

# EY UK Audit Quality Report

November 2020

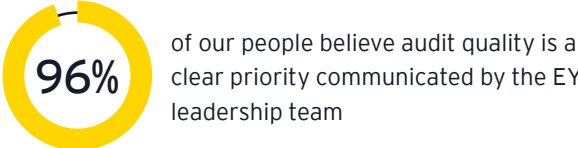
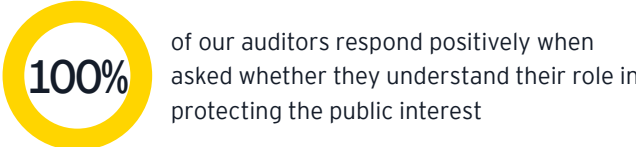


# EY UK 2020 Audit quality report – highlights

## Tone from the top

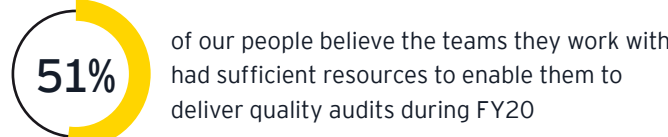
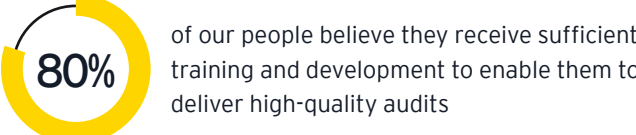
“  
Setting the right tone is vital to ensure that all our audits start with a clear recognition of the importance of audit quality and our purpose in providing confidence in the capital markets.

Michael-John Albert  
(UK Audit Quality Leader)



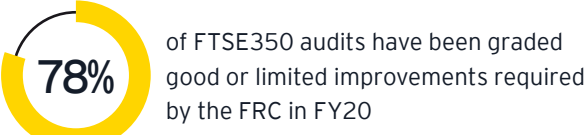
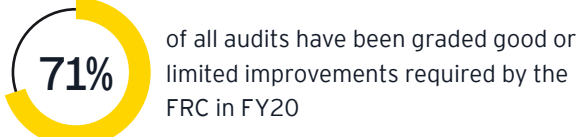
## Our people

98%  
of our people believe delivering quality audits is a priority for them

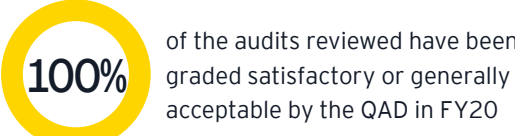


## Audit quality results

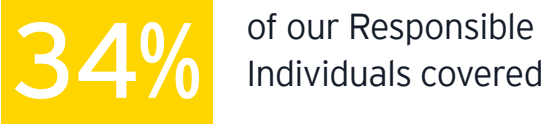
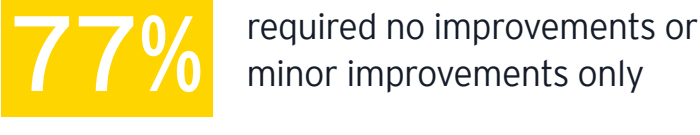
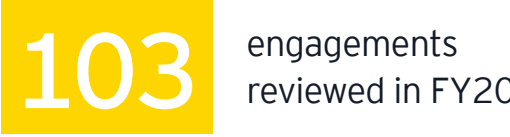
### FRC Results



### QAD Review



### Internal Review



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## **Six Pillars of Sustainable Audit Quality**

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# My vision for audit



**Andrew Walton**

Head of UK Audit



The entire system associated with audit must evolve.

We will play our part in restoring societal trust and personal pride in audit.

## Our purpose is to restore societal trust and personal pride in audit

I am under no illusion that the profession is at a watershed; the seismic shift we are facing and the challenges that brings are well publicised. We now need to create a clear vision of the future of audit, one that is more relevant to users of financial information and one that provides confidence to the capital markets, safeguarding capital and holding financial managers to account.

The needs and demands of our stakeholders have evolved over time, with public and regulatory scrutiny at an all-time high. Regulatory focus continues to expand beyond individual engagement inspections to broader practice-level assessments. Further change is also expected from the package of audit reform measures and the voluntary steps we are taking in support of operational separation.

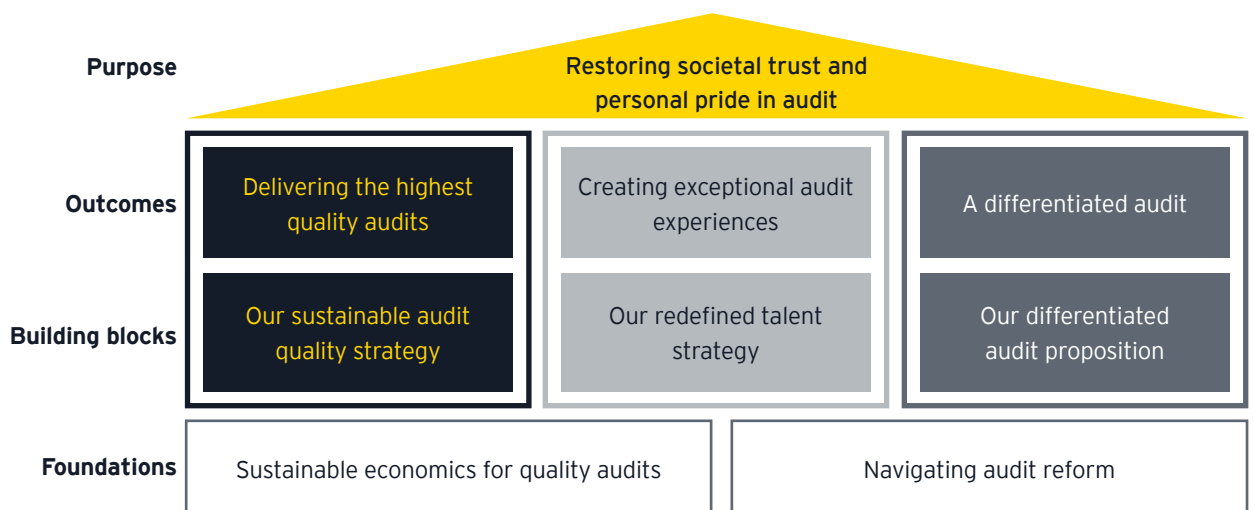
However, we cannot do this alone. We need investors, boards, regulators and the government to adopt a holistic package of measures providing the necessary accountability across the audit ecosystem. Only then will society's trust in audit be restored.

The profession must also be seen as attractive to current and prospective auditors by providing a career that is fulfilling and invokes a sense of pride in the role they play in delivering confidence to the capital markets.

This is why EY's audit strategy is focused on creating exceptional experiences for our people, delivering a differentiated audit that meets the needs of our stakeholders and at its heart has an ambitious, multi-year audit quality strategy, to provide greater confidence to external users and to our people that we get it right all of the time.

## Delivering the highest quality audits

We know, and our regulatory inspections tell us, that we already perform high-quality audits in many cases, but unfortunately this is not consistently the case. Although we have already made significant investments to improve audit quality over the last seven years, we fully accept that there is more to do to meet the needs of our stakeholders and society as a whole. A key focus of



our refreshed multi-year audit quality strategy is to drive greater consistency in delivering high-quality audits. This, our second Audit Quality Report, provides further detail on our audit quality strategy.

## Creating exceptional audit experiences for our people

To deliver high-quality audits we have to recruit and retain the best talent. This relies on the audit profession remaining an attractive place to work. For this reason we are also introducing a redefined talent strategy. We are reassessing the core fundamentals of pay, hours, progression and development, but also important considerations of wellbeing, purpose and belonging that all significantly impact our people's working experience. Two developments planned for FY21 include increasing the link between audit quality and reward, and incorporating rolling secondments through our quality function for our senior managers who are seeking career progression.

We continue to be one of the largest recruiters of graduates and school leavers in the UK and I am proud that we honoured all of our job offers for September 2020's intake. We also recruited around 600 experienced accountants in the last year.

## A differentiated audit

Audit market reform will drive changes in the nature and scope of an audit, which in turn will change the work that we perform. However, we aren't simply reacting to these changes; we are also actively looking at how we can develop the future of audit to narrow the expectation gap. Changes to assurance provided on going concern, fraud, cyber and non-financial metrics are a vital part of this, as are the deeper insights that we are already seeing from our continued transition to a data-driven digital audit. Creating a differentiated audit is fully aligned with delivering high-quality audits and providing our staff with new experiences. In particular, the continued increase in data analytics, which underpin the digital audit, has significant benefits for the depth and breadth of our audit testing, increasing the assurance gained from our work.

## Sustainable economics for quality audits

The costs of mandatory tendering, auditor transition and the increased regulatory scrutiny have placed significant commercial pressure on our audit business. We continue to invest in automation, simplification and centralisation

to create efficiency in the delivery costs of audits, while simultaneously driving quality improvements. However, we must ensure that the returns on our audits support our investments in audit quality. Where companies present higher risk factors this also needs to be reflected in the returns achieved. We continue to evaluate the return on our audit business to create the financial resilience to drive sustained audit quality and manage the impacts of audit reform.

## Navigating audit reform

We are actively engaged in the UK audit market reviews and fully supportive of the desire to create an audit ecosystem that better meets the expectations of our stakeholders and society. The scope of reforms impacting the profession is going to be wide ranging:

- ▶ Operational separation will impact the way our business is structured and governed.
- ▶ The fundamental scope of the audit may change if recommendations from the Brydon review are implemented.

