Transparency Report 2015

EY UK – Volume 1

EY

Building a better working world

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Volume 2

Volume 2 provides further detail on matters like our legal and governance arrangements, our commitment to quality, independence practices, financial information and our work with our stakeholders and communities. It can also be accessed online here. Volumes 1 and 2 combined address our obligations under the European Union's 8th Company Law Directive and the Statutory Auditors (Transparency) Instrument 2008.

More information about EY can be found at ey.com

A foreword from our UK Head of Audit

Hywel Ball

UK Head of Audit

Regional Managing Partner - UK & Ireland Assurance

Welcome to EY's 2015 Transparency Report.

I believe that continuously improving audit quality is central to building trust in the capital markets. For EY, a firm committed to audit, this makes audit quality a business imperative as well as a professional responsibility. For these reasons, we continue to invest in our audit practice and have increased this investment during the last year.

Through our wide reaching Sustainable Audit Quality Programme, we have strengthened our internal review processes, added to our risk management team, improved training for our people and partners, and increased recruitment efforts. Our audit headcount has grown by 10% this year alone. We have also invested in new technology, specifically a new audit and workflow management tool called 'EY Canvas' to increase effectiveness and efficiency. The first volume of our Transparency Report explains these initiatives in more detail.

Our focus on audit quality goes beyond just the UK. We are taking a consistent approach across our international network, in over 150 countries, as part of a $400m global Audit Transformation programme.

We are also working hard to innovate using new data analytic techniques and an expanded range of services, including updated ways of assessing corporate culture and integrity. These developments represent some of the most exciting opportunities for the audit profession in a generation and should contribute to greater confidence in the robustness of our audit and assurance services in the eyes of stakeholders, raising audit quality, increasing efficiency and providing greater insight to those charged with governance.

EY's global governance structure helps to ensure we in the UK put the right controls in place and that our audit business receives the investment it needs. The UK's Financial Reporting Council (FRC) is currently reviewing the UK Audit Firm Governance Code, a process we continue to be actively engaged in. More detail on our governance structure can be found in both volumes of this Transparency Report.

Our efforts are generating positive results. We are pleased the FRC has recognized the steps EY has already taken to improve audit quality. However, there is a significant time lag between the audits we are completing now and when the FRC will report on their inspection of them. Our investment in audit has been well received in the market. Since January, EY has been proposed as auditors to four FTSE100 companies: Royal Dutch Shell, Associated British Foods, Sainsbury's and the RELX Group. Prior to that, our successful tenders include the Royal Bank of Scotland, Sage Group and the BBC. Some of these wins are reflected in our latest financial results, but for most the work will begin next year.

As we gain more experience of the new tender regime, we can see audit committees taking a stronger role on behalf of shareholders in the assessment of audit quality, and the choice of auditor. I am pleased to say that audit quality, rather than price, is generally at the heart of their decision making.

I am encouraged by the progress we have made during the last twelve months. I look forward to building on these achievements over the next year, as we strive to reach our ambitious growth plans and grasp the opportunities that come with a changing audit market.

I would welcome your feedback. Over the coming year, as part of our regular meetings with audit committees, investors, regulators and other stakeholders, we will be providing opportunities for you to discuss any of the issues we cover in this Transparency Report. You can also contact us directly at ppduk@uk.ey.com

I hope you find the report interesting and that you will continue to ask us questions and give us your views. I look forward to those conversations.

A Report from our Independent Non Executive

Sir Richard Lambert - on behalf of the EY INEs

In May this year, EY partners around the world voted to simplify and strengthen the firm's governance arrangements, in line with the recommendations of a Governance Working Party on which I had sat. As a result, the Global Advisory Council has been reshaped into a stronger and more focused Global Governance Council, on which the four Independent Non-Executives (INEs) all sit, and which is intended to give both clearer lines of accountability for the firm's leadership, and a stronger voice for EY Partners around the world.

One consequence of the change that is particularly relevant to this Transparency Report has been the formation of a number of new sub-committees – one for each EY area, along with Finance and Audit, Global Chair/CEO performance and remuneration, and the Public Interest.

From the perspective of the INEs, this latter Public Interest Sub-Committee is perhaps the most important initiative. It is made up of all the INEs, together with Penny Stocks, the Presiding Partner of the GGC, and Lou Pagnutti, EY's Global Managing Partner – Business Enablement. I act as chair. At our early meetings, we have decided to focus our discussions on the big picture: issues concerning the overall leadership of the firm, big reputational challenges if and when they arise, and above all on audit quality.

This must always be the first priority of EY, and all the more so at a time when global regulatory bodies such as the Independent Forum of Independent Audit Regulators (IFIAR) and the Financial Stability Board are setting challenging targets for improved results on the part of the audit profession around the world, and placing a high priority on root cause analysis of the big firms' audit performance.

