



Rachel Reeves MP,
Chair,
Business, Energy and Industrial Strategy Committee,
House of Commons,
London.
SW1A 0AA

6 March 2019

Dear Rachel

**Request for further information following evidence given at BEIS Committee meeting
30 January 2019**

Thank you for your letter of 13 February 2019 requesting further information following the evidence I provided to the BEIS Select Committee on 30 January 2019.

In addition to responding to the questions included in your letter I wanted to take this opportunity to update you on our Future of audit initiative.

In the past few months we have held roundtables in Belfast, Manchester, Birmingham, Edinburgh and London. Representatives from company boards, non-executive directors, shareholders and other stakeholders have attended these roundtables and provided us with a number of views that we will be adding to those we have received from our online questionnaire.

As part of our roundtable programme we have developed a framework for discussion and debate on the future of audit. Specifically, the framework identifies the key questions that we believe help to explore how the audit could evolve. We would be happy to discuss this framework and the initial perspectives from our roundtables if you or any of your colleagues on the Committee would find it helpful.

I am attaching a number of documents that are referenced in some of the answers below. Where personal information was included within the document or where commercially sensitive or non relevant information was present this has been redacted from the document.

With respect to the questions I am able to respond as follows:

PricewaterhouseCoopers LLP, 1 Embankment Place, London WC2N 6RH
T: +44 (0) 1224 210100, F: +44 (0) 1224 253318, www.pwc.co.uk



1. For each year for the last five years, what percentage of your FTSE350 audits cost significantly more (>10%) than originally budgeted. Of those that did cost more:

- **How many did you take up with the audit committee?**
- **Of these, how many did you successfully negotiate the fees for?**

We do not capture centrally all of the information requested and so are unable to provide details of all circumstances where audit costs were higher than those budgeted for all our FTSE 350 audits for the past five years. But in the time available, we have reviewed a sample of those FTSE 350 companies for which PwC has acted as auditor during the past five years.

The percentage of FTSE 350 audits in this sample where costs were significantly more (>10%) than originally budgeted are:

2013/14	55%
2014/15	60%
2015/16	55%
2016/17	37%
2017/18	43%

The financial year includes audits where the financial year end of the company was between 1 July and 30 June inclusive.

Additional costs above those originally budgeted can arise for a variety of reasons such as changes in the scope of our work as a consequence of acquisitions or disposals or new accounting guidance, or where we identify issues during the execution of our audit work which require further work, or where inefficiencies arise in the audit process for us and/or for the companies we are auditing.

We determine if it is appropriate to try to secure additional fees once we have assessed the additional work required. In cases where the additional costs relate solely to inefficiencies in the audit process, this assessment may result in us not seeking to secure additional fees.

Where audit costs in our sample were significantly more (>10%) than originally budgeted, the percentage of those audits where additional fees were negotiated were:

Financial years:

2013/14	83%
2014/15	58%
2015/16	63%
2016/17	82%
2017/18	62%



The Audit Committee will often delegate authority to the CFO to agree the final fee at the conclusion of the audit. We would note however, that our experience is that there is no marked difference in the outcome of the final fee negotiations, whether these are directly with the Audit Committee or with the CFO.

In our experience, Audit Committees are involved in the scoping of audit engagements and any subsequent scoping adjustments and therefore understand that additional fees may be necessary to deal with emerging issues and to ensure quality throughout the audit engagement.

2. How much did you spend overall on FTSE 350 client hospitality and entertainment provided to audit clients and how many such events were held, in each of the last five financial years?

There have been changes to the rules on gifts and hospitality to audit clients following the implementation of the FRC's revised Ethical Standard 2016¹.

These changes apply to the audits of financial periods beginning on or after 17 June 2016 and as a result, our response only includes instances of FTSE 350 client hospitality and entertainment for the relevant financial periods since this change. In this context, whilst the audits of companies with a financial year end of 31 December 2017 would not have been subject to these revised rules until the period from 1 January 2017, we put in place our own internal policy on gifts and hospitality with effect from the second half of 2016. As a result, the figures for 2016/2017 cover the period between 1 October 2016 and 30 June 2017 for hospitality and entertainment that took place in the UK.