We believe that it is vital these reforms are implemented alongside changes in corporate reporting and stronger internal control accountability for directors. We would like to see a UK version of Sarbanes-Oxley Section 404 (SOX) being introduced. We are focused on playing our part in ensuring changes have a positive impact on audit quality, increasing trust in the profession and wider business.

## Conclusion

Auditing in the current environment continues to be challenging and uncertainty remains. The impacts of COVID-19 have exacerbated this and I am proud of how our teams have risen to the challenge in continuing to perform our audits in such difficult times.

In these circumstances it is imperative we have an unwavering focus on audit quality. This Audit Quality Report is intended to help audit committees and other stakeholders understand the steps we are taking at EY to deliver consistent and sustainable high-quality audits. I am convinced we are on the right path and am committed to the continued efforts I and all our people must make to meet the expectations of us.

## Andrew Walton

Head of UK Audit

# Our UK Sustainable Audit Quality programme



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The audit profession is experiencing the most challenging circumstances that I have seen in my 30 years as an auditor. In response we have redefined our audit quality ambition and developed a progressive multi-year audit quality strategy to deliver sustainable and consistently high-quality audits.

Michael-John Albert  
(UK Audit Quality Leader)

## Our UK SAQ programme

EY continues to make a significant investment in audit quality through its global sustainable audit quality (SAQ) programme. The UK SAQ programme aligns with this global programme, and has now been running for seven years. It originated in 2014 in response to our disappointment in the results of the Financial Reporting Council (FRC) review published in May 2014. Although there is more to do to achieve our redefined audit quality ambition, explained further on the following pages, we must not lose sight of the progress that the programme has made over the years. There is little doubt that the efforts of the regulator and our response have resulted in the performance of higher quality audits compared to seven years ago.

Over this time we have continually assessed where further investment is needed to respond to findings from our regulators and our own root cause analysis programme. This has led to a wide range of initiatives, which have been developed and implemented with the sole objective of improving audit quality.

This has contributed to a significant improvement in the FRC inspection result. Over the last five years the FRC has graded an average of 78% of all our audits as requiring no or limited improvements and this rises to 84% for audits of FTSE 350 companies.

These audit quality initiatives all sit under the six pillars of our Global SAQ programme.



**Tone at the top**  
The internal and external messages sent by EY leadership, including audit partners, that establish and encourage a commitment to quality, setting a clear tone at the top

**Exceptional talent**  
Specific initiatives that support EY auditors in devoting time to perform quality work, including recruitment, retention, learning and workload management

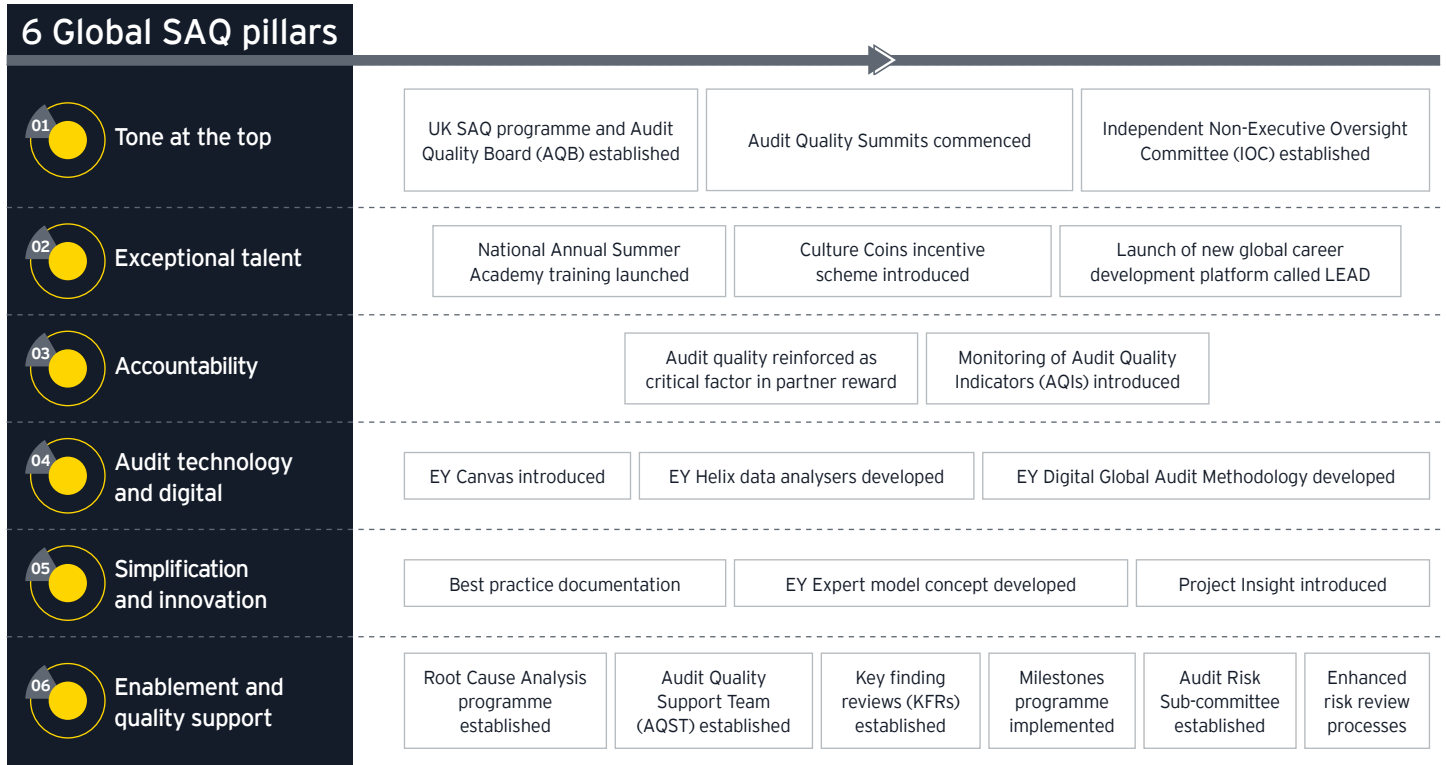
**Accountability**  
The systems and processes in place to help EY people take responsibility for carrying out high-quality work at all times, including their reward and recognition

**Audit technology and digital**  
How the EY Digital Audit is evolving in this transformative age to set the standard for the digital-first way of approaching audit, combining leading-edge digital tools, stakeholder focus and a commitment to quality

**Simplification and innovation**  
How we are simplifying and standardising the approach used by EY auditors and embracing emerging technologies to improve the quality, consistency and efficiency of the audit

**Enablement and quality support**  
How EY teams are being helped to manage their responsibility to provide high audit quality

The timeline below sets out key audit quality initiatives that we have implemented in recent years and that have driven an improvement in our audit quality. We have made good progress in the actions identified in our last audit quality report. Our redefined strategy includes further development of these areas.



FRC results on all audits inspected (% graded good or limited improvements)



FRC results on FTSE 350 audits inspected (% graded good or limited improvements)



\* Five-year average used as SAQ initiatives impacted results from 2016 onwards.

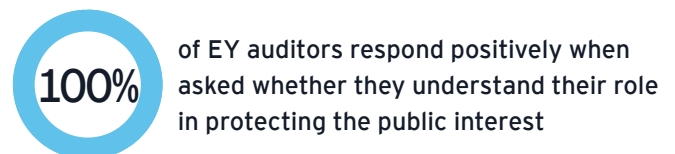
## Our UK SAQ programme – FY21 and beyond

Although these initiatives have improved audit quality, and a large proportion of our audits are performed to a high standard, we're very clear that we have more to do to respond to our regulators' findings; achieve our own audit quality ambitions; and most importantly, to ensure we restore societal trust in audit.

That is why in 2020 we have performed a full reassessment of our UK SAQ programme with a view to making the step change necessary to ensure that we can confidently and consistently deliver high-quality audits that meet all our stakeholders' expectations of us, every time. This has led to the development

of our redefined audit quality strategy, which is embedded in our overall UK SAQ programme.

We know that our auditors understand the importance of the work that they do and this gives us a great platform for the further changes we need to make.



# Our UK Sustainable Audit Quality programme

## Our audit quality ambition

As a first step in developing our updated audit quality strategy we set out a clear ambition of what we wanted to achieve.

**Our redefined ambition is to have a high degree of confidence that we will have no audit failures across all of our audits.**

In this context we considered audit failures to be:

- ▶ Any 2b or 3-rated engagements (or equivalent grades) on FRC inspection
- ▶ Any 'improvements required' or 'significant improvements required' on QAD inspection
- ▶ Any engagements rated 2 with significant findings or 3 on internal inspection
- ▶ Any audit investigations resulting in fines and actions leading to successful claims against the firm

This ambition applies to every single audit we complete.

## Our UK audit quality strategy

To deliver against this ambition, our strategy has been built on a thorough review of those specific factors that most successfully deliver high audit quality. This process has also been subject to

ongoing review and challenge by our independent non-executives (INEs) prior to finalisation.

There is no one action that can ensure audit quality. It requires a carefully considered series of actions across our business that impact our audits on a daily basis.

Our work has led to the identification of 11 strategic priorities that we believe underpin high-quality audits, with each initiative sitting under the existing Global SAQ pillars.

