of the existence and accuracy of assets or liabilities.

262. Assessing and responding to risk

Auditing Standards require the auditor to evaluate the design and implementation of the entity's controls, including relevant control activities, over significant risks. On six audits, evidence of the identification and evaluation of the design and implementation of controls over certain significant risks was inadequate. In addition, on six audits, the audit programs prepared did not adequately record the work planned to address the assessed level of risk.

Name: Nodes\\Factors outside the control of the audit firm

<Files\\KPMG Public Report 2013 - 2014> - § 1 reference coded [0.71% Coverage]

263. Review of financial statements

The firm’s processes for review of the financial statements did not identify certain disclosure deficiencies on the three audits reviewed, including the disclosure errors related to intangible assets on two audits noted above. On one of these audits and one further audit, there was also insufficient evidence of review of the financial statements by the audit engagement partner. In another audit, there was insufficient evidence of consideration of the appropriateness of certain disclosures in the financial statements of the audited entity.

<Files\\KPMG Public Report 2014-2015> - § 1 reference coded [0.38% Coverage]

264. Review of financial statements

The firm's processes for review of the financial statements did not result in certain disclosure deficiencies being identified in the four audits reviewed. These deficiencies included those relating to intangible assets referred to in the "Audit of goodwill and other assets" section above.

Name: Nodes\\Audit reporting

<Files\\KPMG Public Report 2007-2008> - § 2 references coded [0.61% Coverage]

265. However, in a minority of audits reviewed we identified disclosure errors and instances of non-compliance with accounting policies that had not been reported to the Audit Committee.

266. However, in just over half of the audits reviewed, improvements are required in the relevant procedures to ensure that all inadequate or erroneous disclosures are properly followed up and included in the letter of representation obtained from the Board. In some cases, audit teams should pay greater attention to their assessment on file of the adequacy of disclosures in financial statements.

<Files\\KPMG Public Report 2010-2011> - § 2 references coded [2.25% Coverage]

Communicating with Audit Committees We continue to note good examples of reporting to Audit Committees and a few of the issues in prior years have been addressed and have not recurred. However, on two audits issues arising were not adequately reported and on three audits the audit approach and/or the basis on which conclusions were reached on significant areas of judgment were not adequately reported.

267. Dating of working papers and assembly of audit files We identified various issues on four audits regarding the assembly of audit files and instances in two cases where a few key work papers had been backdated. Audit file assembly issues have also occurred in prior years. All audits from 31 December 2010 onwards will be completed using KPMG's new audit software which the firm believes should help prevent the recurrence of these issues.

- Signing and dating of audit reports

As a result of our prior year findings the firm revised and reissued its policy and mandatory guidance in relation to the signing and dating of audit reports and we observed an overall improvement in this area. However, on two audits reviewed, including one follow-up review, we continued to identify some issues in this area, albeit of a more minor nature.

Once these issues had been identified in the current inspection cycle, the firm further enhanced its mandatory guidance in this area. Application of this guidance should continue to be closely monitored.

<Files\\KPMG Public Report 2012 - 2013> - § 2 references coded [1.50% Coverage]

268. On four audits, independence threats and related safeguards adopted, particularly regarding the provision of non-audit services, were not adequately reported to the Audit Committee.

On eight audits there were inconsistencies and/or omissions in the reporting of significant risks to the Audit Committee.

In two audits, there was no evidence that the audit team had asked the Audit Committee to correct unadjusted audit differences close to the level of materiality, as required by Auditing Standards. The firm's Audit Committee report template did not include any wording requesting that unadjusted misstatements be adjusted in finalizing the financial statements.

269. Pre-issuance reviews of financial statements We reported in the prior year that, in our view, there should be a requirement for the firm's Department of Professional Practice to review the clearance of any significant matters raised

by them in a pre-issuance technical review prior to the audit report being signed. The firm takes the view that the engagement partner retains responsibility for the audit report and does not need to seek such clearance. Nevertheless, we recommend that the firm reconsiders this point in the light of increased complexity of reporting and the practice of its peers in this area.

<Files\\KPMG Public Report 2013 - 2014> - § 1 reference coded [0.72% Coverage]

270. Reporting to Audit Committees

We considered the sufficiency, quality, and timeliness of the firm's reporting to the Audit

Committee on all the audits we reviewed. The communication of significant risks identified to Audit Committees and component auditors required improvement on eight of these audits. In addition, the risk of management override of controls and/or the risk of fraud in revenue recognition, presumed to be areas of significant risk under Auditing Standards, were not adequately addressed in communications with the Audit Committee on nine of the audits we reviewed.

<Files\\KPMG Public Report 2014-2015> - § 2 references coded [1.42% Coverage]

271. Most of the audits we reviewed were affected by these new requirements. In four audits, the audit report, in certain respects, did not accurately describe the procedures performed by the audit team.

In another audit, the materiality level disclosed in the audit report had been inappropriately rounded up by management during the final stage of publishing the audited financial statements and this amendment was not identified by the audit team.

272. Communications with the Audit Committee

We considered the quality and timeliness of the firm's communications with the Audit Committee on all the audits we reviewed. This was generally of a good standard. However, the reporting of identified significant risks to Audit Committees required improvement on two audits. In both cases, and on a further three audits, the risk of management override of controls and/or the risk of fraud in revenue recognition, presumed to be areas of significant risk under Auditing Standards, were not adequately communicated. It was unclear on some audits because control deficiencies (three audits) and disclosure errors or omissions (two audits) identified by the audit team had not been reported to the Audit Committee.

<Files\\KPMG Public-Report 2011-2012> - § 2 references coded [1.51% Coverage]

273. All the audits we reviewed used the firm's new 'eAudIT system' for the first time this year. On many audits, a significant number of working papers were prepared outside of eAudIT and added to the system later. This resulted in working papers being dated as having been prepared and reviewed after the date that the firm's audit report was signed. As a result, it was not possible to determine whether all necessary audit work had been performed and reviewed on or before this date.

The firm's systems and working practices must enable it to demonstrate that sufficient appropriate audit evidence has been obtained and reviewed before the date that the firm's audit report is signed.

274. Communicating with Audit Committees

On many audits, we found that independence threats and identified safeguards adopted, particularly regarding the provision of non-audit services, were not adequately reported to Audit Committees in the formal Audit Committee memorandum.

<Files\\KPMG-LLP Report 2009-2010> - § 1 reference coded [0.57% Coverage]

275. Consultation and review

A few instances were identified during our review of audits where the statutory accounts submitted by the audit team for a pre-issuance technical review were not, in our view, in a reasonably complete state. There was no evidence that a complete set of accounts had ultimately been provided for review.

Name: Nodes\\Skills and personal qualities of Audit partners and staff

<Files\\KPMG Public Report 2008-2009> - § 2 references coded [0.76% Coverage]

276. Appraisal process within the audit function ("audit")

Generic goals relating to audit quality have been developed and are included within the appraisal template. However, these can be deselected, and we have found, in a small minority of cases, that they are not always substituted with appropriate, alternative quality objectives.

277. However, on a minority of files reviewed, we identified issues relating to either the adequacy or timeliness of planning procedures. We expressed concerns in relation to the audit of one listed entity and concluded that improvements were required in relation to planning audit work effectively and the adequacy of both controls and substantive testing in the audit of key divisions selected on a rotation basis.

<Files\\KPMG Public Report 2012 - 2013> - § 4 references coded [2.75% Coverage]

278. Revenue recognition We identified weaknesses in relation to the audit of revenue on four audits. On one of these audits, while enquiries were made into the appropriateness of the revenues recognized on long-term contracts, appropriate corroboration of management's explanations should have been obtained. On the same audit, insufficient substantive procedures were performed in respect of non-contract revenues.

Weaknesses identified on the other three audits included insufficient evidence to support the deferral of revenue to cover incomplete installation services; insufficient substantive testing of the revenue recognized during the year at three of the four major sites visited; and inadequate justification of the rebuttal of the presumption required by Auditing Standards that revenue recognition is an area involving significant fraud risks.

279. Substantive analytical review

In three audits, we found weaknesses in the substantive analytical procedures performed. On one of these audits the expectations set did not take account of all relevant information. On the other two audits the work performed was only a high-level analysis and therefore limited audit evidence was obtained.

280. Inventories

On three audits, we identified weaknesses in the audit of inventory balances. In the first case, the levels of audit testing relating to physical verification, cost analysis and provisioning were insufficient. On the second audit, the teams did not review the coverage and results of the company's own perpetual inventory counting and confirm that any material differences had been investigated and

281. On three audits, we raised concerns regarding the level of substantive audit evidence obtained or the level of corroboration of evidence provided by management. In one case, reliance was placed for provisioning purposes on reports prepared by management, but the auditors did not test the reliability of these reports. In the same audit, substantive testing of assets under construction was performed at a high level only with insufficient corroboration of management explanations. In the second audit, we considered that insufficient work had been performed in relation to the completeness and existence of derivatives. In the third case, we found insufficient challenge of the appropriateness of a 100% provision raised against a fixed asset investment.

<Files\\KPMG Public Report 2013 - 2014> - § 5 references coded [3.78% Coverage]

282. General IT controls

We reviewed the testing of the operational effectiveness of IT controls on 12 audits and found weaknesses on six of them.

In two cases, the audit procedures performed relied upon system generated reports which had not been adequately tested for completeness or accuracy. In two further audits, insufficient procedures were performed on IT systems hosted by outsourced service providers. In the remaining two audits, it was unclear how the audit team had responded to deficiencies identified by their testing.

283. Inventories The audit of inventory was reviewed in six audits, and we identified weaknesses in three of them.

On two of those audits, there was insufficient evidence to support the rationale for the locations selected for stock take attendance; and insufficient procedures performed regarding changes in inventory in the period between the dates of stock takes attended and the year end. On the third audit, there was insufficient challenge of the stock provisioning method.

284. Audit of goodwill and other intangible assets

We reviewed the firm's audit of goodwill and other intangible assets on nine audits and found weaknesses in six of those audits.

We concluded that two audits required significant improvements in this area. In both cases, there were errors in the disclosures made in the financial statements which had not been identified by the audit team. In these cases, and one further audit, there was a lack of challenge by the audit team regarding key assumptions used. In two further audits, there was insufficient evaluation of the value in use calculation for certain assets. In another audit, we found insufficient evidence of the audit team's assessment of a valuation model.

285. Audit of revenue

We assessed the quality of the firm's audit work in relation to the audit of revenue on thirteen of the audits we reviewed and identified weaknesses on eight audits.

We concluded that two audits required significant improvements in this area. In both cases, and in one further audit, insufficient testing was performed in respect of certain material revenue balances or to assess whether revenue had been recorded in the correct period.

In three audits, where reliance had been placed on the results of substantive analytical procedures performed, the explanations obtained for variances identified from the expectation set were either too general in nature or were not adequately corroborated. In two further audits, insufficient audit testing was performed for certain revenue balances or to assess controls relating to the revenue cycle.

286. Journals We reviewed the testing of journals on 15 audits.

In six audits, there was insufficient evidence supporting the journals selected and tested by the audit team. Other weaknesses in this area included the design and implementation of controls around the journal entry process not being adequately reviewed (three audits) and insufficient audit procedures being performed when concerns were identified relating to the review and approval of journals (three audits).

<Files\\KPMG Public Report 2014-2015> - § 1 reference coded [0.62% Coverage]

287. Journals

We reviewed the testing of journals on sixteen audits. A number of these audits were performed prior to enhanced guidance on this area being issued to audit teams in December 2013.

On eight audits there was insufficient evidence supporting the journals selected for testing by the audit team. Other weaknesses in this area included insufficient procedures to ensure the completeness of the population of journals (three audits) and insufficient testing in relation to certain risk characteristics (two audits).

<Files\\KPMG Public Report 2015 - 2016> - § 4 references coded [2.42% Coverage]

288. In three cases there was insufficient evidence that the audit team and the firm's Ethics Partner had adequately considered all matters relevant to assessing the appropriateness of non-audit services, in particular the significance of any related threats to the auditor's objectivity and whether the specific prohibitions in ES5 applied. The non-audit services involved:

- o the firm acting as an expert witness for a listed audited entity; and

- o Two instances of tax services provided on a contingent fee basis to listed audited entities.

289. We identified a few concerns in relation to the audit of valuations, impairment reviews of goodwill and other intangibles, tax provisions and loan loss provisions. For example:

- Insufficient challenge of management regarding, in one case, the consistency of the financial projections which formed the basis for the recognition of deferred tax assets.
- For an audit where business combinations were identified as a significant risk, there was insufficient testing relating to key estimates and judgements used in the valuation of acquired intangible assets.
- On two retailer audits, there was insufficient evidence of challenge of management's judgments relating to impairment of stores. In one case the audit team did not sufficiently challenge management's identification of cash generating units. In the other audit there was insufficient evidence of challenge of management as to whether certain stores should have been assessed for impairment.

290. We reviewed the audit of revenue on many audits that we inspected and identified the following issues:

- On a few audits analytical review procedures were used to obtain substantive audit evidence in relation to revenue. These procedures were sometimes ineffective due to a failure either to set sufficiently precise expectations formed from independent sources or inadequate corroboration of management explanations.
- Insufficient revenue testing was performed on three audits. On one audit the analytical procedures and controls testing performed did not provide sufficient audit evidence. On the other two audits, only the recognition of revenue in the correct period was tested in detail without testing the underlying revenue itself.

<Files\\KPMG Public Report 2016 - 2017> - § 2 references coded [4.17% Coverage]

291. Improve the extent of challenge of management in relation to areas of judgment, for impairment reviews, loan loss provisions and other valuations. The audit of valuations, loan loss provisions and impairment reviews require appropriate use of professional judgment. Effective audit teams will consider management's assumptions and compare these to available audit evidence and, where appropriate, challenge management in relation to the basis of those assumptions. We continue to identify a few concerns in relation to the audit of valuations, loan loss provisions and impairment reviews of goodwill and other intangibles. The issues largely related to the extent of audit teams' challenge of management, including:

— Audit teams not adequately demonstrating their critical assessment of valuation assumptions or methodology relating to investments and inventory.

— Insufficient challenge of management's assumptions in relation to the impairment of goodwill and other intangibles, with undue reliance placed on evidence which supported management's assumptions/ position.

—In relation to loan loss provisions our concerns, on both audits where this was relevant, related to there being insufficient procedures performed to corroborate certain of the inputs used. The work performed did not demonstrate sufficient skepticism and challenge of management regarding the appropriateness of the provisions.

Other concerns arose in relation to the identification of intangibles, the challenge of sensitivities considered by management and the compliance of impairment models with Accounting Standards.

293. Reassess the firm's approach to the audit of revenue and the related training provided.

Revenue is an important driver of a company's operating results and is often identified as a key performance indicator on which investors and other users of financial statements focus. It may be open to manipulation as a result, and auditors, therefore, need to evaluate and address fraud risks in relation to revenue recognition.

We reviewed the audit of revenue on many audits that we inspected and identified a few issues:

— Analytical review procedures were often used to obtain substantive audit evidence in relation to revenue. These procedures were sometimes ineffective due to a failure either to set sufficiently precise expectations formed from independent sources or to corroborate management explanations adequately.

— Insufficient revenue testing was performed on certain audits. One audit team did not perform the planned procedures over customer contracts or substantive analytical procedures for two components.

On two audits we identified insufficient understanding and testing of system-generated interest income, regarding the associated IT controls.

Our concerns in relation to the ineffective use of substantive analytical review procedures have recurred over a few of our annual inspections, with similar findings in the firm's own internal quality reviews. The firm's actions to address the quality of work through increased training and guidance have, to date, not proved sufficiently effective. The firm should therefore re-assess its overall approach to the audit of revenue.

<Files\\KPMG Public-Report 2011-2012> - § 1 reference coded [0.55% Coverage]

294. Collective provisioning for loan losses We identified concerns with the methodology used in relation to collective provisioning for loan losses on three audits that we reviewed. In two of these cases, there was insufficient challenge by the audit team of the appropriateness of exclusion of certain loans from the model used to calculate the collective provision.

Name: Nodes\\The culture of the firm

<Files\\KPMG Public Report 2007-2008> - § 1 reference coded [0.63% Coverage]

295. Appraisal process within non-audit functions

All partners and directors who are based outside the audit function and who are authorized to sign audit opinions are expected to adhere to those procedures followed within Audit. The objectives set in one partner appraisal form reviewed by us did not refer to audit quality but concentrated instead on generating advisory fees from clients including one of the partner's audit clients. The Ethical Standards prohibit partners from being rewarded for gaining non-audit work at their own audit clients because this could threaten their independence.

<Files\\KPMG Public Report 2010-2011> - § 2 references coded [1.40% Coverage]

296. Quality control

On six audits there was inadequate evidence of the timely review of certain working papers by the engagement partner and engagement quality control reviewer (EQCR). In two cases there was no evidence of the engagement partner's review of a key area of judgment prior to the date of the audit report. In five of the six cases, planning and/or certain completion documentation appeared to have been signed late or not to have been signed at all by the EQCR. The firm should reinforce its policy regarding the timely review of work papers.

297. Three audit manager appraisal forms included goals that implied objectives had been set to sell non-audit services to audit clients. The firm should ensure that managers and their appraisers are in no doubt that such objectives must not be set as such sales are not to be considered in performance assessments or remuneration decisions.

<Files\\KPMG Public Report 2012 - 2013> - § 5 references coded [2.08% Coverage]

298. Findings in relation to independence and ethics

On three audits, there was insufficient evidence that the audit team had considered the threats and safeguards relating to the provision of non-audit services. On one of these audits, the firm’s Ethics Partner should have been notified of a contingent fee arrangement for certain tax services and asked to confirm whether, in the circumstances, this was permissible under Ethical Standards.

299. Engagement quality control reviews

There was insufficient evidence of the appropriate involvement of the engagement quality control reviewer ('EQCR') on five audits, including those areas involving significant judgment.

Regarding two audits for which an EQCR had not been appointed, we considered that this was inappropriate given the level of public interest involved and the firm's policies should be reconsidered in this area.

300. Personal independence issues do not appear to receive the same degree of scrutiny and attention as business related matters. The firm should review its processes and monitoring procedures in this area and enhance its guidance.

301. On five out of a sample of partner appraisals reviewed, there was insufficient evidence that adverse audit quality metrics had been considered in arriving at the partner's year end grading.

In three cases, the final grade for the partner was altered after completion of the formal appraisal process but there was no supporting evidence for these changes.

302. We reviewed the testing performed by the firm relating to the operation of certain aspects of its quality control procedures. In our view, insufficient testing was performed in certain areas, including business relationships and the rotation of EQCRs and key partners involved in the audit.

<Files\\KPMG Public Report 2013 - 2014> - § 4 references coded [1.99% Coverage]

303. Findings in relation to independence and ethics

On three audits there was insufficient evidence that the audit team had considered independence threats, and related safeguards, arising from the provision of non-audit services. On a further audit, there was insufficient evidence of approval by the firm's Ethics Partner of certain non-audit services which included a contingent fee arrangement.

304. Engagement quality control reviews

There was insufficient evidence of appropriate involvement by the engagement quality control reviewer ("EQCR') on six audits, including reviewing certain audit work performed for significant risk areas and following up how the audit team had addressed matters which the EQCR had raised.

305. One of the staff appraisals we reviewed related to a manager who had received adverse internal quality review ratings. The individual was awarded a highly effective performance rating, the second highest.

There was insufficient evidence that the adverse quality rating had been adequately considered in arriving at the performance rating for this individual.

306. Performance evaluation — Selling non-audit services.

In a third of the partner appraisals, we reviewed and one staff appraisal, the objectives set appeared to include the individual seeking to provide non-audit services to entities audited by the appraisee. In addition, in three partner appraisals and one staff appraisal, the individual appeared to be seeking credit for their success in selling non-audit services to entities which they audited. This is not permissible under Ethical Standards.

<Files\\KPMG Public Report 2014-2015> - § 1 reference coded [0.57% Coverage]

307. Engagement quality control reviews

There was insufficient evidence of involvement by the engagement quality control reviewer ("EQCR") on 11 audits. Our findings included insufficient evidence of review of certain audit work performed for significant risk areas and failure to follow up how the audit team had addressed matters which the EQCR had raised. On one further audit where we considered that the appointment of an EQCR would have been appropriate, no EQCR was appointed.

<Files\\KPMG Public-Report 2011-2012> - § 4 references coded [2.10% Coverage]

308. On two audits, there was insufficient consideration of whether safeguards were required to reduce possible threats involvement in the audit of senior managers. to independence arising from the long

309. Risk considerations

In many of the audits we reviewed, we identified issues regarding assessing and responding to significant risks. Issues included insufficient linkage to the evaluation of the design and implementation of controls over significant risks, a lack of evidence of fraud risk discussions and significant risks not being properly identified or evidenced.

310. Appraisal process

A new appraisal process is being developed and an interim system was used in the current year. The existing system does not ensure the specific consideration or assessment of audit quality as an objective against which staff should be appraised. Whilst supporting guidance stresses that audit quality should be considered, in our view it should be specifically stated as an objective and then specifically assessed in the appraisals of all audit staff.

311. The firm's guidance requires engagement teams to describe the services to be provided, risks identified and how those risks are to be mitigated. We did not consider the information provided by the engagement team to support the risk grade to be in line with the firm's guidance in five of acceptance/continuance forms that we reviewed.

D. <u>PWC LLP</u>

<u>Name: Nodes\\Audit process</u>

<Files\\PwC Public Report 2007 -2008> - § 6 references coded [2.34% Coverage]

312. In our view the firm has comprehensive rotation policies and procedures, but some improvement is required as outlined above.

313. We believe that the firm's audit methodology and systems are generally sufficient to enable audit teams to comply with auditing standard

requirements, but the audit systems relating to risk assessment do not easily facilitate compliance with the relevant requirements, as explained below.

314. In a minority of audits reviewed there were audit risks which were described as significant risks, but the audit team subsequently informed us that they were not considered.

to be such. This made it more difficult for us to ascertain which were the significant risks requiring special audit consideration.

315. The firm requires audit teams to summarize the planned audit approach in a separate document, which is required to be updated for changes to plan and which also provides a summary of the audit evidence obtained. On many of the audits reviewed, the audit approach was not accurately summarized for one of the material areas of the financial statements, typically revenue. In these cases, the actual audit approach sometimes differed from that planned, without explanation, and it was sometimes difficult to determine the actual audit approach based on the audit files alone.

316. We identified issues on many audits reviewed in relation to the quality of analytical procedures which were planned to obtain audit evidence (substantive analytical review'), in one or more areas of the financial statements, particularly revenue. The firm's audit methodology requires audit teams to follow specified procedures in performing this type of analytical review. However, audit teams often did not adequately follow one or more of those procedures.

317. Trade debtor confirmations

On a minority of audits, a sample of trade debtor balances had been circularized but not all responses had been received. We believe that more specific alternative procedures, as required by Auditing Standards, should have been performed for those specific balances where no confirmation was received, to provide audit evidence over the accuracy of the debtor balances relating to those customers who had not responded.

<Files\\PwC Public Report 2008 - 2009> - § 9 references coded [3.24% Coverage]

318. The way audit personnel have been encouraged to improve margins on audits has varied between business units. In the case of one business unit, audit personnel were given an overall objective to reduce audit hours by five percent, through efficiencies.

The achievement of these types of objectives can affect performance ratings, and therefore remuneration. In our view, while it is appropriate to identify means of improving efficiencies on audits, any objective of this nature should make it clear that it must not affect audit quality.

319. We reviewed the firm's A&C policies and procedures and selected a sample of annual continuance forms for review. We concluded that the A&C policies and procedures are generally comprehensive and were complied with on the audits reviewed by us.

320. We met the business unit leaders to discuss the rotation monitoring procedures performed in the year and reviewed the firm's rotation database. In addition, we reviewed compliance with rotation requirements as part of our review of individual audits. In our view, the firm has comprehensive rotation policies and procedures, although we believe that the policies for former engagement partners moving to a client relationship role should be reviewed, as detailed below.

321. We believe that the firm's audit methodology and systems are generally sufficient to enable audit teams to comply with Auditing Standards, but the audit system does not easily facilitate compliance with the relevant requirements relating to risk assessment and the linkage between the planned and actual audit approach.

322. Overall risk assessment

The firm has a standard template which records details of significant risks and the work planned and performed to address those risks. This was generally completed to a good standard, with an improvement in the standard of completion compared with the audits reviewed by us last year. There is no standard format for recording non-significant risks or linking them to the audit procedures performed, and we identified issues with the recording of these risks in practice.

323. Many audits we reviewed did not identify revenue recognition as a significant fraud risk. This is inconsistent with the firm's audit guidance, which states that only in limited circumstances should revenue recognition not be treated as a significant risk. In addition, in a minority of audits reviewed, the rationale for not identifying revenue recognition as a

significant fraud risk was either not set out on the audit files or inappropriately considered the effectiveness of controls.

324. We identified a few examples where Computer Assisted Audit Techniques had been used to identify journals to be selected for testing. In our view, these techniques should be more widely considered, especially in entities with a significant number of journals. In our view, there should be more consideration given to the sampling method and criteria used to select journals for testing and the need to test journals throughout the period to ensure that the testing of journals is sufficiently responsive to the risk of fraud.

325. In our view, there is a need for the firm to ensure that audit teams gain a better understanding of the audit procedures required when relying on perpetual count procedures.

326. In a small minority of the audits reviewed by us, we were informed that there had been no formal assessment of going concern by the Board in support of the statement confirming the appropriateness of adopting the going concern basis made in the Annual Report. In addition, on a minority of the other audits reviewed by us, there was no evidence of such an assessment by way of Board papers or minutes. In these cases, the audit teams had performed their own procedures on going concern. In our view, however, they should have requested the Board to evidence its assessment of going concern.

<Files\\PwC Public Report 2009 - 2010> - § 8 references coded [4.22% Coverage]

327. We were generally satisfied with the justification of significant audit judgments and the sufficiency, and the appropriateness of the audit evidence obtained. However, on occasions, we were only able to reach that conclusion after detailed explanations from the audit team.

328. Improvements are needed in how the specialists are integrated into the audit team and in how they record the results of their procedures.

329. Although there has been a general improvement in the standard of analytical review procedures, further improvement is needed in relation to revenue. There often appears to be a tendency to focus on the balance sheet and assume that the work will cover the income statement. Audit teams should pay more attention to planning the audit of revenue in an effective manner.