In response, EY has launched a Sustainable Audit Quality framework around the world, highlighting auditor integrity and ethics, and focusing on issues such as tone at the top, people issues and the simplification and standardisation of the audit process. The INEs welcomed this initiative, and were enthusiastic about the firm's efforts to simplify and bring greater consistency to its work through innovations such as EY Canvas, a new audit and workflow management tool which was introduced in May this year.

Other topics covered by the Public Interest Sub-Committee so far have included the firm's whistleblowing procedures, and its response to regulatory changes. In the coming year, we intend among other things to discuss EY's approach to network governance, an issue on which regulators are placing more emphasis as professional services firms become increasingly integrated around the world.

As well as focusing on the audit function, we INEs are also concerned with those other aspects of the firm's business that shape public perceptions of its brand and values, and hence its long term well-being. So we take a keen interest in areas such as EY's approach to risk management, its acquisition strategy, significant claims and litigation affecting the business, and the way in which the firm manages the balance of its resources between audit and non-audit services.

As reported elsewhere in this document, EY's INE team has been unchanged over the past year. We expect our workload to increase in the coming 12 months, and the firm's intention is to add two more to our number – one in East Asia and another in Europe. We believe we have a duty of care to the firm, but we do not think of ourselves as corresponding to the non-executive directors of a listed company. Instead, we believe we are accountable to the public interest – a concept that is difficult to define in theory, but relatively easy to identify in practice. We keep this priority always firmly in mind, which among other things means we place a high premium on constructive challenge and debate, on independence and on transparency. We work well together and are happy to be questioned and challenged ourselves about our role and our activities.

As we reported last year, we are confident that the firm's leadership takes our views seriously and responds in a timely way to the questions and challenges we raise. At a global level, the priority for us INEs in the coming year will be to monitor the success of the Sustainable Audit Quality programme, to build an effective Public Interest Sub-Committee, and to help the new Global Governance Council make a positive impact around the firm as a whole.

In addition to this role, I have specific responsibilities for the UK under the Financial Reporting Council's Audit Firm Governance Code. The other big firms have established their INEs at a national level, in contrast to EY which as a truly global enterprise has installed us on its global council. This approach brings real benefits, in that it brings regular access to the highest levels of EY's leadership, and the FRC remains content with this different structure. But the regulator also wants INE engagement in EY's UK activities, and this is my role. I have a constructive relationship with the FRC, with which I meet several times a year to discuss the firm's progress in meeting its goals. In this respect, I have had two main priorities over the past year.

The first has been to monitor EY's response to the findings of the FRC's Audit Quality Review Team over the past two years. The programme started across the firm with an Audit Quality summit held in 2014, and the campaign has continued with determination and consistency through the past year. The full results have yet to show through in the regulator's quality reviews, since the audits for the latest regulatory report were executed in the main before the firm's campaign got under way. But I expect to see progress in the coming year.

I have been impressed by the thoroughness of the EY's root cause analysis of the regulator's findings, and by its focus on specific and actionable measures that will drive through changes in training, planning and business culture. The successful implementation of EY Canvas must be a high priority in the months ahead. There is a palpable sense of energy about the programme that I have picked up even in casual conversations around the firm. But there is no room for complacency. In today's highly competitive environment, EY has to be at the front of the pack when it comes to the regulator's reviews of audit quality.

That leads on to my second priority over the past year, which has been to reassure myself that EY is deploying sufficient resources to cope both with a significant rise in audit bids – as rotation across firms gathers momentum in the UK – and with the requirements of some very large audit wins. The firm has hired significant numbers of new practitioners, and the advantages of its global nature have also been visible as specialist talent has been brought into the UK practice from around the world. This effort will have to continue in the coming year.

The FRC is now reviewing the workings of the Audit Firm Governance Code. EY's INEs will welcome measures that increase public understanding of their role, and the transparency of their activities.

Market Developments

The development of our firm

Over the last financial year to 3 July 2015, the UK firm grew its total revenues to £2.010 billion, an increase of 8% on the previous year's £1.868 billion. Assurance revenue accounts for 29% of the firm's revenue at £585m with revenue from audit clients of £407m, compared to £550m and £376m for 2014, representing growth of 6.4% and 8.2% respectively. A more detailed breakdown of our revenue can be found in Volume 2, page 21.