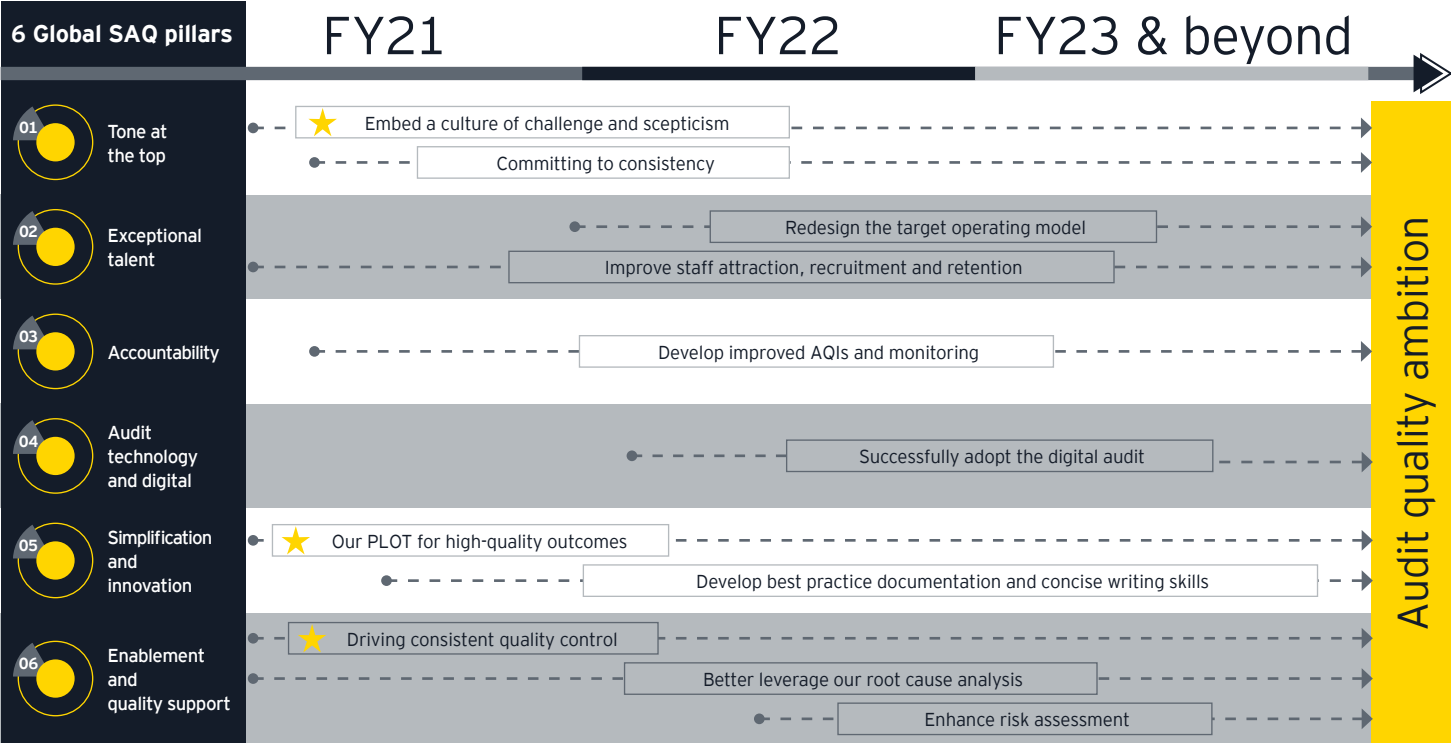
We have already begun to invest in these areas and our specific focus in the short term is on:

- ▶ **Embedding a culture of challenge and scepticism**
- ▶ **Our Purpose-Led Outcome Thinking (PLOT) for high-quality outcomes**
- ▶ **Driving consistent quality control**

Actions are being taken on these three initiatives prior to December 2020.

Our strategy is designed to be adaptable. We need to be able to adjust and refocus as necessary as circumstances change, while keeping our ambition in mind. This has already been important as we have responded to the impacts of COVID-19 on our work and will continue as audit reform takes shape.

The timeline below sets out the 11 strategic audit quality initiatives, how they align to our Global SAQ pillars and the planned phasing of implementation.





Further detail on each of these initiatives is included in the following sections of this report. Work has already begun on developing and implementing many of the changes required. Further key changes will be made as part of a phased rollout, reflecting the multi-year nature of our strategy. We communicated the updated audit quality strategy to our partners and senior staff at the Audit Quality Summit in September 2020, further communication is taking place to all staff before the end of the year.

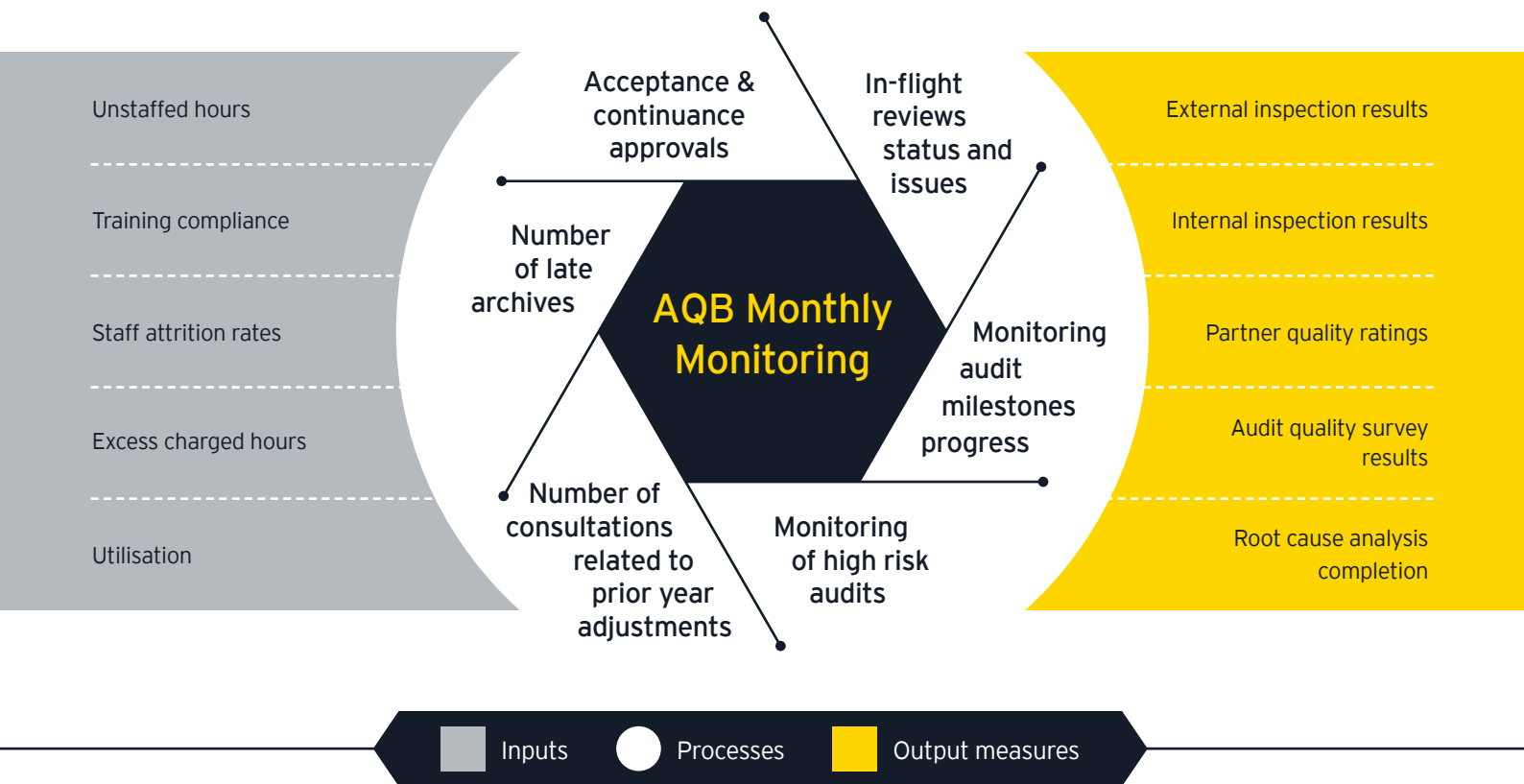
Progress in delivering the strategic initiatives is reported to the Audit Quality Board (AQB) and Independent Non-Executive Oversight Committee (IOC) to ensure there is appropriate assessment and challenge of the adoption of the initiatives in a timely manner.

This ensures that our staff have the capacity to understand and embed these important updates into their work in a structured way. We need to balance pace with the capacity to implement in order to achieve consistent and sustainable high audit quality now, and into the future.

The following pages of this report align with the six Global SAQ pillars. In each section we have set out in further detail the actions we are taking under each strategic initiative, along with a brief summary of other quality initiatives under that pillar. At the end of this report we have also summarised the governance structures we have put in place to drive audit quality.