330. Direct confirmations independent confirmations for the existence of significant investment and bank balances were not sought or obtained directly from third parties in an audit of a financial institution (fixed term deposits) and a pension fund (investments). This is not good practice unless it is unlikely that such confirmations would be obtained. In addition, Auditing Standards recognize that audit evidence is more reliable when it is obtained from independent third-party sources. We believe audit teams should obtain direct confirmations where possible.

331. Consistency between planned and actual audit approach While the audit planning was generally performed to a good or adequate standard, most audits were still not fully executed in accordance with the planned approach. This is partly because the current audit system has several planning-related documents that are not automatically linked to the detailed audit procedures.

332. Revenue recognition identification as a significant risk

On many audits where we reviewed the audit team's assessment of revenue recognition, it was not identified as a significant risk. This is inconsistent with Auditing

Standards, which state that there is ordinarily a presumption that there is a significant fraud risk in relation to revenue recognition.

333. The audit approach relating to the selection and testing of journals was not adequately justified on half of the relevant audit files. This is an important procedure in relation to fraud related risks. Audit teams need to pay more attention to demonstrating that the planned approach is responsive to the risk of management override.

334. The QE findings were consistent with the AIU findings in a few areas. However, on one audit, reviewed by the AIU and as part of the QE, the conclusions on the quality of audit work in relation to the evaluation of goodwill impairment were not consistent. The QE concluded that the work was satisfactory, whereas we believed significant improvements were required. In our view, this difference in inspection findings does not mean that there is a systemic issue with the QE process.

<Files\\PwC Public Report 2010 - 2011> - § 7 references coded [4.21% Coverage]

335. Goodwill impairment assessment: On most of the audits where we reviewed goodwill and other intangibles, we identified issues in relation to the sufficiency of audit evidence obtained or recorded to support the related carrying values. This included issues relating to the sufficiency of evidence or level of challenge of key assumptions and related disclosures.

336. Audit of revenue: On many audits, we identified issues in relation to the audit of revenue. The more important findings arose on five audits and included weaknesses in the performance of detailed testing, substantive analytical procedures, the response to fraud related risks or justification of the audit approach taken. There sometimes appears to be a focus on the balance sheet and an assumption that the work will cover the income statement. The firm should ensure that audit teams pay more attention to planning the audit of revenue in an effective manner.

337. Audit testing of journals: The audit approach relating to the selection and testing of journals was not adequately justified on eight of the audits. This is an important procedure in relation to fraud related risks. Audit teams need to pay more attention to ensuring the planned approach is responsive to the risk of management override.

338. Non audit fees — adequacy of assessment of independence threats Ethical Standards require the auditor to identify and assess independence threats relating to non-audit services. We continued to identify instances where this assessment was not adequately performed.

339. Non audit services - IT Consulting Services

On one FTSE 100 audit, IT consulting services were provided to the client following PwC's acquisition of the Paragon Consulting business. This included updates to the financial reporting system to reflect changes in reporting entities and structures, which the firm ceased providing to the audited entity within a year. It was not clear from the audit team's written assessment why this did not give rise to an unacceptable threat to the firm's independence. In addition, the non-audit services were not formally approved by the group audit engagement partner until three months after the acquisition of Paragon.

340. Partner promotions — reference to selling non-audit services.

In relation to one of the audit directors who was promoted to partner in the year, the partner candidate pack inappropriately included a few references to success in selling non-audit services to the individual's own audit clients, despite the policy and guidance issued by the firm in this area.

341. The guidance stated that internal experts do not need to perform audit procedures or document their work in accordance with Auditing Standards. We raised certain concerns with the firm regarding this guidance and, subsequently, additional guidance was issued by the firm, clarifying that audit

teams are expected to perform sufficient audit procedures for areas where internal experts are used.

<Files\\PwC Public Report 2011 - 2012> - § 4 references coded [2.21% Coverage]

342. In six cases, there was insufficient evidence of involvement by the group auditors at the planning stage in the component auditors' risk assessments and planned.

343. Fair value measurement of assets and/or liabilities. The firm's audit of the fair value measurement of assets and/or liabilities was generally performed to a good or acceptable standard. However, in one case concerning the valuation of financial assets, the audit team did not evaluate sufficiently the reasonableness of "consensus" valuations that were used, or the approach adopted by the entity's management to the fair value hierarchy classification.

344. Plant, property, and equipment We identified weaknesses in the audit of property, plant, and equipment (PP&E) in three audits. In one of them, a high street retailer, management's sensitivity testing comprised increasing sales only. Given the changing commercial environment in the high street, the audit team should have requested management to perform some downside testing on sales. In this respect, it did not demonstrate sufficient scepticism regarding the sensitivity testing of PP&E.

345. Nevertheless, in three audits, there was insufficient evidence of involvement by engagement quality control review partners. In two other cases, there were weaknesses in the audit of financial statement disclosures.

<Files\\PwC Public Report 2012 - 2013> - § 8 references coded [4.34% Coverage]

346. Goodwill and other intangible assets

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

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

347. The UK firm was fully involved in the identification of significant and elevated audit risks, in determining the planned response to them by the component auditor and reviewed the component auditor's work on the consolidation. However, under Auditing Standards, a group auditor cannot delegate responsibility for performing the audit, including the audit of the consolidation process, to a component auditor.

348. The audit team did not obtain sufficient audit evidence in respect of the entity's investment accounting records or the general ledger which were maintained by service providers. Furthermore, insufficient audit evidence was obtained to confirm the valuation of the entity's significant portfolio of investments.

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

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

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

352. Independence compliance

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

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

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

<Files\\PwC Public Report 2013 - 2014> - § 3 references coded [1.87% Coverage]

354 The audit of revenue

We reviewed the firm’s audit of revenue in 18 audits. In two of them, we identified weaknesses in relation to the sufficiency of the testing of revenue controls. In one, the audit team’s testing of certain key areas, including the judgments made by the entity's management, was not performed sufficiently robustly. In the second, there was insufficient explanation of the reasons why it was considered appropriate for reliance to be placed on revenue transactional controls in an overall control environment that was identified as being weak.

354. We reviewed the firm’s testing of the operational effectiveness of IT general controls in five audits. In three of them, we identified that audit teams performed insufficient testing of user and/or developer access controls. In one of the three, the audit team also performed insufficient testing of system generated reports and, in another, there was insufficient evidence of their approach to the testing of system generated reports.

355. Impairment testing of tangible and intangible assets including goodwill.

We assessed the firm's impairment testing of tangible and intangible assets including goodwill in 12 audits. In three of them, we identified weaknesses in the sufficiency of evidence or of challenge of the appropriateness of management's growth rate assumptions or of the following year's budget which supported the carrying value of goodwill and/or other intangible assets.

<Files\\PwC Public Report 2014 -2015> - § 7 references coded [5.77% Coverage]

356. We reviewed the firm's audit of investment properties in four audits. In two audits, there was insufficient evidence to demonstrate the reasonableness of certain key assumptions used in the valuation of the investment properties and the degree of challenge by the audit team. In a third, there was insufficient corroborative evidence to support the valuation of investment properties for which key assumptions used fell outside the identified benchmark range. In the fourth audit, there was an inadequate explanation as to why the limited audit coverage by the firm's overseas property experts was sufficient and limited evidence as to the reasonableness of certain key assumptions.

357. We reviewed aspects of the firm's impairment testing of tangible and intangible assets including goodwill in 11 audits.

In one audit, there was insufficient evidence of consideration and challenge of the appropriateness of the underlying assumptions used in the valuation of customer relationships or of appropriate corroborative audit evidence that was obtained. In another, the audit team evaluated management's forecasts and the reasonableness of the related provision for onerous contracts but did not draw this evidence together to demonstrate that no further impairment of the tangible assets was required.

358. The capitalization of internally generated costs We reviewed the audit of the capitalization of internally generated costs in four audits.

In one audit, the audit team carried out insufficient procedures to ensure that the amount capitalized was appropriate. In another, the entity was continuing to derive economic benefit from fully amortized intangible assets, but the audit team did not challenge the appropriateness of the amortization policy for capitalized development costs to ensure it properly reflected the useful economic lives of the assets.

359. The audit of loan loss provisions We reviewed the audit of loan loss provisions in three audits.

In two audits, the audit teams did not obtain sufficient audit evidence when testing the adequacy of loan loss provisions, as they did not select samples that adequately reflected the whole of the relevant population.

360. Accruals and provisions We reviewed the audit of accruals and provisions in six audits.

In three audits, the audit teams obtained insufficient audit evidence in relation to certain accruals and provisions. In one of them, there was insufficient evidence to support certain accruals recorded in the group financial statements. Additionally, the audit team's consideration of the materiality of a few unadjusted misstatements did not cover all relevant qualitative matters or the continued existence of similar misstatements from one year to the next. In the two other audits, there was insufficient evidence as to why it was appropriate, in one case, for the entity to carry forward a proportion of a material restructuring provision and, in the other, to continue to recognize a material provision for uncertain tax exposures.

361. We reviewed the firm's testing of the operating effectiveness of IT general controls in seven audits.

The work of the IT specialists was generally well integrated with that of other members of the audit team.

In two audits, we identified that the specialists performed insufficient testing of user and/or developer access controls. In both cases, the procedures performed were insufficient for the audit team to conclude whether the controls adequately mitigated the risk of inappropriate access.

In two other audits, the procedures undertaken did not sufficiently address identified IT control deficiencies which might have affected the completeness and accuracy of system generated reports on which management relied. In a further audit, the firm's substantive testing carried out in response to identified deficiencies in certain IT controls was not sufficiently responsive to the identified risk of fraud.

362. Group audit considerations

We reviewed the planning and control of group audits by group engagement teams in all but 2 of the audits.

In one audit, there was insufficient evidence of the group engagement partner's involvement in a component auditor's work to ensure proper consideration was given to significant issues arising. In another audit, there was insufficient evidence to support the conclusion that the level of judgment inherent in the calculation of certain provisions did not give rise to a significant audit risk requiring.

<Files\\PwC Public Report 2015 - 2016> - § 2 references coded [1.18% Coverage]

363. For example, in two audits there was insufficient evidence supporting several longstanding tax provisions and the original basis for the provisions. On one of these audits, there

was insufficient evidence that the audit team had challenged the judgments made for each exposure and jurisdiction.

364. The firm maintains a log of independence breaches, which identified a higher number of breaches of Ethical Standards in the year to 30 September 2015 than in the prior year. Nearly all these related to the holding of prohibited investments and the late approval of non-audit services, being the same areas as last year.

Some of these holdings of prohibited investments had not been self-declared by the relevant partners and were identified through the firm's independence testing, which covers the financial interests of approximately 10% of the partners each year, with additional testing of new partners. The firm should review the scope of its testing in this area and should consider testing a higher proportion of partners each year.

<Files\\PwC Public Report 2016 - 2017> - § 2 references coded [1.90% Coverage]

365. In relation to the valuation of properties, insufficient evidence that corroborating information for some of the changes in market values (e.g., in relation to recent comparable transactions) was obtained to support management's expert's explanations for the extent of the changes.

Insufficient evidence of the audit team's consideration and challenge as to why no brand values were recognized on many acquisitions in the year.

For impairment reviews, insufficient challenge of the discount rates used by management and insufficient evidence that the audit team had adequately challenged whether a cash generating unit was significant and should therefore have been separately disclosed in the financial statements.

366. The audit of tax was an area of particular focus for us this year and we reviewed this on most of the audits we inspected. We found that there was generally a good level of involvement from tax specialists in these audits. However, we identified the following findings on some of the audits:

— Insufficient supporting evidence or challenge regarding the level of certain tax provisions.

- Insufficient evidence supporting certain long-standing tax provisions, in particular the extent to which audit evidence from prior years had been brought forward or reconsidered in the current year.
- Insufficient challenge regarding the adequacy of disclosures relating to the judgments made and related sensitivities for the tax provisions.

<u>Name: Nodes\\Factors outside the control of the firm</u>

<Files\\PwC Public Report 2012 - 2013> - § 1 reference coded [0.60% Coverage]

367. Controls testing

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

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

<u>Name: Nodes\\Audit reporting</u>

<Files\\PwC Public Report 2007 -2008> - § 2 references coded [0.45% Coverage]

368. We found that the technical reviews on the audits reviewed by us were of a good standard, especially for the FTSE 100 audits. However, we were informed that the firm's technical department did not oversee the pre-issuance review of two FTSE 100 audits, in relation to audit opinions issued in 2007, which was not in line with policy.

369. In our view, the audit finalization procedures were generally performed to a good standard.

<Files\\PwC Public Report 2008 - 2009> - § 1 reference coded [0.10% Coverage]

370. We found that the technical reviews on the audits reviewed by us were of a good standard, especially for the FTSE 100 audits.

<Files\\PwC Public Report 2009 - 2010> - § 2 references coded [1.40% Coverage]

371. The audit finalization procedures were generally performed to an acceptable standard. The pre-issuance reviews of listed entity financial statements contributed to audit quality. On some audits more attention should have been given to ensuring that there was evidence of review by the engagement quality control review partner in certain areas involving significant risks and judgments, such as property valuations. In addition, a few of the issues identified by our reviews should have been identified by more rigorous review procedures.

372. The firm identified, in its internal review, that quality was less consistent in those audits where the engagement leader was an audit director, compared with audits led by partners. At the time of our inspection, the firm was considering how best to address this issue. We agree that any apparent

inconsistency in the quality of audits is a concern, and we will review how the firm has addressed this in next year's inspection.

<Files\\PwC Public Report 2010 - 2011> - § 1 reference coded [0.13% Coverage]

373. It is important for audit teams to report their conclusions directly to Audit Committees.

<Files\\PwC Public Report 2011 - 2012> - § 1 reference coded [0.73% Coverage]

374. However, in two cases unadjusted misstatements were not reported and, in cases, aspects of the audit plan and/or audit sufficiently.

375. Further, in nine cases, there was insufficient reporting to Audit Committees of the nature and extent of threats to the firm's objectivity and independence arising from non-audit services provided to audited entities and the related safeguards that were applied.

<Files\\PwC Public Report 2012 - 2013> - § 3 references coded [1.91% Coverage]

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

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

378. Engagement quality control review

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

<Files\\PwC Public Report 2013 - 2014> - § 1 reference coded [1.00% Coverage]

379. Reporting to Audit Committees

We considered the sufficiency, quality, and timeliness of the firm's communications with Audit Committees on all the audits we reviewed.

In one audit, the descriptions of certain partners' roles lacked clarity or could have been misleading; and the materiality level used in the audit and an unadjusted error were not communicated to the Audit Committee. In another audit, notwithstanding the existence of certain mitigating controls, not all the recurring IT control deficiencies identified were reported to the Audit Committee. In a third audit, there was insufficient evidence of appropriate discussion with the Audit Committee regarding the disclosure of key risks and uncertainties facing the entity.

<Files\\PwC Public Report 2014 -2015> - § 5 references coded [2.65% Coverage]

380. Pre-issuance quality review procedures

Of the 22 audits we reviewed in our 2014/15 inspection, 13 were subject to these quality review procedures. We considered that eight of these audits were performed to a good standard with limited improvements required.

381. Communications with Audit Committees

in four audits matters that we considered should have been reported to the Audit Committee had not been reported.

In one audit, the audit team did not report to the Audit Committee the specific assumptions it adopted when it identified that the aggregation of alternative scenarios would have reduced a stock provision by a material amount or those used in its goodwill impairment assessment.

In another, we considered that the audit team should have discussed with the Audit Committee a potential management threat to the firm's independence in connection with certain non-audit services. In the same audit, the audit team did not explain to the Audit Committee why the auditor's report on the group financial statements did not need to refer to the matter which gave rise to a modified auditor's report in relation to a material component.

382. Auditor's report

UK Auditing Standards introduced a requirement for extended audit reports for listed and certain other entities with effect from September 2013 year-ends. From that date, the audit report for such entities is required to include a description of those assessed risks of material misstatement which had the greatest effect on the audit, an explanation of how the concept of materiality was applied and an overview of the scope of the audit. The firm introduced detailed guidance and additional quality control procedures in this area for the assistance of audit teams.

Nearly all the audits we reviewed were affected by these new requirements. In one audit, whilst we were satisfied that sufficient work to assess the need for a goodwill impairment charge had been performed, there was insufficient evidence that the audit team had performed each of the procedures set out in the auditor's report.

<Files\\PwC Public Report 2015 - 2016> - § 2 references coded [1.44% Coverage]

383. First year audits were identified as an area of focus for us this year and we reviewed two such audits undertaken by PwC. In one of these audits, the tender document referred to planned reliance on internal controls and the use of data analytics techniques. However, there was only limited testing of internal controls and use of data analytics. More details should have been provided to the Audit Committee about the actual audit approach undertaken.

On the other first year audit, the audit team did not adequately explain to the Audit Committee the reasons for a change in the level of performance materiality set, compared with the lower level communicated at the time of the audit tender.

384. However, in some cases the accuracy or precision with which certain procedures were described needed to be improved. For example, on one audit, the auditors' report inaccurately stated that the short-term growth

assumptions were supported by a comparison to historic performance by the auditors and that detailed disclosures regarding the key assumptions had been set out in the financial statements. On another audit, the procedures for the estimated costs to complete on long-term contracts stated in the auditors' report were not fully consistent with those performed.

Name: Nodes\\Skills and personal qualities of audit engagement team

<Files\\PwC Public Report 2007 -2008> - § 2 references coded [1.31% Coverage]

385. The firm's policies and guidance explicitly permit internal specialists (such as tax partners) involved in audits, including "key audit partners" (KAPs)11, to be rewarded for selling non-audit services to those audit clients, on the basis that they are not considered by the firm to be part of the "audit team". Whilst the Ethical Standards exclude "professional personnel from other disciplines involved in the audit" from being part of the audit team for this purpose, they do not specifically state whether this extends to KAPs. In our view, the underlying principles of the Ethical Standards would indicate that they should be treated in the same way as other audit partners who are responsible for key audit decisions.

386. The firm's internal specialists are often integrated into the audit, especially in the areas of tax and IT.

We consider the firm's use of internal specialists in support of the audit of complex or specialized areas to be important. However, we found issues in relation to the recording of the work of internal specialists on half of the audits reviewed, mainly in relation to tax, where it was not possible to fully determine the planned audit approach to tax or the audit evidence obtained from the audit files alone.

<Files\\PwC Public Report 2008 - 2009> - § 6 references coded [1.87% Coverage]

387. The firm's procedures for assessing competencies of audit personnel include on the job coaching and appraisals, year-end performance evaluations and the moderation processes. The firm has a competency framework, which details those competencies expected for different levels of seniority.

Last year we noted that this had not been embedded in the performance evaluation processes.

388. We met personnel from the training and technical departments and reviewed certain audit training material and technical updates. We concluded that the mandatory audit training for audit personnel is comprehensive and includes consideration of new requirements and identified development needs.

389. Personnel with recurring quality issues

There were six audit engagement partners and two audit directors who had a “needs improvement” AQR finding on one of their audits in the year and at least the same finding in the prior year. Three of these partners had business unit management positions in the firm, with competing responsibilities. In our view, the firm should identify the extent of the linkage between the client workload and competing responsibilities of those partners and the results of the AQR.

390. The audit methodology and formal audit guidance is designed to cover all types of audits and does not include tailored guidance or a library of standard audit procedures for financial services audits.

While certain informal guidance exists for financial services audits, we understand that some of it is considered by the firm to be out of date. In our view, certain areas of the firm’s audit methodology and guidance need to be tailored for financial services audits.

391. We reviewed several significant audit judgments, including the rationale for accounting treatments, the reasonableness of assumptions in valuations and estimates and the judgments relating to the extent of audit work performed. We were generally satisfied with the justification of the significant audit judgments, although we identified issues relating to the extent of audit work performed in certain areas, as noted in this section of the report.

392. In our view, the reporting to Audit Committees was generally of a good standard and communications were made on a timely basis.

<Files\\PwC Public Report 2009 - 2010> - § 2 references coded [1.17% Coverage]

393. Assessment of competencies for partners the firm has a competency framework which is intended to assist in the assessment of competencies for audit personnel and which covers technical and other skills. However, the firm has not embedded it into the partner performance evaluation systems.

394. On one listed audit reviewed by us, PwC was also the actuary to the group's defined benefit pension scheme and performed the actuarial valuation of the scheme. An independent actuary determined the key assumptions and then updated PwC's valuation in arriving at a value for inclusion in the group accounts. These arrangements were not consistent with the underlying principles of the Ethical Standards, due to the independent actuary's reliance on PwC's valuation leading to an unacceptable level of self-review threat.

<Files\\PwC Public Report 2010 - 2011> - § 4 references coded [1.67% Coverage]

395. In addition, more needs to be done to demonstrate the exercise of professional scepticism in this area.

396. Consultation procedures on ethical matters. This firm does not have documented policies and procedures covering consultation on ethical matters. We were informed that the delay in addressing this matter was mainly to reflect relevant changes to the Ethical Standards, effective from April 2011.

397. Performance evaluation - Assessment of competencies for partners. This firm has a competency framework, which is intended to assist in the assessment of competencies for audit personnel.

However, the firm has not embedded it into the partner performance evaluation systems. While the firm asked partners to assess their technical competence in 2010, there was still limited evidence of the assessment in practice.

398. The firm again identified, in its internal quality review, that quality deficiencies were higher in audits where the engagement leader was an audit director. While there was some improvement compared with last year, following

specific actions taken by the firm, continued effort is needed to further improve the quality of audits led by audit directors.

<Files\\PwC Public Report 2011 - 2012> - § 1 reference coded [0.62% Coverage]

399. Materiality

In two audits, an inappropriate level of materiality was applied to specific areas of the audit. One of these related to the audit of a pension scheme in which, in accordance with the firm's policy, the materiality used for the audit of the scheme's financial statements was also used for the audit of contributions for the purposes of the Auditors' Statement

<Files\\PwC Public Report 2013 - 2014> - § 4 references coded [3.79% Coverage]

400. Capitalization of internally generated costs

Accounting Standards permit the capitalization of internally generated costs if they meet specified recognition criteria.

We reviewed this area in four audits. In one of them, the audit team did not request the entity's management to justify how internally generated project costs met the recognition criteria set out in Accounting Standards. The audit team's own review was not sufficiently comprehensive to establish whether the recognition criteria were fully met. In addition, there was insufficient evidence that, for internally developed software, the chosen useful economic life, which was not separately disclosed in the financial statements, reflected the expected pattern of future economic benefits.

401. Journal testing

We reviewed the firm's journal entry testing in six audits. In one audit, the testing did not adequately address the risk of management override of controls and did not cover the whole sample that was selected for testing. In another audit, there were weaknesses in the approach taken to the selection of journals for the audit of the financial statement consolidation process.

402. Matters concerning components:

- Audit materiality: The audit team inappropriately determined overall materiality for the audit of a component at the same level as for the group audit. Auditing Standards require overall materiality for the audit of a component to be less than that for the group audit.
- Completeness of liabilities: There was insufficient evidence of the audit team's review and challenge of the appropriateness, in a component, of an onerous lease provision set at 50% of the maximum exposure.
- Impairment testing: There was insufficient evidence to demonstrate that the carrying value of property, plant and equipment held by a component was not impaired.

403. Independence and ethics - non-audit services

We reviewed the firm's acceptance procedures for a sample of significant non-audit services provided to some of the firm's largest audited entities. In one case, we identified that the firm's approval procedures were not fully completed until three months after the engagement letter was signed and work had commenced. In another case, the nature of the threats to the firm's independence was not properly assessed and reported appropriately to the Audit Committee.

The firm's own monitoring procedures identified seven breaches in the year of Ethical Standards concerning non-audit services. The first concerned an engagement partner responsible for the audit of a listed entity who failed to consult the Ethics Partner, as required, when it was expected that non-audit fees would exceed audit fees in the year. The second concerned a secondment to an audited entity for an extended period. The remaining breaches concerned the commencement of non-audit services to audited entities before obtaining the approval of the group engagement partner.

<Files\\PwC Public Report 2014 -2015> - § 1 reference coded [0.58% Coverage]

404. We reviewed the firm's journal entry testing in 18 audits.

In nine audits, audit teams undertook insufficient procedures to test the processing of automated journals, being those generated automatically by entities' computerized accounting systems. In three audits, the audit teams took appropriate steps to identify the population of manual journals that met certain fraud risk indicators, but then performed insufficient testing of this population.

<Files\\PwC Public Report 2015 - 2016> - § 3 references coded [0.95% Coverage]

405. For example, in two audits there was insufficient evidence supporting a few longstanding tax provisions and the original basis for the provisions. On one of these audits, there was insufficient evidence that the audit team had challenged the judgments made for each exposure and jurisdiction.

406. Ensure data analytics is better integrated into the audit of revenue.

Revenue is an important driver of an entity's operating results and auditors need to evaluate and address fraud risks in relation to revenue recognition. A failure to perform sufficient audit work in this area increases the risk that the auditors will not identify a material misstatement of revenue in the financial statements.

407. On a few audits reviewed, the fraud risk characteristics were not adequately considered when determining which journals should be tested.

<Files\\PwC Public Report 2016 - 2017> - § 1 reference coded [0.99% Coverage]

408. Further strengthen the firm's monitoring of compliance with ethical requirements Insufficient monitoring of compliance with the firm's independence policies and procedures, to identify or prevent breaches, could compromise the firm's independence and objectivity. The firm maintains a log of breaches of ethical requirements. Most of the identified breaches related to the holding of prohibited investments and the commencement of non-audit services for audited entities in advance of obtaining the audit partner's approval (like last year). They also included cases where the firm's Ethics Partner was not consulted on a timely basis regarding the level of independence threats associated with non-audit fees for listed entities exceeding audit fees.

Name: Nodes\\The culture of the firm

<Files\\PwC Public Report 2007 -2008> - § 7 references coded [1.91% Coverage]

409. We believe that the firm's strategy, communications, and actions demonstrate the importance the firm attaches to achieving high quality audits.

410. Linkage between audit quality and remuneration

We believe that the firm should improve its evidence of how audit quality measurements, including the results of audit quality reviews, are linked to the performance ratings and remuneration of individuals, so that it is able to demonstrate more clearly the extent to which remuneration is based on considerations of audit quality.

411. The firm has a competency framework, which details those competencies expected for different levels of seniority. However, this had not been embedded in the performance evaluation process at the time of our inspection, although the firm was planning to do so soon afterwards.