The UK audit market

The year has been dominated by a significant increase in audit tenders, especially among the FTSE 100. The twin regulatory challenges of tendering arising from UK corporate governance changes and impending firm rotation arising from the EU regulation have galvanised the market. EY has been very successful in this new environment, gaining audits for companies such as Sage, the BBC and RBS in the first half of the financial year and in the last six months Royal Dutch Shell, Associated British Foods, Sainsbury's and the RELX Group. In the case of most of these audit wins, the real work will begin next year. Companies are increasingly tendering well in advance of appointment to deal with potential independence issues and to allow sufficient time for transition from the incumbent auditor.

Tender practice is evolving, and companies are mainly running tight processes, providing detailed data rooms. As audit committees take control of the process, the emphasis on audit quality over fees has increased. Innovation in audits is being driven through these market forces especially in the use of data analytics and we are seeing new areas of assurance being sought such as the assessment of corporate integrity and the use of advanced fraud investigation techniques.

2015 sees the full implementation of our new global audit workflow management tool EY Canvas, designed to increase the effectiveness and efficiency of our audit teams and facilitate the real-time escalation and resolution of issues. EY Canvas is part of our $400 million audit transformation programme, which includes a global suite of data analytic tools, an enhanced knowledge sharing infrastructure designed to deliver insight and better quality to our audit clients.

The attractiveness of EY as an employer of choice continues, and we have seen an overall increase of over 10% in our audit headcount to over 3,000 professionals. We will also see record recruitment of over 800 graduates. In 2015 we were delighted to be awarded the highest ranked Big 4 firm to work for after ranking 14th in the Sunday Times '25 Best Big Companies to Work For'.

We intend to continue to invest heavily in our audit and assurance business and to increase our audit market share as the EU mandatory rotation rules are implemented.

Audit and non-audit services

It is just under a year until the UK government and FRC implement European legislation around the appointment of auditors and the services that listed companies may purchase from them.

Many uncertainties remain but it is clear that the legislation will disrupt the current arrangements of many companies.

We have already seen cases where companies have not been able to involve as many firms in an audit tender as they would have liked because potential bidders provide non-audit services that are incompatible with the role of auditor and which cannot be unwound in time or at all.

At EY, we recognize that this is a significant period of change and one that given the size and complexity of companies and their professional relationships, requires advance planning.

To enable maximum choice at a tender, we are encouraging companies to plan at least 18 months in advance, to have a clear strategy that sets out all the professional services they are likely to need (not just audit) and from whom. They also need to understand as early as possible what services they already receive from those firms being invited to tender for the audit or other services. This can help to avoid their choice of preferred provider being limited.

Clearly these changes bring challenges for companies in the short term. Overall, we believe they represent an exciting evolution in the UK audit and professional services market, which will ultimately benefit businesses and their shareholders if approached strategically.

To be clear, we take our professional and public interest responsibilities seriously and will not seek appointment as auditor for any company unless we are satisfied that we can deliver a high quality independent audit.

Innovations in audit

Advances in technology and the demands driven by changes in the audit market have provided the opportunity for us to innovate in audit delivery. These innovations will bring benefits to the clients we audit and other stakeholders.

Many are around how we can use data analytics to improve audit quality and efficiency while providing greater insight. Companies' financial systems have become ever more standardised and comprehensive, meaning that we can use company data in new ways to identify unusual patterns and in some cases audit whole populations of transactions rather than sampling.

To build a richer picture of business and audit risks, we can go beyond the financial systems, capturing and analysing a wide range of data, including 'structured' internal data such as transactions and 'unstructured' data such as incident reports, planning documents, and even internal electronic communications. In certain cases, we will be able to incorporate external data such as from social media. These techniques allow us to develop a more complete view of risks and issues that influence our audit scope and approach, and provide richer insights to the companies we audit.

Where appropriate we will involve our forensic practitioners in our audits to support our fraud risk assessment and to help design more targeted audit procedures where we see greatest risk of regulatory breaches such as fraud, bribery or corruption. Use of these specialist skills again brings great value to the companies we audit and can provide greater assurance in riskier areas.

We are also researching methods to assess corporate integrity to enhance both our audits and our other assurance services.

We have made significant investments in our UK audit business to drive these innovations. We are also working with our Global firm on a number of initiatives to influence the shape of auditing in the future. We see innovations in our audit as a continual process, and we will report on this in future Transparency Reports.

Emerging financial reporting considerations

The major financial reporting development for many UK companies in 2015 has been the introduction of the new UK GAAP. Except for the very smallest entities and those required or electing to apply IFRS, companies must choose to apply FRS 101, a version of IFRS but with reduced disclosures, or FRS 102, which is based on the IFRS standard for small and medium-sized entities. Adoption of FRS 102 will often not result in many significant changes compared to 'old UK GAAP', but transition is not trivial. In addition, FRS 102 contains less mandatory guidance than either IFRS or old UK GAAP and its application may require considerable interpretative judgment on the part of preparers and their auditors. To help our staff and clients address the challenges created by the new UK GAAP, we have published a comprehensive guide to the new standards.