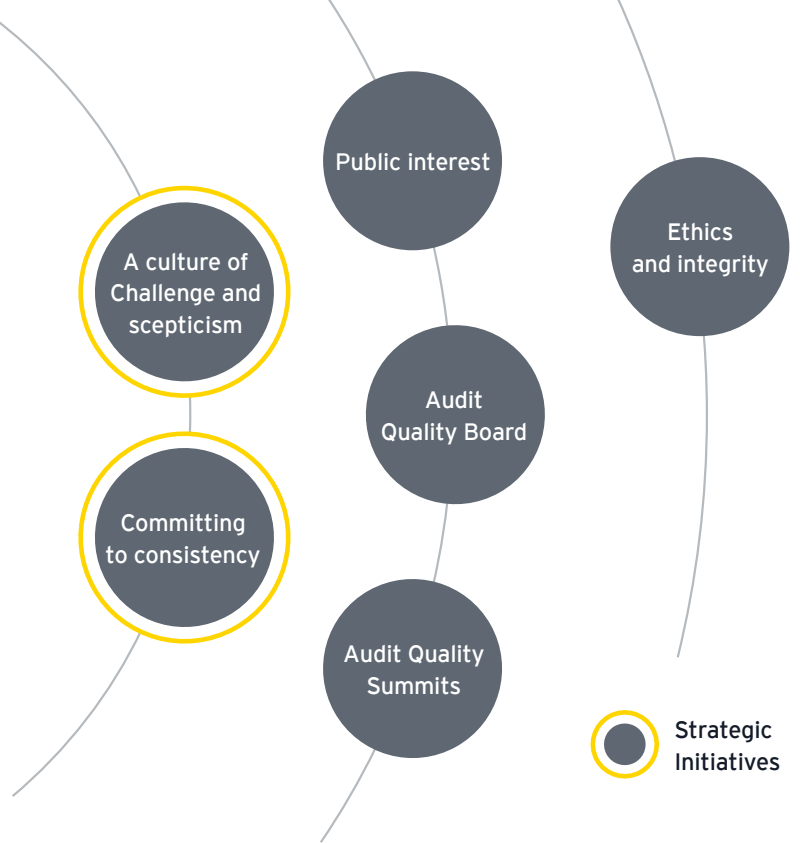
## Monitoring and measuring audit quality

We use a variety of audit quality indicators to monitor the status of our audit practice at both a firmwide and individual engagement level. Although some of these are retrospective in nature others are designed to act as early warning indicators on issues that may impact audit quality and allow timely intervention to take place.



We are building a broader range of audit quality indicators (AQIs) that take account of the FRC's recent thematic review on AQIs to expand our existing indicators to ensure we have a good balance across the lifecycle of an audit.

# 01 Tone at the top



## What are the risks?

Conflicting and inconsistent messaging makes it harder for our people to have clear priorities in the actions they take on a daily basis. We need to have absolute clarity on what comes first – and that is to deliver on our societal purpose by performing high-quality audits.

Our leaders must exhibit the behaviours we want to see throughout our organisation; otherwise we cannot expect our teams to embody these too.

## How does our audit quality strategy respond?

The **Audit Quality Board** and **Audit Quality Summits**, supported by a wide range of other local and national communications, play an important role in cascading the right tone from the top; delivering a consistent, regular message to all our people on the importance of audit quality.

This messaging includes creating an environment where our teams are fully supported to drive a **culture of challenge and scepticism**, particularly where difficult judgements are required.

EY leaders set the right tone from the top by clearly articulating the **public interest** and purpose of the work we perform, with this being embedded in our work as part of the EY Expert Model.

We expect all our partners and staff to act with **integrity** and **commit to consistently** meeting important compliance requirements. Partner remuneration is directly linked to these behaviours.



of our people believe audit quality is a clear priority communicated by EY leaders



of EY auditors respond positively when asked whether they understand their role in protecting the public interest

“

EY leadership will actively support our audit teams in making difficult decisions on our audits, whether on key judgemental matters, needing more time to complete our work, or the nature of the opinions we issue.

Andrew Walton  
Head of UK audit

# Strategic initiatives

## A culture of challenge and scepticism (FY21 priority)

Audits often involve a number of difficult and complex judgements and the extent to which we demonstrate professional scepticism in assessing these continues to be challenged by regulators. In addition, the revised auditing standard ISA 540 places further emphasis on auditors exercising a greater level of professional scepticism in auditing estimates with significant judgements. Although we are able to demonstrate appropriate challenge and scepticism across our audits in many cases, achieving this consistently requires a revised approach.

Our initiative to build a culture of challenge and scepticism aims to drive a cultural shift in mindset to one of 'presumptive doubt'.

As part of this we have already developed and issued in September 2020:

- ▶ An Active Scepticism Framework – built on external research and designed to help our auditors recognise all the factors, internal and external, which may lead us towards a confirmatory bias, so that we can consciously counter this
- ▶ An Audit Purpose Barometer – to help our teams self-assess the current approaches and scepticism applied on their audits
- ▶ More detailed step by step guidance on the auditing of key management estimates and making fraud risk assessments

These developments are being supported by a greater involvement in our audits from our Forensic & Integrity Services (FIS) practice to help support our teams in assessing fraud risk and other indications of management bias.

## Committing to consistency

This initiative aligns with the requirements of International Quality Management Standard 1 (ISQM 1), which is effective from 2022. It ensures we have the appropriate systems and controls in place to achieve full compliance across a wide range of requirements.

Delivering consistency is not just achieved through the day-to-day work on our audits. It requires timely and accurate completion of a range of supporting activities to equip our auditors and business with the information they need to perform effectively.

At a personal level this includes, for example, feedback, training and independence assessments, which need to be completed and maintained. From a business perspective the recording of hours charged, risk assessments, consultations and other data are again vital for ensuring appropriate oversight of audit risk and quality.

Importantly, the initiative is looking to simplify the compliance requirements for our auditors into a single 'one-stop shop' where possible making it easier for our staff and business to comply with all the important requirements placed upon them.

## Public interest

Our purpose is to serve the public interest for a broad range of stakeholders in audit by providing confidence in the capital markets, safeguarding capital and holding financial managers to account.

In collaboration with cognitive psychologists, we have put understanding purpose at the heart of our audits through our EY Expert Model.

A key part of this approach helps our teams to understand the wider societal purpose of the work we do and how every task we complete in an audit contributes to this. In developing this model, the research clearly showed that fully understanding not just what tasks needed to be completed, but also why, was critical in delivering a high-quality output and improving audit quality.

## Audit Quality Board

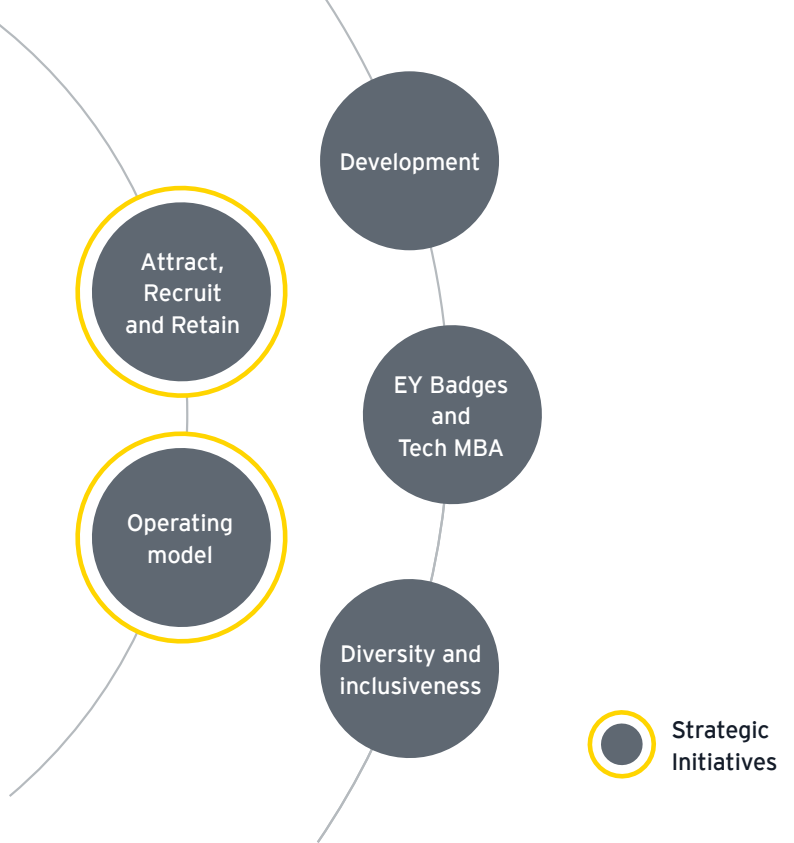
In 2014 the Board of EY UK LLP established the AQB, chaired by our head of audit, as a separate board to oversee quality within its audit practice, reporting directly to the LLP Board and, from 2015, to the INEs. The INEs now attend the monthly AQB on rotation. Following the AQB, a separate meeting is held with the INEs specifically on audit quality matters.

## Audit Quality Summits

2014 also saw the first Audit Quality Summit, which has taken place annually ever since. In 2020 this was delivered virtually across a week of events to over 800 of our partners and senior managers who support our audits. The 2020 event focused on the key developments in our audit quality strategy and the actions we need all our senior staff to take. The summit included sessions led by senior partners and external speakers, including investors, audit committee chairs, journalists, market participants, our INEs and the regulators. Participants gain a broad perspective on the importance of audit quality. This event also provides an opportunity for key leadership messages on audit quality to be communicated and our plans for the year ahead.