412. We concluded that the training for audit personnel is comprehensive and includes consideration of new requirements and identified development needs.

413. We reviewed the firm's A&C policies and procedures and selected a sample of annual continuance forms for review. We concluded that the A&C policies and procedures are generally comprehensive, and that the approval procedures were notably thorough in one of the business units.

414. We reviewed these processes, the 2007 results, and the follow-up actions by the firm. The firm invests significant effort and resource in these processes, which we believe are effective in identifying matters which require improvement. We believe the KPI process to be a particular strength within the quality monitoring procedures.

415. These exercises, in 2007, identified a small number of partners as having inadvertently breached ethical standard requirements. All partners breaching

external regulatory requirements are considered for disciplinary action by the Management Board of the firm.

<Files\\PwC Public Report 2008 - 2009> - § 4 references coded [1.54% Coverage]

416. One element of the staff bonus scheme relates to the relevant business unit's performance against certain Key Performance Indicators (KPIs). We note that the basis of this has changed for 2009 to give a 40% weighting to financial growth as part of the KPI element, double the 20% weighting given to the other KPls, including audit quality. This represents a change from an equal weighting of 25% for each KPI last year and emphasizes the importance of financial growth to the firm. We consider that the underlying message that this change gives represents a potential risk to audit quality in the future, although we were informed by the firm that the change was small in terms of total remuneration and was not intended to undermine the importance of audit quality.

417. We reviewed these processes, the 2008 results, and the follow up actions by the firm. The firm invests significant effort and resource in these processes and responding to the findings. We believe the KPI and ACR processes to be strengths within the quality monitoring procedures.

418. We reviewed the firm's ethical policies and found them to be generally comprehensive. We comment below on those areas where, in our view, the policies or guidance should be reviewed by the firm.

419. As noted last year, the firm's policies and guidance explicitly permit internal specialists (such as tax partners) involved in audits, including "key partners involved in the audit" (KPs)11, to be rewarded for selling non-audit services to those audit clients, on the basis that they are not considered by the firm to be part of the "audit team". In our view, the underlying principles of the Ethical Standards would indicate that they should be treated in the same way as other

audit partners who are responsible for key audit decisions and the firm should amend its policy accordingly.

<Files\\PwC Public Report 2009 - 2010> - § 1 reference coded [0.30% Coverage]

420. Last year, the firm agreed to re-consider its policy, which allowed a cooling-off period of two years. Following further discussion with us at the time of our inspection, the firm has now amended its policy.

<Files\\PwC Public Report 2010 - 2011> - § 3 references coded [1.88% Coverage]

421. Consistency between planned and actual audit approach: On five audits, the planned audit approach was not fully executed in practice. There has been a reduction in the number of issues in this area, partly due to the implementation of the new audit software system, Aura.

422. Disciplinary procedures for non-personal independence breaches

Other than for personal independence breaches, there are no formal disciplinary procedures for non-compliance with Ethical Standards, such as the provision of prohibited non-audit services, and there is no formal process for ensuring such breaches are reported to the firm's Board. The firm believes that these types of breaches would be dealt with in the performance evaluation process; however, this is not stated in the related policies or guidance. The firm should formalize procedures in relation to such breaches.

423. The firm does not have a formal process for considering the impact of QE results on promotions. One audit director, who had recurring deficiencies in the firm's QE, was promoted to audit partner. We were informed that their latest QE result was not available until a late stage in the promotion process and that the decision to approve the promotion was based on the satisfactory results of further independent quality reviews on four of the individual's audits.

<Files\\PwC Public Report 2011 - 2012> - § 4 references coded [2.17% Coverage]

424. The firm's strategy for the forthcoming financial year identified quality as a key performance goal; however, the firm continues to focus on growing the business and achieving efficiencies in the conduct of audit work. The firm should ensure that there is no adverse impact on audit quality because of its initiatives to improve audit efficiency in the light of competitive pressures.

425. Impact of quality on remuneration

Engagement partners responsible for audits identified by internal or external quality reviews as having adverse overall findings are held accountable with implications for their remuneration. However, partners responsible for carrying out the engagement quality control reviews of performance of their role.

426. We reviewed the self-appraisal forms and objectives for a sample of audit directors and managers.

Approximately half of the appraisal forms in the sample had little or no comments on audit quality or from the appraiser.

427. Partner promotions

We reviewed the supporting evidence for many of the candidates put forward by the audit practice for admission to the partnership with effect from 1 July 2011. Audit quality considerations were not addressed directly, although some candidates addressed them indirectly through the inclusion of past appraisal forms.

<Files\\PwC Public Report 2012 - 2013> - § 1 reference coded [0.70% Coverage]

428. Consistency of audit quality

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

<Files\\PwC Public Report 2013 - 2014> - § 2 references coded [1.09% Coverage]

429. Appraisals and promotions

We reviewed the appraisal forms and following year objectives for a sample of partners and staff and identified the following matters:

- Objectives were not signed off on a timely basis for over half of the staff in our sample and, in some cases, adverse audit quality findings were not considered.
- A few partners had not completed the firm's performance evaluation forms properly. In addition, a reviewing partner had used almost identical wording for all the partners whose performance he moderated.

430. We also reviewed portfolios of evidence in support of a sample of candidates for promotion to partner. We noted that the standard form in use for direct entry candidates did not require evidence of any assessment of technical competencies or consideration of other matters affecting audit quality.

5.4 Presentation of data on FRC litigations against audit firms at FRC tribunal

5.4.1 Introduction

This section presents the data in respect of cases of misconduct against audit firms and corporate bodies in the UK.

Cases of professional infractions by audit practitioners and corporate bodies are handled by the Conduct Committee of the FRC UK. The Conduct Committee (CC) is one of two business committees of the board. It has responsibility for upholding the ethical responsibilities of professional members, firms, and the entities represented by them.

The Case Examinations and Enquiries (CEE) team of the Conduct Committee is charged with the responsibility of conducting enquiries on behalf of the FRC. Case enquiries may arise in any of the following ways:

i. Complaints and whistleblowing disclosures.

ii. Referrals from other FRC teams, other regulators, or the professional bodies.

The Tribunal hears cases which are referred to it by relevant organs of the FRC and it is legally empowered to give judgements and impose sanctions as prescribed by law. No member of the Tribunal shall be an employee of the FRC or any of the professional bodies. The chair of the Tribunal shall normally be an experienced lawyer with other members being professionals and laymen. The tribunal panel is usually three or five members.

For our study, a total of thirty-eight cases were researched in respect of audit firms, professional accountants, and corporate bodies, in respect of which judgements have been delivered.

The data presented in Table 4.6 below were extracted from notices of hearing, statement of alleged and admitted facts, and the detailed Tribunal report which encompassed the detailed proceedings and the resultant judgement. The presentation includes the summary of the breaches on which the firms and individuals were found guilty. Although some of the cases related to periods before 2008, proceedings and judgements were given on them between 2008 and 2016 which fall within the study period. The study also used all decided cases within the study period, which included non-Big4 audit firms and accounting staff of client companies to allow for a total capture of the litigation outlook within the accountancy profession which impacted on audit quality. From the table, the analysis concentrated on the audit quality factors involved as contained in the alleged and admitted facts, and the magnitude of the sanctions imposed in the judgement.

5.5 Summary

The chapter presented the secondary research data collected and analysed for the study. The data consisted of the NVivo coded textual data extracted from the FRC audit inspection reports, together with the classification of the FRC audit quality grades on the inspected samples of audits conducted by the Big4 UK audit firms. The key drivers of audit quality as conceptualised by the FRC UK were used as nodes for the coding of the textual data. These reports covered from 2008/2009 to 2016/2017. The chapter also presented the details of FRC litigations against auditors and audit firms in the UK. Thirty-eight (38) such cases were reported from 2008 to 2016. Details of the facts of the cases, the decisions reached, and the punishment imposed were presented.

Table 5.7 Summary of FRC Tribunal decided cases, facts, and decisions.

S/N	Names of Auditor / Accountant	Audit firm represented	Professional body of membership	Name of Client Company	Alleged / Admitted Facts	Tribunal verdict, and penalty imposed	Year of Account	Year of Tribunal decision
1.	Mr David McClean	Moore Stephens (NI) LLP.	ICAI	Presbyterian Mutual Society	"Erroneous and unreasonable" assumption that a client (PMS) was complying with its own rules.	Reprimand and fine of £200,000.00.		Jan 2016
2	Mr Philip Black			Presbyterian Mutual Society	Breach of fundamental principle of professional competence and due care.	Reprimand and payment of FRC costs of £50,000.		Nov 2015
3	Ms Diane Jarvis	Company staff (Chief Financial Officer)	ICAEW	Healthcare Locums Plc.	Dishonest manipulation of company's management accounts to increase profitability.	Payment of FRC costs of £25,000.00.		July 2015

S/N	Names of Auditor / Accountant	Audit firm represented	Professional body of membership	Name of Client Company	Alleged / Admitted Facts	Tribunal verdict, and penalty imposed	Year of Account	Year of Tribunal decision
4	Christopher Gee	Company staff (Finance Director)	ICAEW	Manchester Building Society (MBS)	Misconduct in the form of wrongful application of Hedge accounting under IAS 39, and failure to identify breaches in accounting standards, IAS 39.	Reprimand, £25,000 fine and £5000 FRC costs.	2006 to 2011	June 2015
5	Allastair Nuttall	Grant Thornton UK LLP.		Manchester Building Society (MBS)	Failure to comply with the provision of auditing standards, and the provision of inaccurate information and advice in the course of the audit.	Reprimand and £39,000 fine.	2006 to 2011	June 2015

S/N	Names of Auditor / Accountant	Audit firm represented	Professional body of membership	Name of Client Company	Alleged / Admitted Facts	Tribunal verdict, and penalty imposed	Year of Accou nt	Year of Tribunal decision
6	Marcus Swales	Grant Thornton UK LLP.		Manchester Building Society (MBS)	Same as above.	Severe reprimand, and £45,500 fine.	2006 to 2011	June 2015
7	Grant Thornton UK LLP	Grant Thornton UK LLP.		Manchester Building Society (MBS)	Same as above.	Severe reprimand, £975,000 fine and FRC costs of £85,000.	2006 to 2007	June 2015
8	Mr Maghsoud Einollahi	Deloitte & Touche LLP	ICAEW	MG Rovers Group Ltd.	Breach of objectivity and lack of safeguards on conflicts of interest.	Fine of £175,000.	2000 and 2001	Appeal Tribunal 2013.
9	Deloitte & Touche LLP	Deloitte & Touche LLP	ICAEW	MG Rovers Group Ltd.	Same as above.	Fine of £3,000,000.	2000 and 2001	Appeal Tribunal 2013.
10	Mr Peter Miller	Company staff (Finance Director)	ICAEW	Welcome Financial Services Ltd.	Engaging in market abuse and knowingly concerned in the failure of Welcome	Removal from ICAEW's membership for six years with	2007	FSA decision in March

S/N	Names of Auditor / Accountant	Audit firm represented	Professional body of membership	Name of Client Company	Alleged / Admitted Facts	Tribunal verdict, and penalty imposed	Year of Account	Year of Tribunal decision
					Ltd to take reasonable care	effect from March, 2013. FSA financial penalty of £200,000.00.		2012; FRC tribunal decision in Feb 2013
11	Mr James Corr	Group Finance Director	ICAS	Cattles Plc.	Breach of ethics on integrity and transparency and publishing false and misleading information in respect of credit quality.	Removal from ICAS's membership for eight years with effect from March 2013. FSA financial penalty of £400,000.00.	2007 and 2008	FSA decision in March 2012; FRC tribunal decision in Feb 2013.
12	Mr Mark Woodbridge	Executive	ACCA	Torex Retail Plc	False accounting and conspiracy to defraud.	Convicted by the Oxford Crown Court	2006	Aug 2015.

S/N	Names of Auditor / Accountant	Audit firm represented	Professional body of membership	Name of Client Company	Alleged / Admitted Facts	Tribunal verdict, and penalty imposed	Year of Accou nt	Year of Tribunal decision
						and sentenced to prison terms of 3 years 10 months. FRC Tribunal imposed removal from ACCA membership for 10 years from August 2015.		
13	Paul Newsham	HWCA (Now Sixonethreeone Ltd.)	ICAEW	Worthington Nicholls Group Plc.	Misstatement of the true financial position of WNG for listing purposes.	Excluded from ICAEW's membership for 3 years.	2004 to 2006	April 2014.
14	HWCA (Now Sixonethreeone Ltd.)	HWCA (Now Sixonethreeone Ltd.)	ICAEW	Worthington Nicholls Group Plc.	Professional negligence and failure in the duty of care.	Severe reprimand. Fine of £225,000.00. FRC costs of £225,000.00.	2004 to 2006	April 2014.

S/N	Names of Auditor / Accountant	Audit firm represented	Professional body of membership	Name of Client Company	Alleged / Admitted Facts	Tribunal verdict, and penalty imposed	Year of Account	Year of Tribunal decision
15	Mr Timothy James Hunt		ICAEW	Worthington Nicholls Group Plc.	Same as above.	Excluded from ICAEW's membership for 6 years. £50,000.00 payment of Executive Counsel costs.	2004 to 2006	June 2012.
16	Moore Stephens Chartered Accountants	Moore Stephens Chartered Accountants	ICAI	Presbyterian Mutual Society	Failure to obtain adequate understanding of the legal and regulatory environment of PMS.	Reprimand and fine of £140,000.00.	2007 and 2008	Feb. 2016.
17	Mr David McClean	Moore Stephens Chartered Accountants		Presbyterian Mutual Society	Same as above.	Reprimand and fine of £20,000.00.	2007 and 2008	Feb 2016.

S/N	Names of Auditor / Accountant	Audit firm represented	Professional body of membership	Name of Client Company	Alleged / Admitted Facts	Tribunal verdict, and penalty imposed	Year of Accou nt	Year of Tribunal decision
18	Philips Black	Director	ICAI	Presbyterian Mutual Society	Negligence in the preparation and approval of the financial statements of PMS.	Reprimand and payment of Executive Counsel costs of £50,000.00	2007 and 2008	Oct. 2015.
19	Mazaars LLP	Mazaars LLP	ICAEW	First Quench Pensions Fund	Negligence: Material errors in both facts and judgement, and failure and unwillingness to identify the errors to provide a misleading information and advice.	Severe reprimand. Fine of £750,000.00. FRC costs of £1,120,000.		2014
20	Mr Richard Karmel	Mazaars LLP	ICAEW	First Quench Pensions Fund	Same as above.	Severe reprimand. Fine of £50,000.00. FRC costs of £80,000.00.		2014

S/N	Names of Auditor / Accountant	Audit firm represented	Professional body of membership	Name of Client Company	Alleged / Admitted Facts	Tribunal verdict, and penalty imposed	Year of Account	Year of Tribunal decision
21	PricewaterhouseCoopers LLP	PricewaterhouseCoopers LLP		Mayflower Corporation Plc.	Alleged negligence in the assessment of the going-concern status of the client company	Complaints dismissed by majority of Tribunal members with a dissenting judgement. £400,000.00 costs awarded against the AIDB in favour of PWC.	2002	Dec 2006
22	Mr David Thomas Donelly	PWC LLP	ACCA	Mayflower Corporation Plc and Transbus Plc.	Same as above.	Complaints dismissed by Tribunal members. £500,000.00 costs awarded against the AIDB in favour of Mr Donelly.	2002	Dec 2006

S/N	Names of Auditor / Accountant	Audit firm represented	Professional body of membership	Name of Client Company	Alleged / Admitted Facts	Tribunal verdict, and penalty imposed	Year of Accou nt	Year of Tribunal decision
23	Mr Ian Shelton	Former Financial Controller of Transbus Plc.	ACCA	Mayflower Corporation Plc and Transbus Plc.	Irregularities in the operation of an invoice discounting facility.	Exclusion from ACCA membership for 12 months from February 2007.	2002	2005
24	Mr Allan Flitcroft	Ernst & Young	ICAEW	European Home Retail Plc and Farepak Food & Gifts.	Failure to comply with both auditing and Ethical standards. Insufficient audit evidence and lack of professional scepticism.	Reprimand for Allan Flitcroft and a fine of £50,000.00.	2005	Dec 2013.
	Ernst & Young LLP	Ernst & Young LLP	ICAEW	European Home Retail Plc and Farepak Food & Gifts.	Same as above.	E&Y to pay a fine of N750,000.00 and FRC costs of £425,000.00.	2005	2013

S/N	Names of Auditor / Accountant	Audit firm represented	Professional body of membership	Name of Client Company	Alleged / Admitted Facts	Tribunal verdict, and penalty imposed	Year of Accou nt	Year of Tribunal decision
25	Mr William Rollason		ICAEW	European Home Retail Plc and Farepak Food & Gifts.	Breached the fundamental principles of the ICAEW guide to professional ethics.	Severe reprimand. Fine of £15,000.00. FRC costs of £50,000.00.	206	2013
26	Mr Glyn Williams	RSM Robson Rhodes LLP		iSoft Group Plc.	Insufficient audit evidence and lack of professional scepticism in respect of accounting for long-term contracts	Reprimand. Fine of £15,000.00.	2003 to 2004	Aug 2013
27	Mr Timothy Whiston	Finance director / CEO.	ICAEW	iSoft Group Plc.	Breach of the principles of integrity, and misconduct in exercising judgement on revenue recognition.	Exclusion from ICAEW's membership for 8 years. FRC costs of £50,000.00.	2003 to 2005	Dec 2015.

S/N	Names of Auditor / Accountant	Audit firm represented	Professional body of membership	Name of Client Company	Alleged / Admitted Facts	Tribunal verdict, and penalty imposed	Year of Account	Year of Tribunal decision
28	Mr John Whelan	Group Finance Director	ICAEW	iSoft Group Plc.	Inappropriate recognition of revenue from an unsigned contract.	Exclusion from ICAEW's membership for 8 years.	2003 to 2005	Dec 2015.
29	Mr Ian Storey	RSM Robson Rhodes LLP	ICAEW	iSoft Group Plc.	Insufficient audit evidence in respect of revenue recognition on long-term contracts.	Exclusion from ICAEW's membership for eight years. FRC costs of £20,000.00.	2003 and 2004	March 2010.
30	RSM Robson Rhodes LLP	RSM Robson Rhodes LLP	ICAEW	iSoft Group Plc.	Same as above.	Exclusion from ICAEW's membership for eight years. Fine of £225,000.00.	2003 and 2004	Nov. 2011.

S/N	Names of Auditor / Accountant	Audit firm represented	Professional body of membership	Name of Client Company	Alleged / Admitted Facts	Tribunal verdict, and penalty imposed	Year of Account	Year of Tribunal decision
						FRC costs of £750,000.00.		
31	Mr Christopher Willford	Group Finance Director	CIMA	Bradford and Bingley Plc.	Professional negligence in the failure to have proper regard to the information used for rights issues, in breach of the principles of the FCA.	Reprimand. Fine of £13,000.00. FRC costs of £250.00. FCA penalty of £30,000.	2008	2014.
32	Mr Greg Watts	KPMG Audit LLP	ICAEW	Pendragon Plc.	Breach of Ethical Standards and lack of safeguard against independence and objectivity threats	Reprimand. Fine of £162,500.00. FRC costs.	2010 and 2011	2015.

S/N	Names of Auditor / Accountant	Audit firm represented	Professional body of membership	Name of Client Company	Alleged / Admitted Facts	Tribunal verdict, and penalty imposed	Year of Account	Year of Tribunal decision
33	KPMG Audit LLP	KPMG Audit LLP	ICAEW	Pendragon Plc.	Engaged in self-audit.	Reprimand on one of the charges only.	2010 & 2011	2015.
34	KPMG Audit LLP	KPMG Audit LLP	ICAEW	Cable and Wireless Worldwide Plc (CWW).	Lack of safeguard against the risk of self-audit threat.	Reprimand. Fine of £227,500.00. FRC costs.	2011 and 2012	2015
35	Mr James Marsh	KPMG Audit LLP	ICAEW	Cable and Wireless Worldwide Plc (CWW).	Independence threat: Ex-employee of a client made to audit itself.	Reprimand. Fine of £39,000.00.		2015
36	Mr Rollo McClure	McClure Watters Chartered Accountants	ICAI	Emerging Business Trust	Insufficient audit evidence.	Reprimand. Fine of £6,000.00.		Dec 2008

S/N	Names of Auditor / Accountant	Audit firm represented	Professional body of membership	Name of Client Company	Alleged / Admitted Facts	Tribunal verdict, and penalty imposed	Year of Accou nt	Year of Tribunal decision
37	McClure Watters Chartered Accountants	McClure Watters Chartered Accountants	ICAI	Emerging Business Trust	Acts of omission: Insufficient audit evidence in resolving concerns raised on the materiality and significance of debtors' misstatement and the appropriateness of provisions for bad and doubtful debts.	Fine of £6,000.00. FRC costs of N60,000.00.		Dec 2008
38	Mr Geoffrey Stuart Pearson		ICAEW	Langbar International Ltd.	Ethical failure: Failure to act with due care, skill, and diligence in making RNS announcement	Exclusion from ICAEW's membership for 5 years with effect from Nov 2012. FRC costs £20,000.00.		Nov 2012.

CHAPTER 6: DISCURSIVE INTERPRETATION OF QUALITATIVE RESEARCH DATA

6.1 Introduction

This chapter evaluated the empirical and textual data in chapter five, synthesised with the concepts, theories, and practices contained in the literature review, with a view to making out meanings based on the triangulation of the different sources of data and discussions. The results of the interviews conducted were brought to use here in the understanding of audit quality drivers in the UK and Nigeria.

The discursive interpretation approach follows "the understanding that meaning is negotiated in interaction, rather than being present once-and-for-all in our utterances", "concentrating on events in naturally occurring contexts" (University of Hawaii, 2016). Specifically, the main objectives of the research, as detailed in the research questions formed the central themes to which the discussions and interactions are aligned. Efforts were made to show how the presented data in the preceding chapter supports or disproves existing views on such themes, while bringing out new directions or practices as observed from this study. In essence, this chapter provided the foundation on which the summaries and conclusions in the next chapter was based.

6.2 The conceptualisation of audit quality

Studies on audit quality have concentrated on the search for the appropriate description and the factors that drive audit quality for a determination of when an audit service is of good quality or otherwise. Whereas audit quality was nebulous by nature (Francis, 2004) and not capable of a single definition that is acceptable to all (Kilgore, 2014), with little knowledge of it (Francis, 2004; Kilgore, Knechel et al, 2013), times have changed, and the outlook of audit quality as conceptualised by academic researchers and regulatory actors is being reported in this study.

Different factors were theorised as descriptions of audit quality according to the lens applicable to respective stakeholders, each of which was considered inadequate to fully describe audit quality for the acceptance of all. For an understanding of the conceptualisation of audit quality, the FRC 2008 Audit Quality Framework (AQF), the first of its kind by a regulatory authority (Holm & Zaman, 2012) is assessed for coverage of the diverse perspectives of the different interest groups, and effectiveness in achieving the regulatory intent for which it is deployed.

A comparison of the indicators of audit quality in the FRC UK audit quality framework with the findings of academic researchers in the literature review revealed that the scope of the framework accommodates substantially the audit quality indicators suggested before and after its adoption in 2008. In line with submissions from Duff, 2009; Francis, 2011; Kilgore et al, 2013; DeFond & Zhang, 2014; that suggested the multiple factors or framework approach of assessing audit quality, the FRC conceptualised audit quality as multi-dimensional, and classified into a framework of five main categories. This study revealed that the FRC conceptualised audit quality in terms of indicators which were both considered observable and those, hitherto, considered as non-observable (Smith, 2012). This is so because the audit inspection activities of the FRC provided the opportunity for the observation of the audit process of the auditors and audit firms and to assign grades which reflect the degree of audit performance (audit quality). The public interest requirement formed part the FRC's conceptualisation and regulation of audit quality, being included in the audit quality indicators of the FRC AQF and considered in the planning of the client organisations sampled for audit inspection. It is a deliberate strategy of the FRC to choose public interest entities audited by the Big4 audit firms as audit samples for the regulation of audit quality in the UK.

The conceptualisation of audit quality by the FRC was further explained by engaging the theoretical framework of the study (the public interest theory) with the research findings from the audit inspection exercise, the tribunal decisions on negligent audit firms and clients, and the analysis of the transcript of the interviews conducted at FRC UK.

6.3 The relevance of the public interest theoretical framework to the conceptualisation of audit quality

The public interest theory as applied to the accounting profession espouses the need for accountants, herein signified by the auditors, to act in public interest. Following Cochran (1974) the definition of what is interest, and who the public is, depends on the theoretical perspective of public interest theory under consideration among the four perspectives of the Cochran typology.

The public interest theory requires professionals, such as accountants to act selflessly by refraining from elevating personal interest above public interest. To this end, accountants as professionals enjoy state endorsed monopoly based on their specialist knowledge. The profession has claimed that public interest gets served when quacks are excluded from the membership of the profession, thereby guaranteeing the provision of quality service to clients (Lee, 1995:53). Accountants of that era engaged more in audit and assurance, with minimum incursion into other related business opportunities. Dellaport and Davenport (2008) added that the setting of standards of practice and ethics for the observance of members represents another feature of the exercise of public interest. The activities of the FRC UK in the conceptualisation of audit quality, and the responses observed from the inspection of the audited accounts of the audit firms provide a working basis to test and identify how the findings relate to the tenets of public interest theory, and to place the firms within one of the four theoretical perspectives of the Cochran typology.

From Figure 3.2 in Chapter Three, the theoretical perspectives of public interest theory are: Normative, Consensual, Process, and Abolitionist. The abolitionist and the process theories do not recognize the existence of a large sets of people, whose interests are deserving of protection. These do not fall within the accountant's view of public interest and will not be considered further. The normative perspective recognises the public as all members of the community or a majority members thereof. It also adopts the use of ethics and promotion of shared values.