No new international standards have been required to be adopted in 2015, with only annual improvements and limited amendments to IAS 19 on pension accounting taking effect this year. Much of the activity of the International Accounting Standards Board (IASB) and its constituents had been focused on IFRS 9 Financial Instruments and IFRS 15 Revenue, which will have a major impact on many entities. The IASB (in the case of IFRS 15, in conjunction with the FASB) has established transition resource groups, to examine the consequences of adoption and make recommendations to the Boards where the standards are not clear. As a consequence, the IASB has proposed changes to IFRS 15 and is currently seeking views on whether to allow preparers more time to implement the standard, should it delay the date of its adoption to 2018 (the same year that IFRS 9 will become mandatory). Banking regulators are taking a considerable interest in the application of IFRS 9, and the Basel Committee is preparing additional guidance on how the more sophisticated banks should implement the new expected credit loss impairment model.

2018 is also likely to be the year of mandatory adoption of the new standard on leases, IFRS 16, due to be issued late in 2015. This standard will have a significant impact on lease accounting. It removes the current distinction between operating and finance leases, with the effect that many entities will record a leased asset and a corresponding liability based on the amounts contractually due.

In the meantime, there continues to be a drive in the UK to make financial statements clearer and more concise, while being fair and understandable. As part of its work to support this initiative, the Financial Reporting Lab has begun to publish case studies of clear and concise reporting.

A number of areas of IFRS continue to be a focus for our clients, audit teams and regulators, because of their inherent complexity. These include:

- Revenue recognition, including the risk that policies may not keep pace with new business activities or changes in customer relationships and contracts
- Business combinations, including identification of intangible assets, valuation of non-cash consideration and accounting for contingent payments to vendors

In addition, this year, the FRC has emphasised the adequacy of disclosures of complex supplier arrangements.

Another continuing focus is the adequacy of disclosures in financial statements around accounting policies, significant judgments and estimates, including those concerning revenue recognition, impairment and uncertain tax positions. These are not always sufficiently detailed so as to identify the precise judgments or provide enough information as to the sensitivities of assumptions.

We provide training on these topics to our staff and clients, through conferences, seminars, webcasts and computer-based modules. Meanwhile, our audits of public interest entities are supported by specialist technical guidance and reviews.

Our audit quality performance

We are committed to delivering consistently high quality audits. The achievement of that goal is fundamental to the success of our business and to our public interest responsibilities.

In our 2014 Transparency Report we included information about a series of Audit Quality Indicators (AQIs) that we had agreed with the other major audit firms would provide useful information about audit quality to our stakeholders. We believe that this was an important initiative and we were pleased by the reaction we received.

For 2015 we are again disclosing those AQIs. In the following section we discuss our Audit Quality Programme and our investment in quality, the result of our internal quality reviews, what our people are telling us about audit quality, what our regulators are telling us and how we have sought to engage with the investor community.

Our Audit Quality Programme and our investment in audit quality

In our 2014 Transparency Report we noted that we were disappointed by the results of the FRC's 2013-14 inspection of the firm and explained that we had established a long-term Audit Quality Programme (AQP). The objective of the programme is to ensure that we deliver audit quality at the enhanced level we believe our stakeholders demand. In addition a global programme for audit quality was launched called 'Sustainable Audit Quality' we are currently ensuring these programmes are aligned.

The Audit Quality Board that we established as a permanent aspect of our governance structure oversees all matters relating to audit quality. It has executive decision-making powers over the AQP. The Audit Quality Board has held 10 monthly meetings to June 2015 since it was established in September 2014 and two full away-days specifically focused on audit quality and the direction of the AQP. The Audit Quality Board (AQB) challenges and reviews the AQP before approving recommendations.

The significant changes consequent upon the developments in the audit market discussed earlier also present challenges to audit quality. The AQB has spent time considering the impact of audit tender activity on the practice. New monitoring procedures have been put in place to ensure that the partners involved in the increased market activity are not over committed, and the AQB receives and reviews data in relation to this. Significant bid approval decisions have been brought to the AQB prior to approval to proceed. The AQB has also spent time focusing on the transition of the audit of RBS, which is transformational for our financial services audit practice.

During the last financial year, the AQP, under the direction of the Audit Quality Leader, has considered every part of our organization's role in audit quality today and in the future. This includes how we recruit, train, allocate, reward and retain the best auditors. As part of the work we have looked at the specific observations raised by our regulators, from internal reviews and from the root cause analysis we carried out following the FRC's May 2014 report so we can consider improvements to the actual audit processes carried out at an individual engagement level.