## Ethics and integrity

Our approach to business ethics and integrity is set out in the EY Global Code of Conduct. This covers how our people: work with one another and the companies we audit; act with professional integrity; maintain objectivity and independence; and protect confidential information. Annually all our auditors confirm their independence and compliance with the Global Code of Conduct.



**What are the risks? How does our audit quality strategy respond?**

We need to ensure the audit profession remains an attractive career for our people. If we don't attract, recruit and retain talented people there is an increased risk of not being able to deliver high-quality audits.

There is a risk to audit quality if we do not equip our people with the knowledge and skills to deal with the ever-changing external environment and regulations.

If we don't have the right number of people with the right skills performing the right tasks we increase the risk of not being able to deliver high-quality audits.

We continue to invest in a number of programmes ensuring we **recruit and retain** people who not only have the technical knowledge but also the right mindset to make critical judgements on our audits. Specific new initiatives are being developed, such as a new onboarding programme, a mandatory quality secondment programme for our senior managers seeking career progression and further reinforcing how reward and recognition is closely linked to audit quality.

**Developing** our people and providing the right experiences, along with a carefully targeted training programme, is a key priority. Our **EY Badges scheme and Tech MBA** is a key example where we are not only focusing on technical content but investing in helping our teams develop skills for now and the future.

We are assessing and **redesigning our operating model** to ensure we have the right skills and experience in our audit teams, while leveraging new technologies and centralisation to allow these teams to focus on the highest risk areas of the audit.

**80%** of our people agree they receive sufficient training and development to enable them to deliver quality audits

Under our differential focus on race and gender, we have a target of 40% female and 20% BAME partners by 2025.

EY ranked top 20 in UK's Best Workplaces™ for Women, published by Great Place to Work® UK in July 2020.

In FY20 alone, we have spent more than 258,000 hours (FY19 171,000 hours) on internal training and development for our people, excluding professional qualification training hours.

# Strategic initiatives

## Attract, recruit and retain

Ensuring that we are attracting, recruiting and retaining a diverse range of talented people who share our values and commitment to serving the public interest is a vital part of our audit quality strategy.

Our reputation as a great place to work enhances our ability to attract talented people. In recruiting candidates, we consider not only technical skills, but also attributes such as integrity, curiosity, ethics and the ability to collaborate in high-performing teams. We have continued to recruit significantly throughout 2020, with more than 600 experienced auditors joining us and we honoured all of our graduate offers, building a pipeline of talent for the future.

Retention of the best talent requires recognition and reward of the right behaviours, to keep our people engaged and make sure we have the continuity of skills and experience to deliver high-quality audits.

Alongside our audit quality strategy we have also launched a refreshed talent strategy in 2020. Key elements of the talent strategy align with ensuring our staff receive the training and experiences necessary to deliver high-quality audits.

Specific new initiatives that are being implemented include:

- ▶ Additional competencies that align with audit quality to be assessed during interview and recruitment processes

- ▶ A new onboarding programme specifically covering the UK regulatory environment and expectations
- ▶ A mandatory secondment programme for senior managers seeking progression, who will join an audit quality department to broaden their skills and experience outside their previous portfolio
- ▶ A reassessment of our performance review process to enhance further the linkage between audit quality and reward and recognition

## Redesign our operating model

We are redesigning our operating model to ensure we have the right resource, with the right skills, doing the right tasks. This is a key priority to ensure we are responding to our people's feedback on the resources required to deliver high-quality audits and are adapting to the changing dynamics in audit delivery now and in the future.

The redesign process includes a review of partner capacity, the administrative time spent by our managers and senior managers and the impact of audit automation and offshoring; all with a view to creating more time for our audit teams to focus on the highest risk audit areas and deliver high-quality, data-driven audits. We also continue to expand and drive adoption of centres of excellence, which focus on providing high-quality, efficient and insightful support to audit teams.

## Development

We place a lot of emphasis on supporting our people to develop and ensuring that they have the right skills and expertise to execute high-quality audits.

Due to COVID-19, we replaced our annual residential training with remote webcasts. In this way, and in conjunction with our normal programme of web-based learning, we ensured continuity in the training support provided.

Our learning resources cover key technical content, adjusted to address new technologies and strategic priorities that promote audit quality. For example, we focus on teaching our professionals how to think critically and apply professional scepticism. Our learning resources also respond to our peoples feedback on the training and development they need.

We continue to support a wide variety of initiatives to give our staff rewarding experiences including a number of secondment programmes, supporting our global award programme *Better begins with you*, and embracing flexible and dynamic working practices.

## EY Badges and Tech MBA

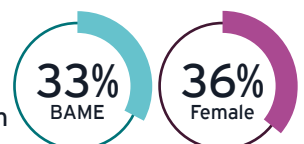
Our EY Badges programme allows staff to learn and develop expertise in a wide variety of areas on demand. From 1 July 2020,

all our EY people will be able to earn an EY Tech MBA. This online qualification, awarded by Hult International Business School, is the first-ever fully accredited corporate MBA. This marks a 'first' not just for EY, but for any large organisation. The EY Tech MBA is completely free to our EY employees and builds on the EY Badge programme. Both of these programmes help to ensure our talented people keep developing the skills they need to deliver a high-quality audit.

## Diversity and inclusiveness

We strive to help everyone at EY feel recognised, valued and included. We believe this has a direct impact on improving audit quality as diversity creates different viewpoints on everything from how a team is project managed, through to challenging key assumptions and approaches adopted by the companies we audit. In 2020 we launched an initiative to track and assess the levels of gender and race diversity in individual engagement teams. To foster a sense of pride and belonging, we also sponsor a wide variety of professional networks.

We recruited 644 graduates and school leavers for the April/September 2020 cohort, of whom





### What are the risks?

Society as a whole and our regulators rightly expect us to be accountable for our work. Without this accountability being recognised and responded to at all levels in the audit process, we will not achieve the improvements needed to deliver the consistent high-quality audits society expects.

Key metrics that measure and monitor audit quality are not tracked or responded to and therefore issues impacting audit quality are not identified in a timely manner.

### How does our audit quality strategy respond?

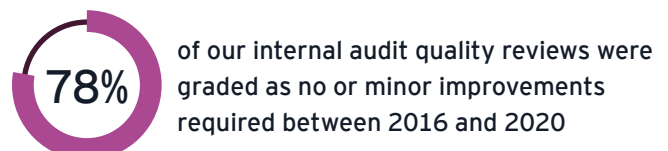
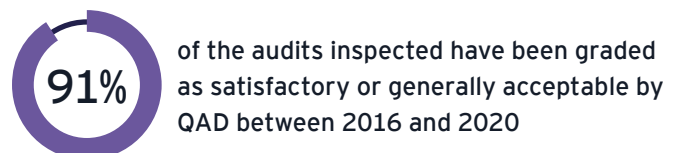
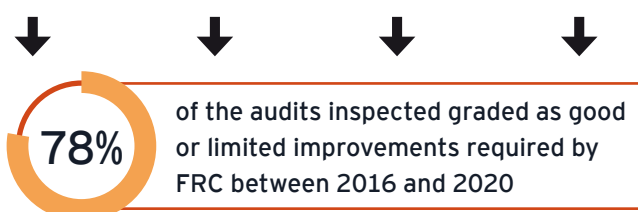
As auditors, we are accountable first and foremost to the broad range of stakeholders in society, but also to our organisation, our teams, and each other.

A critical component of this is a clear link between **reward and recognition** and audit quality. Partners and staff performance evaluations and compensation are therefore impacted by a number of quality measures.

These quality measures which include the results of both **internal** and **external inspections** are a vital part of making our auditors accountable for the work that they perform.

Monitoring our audit performance and the effectiveness of our actions to improve audit quality is a key part of being accountable for our actions. One of our strategic priorities is to build on our existing **Audit Quality Indicators**, giving the AQB and our partners more real-time insight into the progress of our audits.

We take action to **learn** from those occasions where we don't meet the quality standards expected, and share this across the practice.



# Strategic initiatives

## Improved AQIs and monitoring

The AQB receives monthly information on various audit quality indicators that provide key insights into the health of our audit practice.

However, we and EY Global are building a broader range of more granular audit quality indicators that can be tracked both firmwide and at individual engagement level and that take account of the FRC's recent thematic review on AQIs.

We are monitored by EY Global and held accountable for our performance against certain indicators. See page seven for further details.

This will further enable us to understand macro pressures across the audit practice. We will also be able to identify more quickly specific audits that are showing signs of possible

stress, allowing us to provide real-time intervention to better support those teams as and when needed.

Audit quality information is already available to partners at an engagement level, including enhanced project management capabilities in our audit platform EY Canvas. However, we are investigating how it can be reported in a more readily accessible and comparable format so that partners can more quickly assess the status and progress of all their audits.

Our Milestones programme (see page 18) is already a good example of this engagement level tracking and is forming a key base for extending the AQIs for individual audits.

Over the longer term we are looking to automate the collation and analysis of this information so that it will be available live and on demand to all our partners.

## Inspection results

Our audits are subject to annual external and internal inspections. Although the results of the FRC inspections are the most prominent, these on their own provide a relatively narrow measure of quality. The FRC also recognises that results are not always comparable year to year as its own review processes evolve and the concentration of complex audits selected for review increases.

To build a holistic picture of audit quality, it is important to consider a broader range of indicators that include the FRC results and those of the ICAEW's Quality Assurance Department (QAD) and our own internal inspections. Internal inspections cover every responsible individual who signs audit opinions at least every third year. In total each year, approximately 30 audits are selected for external review and 100 for internal review.