The FRC UK planned its regulatory activities, especially the audit quality monitoring exercise, based on the expected compliance of the audit firms with a set of regulations, standards, and conventions. The FRC expects that auditors will comply with company law provisions, accounting methods and judgements as prescribed in relevant accounting standards and company operating policies. Behaviourally, the FRC will expect that auditors are guided by the provisions of ethical guidelines and auditing standards in the execution of their duties to the clients, such that they would have acted diligently and exercised a duty of care. *Consequently, the FRC relates the audit quality framework to the provisions of the auditing and ethical standards, on which auditors are inspected and reported upon (Ardelean, 2013:57). Due compliance with those requirements will be interpreted as operating at a high level of audit quality, and non or partial compliance regarded as low quality.*

6.4 Determinants of audit quality

6.4.1 Introduction

Studies on audit quality and its regulation in years past have emphasised the use of perceptions in the description of audit quality and the adoption of a combination of factors in evaluating changes in audit quality. However, Humphrey (1997:4) canvassed a shift from procedural approach to conceptual approach in the understanding of the works of the auditor. He opined that auditors prefer to view and evaluate audit in procedural terms, which refer to: “A series of practices and procedures, methods and techniques” to which they aim to observe or comply. He described the conceptual approach as entailing an understanding of “Why do auditors do what they do? What do they believe they achieve? And What does the public believe they achieve?”

In the preceding section, the conceptualisation of audit quality was addressed, and key drivers were identified from the FRC UK audit AQF. These key drivers formed the basis for the textual coding of the qualitative audit performance of the Big4 accounting firms, as extracted from the FRC audit inspection reports, using Nvivo (version 12) qualitative data analysis software, the report of which was presented as Figure 5.1 in the preceding chapter. The extracts from these codes were hereunder analysed and related to the findings and perceptions contained in the literature review, for an assessment of the relevance of those drivers to changes in audit quality. There are five parts of the FRC UK AQF, and each of these was analysed in sequence below:

6.4.2 The culture of the firm

Here, the FRC is of the opinion that the attitude and believes of the audit firm, as implanted in the audit partners and staff, are expected to affect the quality of audit services provided by the firm. There are sub-areas (audit quality indicators) covered under this theme (audit quality factor), and these form the basis of our discussion.

From the analysis in Fig. 5.1, the audit quality indicators observed from the audit inspection reports, forming the nodes for the NVivo qualitative data analysis were:

i. Audit quality monitoring
ii. Client acceptance and continuation
iii. Financial consideration

iv. Investment and reward system
v. Consultations
vi. Staff reward system

6.4.2.1 Audit quality monitoring

i. Internal audit staff of clients were used on audit engagements, without adequate consideration to independence issues (see Deloitte 2007/2008).
ii. The outputs of EQCR and PSR reviews were not retained in file, hence insufficient evidence of appropriate challenge to the audit team (Deloitte 2015/2016).
iii. The internal practice review process was observed to be deficient (EY, 2011/2012).
iv. The audit quality review by the engagement partners and engagement quality control reviewer (EQCR) were observed to be inadequate and untimely (KPMG, 2010/2011; KPMG, 2012/2013; KPMG, 2012/2013).

6.4.2.2 Client acceptance and continuation

i. The acceptance and continuation policies and procedures are comprehensive, and the approval procedures are thorough (PWC, 2007/2008). The acceptance of new clients followed the firm's procedures and well documented (Deloitte 0708).
ii. The sign-off of new client acceptance was done before formal approval processes were completed (Deloitte, 2009/2010; Deloitte, 2012/2013; EY, 2010/2011; EY, 2010/2011; EY, 2012/2013; PWC, 2013/2014).

6.4.2.3 Financial consideration

i. The firm has a strategy of increased revenue drive that is not intended to impact on audit quality (Deloitte, 2020/2011).
ii. There was a perceived risk that the quality of future audits may be impacted by fee pressures on staff (Deloitte, 2011/2012).
iii. Firms were observed to have sought revenue increase from non-audit services where an increase in audit fees could not be achieved (EY, 2013/2014).
iv. Approvals were not sought from audit partners in charge of audit clients, or ethics partners before seeking non-audit services from such clients (EY, 2014/2015; KPMG, 2014/2015).

6.4.2.4 Investment and reward system

i. The firm has a good appraisal system for audit partners and staff (Deloitte, 2007/2008).

ii. There is a close linkage between audit quality and remuneration (Deloitte, 2007/2008).

iii. Inadequate documentation of audit partners being subjected to internal and external audit quality reviews (EY, 2013/2014).

iv. Non-disclosure, delayed disclosure, and insufficient disclosure of the financial involvement of audit partners and staff in audit clients' entities were observed (EY, 2013/2014; EY, 2014/2015).

v. There were no penalties for non-disclosure of financial interests in audit clients' entities by audit partners and staff in charge of such clients (EY, 2014/2015).

6.4.2.5 Consultations

i. The independent review partners evidenced their work in line with the firm's procedures (Deloitte, 2007/2008).

ii. A panel of partners was made available to audit engagement partners for consultations (Deloitte, 2008/2009).

6.4.2.6 Staff reward system

i. The firm established a close linkage between audit quality and remuneration (Deloitte, 2007/2008, and the firm's strategy supports audit quality (PWC, 2007/2008).

ii. Audit partners appraisals were required to be completed according to the firm's policy, and to give appropriate weight to audit quality considerations (Deloitte, 2008/2009).

iii. Audit directors and managers were observed to refer to cross selling of non-audit services to audit clients in their appraisal forms, contrary to the firm's policy (Deloitte, 2008/2009; EY, 2009/2010).

iv. Audit partners' promotion process was thorough and considered audit quality matters (Deloitte, 2008/2009).

v. Staff appraisal forms were observed not to include specific objectives relating to audit quality or technical competencies (Deloitte, 2011/2012; EY, 2008/2009; EY, 2011/2012; EY, 2010/2011; PWC, 2007/2008), and some partners claimed to meet audit quality objectives but were observed not to be met (Deloitte, 2012/2013).

vi. Some partners in charge of audits found with deficiencies have no such reference in their appraisal forms (Deloitte, 2011/2012). Also, there was no impact on the quality ratings of partners in charge of audits with grade 1 rating by the FRC audit inspectors (EY, 2013/2014).

vii. Promotions were observed to be granted to two partners that took credit for cross-selling non audit services to audit clients in their appraisal forms (Deloitte, 2011/2012; KPMG, 2007/2008), and internal specialists and audit partners were rewarded for selling non-audit services (PWC, 2008/2009; 2007/2008).

viii. There was no clear reference to audit quality's influence on performance rating as was clearly done of revenue drive (Deloitte, 2012/2013; 2013/2014; EY, 2011/2012; KPMG, 2012/2013; PWC, 2007/2008; PWC, 2011/2012), and audit quality considerations were not addressed in promoting audit staff to audit partners (PWC, 2011/2012; PWC, 2013/2014).

ix. Whereas actions were taken against partners with lowest grades in the firm's internal practice review, but no such action was taken against staff with recurring adverse findings from Audit Quality Review (AQR) team (Deloitte, 2013/2014), while staff received bonuses, or high overall performance grades despite being involved in audits with adverse AQR findings communicated during the appraisal period (Deloitte, 2013/2014; EY, 2008/2009; PWC, 2008/2009), and audit directors with recurring deficiencies in the firm's QE were promoted to audit partners (PWC, 2010/2011; PWC, 2013/2014).

6.4.2.7 Summary and discussion

The analysis revealed a double-faced culture of the firm with regards to audit quality. Whereas the firms agreed to the need for audit quality and formulated policies and internal procedures that reflect the requirements of auditing standards and ethical requirements towards ensuring the attainment of audit quality, but the evidence reveal a culture of non-compliance, disregard, or poor application of rules pertaining to audit quality. As detailed above:

i. Adequate consideration for independence issues was lacking in the use of internal audit staff of clients on the same client's audit engagement, and a compromise of non-disclosure, delayed disclosure, or insufficient disclosure of the financial involvement of audit partners involvement in audit clients' entities, as no penalties were meted on such staff for the infractions. This was the main factor identified by DeAngelo (1981) as driving audit quality. She postulated that a failed audit is likely in situations in which the auditor is less independent.

ii. Whereas the firms' strategy for increased revenue drive was intended for pursuit without adverse impact on audit quality, the implementation of the strategy revealed otherwise. Firms were observed to seek revenue increase in non-audit services where such increase could not be obtained from audit services, and in some cases, approvals were not sought from audit partners in charge of audit client, or ethics partners before seeking non-audit services from such clients, hence the perception of the risk of low audit quality impacted by the fee pressures on staff. This finding supports the clamour by Holm & Zaman (2012) for the emerging commercialisation culture of the audit firms to be addressed by making it a part of the audit quality framework of the FRC.

iii. The staff reward system was revealed to offer little support towards better audit performance when compared to the reward on staff revenue drive. Contrary to firms' policy of non- reference to selling of non-audit services on staff appraisal forms, promotions were observed to be granted to audit partners and staff that took credit for selling non-audit services in their appraisal forms. There was no clear reference to audit quality's influence on performance rating as was clearly done of revenue drive, and whereas no impact on the quality rating of staff involved in the audits with grade 1 rating by the FRC, staff involved in the audits which the FRC gave adverse findings and some with recurring deficiencies received bonuses, or high overall performance grades. Holm & Zaman (2012) anticipated the consequence of the lack of the commitment to professionalism by the audit firms, with consequent effects on the audit staff. They explained that being professional requires the auditor to act in the public interest and not engaging in self-service. The auditor's motivation may be unconsciously shifted from audit quality concerns to increased firm revenue pursuit, since staff reward in several cases are granted for revenue attracted to the firm and little reward, if any, are given for audit quality achievements.

6.4.3 Skills and personal qualities of the audit engagement team

From the analysis in Fig. 5.1, the audit quality indicators observed from the audit inspection reports, forming the nodes for the NVivo qualitative data analysis were:

i. Adherence to audit and ethical standards
ii. Mentoring, and on the job training
iii. Professional scepticism, and
iv. Specialist training.

6.4.3.1 Adherence to audit and ethical standards

i. The ethical policies of the firm were considered as comprehensive (Deloitte, 2007/2008; 2008/2009) and consistent with Ethical Standards (Deloitte, 2008/2009).
ii. Internal audit staff clients were used on the audit of clients in contravention of the Ethical Standards (Deloitte, 2007/2008).
iii. Audit staff failed to disclose, or made partial disclosure, or did not dispose of financial interests in audit client entities (Deloitte, 2007/2008).
iv. The response of the firm to revisions in Ethical standards were quick and timely (Deloitte, 2013/2014).
v. The firm's policies were not well applied, as omitted disclosures and other financial reporting deficiencies identified by the PSR were not noted on the audit file as required (Deloitte, 2014/2015).
vi. The firm's independent policies did not address the selling of non-audit services (EY, 2012/2013), and the concealment of intention to sell non-audit services in the staff appraisal forms was noticed (EY, 2010/2011), including audit partners seeking credit for the selling of non-audit services, contrary to Ethical Standards (EY, 2011/2012; EY, 2012/2013).
vii. Improper consideration of evidence and threats relating to the approval of forms for non-audit services procurement in audit client entities (EY, 2009/2010; EY, 2011/2012; KPMG, 2011/2012, 2015/2016; Deloitte, 2008/2009, 2009/2010, 2012/2013, 2013/2014, 2014/2015, 2015/2016).

viii. Improvements are required in the performance of analytical procedures to obtain substantive audit evidence (EY, 2010/2011; EY, 2022/2012; EY, 2013/2014).

ix. Insufficient monitoring of the staff compliance with the firm's ethical requirements (PWC, 2016/2017).

6.4.3.2 Mentoring, and on the job training

i. The written instructions from the group auditor to the component auditors were of good standard (Deloitte, 2011/2012).

ii. Insufficient involvement of audit team in component auditor's risk assessment and planned audit responses (EY, 2011/2012).

iii. The awareness of ethical principles by the audit staff of the firm were inadequate (Deloitte, 2012/2013).

iv. The firm has no guidance to audit staff on the extent of audit testing required for some transactions, such as multiple stock locations and perpetual counts (Deloitte, 2013/2014), and were not adequately trained on the audit of revenue (Deloitte, 2012/2013).

v. Differences were observed in planned and actual samples for testing of controls in the accounting system of audit clients (EY, 2013/2014).

vi. No policy for mandatory attendance of relevant industry training courses

6.4.3.3 Professional scepticism

i. The firm provides mandatory audit training to audit staff on professional scepticism (Deloitte, 2011/2012), and well attended by staff (Deloitte, 2007/2008).

ii. Insufficient application of professional scepticism (EY, 2011/2012).

iii. Insufficient evidence of the audit team's consideration of management assumptions (PWC, 2015/2016), accounting treatment of some specialized transactions, like forecasts, goodwill impairment reviews, and intangible assets arising on acquisition (Deloitte, 2017/2017; EY, 2011/2012; KPMG, 2013/2014, 2015/2016), hedge accounting, long-term contracts, and carrying value of assets (EY, 2008/2009), the application of accounting standards to the identification of operating segments (IFRS 8) (EY, 2010/2011), audit of revenue (EY, 2011/2012; EY, 2012/2013; KPMG, 2008/2009, 2013/2014; 2015/2016; 2016/2017; PWC, 2015/2016), audit of inventories (KPMG, 2013/2014), loan loss provisioning (KPMG, 2011/2012), capitalisation of internally generated costs (PWC, 2013/2014).

iv. Inadequate documentation of work performed, and the evidence obtained to support the conclusions of the internal experts used (Deloitte, 2012/2013).

v. Weaknesses in the performance of substantive analytical procedures, and inadequate challenge to management assumptions and forecasts to obtain sufficient audit evidence (KPMG, 2013/2013; 2016/2017).

6.4.3.4 Specialist training

i. The firm attaches importance to technical competence and audit quality (Deloitte, 2007/2008).

ii. The use of specialists by audit teams for specialised transactions was inadequate (Deloitte, 2011/2012).

6.4.3.5 Summary and discussion

The audit firms were observed to have comprehensive policies and procedures in place, which are consistent with Ethical Standards. However, the policies were not applied! Instances of omitted disclosures and other reporting deficiencies uncovered in the clients' financial reports by the audit engagement team were not noted on the audit file as required by the firms' policy. The selling of non-audit services was not addressed in the independent policy of the firms, and there was improper consideration of evidence and threats relating to the approval of forms for non-audit services procurement in audit client entities. It was further observed that staff compliance with the firm's ethical requirements was not sufficiently monitored and that audit staff performance of analytical procedures to obtain audit evidence require improvement. Francis (2004) had identified insufficient and incompetent audit evidence as basis for the auditors' issuance of inappropriate audit report, hence providing low quality service.

The mentoring and on the job training of audit staff was observed to require improvement. There was inadequate awareness of audit staff of the ethical principles of the firm, and there was no policy for mandatory attendance of relevant industry training experiences. The use of specialists by audit teams for specialised transactions was reported inadequate. The need for the competence of audit staff to be always ensured, through training and mentorship was identified by Francis (2011) as one the key drivers in the framework for the assessment of audit quality. Just as DeAngelo (1981) identified technical competence and expertise as pre-requisites for the discovery of misstatements in the financial statements.

The application of professional scepticism by audit staff was observed to be insufficient, as there were insufficient evidence of the audit team's challenge and consideration of management assumptions of some specialised transactions which included forecasts, goodwill impairment reviews, intangible assets arising on acquisition, hedge accounting, long term contracts, carrying value of assets, audit of inventories, loan loss provisioning, and capitalisation of internally generated costs, among others.

6.4.4 Audit process

From the analysis in Fig. 5.1, the audit quality indicators observed from the audit inspection reports, forming the nodes for the NVivo qualitative data analysis were:

i. Audit evidence
ii. Audit methodology
iii. Integrity, objectivity, and independence
iv. Quality technical support

6.4.4.1 Audit evidence

i. Insufficient audit evidence and inadequate audit procedures towards the mitigation of audit risks in the audit of group accounts (EY, 2012/2013, 2013/2014; Deloitte, 2014/2015), accounting policies (EY, 2013,2014, 2014/2015), financial statement disclosures, directors report, and trustees report (Deloitte, 2008/2009), impairment testing on goodwill and other intangibles (Deloitte, 2009/2010; KPMG, 2011/2012, 2014/2015), property valuation, loan impairment and loss provisioning (Deloitte, 2013/2014), audit of revenue (Deloitte, 2013/2014, 2016/2017).
ii. The basis of the calculation of component materiality was not adequately justified by the group audit team (Deloitte, 2011/2012).

iii. The audit team and the firm's quality control reviews failed to identify errors in the cash flow statement and in certain notes to the financial statements (Deloitte, 2013/2014).

iv. Weak audit evidence on the appropriateness of audit judgement (Deloitte, 2009/2010), and weak challenge to management assumptions, reports and spreadsheets (Deloitte, 2012/2013, 2013/2014, 2014/2015, 2015/2016, 2016/2017; EY, 2008/2009, 2010/2011, 2013/2014, 2014/2015, 2015/2016, 2016/2017; KPMG, 2012/2013).

6.4.4.2 Audit methodology

i. Insufficient audit procedures on the appropriateness and sufficiency of the disclosures in the financial statements in respect of specialised transactions, such as going concern (EY, 2013/2014).

ii. Insufficient justification of the method and size of sampling for testing of journals (EY, 2011/2012, 2013/2014; KPMG, 2013/2014, 2014/2015; PWC, 2014/2015; Deloitte, 2012/2013; EY, 2014/2015), inadequate consideration of the risk of management override of controls in respect of journal testing (PWC, 2013/2014).

iii. Audit planning procedures were not adequate and timely (KPMG, 2008/2009; Deloitte, 2008/2009).

iv. The recording of the work on file of internal specialists were not sufficiently recorded (PWC, 2007/2008).

v. Weaknesses in the application of auditing standards (Deloitte, 2007/2008), and the implementation of rotation procedures (Deloitte, Deloitte, 2007/2008, 2008/2009).

vi. The audit methodology was too general and less specific, especially for industries like the financial services sector (PWC, 2008/2009), sample size for provisions (Deloitte, 2013/2014).

vii. No documented policies and procedures to guide audit staff on consultation on ethical matters (PWC, 2010/2011), judgemental sampling (Deloitte, 2011/2012; Deloitte, 2013/2014), assessment of IT risks (EY, 2013/2014).

viii. Inadequate justification of low attendance at multiple stock counts (Deloitte, 2013/2014, 2014/2015).

ix. Inconsistency of audit methodology with the Auditing Standards, especially on setting of materiality level and risk assessment (Deloitte, 2013/2014; EY, 2010/2011).

6.4.4.3 Ethical compliance, integrity, objectivity, and independence

i. Inadequate consideration of the threats and safeguards, and the delayed or non-discussion of potential or actual breaches of ethics with the Ethical Partner in respect of financial involvement of audit partners and staff in audited entities (EY, 2013/2014), non-audit services (EY, 2013/2014).

ii. Inadequate consideration of the threat to independence and objectivity arising from non-audit fees exceeding the audit fees from audited clients, and non-discussion of the associated risks with the Ethics Partner as required by Ethical Standards in the UK (EY, 2013/2014, 2014/2015; Deloitte, 2007/2008, 2009/2010; KPMG, 2012/2013).

6.4.4.4 Quality technical report

No evidence of the assessment of the competence, experience, and objectivity of external experts (EY, 2008/2009).

6.4.4.5 Summary and discussion

The audit evidence generated during the audit process, in several cases, were observed to be weak, insufficient, and audit procedures inadequate towards the mitigation of audit risks in certain audits, especially group audits, financial statement disclosures, among others. Audit planning procedures were considered inadequate and untimely, and there were weaknesses in the application of auditing standards. The audit methodology was observed as too general and less specific, in some instances like financial services audit, and the inconsistent with auditing standards in some other instances.

6.4.5 Reliability and usefulness of audit reporting

From the analysis in Fig. 5.1, the audit quality indicators observed from the audit inspection reports, forming the nodes for the NVivo qualitative data analysis were:

i. Audit reports

ii. Communications with audit committees

iii. Proper audit conclusion – truth and fairness

6.4.5.1 Audit reports

i. Audit reports were signed before the completion of all necessary procedures (EY, 2010/2011; 2011/2012)
ii. No evidence to support the statements made in the auditor's report relating to audit procedures performed (EY, 2014/2015; PWC, 2014/2015).
iii. The audit report did not accurately describe the procedures performed by the audit team (EY, 2014/2015; PWC, 2015/2016).
iv. There were errors in the 'form' and 'signing' of audit reports (PWC, 2012/2013).

6.4.5.2 Communications with the Audit Committee

i. Uncorrected misstatements in the financial statements had not been reported to the Audit Committee as required (Deloitte, 2007/2008; PWC, 2011/2012).
ii. Insufficient reporting of errors identified and the independence threats arising from the provision of non-audit services (Deloitte, 2008/2009, 2011/2012; EY, 2009/2010, 2010/2011, 2011/2012, 2012/2013; PWC, 2011/2012, 2014/2015).
iii. Identified significant control, and financial statement disclosure deficiencies were not communicated timely to the Audit Committee (Deloitte, 2011/2012; EY, 2011/2012; PWC, 2012/2013, 2013/2014).
iv. Inaccurate communications relating to certain audit procedures, and the basis on which conclusions were reached on areas of significant risk (EY, 2012/2013, 2014/2015; Deloitte, 2014/2015; KPMG, 2010/2011).
v. Insufficient and inadequate reporting on key areas of judgment, internal control deficiencies, and the lack of clarity regarding the reporting approach to Revenue (Deloitte, 2016/2017; EY, 2013/2014, 2015/2016, 2016/2017; KPMG, 2007/2008).
vi. Inconsistencies between what was communicated to those charged with governance, and the execution of the engagement (EY, 2007/2008).
vii. Indirect communication of audit findings to the audit committee through the management report instead of direct communication to the Audit Committee (EY, 2008/2009; PWC, 2009/2010).

6.4.5.3 Proper audit conclusion

i. No evidence on the audit files of the output of pre-issuance reviews undertaken by the quality control team of the firm (Deloitte, 2008/2009; EY, 2011/2012, 2014/2015; PWC, 2012/2013).

ii. Poor application and evidencing of audit procedures in relation to certain transactions, like subsequent events, going concern, and obtaining representations from management (Deloitte, 2007/2008).

iii. Insufficient evidence on the audit files of the involvement of independent review partners on a timely basis (Deloitte, 2008/2009).

iv. Weaknesses were observed in the audit finalisation procedures (EY, 2010/2011).

v. Incomplete set of accounts were submitted for pre-issuance technical review (EY, 2009/2010).

vi. The technical department did not oversee the pre-issuance review of some FTSE 100 audits (PWC, 2007/2008).

vii. The audit finalisation procedures were not rigorous enough for significant risks and judgment to be uncovered (PWC, 2009/2010).

viii. No evidence of the firm's request for the adjustment of unadjusted audit differences (Deloitte, 2012/2013).

6.4.5.4 Summary and discussion

The audit reporting process was considered unsatisfactory, as reports were found to be signed before the completion of the required procedures in some cases, while in others, there was no evidence to support the claims of audit procedures indicated in the report.

Communications with the audit committee by the auditor were observed to be improper, insufficient, sometimes inaccurate. Matters which the auditors failed to report to the audit committee included uncorrected misstatements in the financial statements, financial statement disclosure deficiencies, and internal control weaknesses. Inconsistencies were observed between what the auditors communicated to the audit committee as going to be done, and what auditors did. The privilege of direct communication with the audit committee which would guarantee the independence of the auditor was observed to be jettisoned in favour of the auditor reporting of audit findings through the management to the audit committee. Cohen et al (2002) recommended a two-way interactive communication between the audit firm and the audit committee of the client company. Turley & Zaman (2004) emphasized that the effectiveness and efficiency of the audit committee's discharge of its governance superintendence on the auditors and client management as a necessary panacea for the improvement of audit quality. The exercised doubt about the adequacy of the performance of audit committees in the UK, given the number of infractions that occurred since its introduction.

The audit finalisation procedures were observed as weak, with incomplete set of accounts submitted for pre-issuance technical review in some instances, while there was no evidence of the involvement of independent review partners before the issuance of audit reports.

6.4.6 Factors outside the control of auditors

These are contextual matters that are external to the direct performance of the audit exercise. The issues relate to the corporate governance structure of the client, the effectiveness of the audit committees of clients' entities, shareholders' support for auditors, and the effectiveness of the regulatory actors and environment. There were no observations in respect of these in the audit inspection reports which were analysed in this study. Evidence on these will normally be based on perceptions obtainable from relevant stakeholders, and this is beyond the scope of this study. The effectiveness of the FRC was discussed in chapter two of this study.