Our newly formed Audit Quality Support Team (AQST) conducted reviews of over 50 audits during the 2014/15 audit cycle, providing challenge and guidance to the engagement teams and enhancing the quality of the audits. The AQST is reviewing a further 50 audits during the 2015-16 cycle. These are in-depth reviews carried out by experienced auditors who are independent of the team.

Other developments during the financial year under the AQP include our development of new templates to assist all teams in their approach to the key areas of the audit, review of the involvement of system specialists, initial work on the performance and review system for both partners and staff and a review of audit training. During the year, the AQP has used employee focus groups and staff surveys to probe areas that our staff believed required review.

As part of our global investment programme, 2015 has seen the roll out of our new audit tool, EY Canvas, and supporting changes to our Global Audit Methodology. All members of our audit practice have been on a training course in preparation for the adoption of EY Canvas and substantially all our 2015 audits will be undertaken using these new tools. We believe they will make it easier for teams to deliver high-quality audits. We continue to invest in other aspects of our audit practice. In the last two calendar years we have delivered the following mandatory structured training hours to our teams, principally relating to audit and financial reporting.

	2014	2013
Senior 2	70	61
Senior 3	52	47
Manager	52	26
Senior Manager	35	26
Director/Partner	35	26

As noted above, during the last year, we reviewed our audit training and decided to increase our investment. The audit practice ran new two and three-day training courses, which focused on case studies in some of the most challenging areas of audits, as well as accounting updates integrated with skill development sessions. The feedback from our people has been overwhelmingly positive and we plan to continue this enhanced training programme into the future.

As well as mandatory structured training, staff and partners undertake personal training and development specific to their needs. Staff and partners involved in PCAOB audits undertake further specific training on those standards for example and staff and partners working on financial services clients undertake relevant industry training. We also set minimum continuing professional development (CPD) requirements for all partners and staff, discussed further on page 20 of Volume 2.

We will be monitoring the effectiveness of our AQP over the coming years. It is, however, important to recognize that there is an inevitable delay between the initiatives we undertake and the impact on audits performed. The audits reported on by the AQRT in their latest public report (discussed further below) were performed before we launched our Audit Quality Programme. Our 2014 audits benefited from aspects of the programme, specifically the activity of AQST and will be reported on by the FRC in 2016, but the 2015 audits undertaken using EY Canvas will not be reported on by the FRC until 2017.

Internal quality reviews

A fuller description of our Audit Quality Review (AQR) programme is set out in Volume 2 of the Transparency Report on page 15.

Each year we undertake a review of a sample of audit engagements. The review is conducted in the Summer months and inspects audits performed in the previous year – so audits reviewed in the summer 2015 are primarily from audits of December 2014 accounts.

This review is performed by EY professionals from offices other than that in which the audit in question was undertaken. It is subject to the oversight of senior partners from our global organization to ensure the rigour, integrity and consistency of the review process.

Our review process is intended to cover every Responsible Individual (partners and directors authorized to sign audit reports) at least every three years and every FTSE 350 audit every six years. Other audits are selected for review to cover a cross section of the audit practice. However, greater weight is given to selecting engagements with certain risk characteristics. The percentage of RIs reviewed in each of the last three years was: 44% in 2015, 32% in 2014 and 34% in 2013.

We evaluate the results of our review on a three-point scale:

1 = no or minor findings
2 = findings that were more than minor but less than material
3 = material findings

The results of recent reviews are as follows:

	2015 Review	%	2014 Review	%
1	65	78	45	73
2	14	17	15	24
3	4	5	2	3
Total	**83**	**100**	**62**	**100**

For audits with material findings, the firm develops and implements a remedial action plan. A quality improvement plan is also developed for each office subject to review. We communicate lessons learned from the reviews to our audit practice and include them in future training. The results of AQR play an important part in our assessment of partner and staff quality, which is in turn a key input into individuals' promotion and reward. This is described further in Volume 2 under partner remuneration (see page 22).

As well as reviewing individual audit engagements, our AQR process also involves a review of our cross-firm processes and controls in such areas as: client acceptance and continuance; consultations and pre-issuance reviews; people processes (hiring, assignment of staff, learning and performance evaluation); and compliance with ICAEW Audit Regulations.

What our people tell us

Our AQP and our commitment to deliver consistently high audit quality are fundamental to our firm. However our ability to deliver on that commitment is dependent on the staff and partners who make up the individual audit engagement teams. It is therefore critical that we understand our people's thoughts and concerns and their views on the progress we are making. Accordingly, in addition to our biannual global people survey, which measures overall staff engagement and morale, we undertook a further survey of staff in our audit practice in September 2015 specifically focusing on audit quality. We included in this survey the questions that we had committed to report on in this Transparency Report, but also took the opportunity to include some additional questions to help our understanding in this area and help us drive our AQP.