The graphics on the preceding page show the average results for the last five years, since our SAQ programme took effect, for each of these review processes.

The external and internal reviews with results released in 2020 had the following results:

- ▶ **FRC Inspections:** 71% of all audits required limited or no improvements, with this rising to 78% for our audits of FTSE 350 companies.
- ▶ **QAD Inspections:** 100% of the audits reviewed were graded as satisfactory or generally acceptable.
- ▶ **Internal Inspections:** 77% of the audits reviewed were graded as no improvements or limited improvements required.

The outcomes from the QAD inspections in the current year were pleasing. However, holistically the results show we must make further progress, through taking the actions set out in this report, if we are to improve consistency, achieve our audit quality ambition and meet society's expectations.

## Learning from our experience

External and internal inspection findings are always analysed, collated and shared with all our staff as part of our continuous process of learning and development. Our Root Cause Analysis helps us achieve this. This process is discussed in further detail on page 18.

We also use regular focus groups and our annual UK Audit Quality Survey to identify areas we need to improve. Certain statistics in this report are drawn from responses to this and other staff surveys.

## Reward and recognition

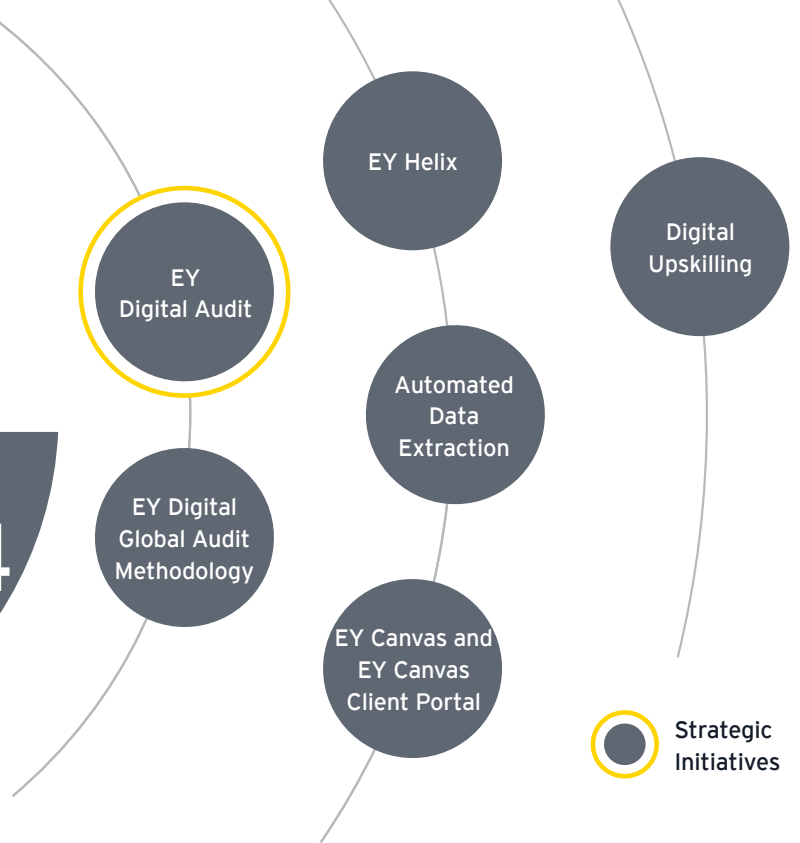
We take inspection results very seriously and performance on audit quality is a critical factor in audit partners' overall evaluation.

Partners' quality performance is determined using a number of criteria, including: internal and external inspection results; compliance with risk management policies; completion of mandatory learning; and level of involvement in embracing and driving quality initiatives. The linking of audit quality to partner remuneration has been identified as an area of good practice by the FRC.

We use our Audit Quality Survey to ask our people whether they believe EY recognises and rewards contributions to audit quality and also collate upward feedback from teams on their assessment of partners' approach to quality. We have seen no improvement in the quality survey response on this question from last year and recognise we need to do more in this area. This year, we gave more weight to quality when determining variable pay awards. We run a non-monetary recognition scheme called 'audit culture coins' to promote and reward a culture of high audit quality. Winners are publicised quarterly and at our Audit Quality Summit. This scheme has been recognised by the FRC in its culture thematic review.

# Audit technology and digital

## 04



### What are the risks?

The extent to which the companies we audit create and use data has increased significantly. This generates a unique opportunity to drive greater assurance and hence improve audit quality through the appropriate analysis of this data. There is a risk that without appropriate analysis, auditors may miss important interrelationships in large volumes of data and we will not be able to efficiently execute a high-quality audit.

### How does our audit quality strategy respond?

The **EY Digital Audit** is a suite of technology and audit approaches that we believe is the profession's first connected, data-driven audit solution. More than a transformation in technology, it is a transformation in how our auditors do their work.

We are expanding our technological solutions to help the companies we audit provide us with their data using our new **automated data extraction** tool. We are also training our teams to improve their **digital skills** and change their mindset on how to approach a data-driven audit. We transformed our methodology, known as **EY Digital GAM**, to support teams' focus on the effective implementation of this transformation.

EY Helix data analysers are currently available globally. More than 80% of the relevant UK audits are already using at least one analyser. We are aiming to increase the number embedding the analysers into their audit approach and the use of multiple analysers over the next 12 months.

Although technology solutions will help drive audit quality improvements, they will always need to be matched with the skills and informed judgement that comes from an experienced auditor. As a profession, auditors must keep questioning, analysing and evaluating data from every perspective.



# Strategic initiatives

## EY Digital Audit

The EY Digital Audit is a suite of technology and audit approaches that is transforming the way our teams deliver quality audits. The adoption of certain data analytics tools and other technologies has been underway for some time, but the EY Digital Audit brings the ever-increasing scope of such tools and new approaches to the audit into a comprehensive data-driven approach.

This seeks to enable high-quality audits through:

- ▶ Better connecting teams and companies
- ▶ Automating standard audit processes and procedures, enabling teams to focus on higher risk, subjective areas
- ▶ Analysing data to improve risk assessments and understand trends or anomalies in entire data populations
- ▶ Providing better insights and challenge to the companies we audit

Various actions have been taken to support the greater adoption of these technologies and audit approaches. These include:

- ▶ Providing dedicated coaches to teams piloting the Digital Audit
- ▶ Establishing centralised specialists dedicated to collecting and collating data for processing in our suite of analytics tools
- ▶ Developing an automated solution to extract data from various systems
- ▶ Continued development of Smart Automation tools to reduce repetitive tasks in the audit process

The sections below provide further details on key advances in our technology and audit approaches which form part of the EY Digital Audit.

## EY Digital GAM

We have transformed EY's Global Audit Methodology (GAM) to put data at the heart of the audit. Known as EY Digital GAM, this new methodology rebuilds the infrastructure of how an audit should be conducted, using data across all stages of an audit. It takes advantage of the digital solutions and automation we have invested in to simplify certain tasks and improve linkages from one audit procedure to another.

We are piloting this approach in 2020. We will extend our adoption to include a further 98 teams in 2021, with further phased rollout in the future.

## Digital upskilling

To support implementation of EY Digital GAM, we have embarked on a journey to upskill our teams. This has included establishing a network of coaches to support those teams adopting EY Digital GAM to ensure a smooth transition, as well as supporting the adoption and implementation of the EY Digital Audit. We also launched our Digital Assurance community, which has 300 people with specific technology related skills. We aim to increase this to over 500 people in FY21.

## EY Helix

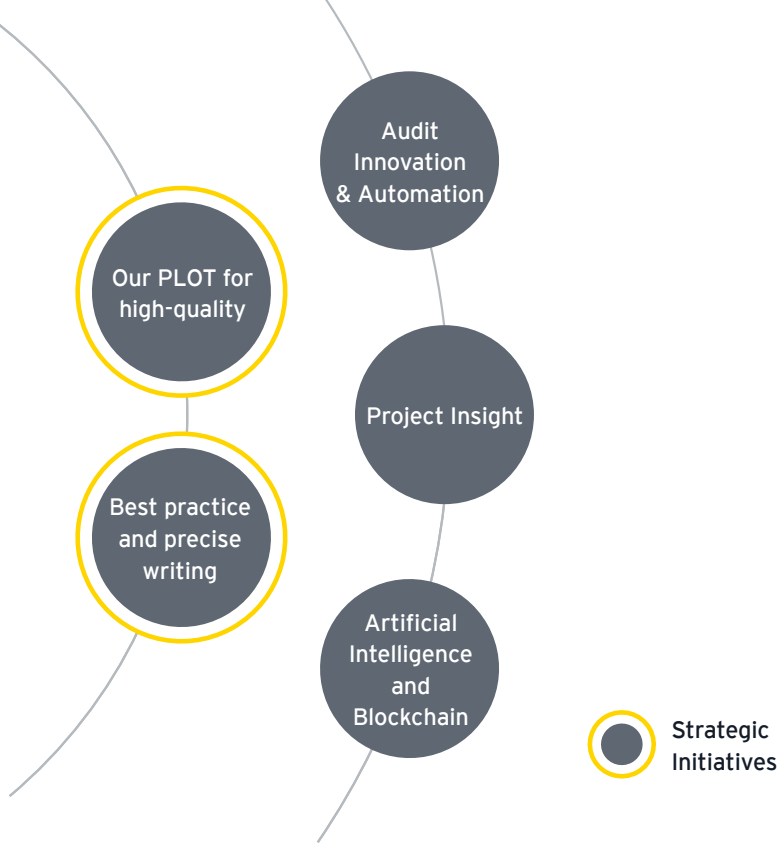
EY Helix is our library of data analysers, which have been developed to capture and transform data from the general ledger and other data sources. These cover a broad range of significant accounts and have a direct impact on improving audit quality by enabling teams to move away from traditional sample selections, to analyse entire populations of data. This improves risk identification and allows teams to focus on unusual trends and anomalies, which can then be investigated.