6.5 Litigations against UK auditors at the FRC Tribunal

6.5.1 Analysis of litigated audit quality factors

From Table 5.7 in chapter five, the analysis concentrated on the audit quality factors involved as contained in the alleged and admitted facts, and the magnitude of the sanctions imposed in the judgement. Using these criteria, the study found that:

i. Much of the breaches concerned the lack of adequate objectivity and independence, or put differently, the lack of will to act in accordance with the requirements of the Auditing and Ethical Standards. It is not that engagement teams lack the knowledge of what to do, but they chose to look the other way in negation of the interest of the shareowners, and in breach of the agency theory which presupposes that the auditor should act to put the management on their toes and to protect the interest of the shareholders. An extended version of this theory is the public interest theory which expects that auditors as professionals and experts should be trusted and relied upon for objective and independent audit of financial statements.

ii. In a bid to ascertain the possible reason for the unethical behaviour of auditors and accounting professionals, the study found that majority of the instances in which the auditor's scepticism was low and the audit evidence insufficient, the auditors had non-audit services in which they engaged for the client. It then looks like the drive for commercialisation impaired the judgement of the auditors. For instance:

   a. In the case of Manchester Building Society involving the financial statements for the years 2006 to 2011, the company accounting staff misapplied the provisions of IAS 39, in respect of Hedge Accounting. The auditor was similarly involved in the provision of advisory services to the client in respect of the same subject matter. The auditor was found guilty of failure to comply with auditing standards and the provision of inaccurate information or advice during the audit. The firm was severely reprimanded and fined for £975,000.00 in addition to making payment of FRC costs of £85,000.00.
   b. In the case of Worthington Nicholls Group Plc, in respect of the financial statements for the periods 2004 to 2006, the audit firm to that client was found guilty of professional negligence and failure in the duty of care, for misstatement of the true financial position of WNG for listing purposes. The firm earned the penalty of severe reprimand and a fine of 225,000.00 in addition to the payment of FRC costs of £225,000.00.
   c. Another case of professional negligence and ethical breach occurred in the case of First Quench Pensions Fund, where the audit firm and the engagement partner were found guilty of negligence in detecting material errors in both facts and judgements, and unwillingness to identify the errors, thereby providing misleading information and advice. In this, the audit firm (name withheld as in others above) was severely reprimanded and a fine of

£750,000.00 was imposed in addition to payment of FRC costs of £1,120,000.00.

d. In yet another instance of the case of European Home Retail Plc and Farepak Food & Gifts, the audit was adjudged to have failed to comply with Auditing and Ethical Standards, with audit evidence being insufficient and the general lack of professional scepticism. The penalty on the audit firm was a fine of £750,000.00 in addition to the payment of FRC costs of £425,000.00.

iii. Other aspects of ethical breaches and compromise of independence and objectivity manifested in the cases of Pendragon Plc and Cable and Wireless Worldwide Plc (CWW) in which self-threat risk was poorly safeguarded against when a former employee of a client company was engaged on the team that audited his former employers, without divesting of his shareholding in the company. The necessary disclosures which ought to be made, especially to the Audit Committee, was not made by the firm. In the two matters, the auditors were reprimanded and fined £162,500.00 and £227,500.00 respectively.

iv. The lack of adequate professional scepticism has come to the fore in quite several cases where the quality of audit evidence has been found to be deficient, unreliable, and insufficient to support a valid audit opinion. In the case of iSOFT Group Plc, the client had inappropriately recognised revenue from a long-term contract, which was unsigned and hence not a legally valid transaction. The audit team had not been sceptical and consequently the audit evidence was insufficient. In this case, the audit firm was fined £225,000.00 and payment of FRC costs of £750,000.00, for failure to qualify the audit report on the accounts, as the situation demands. The firm was further suspended from practice for a period of eight years.

v. How fair is the tribunal to the audit firms and accountants who stand trials before them? The analyses of the cases in this study seem to have found that the tribunal had acted objectively and fairly between the Executive Counsel of the FRC, and the Audit firms. The principles under which fines and sanctions are imposed are documented in the Accountancy Scheme. Guidance has been provided too on what constitutes misconduct and when a matter gets considered as being of public interest concern. The tribunal also operates with all transparency, as all notices of hearing, statement of alleged facts, records of proceedings and the judgement of the tribunal are all published in electronic and paper forms. It is also allowed for aggrieved individual and firms to appeal to the Court of Appeal. In one instance of the case of Mayflower Corporation Plc and Transbus Plc in which an audit was arraigned at the FRC tribunal over alleged negligence in the assessment of the going concern status of the client company. The Tribunal dismissed the complaints against the auditors and a total of £900,000.00 was awarded against the FRC in favour of the engagement partner and the audit firm.

From above, it could be ascertained that while there are no major corporate collapses in recent times, it does not imply that accountants and audit firms have been free from blames over the ways in which they discharge their duties. The activities at the FRC tribunal confirm the spate of negligence and wilful breach of Ethical and Auditing Standards by firms and partners. However, the rate of litigation against the auditors is considerably lower than there was in the past.

There might not have been reported cases of corporate failures as they were in years past, the outcomes analysed above point to the fact that all is not well yet with the audit profession, though considerable improvements have been recorded.

The UK Tribunal system can be said to be fair and transparent, evidently from the documentation and publication of their detailed operating rules and procedures for imposing sanctions. Representations are allowed for the auditors to defend themselves, and instances abound in which judgments were given against the FRC, UK and damages and costs awarded in favour of audit firms. For instance, in the 2006 case an alleged negligence against Price Waterhouse LLP in the assessment of the going concern status of Mayflower Corporations Plc (see nos. 22 and 23 of Table 5.7), the tribunal dismissed the allegations and awarded £400,000.00 and £500,000.00 costs respectively against the AIDB (prosecutor) in favour of PWC LLP and Mr David Thomas Donelly (PWC LLP's staff) respectively. This resonates confidence in the tribunal system, as an impartial arbiter.

6.6 Analysis of structured interviews with management staff of the FRC UK

6.6.1 Introduction

Four structured interviews were conducted with senior management staff of the FRC UK. The interviews were necessary to obtain primary data on the operations of the FRC UK. This was necessary for the corroboration of some of the findings of the analysis of the secondary data used for the study, which predominantly came from the organisation as the main regulator of audit in the UK.

Although the number of interviews held were just four, the spread and quality of personnel interviewed provided a great deal of satisfaction. The case conduct, audit quality monitoring and FRC audit inspectorate were represented. Almost similar questions were put to the respondents at different times, supplemented by few questions which addressed the specialisation of the respondents. The responses were considered for an understanding of the driving force in the audit regulatory space in the UK, and to identify commonalities in their responses for adoption as input in further interacting with other sources of data.

6.6.2 Analysis of regulatory response to audit quality factors

The main issues following from the interviews are presented below:

6.6.2.1 Audit quality

Respondents agreed to the general view of the nebulous nature of audit quality and subscribed to the adoption of a quality framework, the elements of which are inter-related for the enhancement of the quality of professional services. A respondent informed that the FRC audit quality framework should not be taken as a measure or standard for evaluating changes, but rather, it represents an "indicators and drivers" to assist in examining the activities of the regulated firms (FRC, Respondent 2). When asked to identify the most breached audit quality indicator or driver, the respondents had diverse but informative responses. R2 suggested "the effectiveness of the audit process". R3 observed "the firm's compliance with audit and ethical standards". R4 indicate its "failure by the auditors to challenge management representation".

6.6.2.2 Commercialisation of audit practice

The respondents noted a tendency in the audit firms to pursue a policy of financial growth at the expense of audit quality. According to R2: "There is again the risk that the audit firms would be reducing the amount of audit work that they are performing to be able to achieve the right amount of profit on the fees they are charging". Other things that firm do is the reduction of audit time available, Hence R3 wondered if "the amount of audit work they are doing is appropriate to be able to achieve the right audit opinion".

6.6.2.3 Public interest mandate

While R1 believes that the FRC discharges its public interest mandate by focusing resources on public interest entities where the greatest public interest abounds. R stated that the transparency with which inspection reports and other FRC communications are made public, serves the public interest mandate.

6.6.2.4 Regulatory independence

Both R1 and R2 are unanimous in the view that the structure and operating procedures of the FRC are pivotal to the high level of independence exhibited at the FRC. The installed levels of controls and the operational checks and balances, supported by the open and transparent discharge of services, all combine to ensure independence.

6.6.2.5 Relationship with the regulated firms

R1 described the relationship existing between the FRC team and the auditors as that of "constructive tension", borne out of the need to defend each other's position, but ensuring mutual display of professionalism and respect. However, he added that collaborations exist between both teams, with a view to moving ahead in the attainment of better audit quality.

6.7 Analysis of structured interviews with staff of the practice monitoring units of professional accounting bodies in Nigeria

6.7.1 Introduction

Two group structured interviews were conducted with staff members of the professional practice monitoring units of the professional accountancy bodies in Nigeria. The first group consisted of two staff members of the Institute of Chartered Accountants of Nigeria (ICAN), the foremost accounting body in Nigeria, established by an Act of Parliament in September 1965. The second group consisted of three staff members of the Association of National Accountants of Nigeria (ANAN), established by an Act of Parliament in January 1979.

The same set of questions were put to the two groups at different sessions, and the responses do not reflect significant differences in views among both groups, hence the analysis was taken together.

6.7.2 Analysis of responses

6.7.2.1 Audit quality

The respondents conceptualised audit quality in terms of the auditor's compliance with relevant auditing and ethical standards. They considered that the skills of the audit engagement team, size of audit firm, length of audit practice, audit process and documentations are key determinants of audit quality in Nigeria.

6.7.2.2 Audit firms and audit committees

The respondents identified the lack of technical and information technology knowledge as challenges to most audit practitioners in Nigeria. They informed that the activities of the audit committee were not subjected to proper review previously, but that it is now the focus of the FRC Nigeria, through the review of the corporate governance codes in Nigeria.

6.7.2.3 Independent regulation of auditing in Nigeria

The respondents hailed the establishment of the Financial Reporting Council of Nigeria, in 2011, but took exception at the unfriendly and immoderate mode of operation and interaction with stakeholders. They noted the prevalence of tensions between the auditors and the FRC and observed that the charges of the FRC for auditors' consultation is prohibitive relative to the benefits derived. They suggested the need for the FRC to disengage from issues of accounting formal education to enable it concentrate more on its regulatory mandate. They noted that no inspection or supervision was ever made by the FRC on their professional bodies, as required by the FRC Act of 2011.

6.8 Effect of independent regulation on audit quality

6.8.1 Introduction

For the assessment of the effect of independent regulation on audit quality, the audit inspection grades assigned to the sampled audits from 2008 to 2016 were analysed for the progression of growth or decline in audit performance during the review period. This was followed by a summary of the developments relating to audit quality which arose from the regulatory approach and audit inspections of the FRC that could be considered as having contributed to audit quality in the UK and Nigeria.

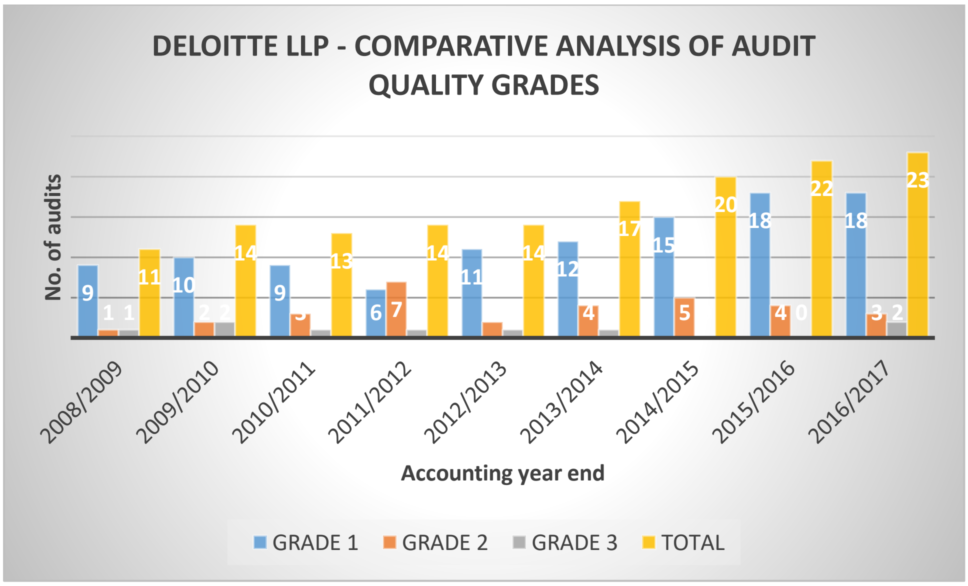
6.8.2 Analysis of audit inspection grades

6.8.2.1 Deloitte LLP

Table 5.2 in chapter five presented a summary of the audit inspection grades of samples of the audits of public interest entities conducted by Deloitte LLP from 2008/2009 to 2016/2017.

From Table 5.2, the number of good audits (Grade 1) continued to be of a higher number in all the years, except for 2011/2012, when the audits requiring improvements (Grade 2) had a greater number. In 2014 to 2015, cases abound when there were no audits adjudged to require significant improvements (grade 3) while the number of grade 3 audits which require significant improvements were just one or two in all other years. The relationship between the audits in the different classes of audit quality grades has been represented in the clustered column chart in Figure 6.1 below:

Figure 6.1: Deloitte LLP – Comparative analysis of FRC UK audit quality grades for 2008/2009 to 2016/2017



Source: Table 5.2

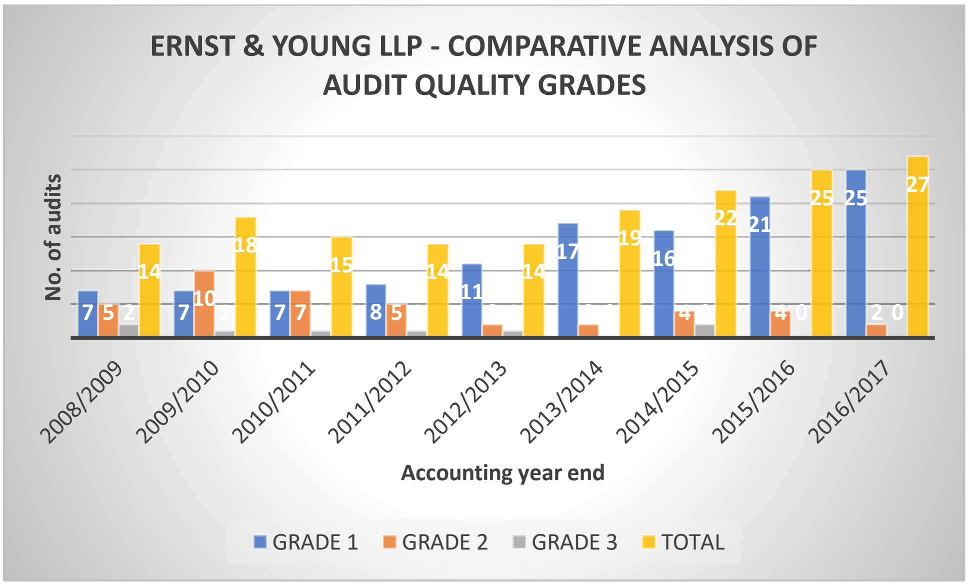
6.8.2.2 Ernst and Young LLP

Table 5.3 in chapter five presented a summary of the audit inspection grades of samples of the audits of public interest entities conducted by Ernst and Young LLP from 2008/2009 to 2016/2017.

From Table 5.3, it was observed that the number of Audits Requiring Significant Improvement (grade 3) were generally low, and in fact none existed in the years 2009, 2015, and 2016, while a high number of grade 3 audits was recorded in year 2013 at 4. There were large numbers of both Good Audits (grade 1) and Audits Requiring Improvements (grade 2) over the years. Both categories were of almost equal numbers in the earlier years 2008 to 2010, and in 2013 and 2014. However, the grade 1 audits exceeded the grade 2 audits by a wide margin in 2011, and by a wider margin in each of the years 2015 and 2016.

The comparative analysis of the number of audits in each audit quality inspection grade is presented in Figure 6.2 below.

Figure 6.2: Ernst and Young LLP – Comparative analysis of FRC audit quality inspection grades for 2008/2009 to 2016/2017



Source: Table 5.3

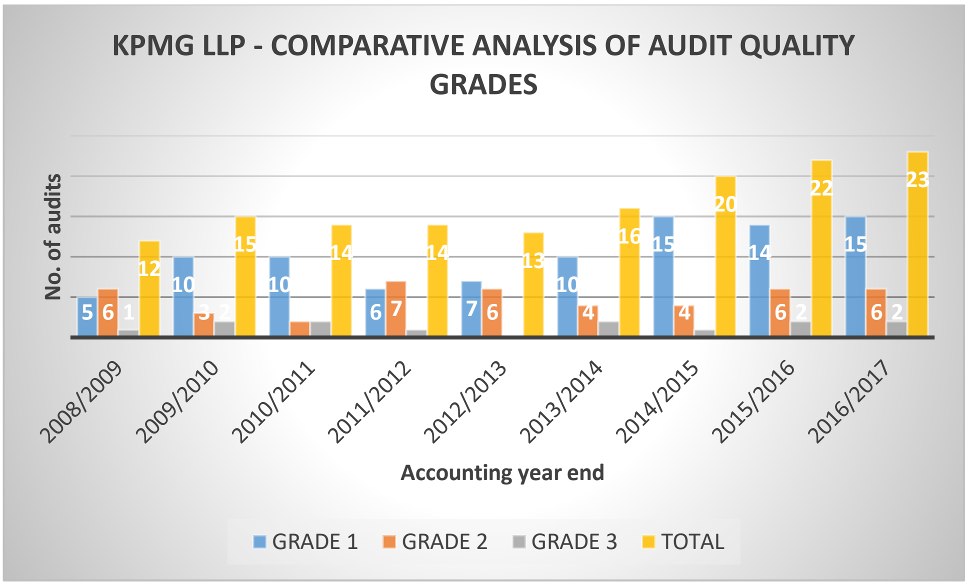
6.8.2.3 KPMG LLP

Table 5.4 in chapter five presented a summary of the audit inspection grades of samples of the audits of public interest entities conducted by KPMG LLP from 2008/2009 to 2016/2017.

From table 5.4, the number of Good Audits (grade 1) is more than those requiring improvements in all the years, except for the year 2008/2009. The number of audits requiring improvement (grade 2) appears to maintain a constant average number of between four and seven audits, except for 2009/2010 and 2010/2011 when they were lower, and stood at three and two audits respectively. Incidences of audits requiring significant improvements (grade 3) occurred in all the years, except in year 2012/2013. The annual number was between one and two audits.

The comparative analysis of the number of audits in each of the audit grade categories is shown in the clustered column chart in Figure 6.3 below.

Figure 6.3: KPMG LLP – Comparative analysis of FRC audit quality inspection grades for 2008/2009 to 2016/2017



Source: Table 5.4

6.8.2.4 PWC LLP

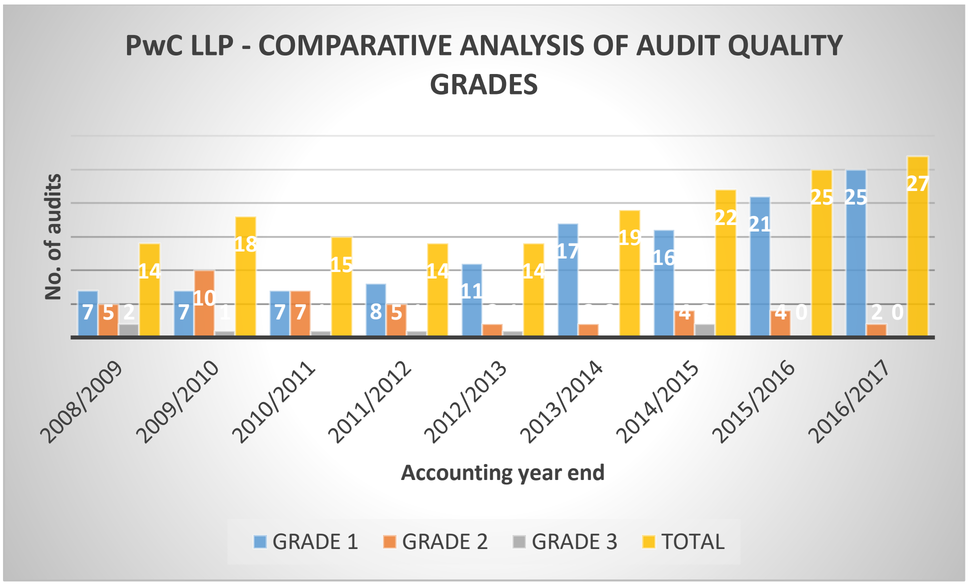
Table 5.5 in chapter five presented a summary of the audit inspection grades of samples of the audits of public interest entities conducted by PWC LLP from 2008 to 2016.

From table 5.5, it was observed that:

- The good audits (Grade 1) increased in number progressively from 2008/2009 to 2015/2016, except in 2014/2015 was a slight fall was recorded.
- The category of audits requiring improvement (Grade 2) reduced in number over the years, though not following a defined pattern. However, high numbers of 10, 7 and 5 were recorded in 2009/2010, 2010/2011 and 2011/2012 respectively.
- The number of audits requiring significant improvement (grade 3) was few, with none in three of the nine years under review, two numbers in three years and just one each in the remaining four years.

Figure 6.4 below presents the comparative analysis of the number of audit files in the respective audit quality inspection grades classification.

Figure 6.4: PWC LLP – Comparative analysis of FRC audit quality inspection grades for 2008/2009 to 2016/2017



Source: Table 5.5

6.8.2.5 Big4 UK Audit firms

Table 5.6 in chapter five presented a summary of the audit inspection grades of samples of the audits of public interest entities conducted by the Big4 UK audit firms LLP from 2008 to 2016.

From Table 5.6, the annual audit inspection samples varied between 48 and 90 representing between 2.9% and 6.9% of the population of public interest entity clients of the Big4 UK audit firms, the lowest and highest proportion occurring in 2008/2009 and 2016/2017 respectively. This proportion is considered too low to for a reliable generalisation of the attributes represented to the population of audits. However, the outcome is considered useful for the assessment of UK audit quality outlook during the review period, especially when considered in conjunction with the qualitative analysis of the textual data coded from the audit inspection reports.

Table below presents the summary of the combined audit grades for all Big4 UK audit firms, as previously presented in Table 5.6 in chapter five, with additional columns to show the relative proportion of each class of grade to the sample size in each of the years, and for the nine-year period combined.

Table 6.1 Big4 UK Audit Firms: Summary of relative proportion of audit grades to inspected audit samples for 2008/2009 to 2016/2017

Year	Grade 1	Grade 2	Grade 3	Sample Total	Total public interest clients	Sample % to Total clients	Relative % of each grade to sample		
2008/2009	26	17	5	48	1662	2.9	54.2	35.4	10.4
2009/2010	34	21	5	60	1325	4.5	56.7	35.0	8.3
2010/2011	31	19	5	55	1538	3.6	56.4	34.5	9.1
2011/2012	26	22	5	53	1476	3.6	49.1	41.5	9.4
2012/2013	39	11	3	53	1555	3.4	73.6	20.8	5.7
2013/2014	45	16	7	68	1733	3.9	66.2	23.5	10.3
2014/2015	54	19	5	78	1831	4.3	69.2	24.4	6.4
2015/2016	70	17	2	89	1759	5.1	78.7	19.1	2.2
2016/2017	73	13	4	90	1304	6.9	81.1	14.4	4.4
Total	398	155	41	594	14183	4.2	67.0	26.1	6.9

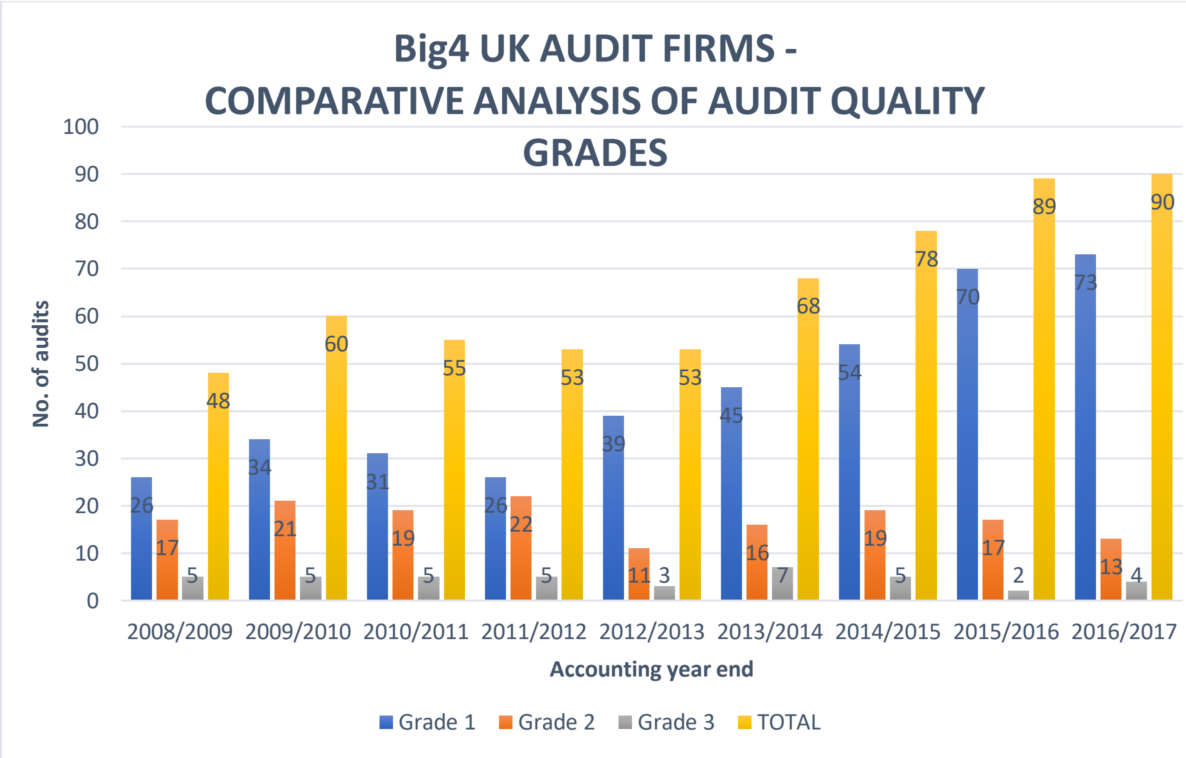
Source: Table 5.6

The analysis in Table 6.1 above does not show any specific pattern of changes in the audit quality grades, as upwards and downwards movements characterized the three grades. The good quality audits (Grade 1) varied between 49.1% and 81.1% in 2011/2012 and 2016/2017 respectively. The initial and concluding results for 2008/2009 and 2016/2017 were 54.2% and 81.1%. The overall relative proportion of Grade 1 audits to the sampled audits for the whole period combined was 67.0%. the Fair quality audits (Grade 2) fluctuated between 14.4% and 41.5% in 2015/2016 and 2011/2012 respectively. The initial and concluding results for 2008/2009 and 2016/2017 were 35.4% and 14.4% respectively, while the overall relative proportion of Grade 2 audits to the sampled audits for the whole period combined was 26.1.0%. For the low-quality audits, requiring significant improvements (Grade 3), varied between 2.2% and 10.4% in 2015/2016 and 2008/2009 respectively. The initial and concluding results for 2008/2009 and 2016/2017 were 10.4% and 4.4%. The overall relative proportion of Grade 3 audits to the sampled audits for the whole period combined was 6.9%.

The rise from 54.2% in 2008/2009 to 81.1% in 2016/2017 for Grade 1 audits can be considered as evidence of an improvement in audit quality. Similarly, the fall from 10.4% in 2008/2009 to 4.4% in 2016/2017 for Grade 3 audits can also be considered as evidence of improvement in audit quality. However, the fall from 35.4% in 2008/2009 to 14.4% in 2016/2017 for Grade 2 audits can be interpreted in two ways, depending on the other grade of audit affected by the changes in the proportion of grade 3 audits. Since the grade 1 audits experienced an increase and the grade 3 audits experienced a fall, in the base year relative to the final year, the loss in the proportion of the grade 2 audits accounts partly for the increase in the proportion of grade 1 audits over the years, hence can be considered an improvement to audit quality. With the overall proportion of grade 1 audits at 67.0%, grade 2 audits at 26.1% and grade 3 audits at 6.9%, the evidence reflects an improvement in audit quality in the UK during the period 2008 to 2016.