That survey produced the following results:

Questions	% Positive
My firm places sufficient emphasis on audit quality	91
Delivering quality audits is a priority for me	99
I have delivered or supported the delivery of high quality audits this year	98
I have sufficient time and resources to deliver quality audits	36
I receive enough training and development to enable me to deliver quality audits	81

We are pleased that this additional survey demonstrates strongly that our people feel they have helped deliver high quality audits and that they recognise how important it is to EY. The feedback on our investment in training and development is also pleasing.

We budgeted and achieved a significant 10% increase in headcount during FY15. However, the pressures of implementing change and new investments for example our new audit tool 'EY Canvas' has been felt by our people and we are disappointed with the response to the question on sufficiency of time and resources. We are

looking to understand the underlying causes of this concern particularly given the very positive response to all the other questions.

We plan to undertake a similar survey in 2016 and report on the results in our Transparency Report.

External reviews

The firm is subject to external inspection by the ICAEW's Quality Assurance Department (QAD), the FRC's Audit Quality Review Team (AQRT), and the Public Company Accounting and Oversight Board (PCAOB) in the US.

The last QAD inspection took place in 2014 and its report was issued in Spring 2015. The QAD noted that: 'The audit work on the files we reviewed was of an overall high standard'. Nine of the 10 files reviewed were rated as 'satisfactory' or 'generally acceptable' (the two highest ratings). One engagement was rated 'improvement required'. There were no engagements rated 'significant improvement required'. We have taken action to address the matters identified by QAD.

The results of recent QAD reviews are as follows:

	2015 Report	2014 Report	2013 Report
Satisfactory	7	6	3
Generally Acceptable	2	3	7
Improvement Required	1	0	0
Significant improvements required	0	1	0

The QAD also performed two follow up reviews in 2014 and identified that there was a recurring finding on one of the two files. We have performed specific scope reviews in 2015 covering the 'Remedial Action Plans' of all engagements graded 'generally acceptable' or 'improvement required' in the 2014 QAD review and ensured that the agreed actions had been completed.

The FRC's AQRT rates audits on a four point scale: 1, 2A, 2B and 3. In its public reports on the firms, it combines 1 and 2As as 'good with limited improvements required'. A 2B is reported as 'improvements required', while 3s are reported as 'significant improvements required'.

The 2015 AQRT report highlighted the following results:

	2015 Report	2014 Report	2013 Report
Good with limited improvements required	8	6	10
Improvements required	6	6	1
Significant improvements required	2	4	1

In all of their reports for individual firms, the AQRT highlighted key messages for each firm. The key messages highlighted for EY were:

- Monitor actions taken to address the deficiencies identified in the firm's independence processes and guidance and ensure that resources are sufficient to identify and respond in an appropriate and timely manner
- Take further action to ensure all partners in the firm are fully aware of and comply with the requirements under Ethical Standards and the firm's independence policies and procedures
- Review the firm's audit methodology and training in the light of the continuing issues concerning the audit of revenue (including substantive analytical review procedures and revenue recognition)
- Ensure audit teams pay more attention to the nature and complexity of entities when determining the scope and extent of group and component audit procedures
- Improve the audit approach in relation to the testing of journals including the selection of journals based on the characteristics of fraud risk

- Ensure that the firm's auditor's reports accurately describe the audit procedures performed to address the identified risks and include a clear description of the audit scope, coverage and materiality.

All comments about the results of the AQRT's inspection have to be considered in the light of the FRC's comment that changes in gradings are not necessarily indicative of any overall change in audit quality at the firm. Nevertheless, we were pleased that the 2015 report indicated an improvement over 2014, in particular, the reduced number of audits rated 3 and the non-recurrence of findings in relation to letterbox companies following the issuance of our revised guidance in this area.

However, we are not satisfied with these results and they are not consistent with our long-term quality ambition. As discussed above, the results reported in 2015 relate to audits undertaken before the implementation of our Audit Quality Programme and we anticipate that we will begin to see the impact of that in the FRC's 2016 report.

We have taken further specific actions in response to the specific findings of the AQRT. In particular;

- We are increasing the resources of our Independence team and revising our processes to address the AQRT's observations in relation to independence and ethics
- Our summer training included a specific focus on the audit of revenue
- Our updated Global Audit Methodology includes further guidance on the scoping of group audits
- We have updated, and will continue to review our guidance in relation to auditors report

We have also undertaken a review of all the engagements reviewed by AQRT to understand the underlying cause of the findings identified and the results of that review continue to be fed back into our wider AQP.