## Automated data extraction

To facilitate implementation of EY Helix, we have developed an automated general ledger data extraction tool, which operates across 36 IT systems. This ensures we obtain the right data in a smooth and efficient way, and minimises disruption of the IT teams of the companies we audit.

## EY Canvas and EY Canvas Client Portal

EY Canvas is our global audit platform where all our audits are documented. We are continually investing and developing additional functionality. In 2020, we enhanced the project management visibility, and better embedded our milestones programme into the core functionality. In addition, we continued to invest in the EY Canvas Client Portal where teams and the companies we audit are able to share information in a secure way. This year we introduced multi-factor authentication to enhance the security in using this portal.



**What are the risks? How does our audit quality strategy respond?**

In responding to the increasing complexity of the companies we audit, and our regulators' inspection findings, there is a risk we do more work, but this is not targeted in the right way. Just producing more audit documentation without clarity of purpose can be counter-productive to audit quality.

A key aim of our strategy is to raise the bar for all our audits so that each one achieves the standard of quality we and our stakeholders expect.

One of the simplest ways to achieve this is to learn from where we already achieve high-quality outcomes and replicate desired behaviours and actions across our audits. This approach drives the **EY Expert Model**, **Best practice** and **Project Insight** initiatives.

If too much of our documentation is created in a bespoke manner by individual teams, this increases the risk of key omissions and the time taken to review.

Within the **Best practice** initiative we are increasing the levels of standardisation in our approach to specific audit areas. This will ensure greater consistency and efficiency in review.

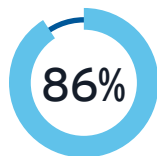
High-volume analysis or testing is an important part of our audit work but can be time consuming and risk reducing time available to focus on key risks or more subjective areas of the audit work.

**Audit innovation and automation** continues to be an area of significant investment, with many automation tools being developed by the UK practice. The principle aim is to complete the routine or high-volume activities in an audit as efficiently as possible and drive consistency across our audits, thus allowing more time for analysis and investigation. This work is inextricably linked with the development of the EY Digital Audit described on page 15.

The EY Expert Model was developed in conjunction with cognitive psychologists, who spent several months in our business, understanding how our teams and individuals who achieved good quality outcomes operated, so that we could identify and replicate these positive behaviours across all our audits.



75% of our people agree they set aside adequate time to coach their team members prior to them commencing any tasks to ensure they understand the purpose of the task and the expected outcome



86% of our people used at least one audit innovation and automation tool in at least one of the companies they audit

# Strategic initiatives

## Our PLOT for high-quality outcomes (FY21 priority)

The EY Expert Model identified 10 core factors of individual drive, thought processes and team culture that were common among high-performing audit teams.

A key component of this model is ensuring that teams are clear on the purpose and expected outputs of any task on an audit before they start, commonly known as PLOT (Purpose-Led Outcome Thinking) within EY. Root cause analysis highlights that where this is not done, time can be wasted in preparing and reviewing work and documentation, and audit quality can suffer as a result.

This behavioural model and the approach we take to our work remains fundamental in delivering high-quality audits. PLOT is commonly used across our audits to coach and approach work. However, we continue to take action to embed this as a cultural way of operating in everything that we do.

At our recent Audit Quality Summit we re-emphasised the importance of this model to all our senior staff, sharing best practice and success stories. This reinforcement of the PLOT approach is being cascaded to all staff in 2020.

## Best practice and precise writing

Ensuring that our audit documentation clearly communicates the work performed, and in particular the judgements made, is critical for facilitating effective review and challenge by our teams and for demonstrating this when our audits are subject to regulatory review.

This strategic initiative builds upon from the best practice documentation that already exists across many of our audits. It will drive greater consistency through:

- ▶ Creating easier linked access to best practice documentation from within EY Canvas
- ▶ Improving standardised approaches to specific work by redesigning standard work programmes and templates
- ▶ Implementing further training to develop clear and concise writing skills

This will also provide the benefit of a simplified but more effective review process, allowing senior members of the team to focus more on challenging the judgements involved in the audit and ensuring we have the right quality evidence to support a high-quality audit.

## Audit innovation and automation

We continue to invest in other areas of audit innovation to improve audit quality. For example, our UK team is continuing to develop automated robotics (bots) to complete routine tasks. These often align with the other technology developments, such as EY Helix analysers, to improve the efficiency with which tools are populated, giving teams more time to investigate the results. Other bots have been developed to assist in specific audit tasks, such as unrecorded liability testing, and with more administrative aspects of the audit, such as preparing engagement letters.

EY globally is also investing in EY Smart Automation. This is a global programme to automate specific audit tasks, for example, sending and receiving confirmation requests and performing accounts disclosure checklists, which are directly linked with EY Canvas.

By automating routine and potentially time-consuming tasks, our teams can spend more time assessing the outputs and focusing on key judgements in the audit – which we believe will further improve audit quality. We are increasingly deploying these new technologies and will continue to invest in these initiatives to assist our teams in preparing consistent and high-quality outputs from their work.

## Project Insight

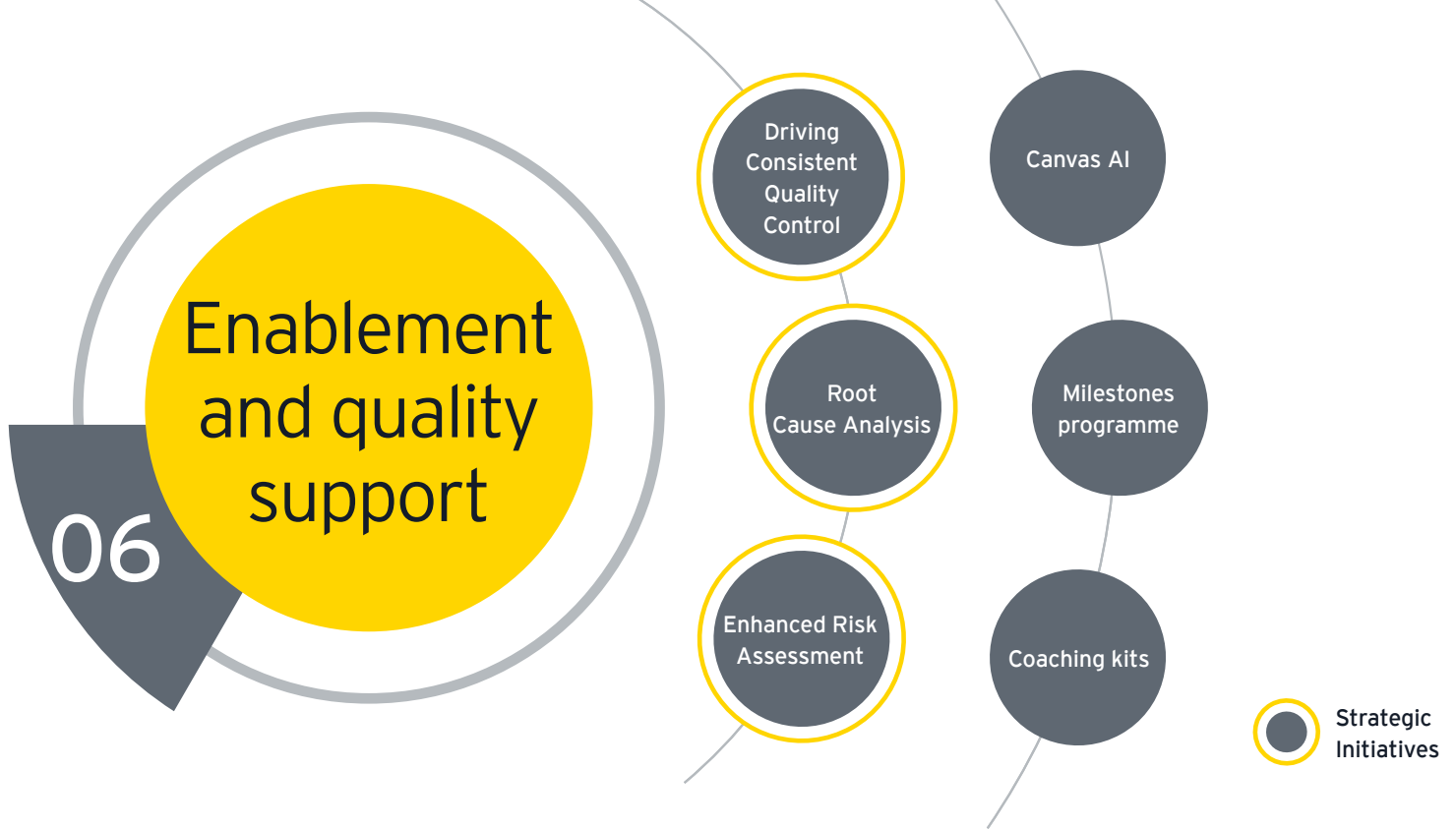
Project Insight drives early intervention from the most senior members of the audit team to improve risk identification in a company's business processes and controls, and design procedures to address these. The programme was initially developed by EY US to support meeting its responsibilities on SEC registrants under the Sarbanes-Oxley regulations.