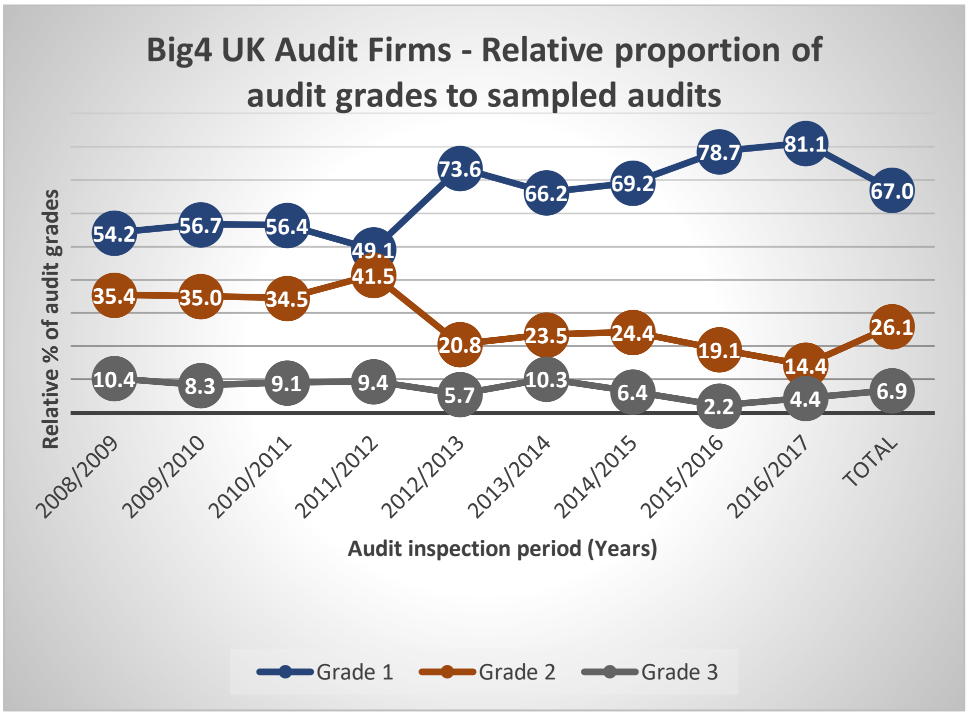
Figures 6.5 and 6.6 below present first, the categorical, and then the relative relationship between the three grades of audit performance by the Big4 UK audit firms.

Figure 6.5: Big4 UK Audit Firms – Comparative analysis of audit quality grades for 2008/2009 to 2016/2017



Source: Table 6.1

Figure 6.6: Big4 UK Audit Firms – Relative (%) analysis of audit quality grades for 2008/2009 to 2016/2017



6.8.3 Summary of developments in audit quality in the UK arising from independent regulation by the FRC UK

6.8.3.1 Increased transparency and public disclosure of information

The FRC regulatory approach and public dissemination of inspection reports has gone some ways to provide more information about the quality of services offered by the accounting firms, hence enabling prospective clients and investors to make informed decisions as to their choice of auditors, and/or choice of investments. The risk-based approach of selecting samples of audits for inspection, in accordance with its public interest perspective, and the disclosure of key areas of inspection before the inspection both provide evidence of fairness in regulation, though tensions and resistance on the part of the accounting firms were reported. The positive contribution of this factor was corroborated by Yuan et al (2020) who reported that the disclosure of the inspection reports of individual firms made audit firms to change their reporting behaviours, becoming more likely to issue qualified opinions to clients, more cautious and efficient.

6.8.3.2 Enhancement of corporate governance

The corporate governance mechanism of both the audit firms and their clients are enhanced because of the FRC's communication of inspection reports to the audit firms and the chair of the audit committees of clients in respect of which inspection reports were issued. The report assists audit firms to identify areas of deficiency and the audit staff involved, to facilitate further improvement and offer better training to audit staff, thereby contributing to improvement in audit quality. This is consistent with the views of Eldaly & Abdel-Kader (2016) that regarded the inspection findings as "valuable feedback", with a tripartite benefit to all parties involved. The audit firm is enabled to rework its processes, the client company is assisted to effect restatements as appropriate on the inspected audit and measures planned to prevent a re-occurrence, and the regulator too will take the findings into consideration when reviewing its regulatory approach.

6.8.3.3 Litigations and FRC Tribunal

The decline in the quantum and depth of audit evidence, failure to perform necessary audit procedures, breach of objectivity and lack of safeguards on conflict of interest, were part of the observations contained in the inspection reports. It is the practice of the FRC to prosecute auditors and audit firms where the inspected audits reveal infractions attributable to the professional negligence and / or non-compliance with auditing and ethical standards. The FRC tribunal offers the opportunity for the alleged auditor or firm to defend themselves. The outcome of previous litigations was presented and analysed above. Consequent on this development, the firms have become conscious of the damage that such litigations caused to their reputation, and the financial loss that may arise because of adverse outcomes. Such awareness will compel the auditors and the audit firms to exercise greater care and due diligence, hence improving audit quality in the UK. This conclusion is supported by Abughazaleh (2015) who reported that: "Big Four auditors are more conservative towards a client's financial reports as response to high litigation risk caused by stricter investor protection".

6.8.3.4 Increased audit risk and audit efforts

For the audit firms to meet the expectations of the FRC, they may need to commit more efforts in terms of audit hours, and greater investments on human resources, and audit technology, among others. This may trigger an increase in the audit fees charged out to clients but will contribute towards improved audit quality. Abdumalik & Che-Ahmad (2020) submitted that because of regulatory changes, "auditors require skill transformation and must reach appropriate judgments".

6.8.3.5 Improved audit judgment (Professional Scepticism)

A major recurring factor in the FRC audit inspection reports is the lack of professional scepticism on the part of audit engagement staff of the audit firms. This was observed as including the failure to challenge management assumptions, forecasts, and valuation, when they ought to. This factor relates frontally to the attributes of independence and competence espoused by DeAngelo (1981). The relevant question is whether the auditor lacks the technical competence to carry out such procedures. Evidence extracted from the analysis of the inspection reports reveal instances of inadequate experience, and in some cases, wilful compromise. The FRC ranked this issue as one of the thorny issues which were uncovered more frequently and continue to be of regulatory focus. Following the resilience of the FRC audit firms were noted to accept this challenge and worked on both the audit process and audit staff, and the desired improvement was acknowledged in subsequent reviews of the FRC.

6.9 Summary

The chapter presented the analyses of the data presented in chapter five, and the analysis of the structured interviews conducted for the study. The analyses were conducted according to the research questions of the study. The relevance of the public interest theory and its adaptation to the conceptualisation of audit quality in the accounting profession was examined. The analysis of the interviews was used corroboratively in the interpretation of the analysed data and in sense making in arriving at findings and conclusions for the study. The FRC audit quality grades were presented in tables and figures in comparative and relative terms, for an assessment of the audit quality outlook for each of the Big4 firms, and for all four firms combined. The chapter concluded with an assessment of changes in audit quality which arose because of the independent regulatory perspective.

CHAPTER 7: SUMMARY OF RESEARCH FINDINGS, CONTRIBUTION TO KNOWLEDGE, RECOMMENDATION, AND CONCLUSION

7.1 Introduction

This study was conceived to address the absence of qualitative studies on the effect of the activities of audit regulatory actors on audit quality in the UK. The conceptualisation of audit quality and the consequence of independent audit regulation were largely dependent on perceptions elicited from quantitative procedures without regards to the lived everyday experience of the auditors and independent regulators. Brown & Tarca (2007) observed that: “There has been limited research on the activities of enforcement bodies and different approaches to enforcement”. Humphrey (1997:26) expressed the need “to develop understanding of the practical activities of auditors, not from the basis of hypothetical laboratory experiments but from detailed studies of the lived experiences of auditors in real contexts”. Similarly, Berg (2000) in Dabbler (2006) called for “future research to aim at obtaining a better understanding as to why and how regulatory decisions affect business performance”. Yin (2009:9) stated that “how and why questions deal with operational links needing to be traced over time, rather than mere frequencies or incidence”, a gap now filled by this study in the assessment of the impact of independent regulation, as typified in the Financial Reporting Council, UK, on the audit quality outlook of the UK.

To achieve the above objectives, the two Financial Reporting Councils (FRC) of the UK and Nigeria were selected as case studies for a cross country comparative evaluation of their structure and operations, and strategies. The Big4 UK audit firms constituted the units of analysis and the core data for the research consisted of the FRC audit inspection reports and judgments decided by the FRC Tribunal. Interviews were conducted on staff of the FRC and professional accounting bodies for a better understanding and interpretation of the inspection reports as related to the audit quality outlook in the case study countries.

7.2 Summary of research findings

The followings were the findings from the study:

7.2.1 Conceptualisation of audit quality

The study found that the opaqueness and nebulous characteristics of audit quality is gradually fading, and successes have been recorded towards ascertaining how and when the quality of professional services, such as auditing, can be determined. The progressive understanding of audit quality resulted in the near consensus that multiple factors, instead of single factors, are better determinants of audit quality. Significantly, the FRC UK is the first regulator to adopt an audit quality framework, in 2008, for the conduct of audit inspections.

The study revealed that the FRC conceptualised audit quality in terms of key drivers some of which researchers previously regarded as non-observable because of the ignorance of users of professional services about the methodology and procedures for dispensing professional services, such as the audit process and reporting procedures. The FRC through the expert inspection and review of the audit firm’s culture, audit process, audit competence, and audit methodology has removed the veil of non-observability and provided reports on those matters for public knowledge and decision making.

It was found that the FRC considered the public interest policy as a major influence in its conceptualisation and regulation of audit quality. It was included as part of the audit quality indicators adopted as yardsticks for audit inspection, and it was considered in the selection of samples of audits for inspection, as the inspected audits were selected only from public interest entity clients of the Big4 audit firms.

7.2.2 Determinants of audit quality

The study represented a shift from the use of perceptions to direct observation, for the understanding of the determinants of audit quality, as the research data consisted of reports on the activities of direct participants in the provision of audit services.

The study revealed a double-faced culture of the firm with regards to audit quality. Whereas the firms agreed to the need for audit quality and formulated policies and internal procedures that reflect the requirements of auditing standards and ethical requirements towards ensuring the attainment of audit quality, but the evidence reveal a culture of non-compliance, disregard, or poor application of rules pertaining to audit quality. Common areas of observation included the use of internal audit staff of clients on the audit engagement of the client, financial involvement of audit staff and partners in audit clients' entities, revenue increase drive and immoderate pursuit of non-audit services, and a staff reward system that pays rewards the selling of non-audit services without corresponding reward for contributions towards higher audit quality in the firm.

The study found that the application of professional scepticism by audit staff was reported as insufficient, as there were insufficient evidence of the audit team's challenge and consideration of management assumptions of some specialised transactions which included forecasts, goodwill impairment reviews, intangible assets arising on acquisition, hedge accounting, long term contracts, carrying value of assets, audit of inventories, loan loss provisioning, and capitalisation of internally generated costs, among others. Was the lack of scepticism due to a lack of competence in understanding what to do, or a wilful compromise of independence? The analysis of the pleaded facts in the FRC Tribunal cases indicate a lack of the required professional independence, integrity, and objectivity, rather than incompetence.

The corporate governance system of the client entity is intended to be strengthened through communication of significant issues and processes relating to the audit to the audit committee of the client entity by the audit firm. It was reported that the audit firms' communication with the audit committee were observed to be improper, insufficient, and sometimes inaccurate. Matters which the auditors failed to report to the audit committee included uncorrected misstatements in the financial statements, financial statement disclosure deficiencies, and internal control weaknesses. Inconsistencies were observed between what the auditors communicated to the audit committee as going to be done, and what auditors did. The privilege of direct communication with the audit committee which would guarantee the independence of the auditor was observed to be jettisoned in favour of the auditor reporting of audit findings through the management to the audit committee.

The audit finalisation procedures were observed as weak, with incomplete set of accounts submitted for pre-issuance technical review in some instances, while there was no evidence of the involvement of independent review partners before the issuance of audit reports. Similarly, the documentation of audit evidence in the firms' files was found to be inadequate.

The study observed that few cases of corporate failures and auditor litigations were reported during the period, compared to past times when such scandals made headlines in the news. However, does not translate to improved diligence and public service for the auditors, as the avalanche of independent and ethical breaches revealed in the FRC Tribunal judgments, and the resultant huge reputation and financial losses suffered by auditors and audit firms in terms of fines, penalties, costs, reprimands, and in few cases, suspension from practice for a period or outright withdrawal of practice license, proof otherwise.

7.2.3 The effect of independent regulation on audit quality

Based on the analysis of the audit quality grades assigned to inspected audits by the FRC, the study found a satisfactory audit quality outlook in the UK. Of a total of 594 inspected audits, 398 were scored as high in quality (67.0%), 155 were scored as fair in quality (26.1%), and the remaining 41(6.9%) were scored as low in quality. The movement in audit quality in the years under review did not follow a regular pattern to allow for predictability, however, improvements were observed more in the later years than in the earlier years, thereby reflecting the positive effect of the regulatory feedback to the firms.

The study found that there was increased transparency and public disclosure of information, which allows the management of the client entities and the public to understand the quality of the audit services offered to them and to make informed decisions based on the information at their disposal. The quality of financial reports was positively impacted by the independent regulatory regime, as auditors were observed to be more cautious and mindful of the reputation damage and / or financial loss which may arise from the FRC's disclosure of adverse findings on the firms' audits, or adverse judgments from the FRC Tribunal.

7.3 Contribution to theory and knowledge

The study contributed to debates on the public interest theories by relating the observed practices of the inspected audit firms, and the regulatory approach of the independent regulator to the basic tenets and expectations of the public interest theory. The consideration of public needs in the risk-based mode of inspection sample selection, and the release of inspection reports as feedback to the public, were considered in this study as motivational for the increase in public confidence in the audit outcomes as an instrument for investment decision making. The study further revealed that the audit firms have not been acting sufficiently in the public interest as claimed. The study provided a practical explanation of the basis of classifying accountants into theoretical perspectives of public interest. The normative perspective is the perspective which captures the features of the public interest ideology claimed by the accounting profession. However, when accountants operate in self-serving ways, despite claims of public interest mandate, the appropriate perspective is the abolitionist perspective.

The use of qualitative method represented a major shift from the common application of quantitative methods to practice based issues which are best researched in the context of their lived day to day experiences.

The study is novel in its use of the textual report of the audit firm-specific inspections of the FRC UK towards the understanding of the conceptualisation of audit quality.

It provided a guide for policy initiatives for the strengthening of audit regulation, especially in developing countries like Nigeria.

7.4 Recommendations

It is recommended that the FRC should continue to insist on the audit firm giving the audit engagement team the freedom to exercise their professionalism, through independent and objective discharge of their audit functions, without being subjected to pressures were observed to come from the commercialisation drive of the firm. In the submission of Broberg et al (2018), the professional identity of the auditor should be allowed to prevail over their organisational identity, without repercussions.

It is also recommended that the size of the sample of the audits to be inspected by the FRC should be increased, if possible. The sample selection for the nine-year period covered by this study was found to be between 2.9% and 6.9% in the first and the last years of the study period (2008/2009 and 2016/2017). It is satisfying to note that the sample size increased progressively from 2012/2013 to 2016/2017.

7.5 Suggested areas for further research

This study is a doctoral thesis which is limited by the scope of the study as approved by the university, quantum of data available for use, and the time available for the conduct of the research. Consequently, the researcher recommends that more studies be conducted in related areas of the study as suggested below:

- An assessment of the effect on the market value of the equity of entities with audits that the FRC classified as requiring significant improvements.
- An assessment of the responses of the audit committees of public interest entities to the FRC independent regulatory intervention.
- Evaluating the challenges faced by audit staff of firms with excessive commercial drive.

It is considered that a look into the above will assist in promoting audit quality.

7.6 Limitations to the study

The study suffered from the non-availability of primary data from the Financial Reporting Council, Nigeria, which did not grant access to their management personnel for structured interviews to be conducted at the time of data collection for the study, hence limiting the evidence for the evaluation of audit quality in Nigeria. This accounts for the seemingly overdependence on UK data, where the FRC UK provided tremendous support and access. Attempts at obtaining primary data from the staff of the Big4 firms in the UK and Nigeria, and the professional accountancy bodies in the UK, were unsuccessful, for the corroborative views of these stakeholders to be evaluated alongside the data obtained from the FRC, UK. It was only the Institute of Chartered Accountants in Scotland that responded to the request for access. Furthermore, the details of the client entities whose financial statements were sampled, was not contained in the FRC audit inspection report for the period covered by the study. This information has been provided in reports of subsequent periods.

Notwithstanding the above limitations, it is assured that the process and findings in this study remain valid.

7.7 Conclusion

The study concluded that the improvement in audit quality in the UK during the study period, as found in this study, is attributable to the independent regulatory perspective, represented by the FRC in the UK. The detailed audit inspection reports which is the outcome of the rigorous inspections conducted by the experts in the audit inspection team of the FRC, facilitated the discovery of the mode of operation of the audit firms. This discovery was considered in the academic literation as non-observable (Duff, 2009), hence falling on the use of perceptions or proxies for the evaluation of audit quality (Kilgore et al, 2014). More contributory to the improvement in audit quality in the UK is the FRC's policy of public disclosure of its findings in the year of inspection. Other regulators, especially the PCAOB in the USA do not publish adverse findings from their inspections until a year after and will only be published if the firms do not carry out the recommended corrections in the report (Eldaly & Abdel-Kader, 2016). This study considers the transparency of the FRC UK as the foremost factor that facilitated the improved audit quality outlook in the UK.

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APPENDIX

APPENDIX 1

FRC Financial Reporting Council

Mr Alexander Akinduko
Doctoral Student (Accounting and Finance)
Manchester Metropolitan University
Manchester
M15 6BH

24 March 2015

Dear Alexander

Nomination of Financial Reporting Council (FRC) UK as Case Study

I refer to your emails on the above subject matter in which you sought approval for the use of the FRC as a case study for the purpose of your doctoral research, investigating the effect of independent regulation on audit quality in the United Kingdom.

I am pleased to convey approval for the project. Although we are usually busy, we are able to schedule a series of meetings to facilitate the conduct of your research and the collection of necessary data in support.

It is hoped that you will avail us of the outcome of your research which we believe will assist us further in enhancing the quality of audit in the UK.

I would envisage that my colleague Mark Mainwaring will be your primary contact for this exercise and he will meet with you in the first instance, but other colleagues may be involved from time to time.

While appreciating your interest in our organisation, we assure you of the best of our cooperation. Please contact the undersigned for further necessary actions.

Yours sincerely

AG Jones

Andrew Jones
Director, Audit Quality Review
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TRANSCRIPT OF INTERVIEWS CONDUCTED AT THE FINANCIAL REPORTING COUNCIL, UK

INTERVIEW 1 (APRIL 2015)

Interviewer (I): Good morning sir. I am Alexander Akinduko from Manchester Metropolitan University, Manchester, United Kingdom, and a doctoral research student conducting a study on: 'The Assessment of the Effect of Independent Regulation on Audit Quality in the United Kingdom – Lessons for Nigeria', using the Financial Reporting Council (FRC), UK as a case study. Can I meet you please?

Respondent 1 (R1): Yes, you can. My name is Paul George, an Executive Director (Conduct) within the FRC.

I: Thanks for that. I will be asking a couple of questions which are about eight in all, lasting not more than 45 minutes. I will appreciate your time and attention. Can we go ahead please?

R1: Yes, you can.

I: What is the main objective of the FRC as an independent regulator of audit in the UK, sir?

R1: I think first, we need to start with the FRC overall mission which is set out on our web pages, which is based on governance to foster investments, but I will like you to get the precise words from our website. Aside from that, many features of our ...... objectives in terms of regulation is first to make sure that we discharge our regulatory responsibilities. So, we got fresh powers delegated to us from government and we need to ensure that we properly discharge those powers. In discharging those powers, we seek to ensure overall continuous improvement in audit quality, and where we find deficiency in audit quality, we need to make sure the people are made to account, at least to drive and provide improvement in quality.

I: Thank you. Talking about government delegation of power to the FRC, how does the statutory backing, structure and composition of the board of the FRC position it for the effective discharge of her responsibilities?

R1: Hem, first of all, we have a unique start with company law. The Company Law sets out what is required for audit regulation. The Secretary of State for Business is given necessary powers. He delegates authority to the FRC to undertake various activities through the FRC board. The FRC board is a fully independent board comprising of a number of non-executive members and three (3) executive members. It then breaks its activities down into Codes and Standards, and Conduct activities, and established committees to oversee works in those areas and report back. The Codes and Standard Committee supports the development of appropriate auditing and ethical standards for auditors, and the Conduct Committee ensures there is appropriate monitoring and enforcement of audit quality regulation in the UK. I will refer you to the website for the FRC regulatory philosophy and structure for more information that can provide you with detailed information to write your report.

I: Thank you. Still on that question 2. Is there a deliberate choice of board members in a way that ensures that those that you supervise are not on the board?

R1: Again we got ..., currently we have those within our Articles of Association, around have committees that would not have any practicing auditor or officers of professional bodies that we supervise, on our board. What we then would be doing as we implement the statutory directive, we will make sure that, we have to make sure that nobody involved in the bigger decision making will have practiced auditing within the last three years of being a member of audit firms we regulate, but it is something we would be implementing by June 2016. There is a further refinement in terms of .... We also have Articles of Association that has provision around labour choices as well, and in calculating whether we chose our labour choice from those we regulate, we look to see ...., we use a three year period. I need to check our Articles of Association, in fact it will quite be a useful document for you, which would then set out what we put in therein in terms of governance. If it is not on our website, I will make sure it is forwarded to you.

I: Thank you very much sir. Funding is another important issue when it comes to organisational independence.

R1: Yes.

I: How is the FRC funded, and of what effect is this funding pattern on the independence of the FRC as an audit regulator?

R1: The funding structure is quite complicated within the FRC and it is set out in details in the Annual Plan Budget, but at a high level. There is the funding of the FRC. Majority of our work .... The funding of the normal audit inspection activities and non-disciplinary activities are from a combination of levies on public companies, contributions from Insurance and Pension companies that perform actuarial activities, contribution from private companies and public sector bodies who use our standards or subject to our monitoring enforcement, and a very small contribution from government, and that has been diminishing over time. Ten years ago, this item, non-inspection and non-disciplinary activities was funded 1/3 by government, 1/3 by business and 1/3 by the profession, but over time the percentage of funding by government has reduced significantly, so it is a very very small proportion now. Our audit inspection activities is funded by a charge to the professional bodies, who register audit firms or give the audit firms a licence to conduct audits. They are not able to influence the contents of the budget. We tell them or we calculate what we believe is required. We tell the professional bodies how much that is, and it is free from their interference and they have to recover the costs as appropriate from their member firms. The disciplinary activities in terms of investigation costs beyond a small central team of professional disciplinary is funded by our general levies first of all, and then the incremental cost of investigating individual cases is charged to the professional body whose member is investigated, and again the body is required to provide funding and it does not have a role in agreeing what the budget would be.

I: Thank you very much sir. We now want to go to the engagement team that are involved in the actual audit inspection exercise. The task of audit regulation and supervision requires technical skills and expertise in accountancy, with the consequence that majority of your staff members that are involved in the audit inspection might belong to professional accountancy bodies supervised by the FRC, or are ex-employees of those large accounting firms whose works are being inspected. What is the likely impact of this on the independence and quality of inspection work by such staff?

R1: First of all, it would be impossible have been experienced in auditing and the firms that we inspect. The easiest criticisms that they can make of us is that: 'your staff are insufficiently experienced. So, we guard against that by trying to recruit qualified people. We have various provisions within our operating procedures to ensure that we do not send inspectors to inspect audit firms where they have recently left. We got a sort of high curriculum in terms of the number of years that a practice, because most of the individual practitioners, the industry staff member firms that would be any threat to their independence and there is a further safeguard which is, the outcome of their inspection activities right down to the majority of the individual engagements that have been reviewed, are reviewed by the independent committee.

I: Thank you very much. How would you describe the relationship between the FRC and the supervised Recognised and / or Qualifying Professional Bodies, such as the Institute of Chartered Accountants, England and Wales (ICAEW) or Association of Chartered Certified Accountants (ACCA)? I mean the impact of your regulatory works on the professional bodies in terms of relationship.

R1: In some areas, we operate, or seems to operate, in a collaborative way with the professional bodies, that is around the development of standards and in ensuring that their members understand the best practices. We also have a responsibility to determine whether the bodies should continue with their recognition, and that ...., we act as a regulator of the professional bodies, and is like any relationship between regulator and regulate, there is some constructive tension from time to time, in that no one likes to be challenged by the regulator and therefore rightly the firms want to make sure that where we do challenge them, are our challenges proportional? Are our challenges valid, and delivered in the right way? I think that given the natural relationship between the regulators and regulate, that relationship is very constructive. There is a further complication in that relationship, and that is that the professional bodies have dual responsibilities. They have regulatory responsibilities and they have responsibilities to promote their members' interests, and again in promoting members interest. In that process, we have dialogues with professional bodies where their members feel that we have been over-challenging in delivering our regulatory objectives. It is a complex relationship but I will consider it a constructive relationship.

I: Thank you very much. It would look like the large accounting firms represent the image of the profession in terms of measuring activities within the accountancy profession. That takes us to the next question. How will you describe the relationship between the FRC and the large accounting firms in particular, that serve as auditors of public interest entities?