During the year, the FRC also published the findings of the thematic reviews of bank audits and smaller companies' financial reporting. For our part, we have developed action plans to address the various matters raised by the FRC across the profession.

The FRC has also begun thematic reviews of the firms' approaches to internal quality reviews (our AQR process discussed above), the role of the Engagement Quality Control Reviewers and audit sampling. We await feedback from the FRC on these reviews with interest and will seek to address any findings in our process and training.

The firm is inspected every three years by the PCAOB. The PCAOB conducted its latest inspection in the Autumn of 2014. At the time of drafting this report, the PCAOB has not published the results of this inspection and we will report on those results in our 2016 Transparency Report.

Regulatory findings

Our firm is regulated and subject to professional disciplinary action in cases of potential misconduct. The FRC deals with cases that appear to raise issues affecting the public interest in the UK. Other disciplinary matters are addressed by the ICAEW, our recognized supervisory body.

During the last financial year, we agreed to pay a regulatory penalty of £2,700, determined by the ICAEW following our admitted breach of the Crown Dependencies Audit Rules and Guidance in that we issued two audit opinions under US Auditing Standards that did not also confirm that our audit had been carried out in accordance with ISAs or UK and Ireland ISAs. This matter was identified by AQRT during their inspection and is referred to in their report within their comments on audit reports. We believe that this was an isolated incident, but we have put in place further training for individuals involved in audits under the Crown Dependency Rules.

Also in the year, we accepted a sanction from the ICAEW under the FRC's Auditor Regulatory Sanctions Procedure. This sanction - a regulatory penalty of £52,500 and our agreement to a condition that we prepare and deliver to the FRC by 28 February 2015 an action plan to improve future audits - arose in respect of one of our audits requiring significant improvement in the FRC's 2015 Audit Quality Inspection report. We have undertaken remedial work in relation to the audit inspected by AQRT. We concluded that the audit report we issued remained appropriate. The subsequent audit of this client has been inspected by AQRT, which will be reported on in the FRC's 2016 Audit Quality Inspection report.

The regulation of the firm extends beyond our audit business to other service lines. In the year to 3 July 2015, we have accepted a severe reprimand and agreed to pay a fine of £250,000 and costs of £95,000 to ICAEW in

respect of breaches of the ICAEW's Code of Ethics in relation to an insolvency appointment we undertook in 2009. Our review of the circumstances giving rise to this unintended breach indicated that an unusual combination of events had led to the underlying conflict of interest not being identified during our acceptance process. Nevertheless, as already noted, we are increasing the size of our independence team and strengthening our processes.

As noted in the 2014 Transparency Report, we remain subject to investigation by the FRC in relation to our conduct in relation to the audits of Computer 2000 Distribution Ltd.

Interaction with investors

Since 2013, EY has been running the Dialogue with Investors programme, a series of events which facilitates collaborative and constructive conversation between the firm and leading institutional investors.

These interactive events are designed to provide greater insight into how we fulfil our public interest role. They aim to promote mutually beneficial discussions and provide an opportunity to debate key business risks with this important stakeholder group. We also seek to equip investors with the tools they need to effectively engage on reporting and auditing matters, something EY believes is of great importance.

During FY15 we held two successful Dialogue with Investors events. These were attended by a wide range of investors from leading organisations. These individuals, along with EY partners and academic experts, engaged in meaningful discussion around a range of pertinent subject areas, including audit quality, scope and materiality, the UK audit market and impact of EU reforms, corporate culture, the viability statement, and observations from our review of FTSE 350 2013 annual reports.

Going forward, we plan to enhance and expand upon this important initiative, with work already underway. This has included enhancing the way in which we seek investor feedback as we set event agendas and shape our offering, thereby ensuring we are engaging in the most effective way. We also plan to diversify our calendar of engagements, providing a range of interactive forums where we can take an in-depth look at the areas most relevant to today's investors.

We place a high premium on clear communication with investors across all areas. We want to make sure we understand, and can articulate, their views on corporate governance, corporate reporting, audit, assurance and other capital market issues. We do this through meetings with individual organizations, conversations with trade bodies and other groups, as well as at EY events. For more details on how this is working with our stakeholders and communities, please see pages 23-24 of Volume 2.

Delivering value to Capital Markets

We recognize the critical importance to capital markets of high quality audit and confidence in the audit process. Our audit serves a socially important role.

Historically, the invisibility of the audit process meant that many of our stakeholders had only limited insight into what we do. The introduction of revised auditing standards in 2013 and the consequent expanded audit report have changed that and brought much greater transparency to key aspects of our audit process, the key risks we have focused on and how we have responded to them, how we determine materiality and how we set the scope for our audits.