The programme was originally piloted across the globe in 2019, including 59 teams in the UK. We are looking to roll this out more extensively in the future.

## Artificial Intelligence and Blockchain

AI-enabled tools are already in use across our audits and new tools continue to be developed. Current AI-enabled tools being piloted include a machine learning tool to detect anomalies in journal entry data extracted from a general ledger, a spreadsheet analyser and Document Intelligence solutions using individual data from companies we audit or publicly available data.

The EY Blockchain analyser is a suite of blockchain audit technologies, for example, analysers that enhance the ability to perform an in-depth review of cryptocurrency transactions.



### What are the risks?

Audit risk increases where we do not have the right support processes in place for our teams engaged in our most complex audits to help them identify all relevant issues in the audit and to challenge company management appropriately.

If our risk assessment processes are not effective, there is an increased likelihood that new material issues or difficulties being faced by the companies we audit are not identified and addressed in the audit.

Where effective project management and early involvement from senior staff is not sufficient, this increases the risks to the quality of the audit.

Where we do not meet expected audit quality on certain audits, there is an increased risk that failings are repeated if we don't have processes to learn from experience, take remedial action and share findings across our teams to improve in the future. Similarly, a risk also exists where we don't learn and share best practice from our high-quality outcomes.

### How does our audit quality strategy respond?

Our analysis has shown a clear improvement in internal review inspections where teams have received support from coaching programmes (Audit Quality Support Team (AQST) and Key Findings Reviews (KFRs)). Our strategy will continue to increase the scope of these programmes as part of **driving consistent quality controls** across our audits.

We are developing a risk radar solution to support an **enhanced risk assessment** of the companies we audit. The tool will use a variety of data sources to inform our risk assessment on the audit.

The EY Global **Milestones programme** is designed to give greater visibility on audit status and drive early senior involvement in key audit planning stages on our larger audits. This allows individual teams to monitor the status of their audits, but also provides central oversight of status.

We have run a **Root Cause Analysis (RCA)** process as part of our SAQ for several years. As part of our strategy, we are now extending the scope of these reviews to cover a greater range of positive and negative quality outcomes to take the learnings from these.

We doubled the number of hours on coaching programmes from FY19 to FY20 and have budgeted to spend over 25,000 hours in FY21.

In FY20, we more than doubled our hours performing RCA from prior year to over 2,500 hours. In FY21 we aim to increase resources by over 45%.

# Strategic initiatives

## Driving Consistent Quality Control (FY21 priority)

The review processes inherent in every audit are key to driving consistency and this initiative addresses all levels of review in an audit.

Further training on conducting efficient and effective detailed and general level review is being run for all our audit teams. In addition, we are reassessing capacity constraints so that more time can be dedicated to this critical task.

In recent years we have also put in place a variety of coaching programmes to support our teams. Due to their success, we are extending the scope of both our Audit Quality Support Team (AQST) and Key Findings Reviews (KFRs) programmes. Both programmes involve in-flight reviews of audits and provide feedback to audit teams on a timely manner.

The final key element of this initiative is a reassessment of the Engagement Quality Control Review partner on our public interest entity (PIE) audits. This includes further training but also additional support to help partners perform this role in the most effective way possible.

**The KFR coaching programme supported over 100 audit teams in FY20. We aim to increase this by 40% in FY21.**

## Root Cause Analysis

Root Cause Analysis (RCA) is considered a key function in our quality improvement framework. Our strategy aims to introduce a more streamlined process, increase the scope of these reviews and deliver more timely feedback.

This will include in FY21:

- ▶ Increasing resources and time in the RCA team by over 45% to perform a greater number and broaden the scope of RCA reviews
- ▶ Reviewing the existing RCA process to make it more streamlined, with earlier identification of themes, actions and feedback to the practice
- ▶ Using the RCA team to perform thematic reviews

## Enhanced risk assessment

We are developing a new risk radar tool to support teams in performing risk assessments for the companies they audit. The tool will analyse multiple data sources (e.g. Financial Conduct Authority short selling, social media etc.) to identify adverse factors in relation to specific companies or sectors that audit teams should be aware of. This enhanced risk reporting will enable teams to have broader insights and support them in responding to those risks in a timely manner.

## Milestones programme

The EY Global Milestones programme tracks the progress of audits against an expected benchmark including completion of early planning and timely partner involvement. 2020 has seen continued developments to further embed this programme within our EY Canvas audit platform and to significantly extend the central monitoring of compliance against the milestone due dates.

We now expect every audit taking over 500 hours to comply with the milestones programme and monitor the progress of audits that exceed 2,500 hours in doing so. Where certain engagements are behind schedule, we agree action plans to support the teams in getting back on track.



**90%** of our people agreed that they delivered, supported or contributed towards the delivery of quality audits during FY20

## Canvas.AI

To help teams drive consistency in the performance of quality audits, we are using artificial intelligence that benchmarks the audit strategy decisions documented in EY Canvas across engagements. This seeks to identify if any audit teams in specific sectors are outliers compared to companies with similar risks, particularly in the risk assessments and designation of significant accounts. This tool will be launched in the coming year.

## Coaching kits

Over the last few years, we have introduced targeted coaching kits to support our audit teams. We have continued with our short video tutorials under the banner 'Can You Say Yes'. These on-demand videos aim to promote a curious mindset and encourage our people to challenge themselves with the right questions.

# UK audit quality governance

There are several global roles and functions that have direct accountability for creating, implementing, improving and monitoring specific audit quality control-related activities and processes.

In the UK, we have embedded and built upon these global roles to develop a clear structure for the oversight and monitoring of audit quality. Our firm governance structure is currently under review as part of operational separation reform. Below is the structure in the current year under review.



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Having the appropriate governance structures in place is an important component of ensuring high audit quality. The UK LLP Board and AQB play a vital role in setting the right tone from the top for EY’s auditors. As Independent Non-Executives our role in the IOC is to challenge and hold the AQB to account for driving audit quality. During 2020 we have further increased our scrutiny of the steps being taken by the AQB in response to the impacts of COVID-19 and the development of the audit quality strategy. We have confidence in the firm’s strong commitment to the public interest and high-quality audits.

**David Thorburn**

(Chair of EY’s Independent Non-Executive Oversight Committee)

## UK LLP Board

The UK LLP Board is made up of ten members, of whom eight are practising auditors. The UK LLP Board and the IOC support, challenge and hold the Audit Quality Board to account for driving audit quality.

## Independent Non-Executive Oversight Committee (IOC)

The Independent Non-Executives (INEs), who form the IOC, have full visibility of the entirety of EY UK's business and pay particular attention to the risks to audit quality. For the first three quarters of FY20 the chair of the AQB would present a progress report to the INEs at the quarterly IOC meetings.

With effect from May 2020, a new Audit Quality IOC (AQIOC) was established. Its meetings are chaired by David Thorburn, an INE, and supplement the IOC meetings.

The AQIOC meetings are held after each AQB meeting (typically within one week) and give the INEs the opportunity to ask more detailed questions about the topics covered by the AQB and challenge on matters as they see fit. The chairman and other members of the AQB attend these AQIOC meetings to respond to questions as necessary.

In FY20 our INEs reviewed and challenged the development of our redesigned audit quality strategy, and how we plan to implement it. We will continue to seek challenge and input from the INEs on the implementation of the strategy throughout FY21 to ensure it is effectively addressing the RCA findings and driving improved audit quality.

## Audit Quality Board

In 2014, the UK Board of EY established the Audit Quality Board. The AQB is part of the permanent governance structure of EY and is chaired by the head of audit. It oversees all matters relating to audit quality. It has executive powers over the UK SAQ programme. It reports to the UK LLP Board and to the INEs.

## UK Quality Enablement Leaders and UK SAQ programme

The UK QELs are members of the Audit Quality Board and lead the audit quality programme in the UK (to reflect specific skills and experience we have designated separate QELs for our financial services and non-financial services audit functions). The UK QELs are representatives in the regional and global QEL networks.

The objective of the UK SAQ programme is to ensure that we deliver audit quality at the level we and our stakeholders demand. The UK programme is aligned with the global programme for Sustainable Audit Quality. The details of this programme are contained on the previous pages.

## UK Director of Audit Risk

The UK Director of Audit Risk was introduced in 2019 with responsibility for our processes to identify threats to the quality of our audits at an early stage, and for ensuring that appropriate responses to those risks are put in place. The Director of Audit Risk also has overall responsibility for our external and internal quality inspection process and ensuring that lessons learned from inspections are addressed, both on the specific audit inspected and more widely in our audit practice.

## Audit Risk Sub-Committee

The Audit Risk Sub-committee was introduced in 2019. The committee meets regularly to consider the output of our broader horizon-scanning activities (e.g., press comment and evidence of short-selling activity) and our internal risk assessment process. It also holds discussions with selected engagement teams to assess what further actions are required on individual audits or across our entire audit practice in order to drive enhanced audit quality.

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