R1: Again in many ways it is similar to our relationship with the professional bodies. Probably, on balance, I will suggest it is slightly more constructive, because I think the major firms recognise that it is in their main interest to ensure effective regulation. I think that it is somewhat different when you move there from the very large firms to much more smaller firms where regulation can appear disproportional to the smaller firms and therefore they don't necessarily see much of the benefits to their business. Whereas, if you are a major firm, and the firms want to have an effective regulatory regime because if the regime is not effective, then government will have to change it, and that might bring something which ..... soil the constructive relationship that we got with them. I think they are all aware of the codes and standards, the relationship is particularly constructive because we draw from their own expertise and their knowledge, and I think their firms respect our formation. If you then look at it from our monitoring and enforcement activities, I think if we look at monitoring first of all, the relationship with the major firms is believed will benefit for good and our focus has made them focus a lot more on audit quality. So, the leadership will consider our inspections to be in positive to total audit quality in the UK and therefore that safeguards their interest. I think, inevitably, the individuals in the engagement teams that are subject to a detailed review will not want to be criticised. There are strong incentives within the firm for them to get high grades from our own assessments. That has an impact on their own peer evaluation process within the firm and therefore there is a constructive tension between the partners and engagement teams not wishing to be criticised and trying as hard as they can to minimise the impact of our assessments. You then have to look at the relationship between the firms and our disciplinary activities, and the stakes are lot higher there and therefore the relationship with the firms is tough but remains very professional and very constructive, and the external legal resources that the firms will employ to mitigate the reputation risk, make it very hard for a serious process. A disciplinary process is an adversarial process. Ultimately, we take a matter to a tribunal and we operate at the tribunal as a prosecutor at the FRC presenting its case and the defender presenting its case, and they are very robust discussions, but that is to be expected for a serious system. The relationship with the major firms remain constructive.

I: We have been looking at some aspects of your previous work. Research studies on cross-national audit regulatory regimes such as in Canada and United States of America indicated a lack of significant improvement in audit practice and quality, according to Kleiman (2013), but your own organisation, the FRC, has adjudged the UK audit climate as fair. Looking at the analysis of some of your recent inspection reports, we found that the 'good' audits were steadily on the increase between about 40% in 2009/2009 to about 60% in 2013/2014.

R1: And that would be higher in 2014/2015 when we publish our results in a few months' time.

I: The total audits requiring improvements then equally went down from about 60% in 2008/2009 to as low as 40% in 2013/2014. We can see a kind of opposite movements with the 'bad' audits declining and the 'good' audits increasing. That trend looks different from the international trends in America and Canada, for example. So, the question now is: What in your opinion accounts for the difference in the situation in the UK?

R1: Quite a difficult question for me to answer. I spent a lot of time with the major regulators of the United States and regulators internationally. I think that the level of transparency that the UK has in terms of its audit inspection work is a force for good. The fact that we assess the overall audits which we inspected and are transparent about that assessment, provides good incentives for the firms to improve. The fact that we provide that assessments and the details to the audit committee chair of the entity that we have inspected adds to the incentives of the firm to make improvements. We haven't yet seen the impact of increased tendering, but if you got a scenario where you got a very transparent audit regulator, and audit committees .... having access to information, and seems to determine which auditors to use, there is incentives for firms to get things right. I used to think that the UK firms have devoted a lot of resources in seeking to improve what they do, which is a very good one.

I: Thank you sir. My final question is a two part question, and that concerns the public interest perspective of the audit work. There are demands in the academic literature in recent times, particularly from Christopher Humphrey, Prem Sikka and quite a lot of leading accounting researchers saying that there is a need for a shift from the technical view of accounting to the social view of accounting that encapsulates the public interest framework, since the profession derives its powers , social powers, from the state, and they are meant among others, not just to serve the shareholders but the stakeholders as a whole. With that, how is the public interest framework served in your approach to audit regulation; and what difference has your method of regulation made over the ones previously used by professional bodies in addressing the same issue?

R1 First of all, we assess the performance of auditors against the standards they are required to follow, and therefore it doesn't meet the Prem Sikka's observation you have just cited, because we don't assess auditors through the Prem Sikka's lens. We assess auditors in terms of the legal framework. There is a legal framework to establish what the auditor is required to do which is underpinned by auditing standards and underpinned by our monitoring. So we make sure firms do what is expected of them. In terms of 'how do we think about public interest'? We focus our resources on inspection of audits where there is the greatest public interest, and the public interest in that regard is where there is the greatest amount of investments. Quite often, that also links to the greatest amount of employment as well, but it's focused on large public companies because large public companies are where pension funds are invested, so that's where we focus our public inspection activities. In respect of our disciplinary activities, we rarely undertake cases where we believe that there may be misconduct and the matter in question is a matter of public interest. Cases which do not meet the public interest test, the professional bodies will be asked to investigate. The second part of your question which is the difference which the FRC makes from the professional bodies, we have made a significant difference in that, I believe, their own monitoring and disciplinary schemes have developed over the years in which we have been overseeing their work. We believe that the focus of their ow inspection activities is much closer to our own processes now, compared to where it was before we first start off, and there is a good level of dialogue between the respective teams and a good level of dialogue in terms of what is a .... system. We have ensured that the professional bodies think about the competencies that is required to be a good auditor and remained focused, and think about wanting the auditor to ensure good quality.

I Thank you very much. I want to thank you for your time and attention, and for coming up for this interview. Please permit me to revert to you again for further clarifications, if any.

R1 Okay, thank you.

TRANSCRIPT OF INTERVIEWS CONDUCTED AT THE FINANCIAL REPORTING COUNCIL, UK

INTERVIEW 2 (APRIL 2015)

Interviewer (I): Good morning sir. I am Alexander Akinduko from Manchester Metropolitan University, Manchester, United Kingdom, and a doctoral research student conducting a study on: 'The Assessment of the Effect of Independent Regulation on Audit Quality in the United Kingdom – Lessons for Nigeria', using the Financial Reporting Council (FRC), UK as a case study. Can I meet you please?

Respondent 2 (R2): Yes, you can. My name is Mark Mainwaring, I work in the Audit Quality Review (AQR) team and I am a member of the central team which is responsible for audit quality control and technical issues.

I In view of the nebulous nature of audit quality, what is the FRC's conception of audit quality?

R2 I think it is right to say that audit quality is a difficult topic, quite difficult to clarify, and so the FRC in a bid to have written document to try and identify and create a framework within which reporting should take place. I think audit quality is something not so much definable but which is identifiable from some characteristics of any audit one might look at, say for example, if one wants to think of what audit quality might look like in an individual engagement, one might think it could be demonstrated by a number of factors, for example, there was an audit opinion which could be relied upon (reliable audit opinion); that audit opinion was based on sufficient, appropriate audit evidence; and that the audit team that performed that work have a number of characteristics, for example: they demonstrated appropriate independence and complied with the ethical requirements which underpin their audit; they were sufficiently knowledgeable and experienced to carry out the audit and have sufficient time and resources allocated to do the work properly; their audit was a rigorous one which demonstrate efficient professional scepticism in challenging management, and that their audit was undertaken suitable quality control; they provided timely and valuable report; the auditor interacted appropriately with the various stakeholders, for example, the audit committee that is charged with governance, who were the recipients of their audit report. Again, I think those qualities are probably the fundamental ones that underpin what good quality audit looks like. Obviously, depending on the circumstances of individual audits, audit quality can be slightly different depending on the complexities and difficulties being by the engagement team working on it, but I think that is the basic fundamental qualities that defined audit quality.

I The FRC was reported as the first regulatory body to come up with an audit quality framework (AQF), See Holm and Zaman, 2013. How in your opinion, does this framework represent an adequate measure of audit quality?

R2 By definition, it is a framework and therefore it doesn't go into the significant amount of details as to the factors. I think it refers to the drivers of audit quality and also refers to various things which should be indicative of that quality. It is a relatively short document , I think the IAASB document which came along five years later, probably, is at least three or four times longer than the FRC document. I think the indicators which we just set out in the FRC document and then are good indicators of what audit quality are. I think for example if you want to say that an audit didn't have a number of these indicators. I think that would probably be indicative that the audit wasn't one of good quality. So, for example, if you are looking at one of the drivers, culture within the audit firm, one of the things we mean there is for example to deal with difficult issues as they arise. So, for example, you said one of the partners in the team don't have time to deal with the difficult issues as they arise, you would probably think that it would suggest that there were problems in the quality of the audit, and therefore the framework provides a good structure within which the audit must be carried out, and I think in response to the first question, it is the specific things to be done by the team in relation to the circumstances of an individual engagement, within the overall structure of the framework which will ultimately decide whether the audit was being done to a good standard or not.

I Which factors have you observed to have been most breached by auditors, since the adoption of the AQF in 2008?

R2 Okay, I think you could see a variety of problems here. I say, probably, the principal driver they get breached most often, is probably 'the effectiveness of the audit process', when they might discuss a little bit later some of the problems which might arise on an audit, makes often the ability of the team to do the right work in relation to the issues of that engagement is probably when you first met the problems, the question then arises of why the ____ work was not being done appropriately, it could be, for example, the audit team don't understand the significant risks in relation to that particular engagement, they don't understand well enough the business issues surrounding that client, their understanding of the client is deficient. It could be for example, that the attitude of the partner to the engagement is wrong to be heard off and therefore his level of proper view as to the top of procedures that will be performed actually is not good enough. So, it could be a whole number of factors which contribute to the audit not being effective. I think probably, the effectiveness of the audit is probably the key one, one can see some of the cultures in the firm issues affect the audit in terms of the audit team doing the right thing, may be because of time pressure, may be the team have not identified what the right thing to do actually is. I think the effectiveness of the audit process is probably the key one.

I Of concern to researchers, is the seeming neglect of the entrepreneurial or commercialised nature of audit practice with emphasis on profits as a driving factor over and above the provision of independent services to meet the expectations of the state and public. How does your AQF and inspection procedures address these concerns?

R2 In the Audit Quality Review Team (AQR) of the FRC, we are always conscious that the audit process operates within an entrepreneurial environment that ultimately audit firms are conducting a statutory requirement to conduct the audit. They are doing so within the environment where there they are ultimately making profits, and therefore you almost find that conflicts to some extent between the firm which is conducting audits in a commercial environment was at the same time being subjected to the requirements of the ISAs and the legal requirements to conduct the audit in appropriate manner. Now, in terms of our inspection procedures, we are always aware of that issue, and our inspection focus a lot on both how the audit was conducted and quality and sufficiency of the audit evidence which the audit team gathered and the way in which it reached its professional judgement on the most difficult risks and issues in the audit, and we also look at the firm wide procedures within the organisation, that is, how the firms conduct their audits across a whole number of areas, so we can see the way the firm has complied with the independently selected issues, we look at the tone at the top and the culture within which the audit is conducted. We look at the way the training and challenge is done, the extent to which the audit team consulted and seek independent view on difficult issues that arise from that particular engagements. So we are trying to see the degree of proper scepticism challenge which is performed by the team. The auditor must ensure that the commercial entrepreneurial factor does not take charge of the audit, and so, we on occasions, not very often, but occasionally, we issue query letter to the firm which also goes to the Chair of the Audit Committee for that engagement, the extent to which the number of hours on the audit must not be lower than they might, and would expect, auditors of that size and prestige, and we will also query the degree of professional scepticism which has been applied by the audit team and whether they have been rigorous enough in evaluation of complex issues within the audit, and therefore we always have on our side, a sceptical mind set as to whether the audit has satisfied its own professional requirements, operating within its commercial environment, because it is a threat that we as a regulator look at the audit in an impartial way and say whether the audit has been done to the requisite standards we would expect, given the risks surrounding it and therefore we are ______ both aware of the conflict and are prepared in our individual letters on the engagement ultimately communication to the Chairman of the audit committee where we think the audit team might not be as rigorous as it should have been.

I What in your opinion is the effect of the global transformation from industrial capitalism to finance capitalism, with the attendant influx of specialised and opaque assets - some of which defy accurate understanding and valuation – on the competence of audit firms and auditability of financial statements?

R2 Under the audits of the financial and banking sector, it would be a significant issue we intend to see a high level of competence in those areas, and indeed a number of specific specialists which the firm employs and are actively involved in those audit engagements. We haven't seen many significant findings arising from audit on these areas, probably because the firms are well aware of the potential harms that could be done in these areas not being audited properly, and therefore it hasn't been one of our major findings in the last two or three years, although our banking thematic review which we published earlier this year was and did find its origin Certainly, there is actually no doubt that the increase in a range of complex financial instruments obviously in the last ten years has grown from situation where perhaps they were wrongly seeing in a route of a small number organisations, they are now seeing those derivatives as ____________ as a complex instruments across a lot of the engagements which we now inspect, and therefore the ability of quite a lot of auditors to be able to audit these things now has gone far beyond just a few specialists who will be required to deal with this, and as with any type of new requirement it is incumbent upon the firms to ensure that there is sufficient degree of understanding and expertise in the firms in order to be able to audit these type of investments which lead to a lot of assets and liabilities. Do we see that level of competence in every single audit and every single member of every team? We probably haven't reached that stage because it is a very difficult area and it's an area that is extremely different to the type of more traditional auditing you might see in retail environment or the construction industry and a whole range of other more traditional trades. I think it does have significant influence on certain audits, not all audits that we inspect, some audits that we inspect it isn't a significant risk, whereas in other audits it could be a major risk where we come to determine which of the areas we which to review, because in our audit inspections we don't review every single area of the audit, we consider only the areas we consider to be most significant on the bankers and criticisms increased in auditing firms and auditing the banks and the Complex Financial Institutions Banking Edict of 2013. So these are the areas we keep under review and we are considering the firms are conscious of the report to which we attach to this and the need to keep their staff adequately trained and to have the specialist knowledge to do this. It is not an easy area for the firms to deal with nor categorically pleasant, but they are all aware of the importance we attach to understanding this. I don't think it's an area that is going to go away soon. It is going to remain an important area wherein we would have to have the knowledge to do it properly.

I How would you describe the audit quality outlook since the FRC took over the regulation of audit from the self-regulating professional accountancy bodies?

R2 Certainly, over the years, there has been a gradual improvement in the results since we first started to produce our reports back in 2005 but the increase is, I don't think there is any sense of complacency, that we have gone as far as we could. One of the important thing to understand about our results is that our results is based on the engagements which we review in that particular year. So if one takes the ____350, we are reviewing every single audit in the ____ every year. The recommendations of computations of market ___________ which came out last year will require us to review each of the ___350 audit every three years and suddenly this year we will be auditing over 110 of the __350 and therefore provides a sample, a lot of significant sample of the audits we look at. We see the performance of the firms move slightly from year to year, so that in one particular referral year, the firm might have had a pretty good results, in the following year they might be slightly less good, but what we are looking is the underlying trend of the results getting better or results getting worse, and therefore we accept that in any particular year the firm might not have a good results as they would like but across all the engagements which we review, we can say is the grade profile, as we rate the individual engagements we look at, is that grade profile going up or is that grade profile going down, and certainly the acceptable, what we call 'good quality' or 'limited improvements required' categories of our inspections have gone up slowly but steadily over the past ten years and the number of our engagements where more specific improvements or quite significant improvements required has slightly and steadily gone down over that length of time, and therefore that is a pleasing trend both in terms of the 'bad' engagements and the 'less good' ones, but suddenly, given the findings we have, we don't see the job done. Primarily because if you look back over our key messages to the firm in the last four or five years, the key messages have tended to focus on relatively similar areas, so in no particular order we are looking at things like:

- The audit of revenue recognition
- The audit of fair value
- Inventory and debt repayments
- Great professional scepticism
- The extent to which those have been done properly
- The firm's compliance to independent issues and group audits

Those are relatively consistent key messages to the firms over a number of years and therefore the fact that we are making or bringing forward those messages suggest that there is still some work to be done as there is across a number of our findings in the larger audit regulators in other countries where one sees similar findings. In Canada, the USA, Australia, Germany, the Netherlands, these are countries where there has been some improvement, but we still expect to find issues every year and we don't think the job is done yet, and I doubt there will ever be a time when we hardly had good results, I think some results that fail below the level that we do hope.

I What factors distinguish the FRC from the professional accounting bodies in achieving the outlook described in the answer to the last question?

R2 I think perhaps one of the most powerful thing that we do which perhaps the professional bodies didn't do previously something we did, was to introduce, I think from about 2008, individual letters on the engagement we look at, and the fact that those letters go to the individual engagement partners that we inspected. It also goes to the head of audit of that firm, perhaps the most important thing that we started to do was that the letter started to go to the Chair of the Audit Committee of that engagement. I think once the letters started going outside of the firm, and started to go the Chair of the Audit Committees, those letters started to have a lot of impacts on the firm. When you have a situation when we will publish an anonymised annual report on that particular firm and its results, obviously that has its own power and the firm doesn't like to be portrayed as having a poor results from one year to the next, that the UK press take quite a lot of interest when the individual reports on the firms come out, but I think if you go on a level down below that the individual engagement partners probably are particularly keen for a poor inspection to be reported to the Chair of the Audit Committee. If you look at the environment now where there is a lot of tendering activities across the __350 and the large entities, the quality of the individual inspections as reported to the audit committees is actually quite a powerful driver in the audit committees determining how well the audit is done when it comes to the time of the next audit. Certainly we have had some communications from a few audit committee chairs ____ on the back of the last inspection letter, we decided to bring forward the audit tender that we are mindful the audit tender was going to happen in say four or five years' time but on the back of your inspection we decided to bring that forward and therefore the power of reporting not just to the firm but to also reporting to the Chairs of the audit committees is actually a quite significant factor in how the firms react to our report. We are the only major audit regulator that grade individual audits in terms of how we the audit from 'one (1)' for 'good audit' and 'three (3)' for 'audits requiring significant improvement', and also we are the only one that actually report those findings to the chair of the audit committees as well, although the Dutch regulators is recommending to its government that powers be given to it as an audit regulator. Going forward, and so if you look at the Canadian regulatory regime, it stresses the importance of the audit committee and the power the audit committee can have as a driver for improving audit quality. We are the only one that does that when we took over from the professional bodies, that did have a quite significant impact in driving up audit quality over a number of years.

I What suggestions do you have towards the improvement of audit quality in the UK and internationally?

R2 Right, well, I think if one looks at findings worldwide from audit regulators, as I said in response to one of the earlier questions, everybody tends to find very similar shortcomings in audit. So when we report and say there are issues with scepticisms of quality of group audit, or the extent to which the firm effectively audit fair value for example, these are things which should be found everywhere, not just in the UK, and therefore that would suggest it's not a specific UK problem but a global issue for the firm and therefore the firms still have work to do to deal with these fundamental areas. Now, one needs to understand that the firm allocates a considerable amount of time and effort and money to trying to improve audit quality, the firms are not as effective. What needs to be done to improve audit quality, they work very hard trying to improve it. I think ultimately the key thing that drives audit quality are the extent to which professional scepticism is adequately applied, because when you tend to find the most significant failings when we do our inspections is the extent to which the audits have adequately challenged management on difficult issues, like fair values or some other issues surrounding group audits, or issues surrounding revenue recognition, and a lot of that. So when the said challenge fall down, how can audit quality be improved? There are a number of factors that one would talking about the audit quality framework, is the issues in relation to quality set by the partner on the audit, the robustness of the audit process, and it's the rigour with which the audit team apply scepticism in those areas. Now, can the scepticism be weakened by the commerciality the firm might take, or the entrepreneurial attitude the firm might take, but on occasions that might happen, but ultimately it's about how firms are prepared to go to drive through to get to the right hands, if you like, how difficult is that? It can't be quite difficult to make the firms to do this. We started last year, and we continue this year to conduct report analysis with the firms. When we send annual reports, we ask the firms to conduct a detailed report analysis of where the problems are which have been identified from our reports. There is a technique which some of the other international regulators called the 'five (5) whys'. Say, if you say to an audit firm:

- Why was the audit of fair value of this engagement not done properly?
- Why was the quality of the audit procedures, not very good?

And you keep drilling down, asking 'why' each time to try to get to the absolute root of what the problem was, and one of the issues I think the firms will have to identify in this process is to drill down to the very bottom of what the problem is, and sometimes, it's quite easy to stop at the first or second level. We need to improve our identification of risks when why does that go wrong, or why don't we do the right procedures, and I think the key improvements to audit quality ultimately would come from firms properly understanding what the issue is. It is very easy to say we just need to audit better, when why are the audits not particularly well in the first place? Or why are the group audits not been done properly? Or what are the root causes of that not happening? That key driver is the firm's achieving the right level of awareness of what the problem is, and the first step in improving anything is understanding and what the fundamental in the process is the first step to improving quality. So a proper and realistic understanding of what the problems are is the key, without that you will always do things on the surface, and you will be making superficial changes to quality and you are not getting the grips with the real issues that drive quality. Is that an easy process? Categorically no, it's not an easy process for the audit firms to do, but certainly we then __to keep drawing the message home to the firms that that's how the quality improves, and we will be doing that for a considerable time to come.

TRANSCRIPT OF INTERVIEWS CONDUCTED AT THE FINANCIAL REPORTING COUNCIL, UK

INTERVIEW 3 (APRIL 2015)

Interviewer (I): Good morning sir. I am Alexander Akinduko from Manchester Metropolitan University, Manchester, United Kingdom, and a doctoral research student conducting a study on: 'The Assessment of the Effect of Independent Regulation on Audit Quality in the United Kingdom – Lessons for Nigeria', using the Financial Reporting Council (FRC), UK as a case study. Can I meet you please?

Respondent (R3): My name is Julie Long, I have been a member of the audit quality review team at the FRC for the last eight years, and I am currently the Inspections Director that is responsible for the whole of the audit firms outside of the big six.

I: In view of the nebulous nature of audit quality, what is the FRC's conception of audit quality?

R3: It is a difficult area and it is something that is very difficult to measure. As an Inspector, I am offered with the files and the things we are looking for are audit firms' compliance with the auditing standards and the audit regulations, and also that the audit teams have applied those appropriately to the entities they are auditing; Have applied good judgement and professional scepticism, and part of that is that they have to be able to record that in a way that someone can understand the processes they have gone through, and in reaching their final judgement on that audit.

I The FRC was reported as the first regulatory body to come up with an audit quality framework (AQF) (See Holm and Zaman, 2013). How in your opinion, does this framework represent an adequate measure of audit quality?

R3 As part of my comments, looking at the audit quality framework is it's not a measurement framework. It gives some indicators and it gives some drivers. In terms of our audit inspections, we are using the auditing standards to measure how good the audit quality is on all the firms' files we are looking at. That's not to say that a lot of things in the framework are things that come out of those standards and a lot of the discussions which we had with the audit firms, both stem from that framework. So for example, when the framework is talking about the 'appraisal processes and ensuring that audit quality is appropriately reflected through those appraisal processes', that's not something that is required by standards. It's certainly something we've seen as being conducive to improving the culture of the firm and audit quality as a presenter of what it is, the firms are trying to achieve. So we will use all those to help us in forming our recommendations to the firms, and they are not necessarily the way we measure audit quality. Internationally, they are trying to, I think it's IFIAR, they are looking at some key performance indicators they might use to actually try to come up with a measure of audit quality, and to be able to compare across the firms and that at the moment is still very much in development.

I Thank you madam. Of the various drivers that you have identified and applied in your inspection work in the last eight years since you have been with the FRC as a Director, which of these drivers or variables have you observed to have been most frequently breached than others by audit firms?

R3 There are regulations that are set in terms of some standards being made we frequently raise with audit firms as to how they assess the audit quality being applied by their staff and their partners and how that fits into their rewards and remuneration policies for these individuals. We are looking at most of the exhibitions such as executing professional scepticism is something we frequently are raising with audit firms, and making sure that the people that are doing the audit work have got the appropriate and competence and ability to do the audit. Things like adequate review procedures and how involved are the partners in the actual audit work being performed, are they reviewing the work appropriately? A lot of the things that are in the audit quality framework are things we are raising with audit firms on fairly regular basis, and pretty much across most of the firms we are assessing.

I Thank you very much, and that leads us to the next question. It is usual for the FRC to consult widely before your framework or rules and regulations are applied to the regulates. In 2006, when the audit quality framework was in process, there were consultations. In the specific academic paper by Holms and Zaman (20xx), which I earlier cited, they said that there were two aspects of the consultations which were not adequately addressed in the eventual framework that came out of the consultations, and they mentioned: 'The commercialisation of the audit process, that auditors have now come to more profit focused instead of being goal based in terms of pursuit of public goals or state goals, and that because of the development of some new assets, the auditors competence has become challenged, and that this has not been factored into your framework'. How does your audit quality framework and your inspection procedures address these concerns?

R3 We are very aware of these concerns and one of the things that we are concerned particularly is where there has been an increase in materiality because the impact of that is that where materiality has been increased, we would have to do less work. So, where we see auditing the initiatives to increase the level of materiality, we do then have a very close look to see whether the amount of audit work they are doing is appropriate to be able to achieve the right audit opinion. Things in other areas we will look at quite closely. Where we are looking at where auditors have changed from one firm to another and if the audit has gone down as part of that process, there is again the risk that the audit firms would be reducing the amount of audit work that they are performing to be able to achieve the right amount of profit on the fees they are charging. We are very aware of it, and it is something sometimes that could be quite difficult to assess but certainly fees and materiality and ______ methodology ____________ as well if audit firms are introducing new methodologies that will require audit teams to sample test a fewer number of items , and that might be because they are trying to reduce the amount of work that they are doing to improve profitability. There is a number of things that we can look at to try and assess whether audit firms are trying to curb their costs to improve their profitability and then we can try to assess whether that has impact on the quality of the audit work being performed, but it's not an exact science, it is quite difficult to do.

I As a further follow up to that question, what in your opinion is the effect of the global transformation from industrial capitalism to finance capitalism, with the attendant influx of specialised and opaque assets, some of which defy accurate understanding and valuation, on the competence of audit firms and auditability of financial statements?

R3 It's been challenging. The audit firms for a number of years when I started in practice, we were very much audit generalists, but within a year or two of me joining the firm, there was a drive towards specialisation into industry sectors, such that auditors became more experts in the areas they are auditing. I think that has definitely increased over the years and audit firms have invested more in technical specialists, for example, if we are looking at a company that owns a lot of properties, we would expect that the firm has got a property specialists, and that the audit team can to have a look at the assumptions and methodologies used to value those properties to provide that specialist input to the audit team, and that will apply to some of these financial assets that are being developed over the years. We would expect the audit firm to have sufficient financial valuation specialists the audit teams have access to, to provide input into their audits. One of the difficulties we often see is that the audit team involve those specialists on the audit and the instructions the audit team might give the specialist might not be appropriate, and on occasions some of the output that they get from the specialists of areas where the audit team needs to do some further works and always followed up. There are some challenges and difficulties in involving some of these of specialist and technical expertise but we certainly expect firms to develop their technical competence as the technical and complexity of the things they are auditing increases.

I Would you say in your opinion that the audit quality outlook has been better or worse, since the FRC took over the regulation of audit from the self-regulating professional accountancy bodies.