Discussions with investors have confirmed that these new-style audit reports have added real value. It was also encouraging that Citigroup in their analysis of FTSE100 audit reports this year noted a general improvement in their quality and usefulness across the firms. We now have two years' experience and feedback, with which we can further enhance the value of the reports we issue in 2016. Investors continue to look for as much insight as possible from the audit report. We recognize that desire and so use investor feedback and other intelligence from across the market to ensure our thinking on audit reports remain as useful and relevant as possible.

We have also welcomed the opportunity of our regular engagement sessions with investors to discuss in more detail the new audit reports and what they mean. For example, in our recent session, we discussed the audit scoping process and how the various audit scopes complement each other to arrive at an appropriately balanced audit approach.

2015 will see the first application by companies of the 2014 Corporate Governance Code. This will require companies to make further disclosures about their approach to risk management and in particular to make a longer-term viability statement. These changes and the need to ensure that the related disclosures are meaningful will create real challenges for companies. We are working with directors as they develop their response to the 2014 Code and continue to improve the quality of corporate reporting more generally.

We noted in our 2014 Transparency Report the call to audit committees to report on audit effectiveness. Our discussions with audit committees indicate that they continue to find this requirement a challenge, both in terms of defining and assessing audit quality. We continue to work with Audit Committee members to assist them in meeting this objective. Our audit professionals also work with our clients to help them address other regulatory challenges, in particular the new regulatory capital requirements that impact on many of our financial service clients.

Our governance

Volume 2 describes our legal structure, ownership and governance in some detail. However, we highlight certain aspects that we think are important to our stakeholders.

Oversight

EY is unique among the large audit firms in its governance arrangements. Several years ago, we went through the process of global integration to help drive consistent approaches to delivering professional services and risk management in general and audit quality in particular. We continue to believe this is the best approach in the long run for delivering high quality audits.

Setting up this structure, which included the establishment of Ernst & Young Europe LLP (EY Europe – see Volume 2), we sought and obtained authorization of EY Europe from the ICAEW. As a normal condition of authorization, all partners of EY Europe (ie not just those who are UK based or those who are accountants or auditors) became affiliated members of the ICAEW. This means that they are all subject to, among other things, the ICAEW's ethical and professional standards.

Under this integrated model, our UK Board and management (the UK team) is subject to oversight from higher levels of area and global leadership. The UK team is subject to regular review of its actions and its performance across all areas of business activity and benchmarked relative to comparable firms elsewhere in the world. EY UK management participates in a number of international EY forums, which enables them to share best practice with peers, along with other approaches and different techniques for running the UK business sustainably.

While decision making is primarily local, the regular review process provides another level of informed challenge to intended decisions and plans. To reinforce the importance of engaging with the challenges that are made, the remuneration of the UK team requires concurrence at an Area level.

This approach applies to all our service lines, but there are particular features that apply to the audit practice. For instance:

- Certain kinds of decisions on audit engagements require prior approval at an area or global level so that we obtain globally consistent outcomes where the fact patterns are the same
- The audit engagements that are selected for our internal quality inspections are approved at an area level so as to avoid an inappropriate population being selected
- Our UK Audit Independence team is accountable to the firm's global independence leadership and its decisions are subject to their review, as appropriate.

This oversight process also adds value to the UK team as it gives insights to best practices seen in comparable EY firms in Europe on firm management matters. It counteracts the possible insularity that could arise relying only on the UK frame of reference.

While operating this integrated structure, our leadership is mindful of the need to listen the views of local partners about strategy, management and governance more generally. Such engagement and feedback is achieved through a Partner Forum to which UK partners elect members. Some of these elected partners serve on senior bodies outside the UK including the Global Advisory Council (as referred to in Volume 2).

Finally and for sake of completeness, following our integration and implementation of the EU's 8th Company Law Directive, a group of independent audit regulators came together to form the EY European College of Supervisors (now the EY SubGroup of the European Audit Inspection Group). We have engaged extensively with these groups since 2010. As part of that engagement, EY makes available to the EY SubGroup detailed information describing our operating model and processes for EY's audit businesses across Europe. This has been supplemented by discussions with leaders from EY Europe in areas such as assurance, audit quality, independence, human resources and risk management not to mention senior management. This engagement continues on a regular basis.

Conclusion

We hope that Volume 1 has provided helpful insights on how EY performs its public interest role. In Volume 2, you can learn about the recurring aspects of our account to you. Volume 2 provides further detail on matters like our legal and governance arrangements, our commitment to quality, independence practices, financial information and our work with our stakeholders and communities. It can also be accessed online here. Volumes 1 and 2 combined address our obligations under the European Union's 8th Company Law Directive and the Statutory Auditors (Transparency) Instrument 2008.

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About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

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