R3 I wouldn't say it has gone better but there is still more that they can do. I think there has been a greater focus on audit quality and I think the factors that have impacted on that is that we are quite transparent in our findings, so we have a public reporting framework for the audit firms that we are primarily responsible for and we also have a communication with the audit committees of the audits we have looked at and to tell them about key findings on the audit. So, because of that transparency that has increased the focus by the audit firms and their audit clients on what audit quality actually is and what it looks like and I think we have also tried to encourage audit committees to be asking the right questions of their auditors to help them assess audit quality. Some of the work the FRC has done has driven audit committees to assess the quality of their auditors and some of the information we provide to them help them in that assessment. We have been looking at it not only from the auditors' point of view but the wider market as well.

I A look at your inspection report from 2008/2009 to 2013/2014 using the grades allocated to the various audits which were examined showed a gradual increase from about 40% in 2008/2009 to 60% in 2013/2014 for the good audits, and a gradual decrease in the audits requiring improvements, and this position differs from those of Canada and the United States of America, where said that audit improvements remain stagnant in those countries. There are few things coming into that, one is how we chose our samples, so up till now we have selected the audits we are going to review on a risk based approach. So at the onset, we are selecting those audits where we think the most issues are going to arise. So we it is more likely that we will find problems with those audits that if we didn't take the risk based approach. For the exact impact on it, that is going to change, I think over the next few years, because we are now being required to review the __350 largest companies on a five year rotation basis, so each year we have to select seventy of those to review. That risk based element would come out of that selection. I suspect the profile of our inspection grades would change slightly over the next few years because we are not selecting those most difficult and most complex audits to review. Our sample size that we look at each year might not necessarily be representative of the population that we are looking at, in the last year or two, we've been increasing our sample size, and that has because of the requirement to review the __350 audits every five years and that has changed the grading profile of the audits that we are selecting. I think we are seeing a greater proportion in our second best quality grading because of our increase in sample size. There are a few things that will impact on that. I think one of the other things I found as we do the review each year is that you raise an issue with the audit firm in the first year. The next year they will address that issue, it then leads on to another issue. So and they said to us: 'We've done what you asked us to do last year,' and we say yes, you've done it but you haven't done it in quite the right way, or because you don't think about the next thing. It's a bit of a journey for the audit firm to address some of the issues that we are raising. So I think that's why you don't get to see a huge amount of movement.

I What suggestions would you have for the improvement of audit quality generally, both in the UK and internationally?

R3 Transparency has been the key. Before I joined the FRC, as auditor on the ground, I had no concept of independent regulation. I had known the professional bodies would come in and inspect our firm but never because there was no public reporting of it, unless there was a really serious problem on the ground. Because it is publicised and because it's transparent. When you speak to auditors, they are aware of what we do and why we are doing it. So, I think it has really increased the profile of audit quality, and my area is inspecting the audit firms. in law the FRC does the reporting in addition to setting of standards, talking to companies, corporate checks, and other activities that we do, all come together to promote audit quality. It is one of those things, each year there is always still more work to do. Audit firms and processes are changing all the time, so then you get to a point when you can sit back and say it would work brilliantly and I think there will always be things for us to be doing.

I Thank you Julie. I appreciate your time and attention.

TRANSCRIPT OF INTERVIEWS CONDUCTED AT THE FINANCIAL REPORTING COUNCIL, UK

INTERVIEW 4 (APRIL 2015)

Interviewer (I): Good morning sir. I am Alexander Akinduko from Manchester Metropolitan University, Manchester, United Kingdom, and a doctoral research student conducting a study on: 'The Assessment of the Effect of Independent Regulation on Audit Quality in the United Kingdom – Lessons for Nigeria', using the Financial Reporting Council (FRC), UK as a case study. Can I meet you please?

Respondent (R4): My name is Gareth Rees, Executive Counsel to the FRC and I lead the professional disciplinary team which investigates misconducts affecting UK public interest by Accountants.

I Thank you sir. I have a number of questions here, eight specifically, which may take you about thirty to forty minutes, and I will appreciate having your answers to them.

Since the failure of the banking institutions in the wake of the credit crisis of 2008, not much of corporate failures has been publicly reported. Do you see this as representing improvement in audit quality sir?

R4 No. I don't think that's a logical conclusion one can be drawn from that. I can say there were corporate failures which should be investigated, and if investigated there wouldn't be evidence of misconduct, even when there is failure, but I do believe there is a question mark over whether or not various investigatory authorities, whether in the criminal sphere or regulatory sphere should have investigated some of the failures in the banking institutions and the SA of that time now the FCA did make some investigations but in the end their major findings against one individual and everything that happened.

I One favoured approach for the assessment of audit quality, especially in the United States is the number of successful litigations against the statutory auditors. From the history of the FRC Tribunal decisions in the UK, especially from 2008 to date, what does the litigation climate portend for the quality of audit work in the UK?

R4 I think that there is some need for there to be much greater scrutiny of audit and the extent of the scrutiny is changing and improving all the times. Certainly, changes have improved since 2008 and again in the last couple of years, the audit quality review which does the monitoring here in the FRC, that function has changed and is changing again because of Market authority has intervened and the audit directive of 2014 is to be introduced in 2016. So far as my work is concerned on the disciplinary side, would change and improve things. The need for improvement is that they have only been too concluded all the cases that the FRC has dealt with as a matter of misconduct, although there are many more open investigations, and I think that is insufficient, and there needs to be far greater scrutiny.

I Quite a number of complaints have been made against auditors in the last few years, especially from 2008, and the FRC tribunal, to which you are an Executive Counsel, has had cause to investigate and take decisions on some of them, including sanctions been imposed and punishments meted on some of the errant auditors. What are the most frequent acts or breaches that you have noticed against the auditors in the UK?

R4 It usually involves a failure by the auditors to challenge management representations made by those responsible for the preparation of the financial statements which are being audited, therefore involves failure in professional scepticism. Another common feature is in relation to revenue recognition. It seems to us investigating these cases, that comes up most frequently, things that do happen would mean that much more misconduct issues are dealt with by an independent body such as the FRC in future.

I In what ways do you feel that the professional disciplinary scheme of the FRC has helped to align the behaviour of auditors with public interest expectations?

R4 What I think is, carrying on from my last answer, is because we are independent. The whole team is independent and we are trying to be successful in being objective about the behaviour and the conduct we are investigating. We consider we have the powers to consult with external lawyers and external accountants to assist us in assessing what happened, to try and make a fair judgement on whether we should take it to the tribunal.

I My last question sir, what are your suggestions for the improvement of audit quality in the UK and internationally?

R4 Starting from the very top, internationally, there needs to be a continuation of the very good work in trying to draft the auditing standards which obviously govern the way which audits needs to be undertaken and that needs to be international because so many companies these days of a global economy thrive in different jurisdictions and it means that if you have universal clear auditing standards, then that can improve matters, then you need to ensure that within each jurisdiction, including the UK, we have robust, well-resourced experts regulations and regulators who are able to tackle the very large firms who do the national audits, especially the big 4 and we need to think of taking them on properly investigating them as we have been talking about in this meeting, and we need to engage with other jurisdictions where appropriate to exchange information to be able to properly regulate both nationally and internationally for potential audit failure.

I Thank you very much for your time and attention. I may need to consult further with you in the future, in respect of follow-ups to this interview.

things that do happen would mean that much more misconduct issues are dealt with by an independent body such as the FRC in future.

I In what ways do you feel that the professional disciplinary scheme of the FRC has helped to align the behaviour of auditors with public interest expectations?

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I My last question sir, what are your suggestions for the improvement of audit quality in the UK and internationally?

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I Thank you very much for your time and attention. I may need to consult further with you in the future, in respect of follow-ups to this interview.

APPENDIX 3 R1

AN ASSESSMENT OF THE EFFECT OF INDEPENDENT REGULATION ON AUDIT QUALITY:

A CASE STUDY OF THE FINANCIAL REPORTING COUNCIL, UNITED KINGDOM AND NIGERIA

ETHICAL PROCEDURES FOR THE COLLECTION, PROCESSING AND STORAGE OF RESEARCH DATA

This document serves to provide the rules of engagement observed in the collection of primary data through interviews and surveys; and secondary data consisting of printed and electronic materials from the case study organisations and related units of analysis. It is also used to obtain the consent of respondents or interviewees with regards to the processes applied in the collection and processing of data in the course of this study.

The procedures are set out below:

i. Participants have been informed of the purpose and motivation for this study, in a separate 'statement of purpose', submitted at the point of applying for permission for the use of the organisation as a case study. Please see attached for ease of reference.

ii. The respondents to be interviewed will consist only of management staff and operational staff within the organisation who are directly involved in and possess the technical understanding of the subject matter of our investigation. In this case, the executive secretary or his nominated representative, Head of the Conduct Committee and the heads of each of the five sub-divisions of the Conduct Committee, making a total of seven members.

iii. A minimum period of 30 minutes and a maximum of 45 minutes will be required rom each respondent, for a total maximum of five hours, twenty five minutes of disruption to the activities of the organisation. To further minimise the spread of disruption, all seven interviews are required to be scheduled for the same week, if possible.

iv. The names and official designation of officers interviewed will be obtained for the purpose of storage and identification of the sources of data.

v. All interviews will be audio recorded digitally using a digital recorder to be complemented by a smart phone voice recording, to avoid loss of data due to possible equipment malfunctioning.

vi. Though data were obtained and stored on respondents' names, results will be suitably anonymised for analysis.

vii. Data will be managed by storing recordings and notes taken temporarily on the Manchester Metropolitan University 'moodle' drive and a personal external usb drive, and more permanently on a network drive such as 'i-cloud' or 'google'. Consequently, all paper copies will be shredded to maintain confidentiality.

viii. The outcome of the study will be shared with the case study organisation and individual interviewees, after approval by the research board of the Faculty of Business and Law, Manchester Metropolitan University, Manchester, UK.

For an indication of your agreement to the above procedures which will be applied with respect to the data to be collected from you, kindly sign in the space provided below, with your names and designation indicated as appropriate.

Signature of respondent: ....

Names of respondent: PAUL GEORGE ....

Official designation of respondent: ....

Researcher / Interviewer: Alexander Akinduko
Doctoral programme member
Manchester Metropolitan University, Manchester, United Kingdom.

R2

AN ASSESSMENT OF THE EFFECT OF INDEPENDENT REGULATION ON AUDIT QUALITY:

A CASE STUDY OF THE FINANCIAL REPORTING COUNCIL, UNITED KINGDOM AND NIGERIA

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For an indication of your agreement to the above procedures which will be applied with respect to the data to be collected from you, kindly sign in the space provided below, with your names and designation indicated as appropriate.

Signature of respondent: ....

Names of respondent: MARK MAINWARING

Official designation of respondent: MANAGER, AUDIT QUALITY REVIEW

Researcher / Interviewer: Alexander Akinduko
Doctoral programme member
Manchester Metropolitan University, Manchester, United Kingdom.

R3

AN ASSESSMENT OF THE EFFECT OF INDEPENDENT REGULATION ON AUDIT QUALITY:

A CASE STUDY OF THE FINANCIAL REPORTING COUNCIL, UNITED KINGDOM AND NIGERIA

ETHICAL PROCEDURES FOR THE COLLECTION, PROCESSING AND STORAGE OF RESEARCH DATA

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ii. The respondents to be interviewed will consist only of management staff and operational staff within the organisation who are directly involved in and possess the technical understanding of the subject matter of our investigation. In this case, the executive secretary or his nominated representative, Head of the Conduct Committee and the heads of each of the five sub-divisions of the Conduct Committee, making a total of seven members.
iii. A minimum period of 30 minutes and a maximum of 45 minutes will be required rom each respondent, for a total maximum of five hours, twenty five minutes of disruption to the activities of the organisation. To further minimise the spread of disruption, all seven interviews are required to be scheduled for the same week, if possible.
iv. The names and official designation of officers interviewed will be obtained for the purpose of storage and identification of the sources of data.
v. All interviews will be audio recorded digitally using a digital recorder to be complemented by a smart phone voice recording, to avoid loss of data due to possible equipment malfunctioning.
vi. Though data were obtained and stored on respondents' names, results will be suitably anonymised for analysis.
vii. Data will be managed by storing recordings and notes taken temporarily on the Manchester Metropolitan University 'moodle' drive and a personal external usb drive, and more permanently on a network drive such as 'i-cloud' or 'google'. Consequently, all paper copies will be shredded to maintain confidentiality.
viii. The outcome of the study will be shared with the case study organisation and individual interviewees, after approval by the research board of the Faculty of Business and Law, Manchester Metropolitan University, Manchester, UK.

For an indication of your agreement to the above procedures which will be applied with respect to the data to be collected from you, kindly sign in the space provided below, with your names and designation indicated as appropriate.

Signature of respondent: ....Julie Long........

Names of respondent: ....JULIE LONG........

Official designation of respondent: ....Inspections Director........

Researcher / Interviewer: Alexander Akinduko
Doctoral programme member
Manchester Metropolitan University, Manchester, United Kingdom.

R4

AN ASSESSMENT OF THE EFFECT OF INDEPENDENT REGULATION ON AUDIT QUALITY:

A CASE STUDY OF THE FINANCIAL REPORTING COUNCIL, UNITED KINGDOM AND NIGERIA

ETHICAL PROCEDURES FOR THE COLLECTION, PROCESSING AND STORAGE OF RESEARCH DATA

This document serves to provide the rules of engagement observed in the collection of primary data through interviews and surveys; and secondary data consisting of printed and electronic materials from the case study organisations and related units of analysis. It is also used to obtain the consent of respondents or interviewees with regards to the processes applied in the collection and processing of data in the course of this study.

The procedures are set out below:

i. Participants have been informed of the purpose and motivation for this study, in a separate 'statement of purpose', submitted at the point of applying for permission for the use of the organisation as a case study. Please see attached for ease of reference.

ii. The respondents to be interviewed will consist only of management staff and operational staff within the organisation who are directly involved in and possess the technical understanding of the subject matter of our investigation. In this case, the executive secretary or his nominated representative, Head of the Conduct Committee and the heads of each of the five sub-divisions of the Conduct Committee, making a total of seven members.

iii. A minimum period of 30 minutes and a maximum of 45 minutes will be required from each respondent, for a total maximum of five hours, twenty five minutes of disruption to the activities of the organisation. To further minimise the spread of disruption, all seven interviews are required to be scheduled for the same week, if possible.

iv. The names and official designation of officers interviewed will be obtained for the purpose of storage and identification of the sources of data.

v. All interviews will be audio recorded digitally using a digital recorder to be complemented by a smart phone voice recording, to avoid loss of data due to possible equipment malfunctioning.

vi. Data will be obtained and stored based on date and time of interview. The schedule of interviews, which links names with date/time will be separately and securely stored in an encrypted drive, so as to ensure and preserve anonymity.

vii. Data will be managed by storing recordings and notes taken temporarily on the Manchester Metropolitan University 'H' drive while the study lasts, and more permanently on an encrypted personal usb drive to maintain confidentiality.

viii. All digital information to be cross referenced by date and time on a separate and secure file which links date and time to individuals, thus allowing for names to be matched with dates. The file will be kept on the 'H' drive of the Manchester Metropolitan University.

ix. Materials which might identify the respondents in this study will not be taken or allowed to be taken out the premises of the Manchester Metropolitan University.

The outcome of the study will be shared with the case study organisation and individual interviewees, after approval by the research board of the Faculty of Business and Law, Manchester Metropolitan University, Manchester, UK.

For an indication of your agreement to the above procedures which will be applied with respect to the data to be collected from you, kindly sign in the space provided below, with your names and designation indicated as appropriate.

Signature of respondent: ....

Names of respondent: GARETH REES QC

Official designation of respondent: EXECUTIVE COUNSEL

Researcher / Interviewer: Alexander Akinduko
Doctoral programme member
Manchester Metropolitan University, Manchester, United Kingdom.

Appendix 4

TRANSCRIPT OF INTERVIEWS CONDUCTED AT THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA (ICAN), LAGOS IN JANUARY 2016.

Interviewer (I): Good morning, sir. I am Alexander Akinduko from Manchester Metropolitan University, Manchester, United Kingdom, and a doctoral research student conducting a study on: 'The Assessment of the Effect of Independent Regulation on Audit Quality in the United Kingdom – Lessons for Nigeria', using the Financial Reporting Council (FRC), UK as a case study. Can I meet you please?

Respondents (R): My name is Ejike, I am a Senior Manager, Practice Monitoring Unit (PMU), involved in quality control and monitoring of audit firms in Nigeria under the auspices of ICAN. My name is Dr __________________, I am a Research Fellow of ICAN.

I What do your understanding of audit quality, from your regulatory viewpoint?

ICAN: Audit quality means the procedure, or the steps taken by the engagement team to ensure that the output of the audit complies with relevant standards.

I What is your assessment of the audit quality outlook in Nigeria?

ICAN The assessment is good based on the evidence in terms of the audit documentations as witnessed by the team during our inspection.

I What are the major factors that you would consider most appropriate for the evaluation of audit quality?

ICAN Yes, you consider the level of skill of the audit team, practice set up as to whether it's a sole practitioner, partnership, or large firm. By experience and based on field assessment, it has been confirmed that firms with a greater number of partners do perform better quality audits than sole practitioners. I also think in some ways that audit firms with international affiliations are more able to access technical information from their international partners and make them to perform quite well or better than local firms. The age of the audit firm is also a factor that requires consideration in the assessment of quality. These are external factors.

I What weaknesses can you associate with professional accounting firms in relation to audit quality in Nigeria?

ICAN Basically, it's the issue of capacity and skills of the staff. Second, it is the availability of audit evidence which have been found not adequate. Also, firms lag in terms of IT competence in Nigeria, and it is not possible for firms to audit what they don't know.

I How effective do you think that audit committees of public companies are in the promotion of audit quality in their companies, as far as Nigeria is concerned?

ICAN Of recent we had the FRC Act which placed a lot of responsibilities on the audit committees, and this has drawn attention to the composition of the audit committees. Previously, no one looked at the background of such members. The FRC is very unforgiving when it comes to their penalties. Aside, they are also coming up with the draft national code on corporate governance in which the roles of the audit committees are clearly identified. In the long run, we are going to see some effectiveness in our audit committees, but for now, of course the awareness of what the FRC is doing has led several companies to pro-actively compose these committees and ensure that they promote audit quality.

I How desirable is the establishment of the FRC of Nigeria as an independent regulator of audit in Nigeria?

ICAN Yes, I think having a government body responsible for audit regulation is desirable, but the only challenge is how they carry out their responsibilities. For now, it is desirable and a noble gesture from government, particularly that the various professional bodies regulating accountancy in Nigeria may have different standards. The establishment of a more objective public body comprising of all professional bodies would lead to an improvement of audit quality in Nigeria.

I The governing board of the FRC in Nigeria is composed mainly of representatives of institutions and parastatals most of which form the subject of regulation by the FRC. In your view, how appropriate is this structure for the independence and regulatory independence of the FRC?

ICAN Irrespective of the composition of the board as drawn from the various institutes and parastatals, I think that the big picture is what the board sets out to achieve. I think its ok. It augurs for objectivity particularly if members of the board do what they are supposed to do without playing politics.

I The FRC for now is funded through government and levies imposed on corporate entities. How moderate do you consider the imposed fines and levies?

ICAN Going by the FRC Act, the fines and levies as provided in the Act are not moderate in relation to the level at which we operate. I think the levies are just to enforce compliance, but the approach does not seem satisfactory. The levies are supposed to deter non-compliance and not to cripple businesses entirely as it now looks. However, the fines should not be ridiculously low as it is in the Companies and Allied Matters Act of 1990 which tends to encourage the continuation of professional misconduct. The conflict in CAMA and the FRC fines regime should be abridged for a moderate set of figures that will keep businesses in operation while deterring wilful misconduct.

I Do you consider it appropriate for the FRC to charge fees in respect of consultations made to it by auditors and managers of public interest entities in respect of interpretations of auditing and accounting standards?

ICAN Personally, I would feel that the FRC should distance itself from consultations because professionals are supposed to understand the requirements of the law and standards. FRC consultations appear very costly, and which does not guarantee the solution to the problems. This is not affordable to SMEs in Nigeria. Penalties are also in millions of Naira. I think the FRC should render services to buy the confidence of the stakeholders. It is even doubtful if the FRC has the knowledge capacity it lays claim to without relying on the professional bodies whose members are consultants to the FRC. The huge levies may be scary.

I How often is your professional institute the subject of FRC inspection, and what has been the focus of their inspection?

ICAN No. There has not been such an inspection.

I How do you view the involvement of the FRC in the direct education of accountants in Nigeria, especially through the IFRS academy?

ICAN It is the same issue of their providing consultancy. I feel ICAN has enough members with IFRS training who can train others. Those who subscribed to the IFRS academy since 2013 have not received any communication about the programme, neither has their monies been refunded. The challenge is when things are not transparent, meanings can be read into it. If there must be an IFRS academy, it should not be the IFRS that should host it. The idea was objected by the stakeholders, and I think that the academy is non-existent as of now. I think FRC wants to provide academic qualifications, since ICAN only provides professional qualifications, but the programme could have better been handled by educational institutions and passed through the National Universities Commission (NUC).

I How would you describe the relationship between the FRC's team and the public interest entities in Nigeria?

ICAN If not for the draconian nature of the FRC directives and penalties, the relationship would have been okay, but based on perceived negative effects that those policies and levies will have on business, I think there is no cordial relationship.

I How would you describe the relationship between the FRC and the auditors of public interest entities in Nigeria?

ICAN Not cordial because of the excessive nature of their policies and fines.

I What specific contribution do you consider that the FRC has made towards audit quality since its establishment?

ICAN They have brought quality financial reporting to the forefront and it's no longer business as usual. Their objective is to provide a business environment that will create confidence in the minds of investors, especially international investors, so that we can improve our economy. However, the objective and its implementation differ. If things are done well, it is a very noble course. It provides a means to audit the auditors and improve the confidence of the shareholders.

I	in your own opinion, which of independent regulation as depicted by the FRC, and self-regulation as represented by the professional accountancy bodies (ICAN and ANAN), is more effective in promoting audit quality in Nigeria?

ICAN,	I don’t think either of them independently is effective without the other. The presence of both forms of regulations has a way of promoting audit quality.

I	Thank you very much for your time and attention.

Appendix 5

TRANSCRIPT OF INTERVIEWS CONDUCTED AT THE ASSOCIATION OF NATIONAL ACCOUNTANTS OF NIGERIA, LAGOS IN JANUARY 2016.

Interviewer (I): Good morning, sir. I am Alexander Akinduko from Manchester Metropolitan University, Manchester, United Kingdom, and a doctoral research student conducting a study on: 'The Assessment of the Effect of Independent Regulation on Audit Quality in the United Kingdom – Lessons for Nigeria', using the Financial Reporting Council (FRC), UK as a case study. Can I meet you please?

Respondents (R): My name is Sulaimon, I am Mustapha, and I am ________.

I What do your understanding of audit quality, from your regulatory viewpoint?

ANAN: Audit quality relates to financial statements prepared in compliance with auditing standards, regulations, and professional judgement.

I What is your assessment of the audit quality outlook in Nigeria?

ANAN The assessment of the audit quality outlook in Nigeria is that audit quality in Nigeria follows the IFRS. I can say it is of moderate quality because the IFRS has not taken off too long in Nigeria.

I What are the major factors or variables that you would consider most appropriate for the evaluation of audit quality?

ANAN We want to look at it from the angle of audit process. We want to consider audit planning and programme. If you have a good programme and plan, the audit is adjudged to be of good quality. We also consider audit documentations, the use of Internal Control Questionnaires, and above all, compliance with audit standards and regulations. In addition, if we are to look at the audited financial statements, then for such financial statements to be considered of good quality, it must comply with auditing standards, IFRS or IPSAS and other regulations in Nigeria, with reference to the Corporate Information, Chairman's Report, Notes to the accounts and the Summary of the financial statements.

I What weaknesses can you associate with professional accounting firms in relation to audit quality in Nigeria?

ANAN My idea about that is that most of our audit firms lack independence and our people are very reluctant to change.

I How effective do you think that audit committees of public companies are in the promotion of audit quality in their companies, as far as Nigeria is concerned?

ANAN Yes, the performance of audit committees of public interest entities in Nigeria is highly effective, because they are the one that recommends the external auditors to the management. They also planned the audit work with the external auditors. Again, they meet regularly at least four times in a year to consider audit issues from the external auditors.

I The governing board of the FRC in Nigeria is composed mainly of representatives of institutions and parastatals most of which form the subject of regulation by the FRC. In your view, how appropriate is this structure for the independence and regulatory independence of the FRC?

ANAN I think the structure is appropriate.

I The FRC for now is funded through government and levies imposed on corporate entities. How moderate do you consider the imposed fines and levies?

ANAN I think they are moderate, but then not limited to corporate entities alone, they also charge professionals for registering with the FRC.

I Do you consider it appropriate for the FRC to charge fees in respect of consultations made to it by auditors and managers of public interest entities in respect of interpretations of auditing and accounting standards?

ANAN No, not appropriate, because as a regulatory body they should provide information free of charge to interested members of the public.

I How often is your professional institute the subject of FRC inspection, and what has been the focus of their inspection?

ANAN Hmm. Not very often.

I How do you view the involvement of the FRC in the direct education of accountants in Nigeria, especially through the IFRS academy?

ANAN The direct education of accountants by the FRC is not relevant because it is a regulatory body and should not involve in training. It should limit itself to regulation and not involved in academic activities of accountants.

I How would you describe the relationship between the FRC's team and the public interest entities in Nigeria?

ANAN The relationship is very cordial.

I How would you describe the relationship between the FRC and the auditors of public interest entities in Nigeria?

ANAN The relationship is also very good.

I What specific contribution do you consider that the FRC has made towards audit quality since its establishment?

ANAN The contribution that the FRC has made is in respect of the registration of the professionals who have been made to sign with their numbers as allocated to them by the FRC, on the financial statements. This gives the profession to be free to do what they are supposed to do very well, for fear of sanctions which may be imposed on erring members who do not work according to standards and regulations.

I in your own opinion, which of independent regulation as depicted by the FRC, and self-regulation as represented by the professional accountancy bodies (ICAN and ANAN), is more effective in promoting audit quality in Nigeria?

ANAN The professional accounting organisations (PAO) do more of inspections in terms of audit quality. We expect FRC to collaborate our efforts. We love to see that they complement each other.

I Thank you very much for your time and attention.