For these FTSE 350 companies where we act as auditors, the amount spent on hospitality and entertainment was:

1

<https://www.frc.org.uk/getattachment/0bd6ee4e-075c-4b55-a4ad-b8e5037b56c6/Revised-Ethical-Standard-2016-UK.pdf> at Part A, para 2.10 and Part B 4.61D

Period	Hospitality and entertainment spend for FTSE 350 companies for which PwC acted as auditor £'000	Number of FTSE 350 companies for which PwC acted as auditor	UK Audit revenues for FTSE 350 companies for which PwC acted as auditor
1 October 2016 to 30 June 2017	48.7	103	£181.7 million
Year ended 30 June 2018	45.0	101	£169.3 million

In collating this data, we have captured the costs charged in our systems to client codes as hospitality and entertainment expenses, as well as costs relating to specific hospitality and entertainment events. Therefore the above figures include the reimbursement of expenses which will typically include the costs of business meals and events which are attended by PwC staff and representatives from the company, and the amounts include the costs related to both the PwC employees and the employees of the audited entity.

3. How much did you spend on FTSE 350 client hospitality and entertainment provided to non-audit clients, who subsequently became audit clients, in each of the last five financial years?

We have set out below the amount spent on hospitality and entertainment in each of the last five financial years for FTSE 350 companies which were not audit clients of PwC at the time the spend was incurred, but which had appointed PwC as their auditor by 1 March 2019:

Period	Number of non audit clients who subsequently became audit clients by March 2019	Hospitality and entertainment expenditure £'000
Year ended 30 June 2014	38	73
Year ended 30 June 2015	37	67
Year ended 30 June 2016	29	54
Year ended 30 June 2017	15	20
Year ended 30 June 2018	8	3

We adopted the same approach to the collation of this data as set out in our response to question 2. As we have explained, the figures include costs incurred for PwC staff as well as staff attending from the audited entity. Most instances of 'corporate hospitality and entertainment' relate to expenditure for business meals and events which are attended by PwC staff and representatives of the company.

Expenditure on hospitality and entertainment is in respect of all partners and staff across PwC UK's business, as well as representatives of the clients.

4. For each new FTSE 350 audit client taken on over the last five years, how many hospitality and entertainment events did you invite them to before they became a client?

We do not record instances where we have sent an invitation to a hospitality and entertainment event to a client, but do record instances when individuals (including potential audit clients) actually attend an event.

We have set out below the number of FTSE 350 companies represented at specific hospitality and entertainment events, and the total number of events attended, in each of the last five financial years, for those FTSE 350 companies which were not audit clients of PwC at the time of the event but which had appointed PwC as their auditor by 1 March 2019 (the financial year refers to 1 July to 30 June):

- In the 2013/14 financial year 15 companies attended 14 events.
- In the 2014/15 financial year 16 companies attended 18 events.
- In the 2015/16 financial year 13 companies attended 13 events.
- In the 2016/17 financial year 7 companies attended 7 events.
- In the 2017/18 financial year 3 companies attended 3 events.

The above analysis only captures specific hospitality and entertainment events, as opposed to those occasions which lead to the reimbursement of expenses as referred to in our answers to Questions 2 and 3.

5. What targets are senior audit managers set in order to progress to audit partner level? Can you provide progression letters and appraisals which illustrate the targets used and how they are assessed?

Business cases are developed specifically in respect of each new partner role which include details of the experience required for each role that needs to be demonstrated by the partner candidate.

For those being considered as an audit partner, completion of an Audit Quality assessment form (attached at Annex 5.1) is additionally required.



When considering candidates to become an audit partner in our business, candidates are tested for audit quality, their files are reviewed and on average one candidate per year is not admitted as a result.

Senior staff are set targets specific to their area of work so it is difficult to generalise about what is required to progress to partner. This applies to individuals in all lines of service across the firm (not only those in audit).

Each partner candidate and their sponsor (a current partner, typically the partner who leads the business unit in which the partner candidate works) are provided with the guidance and paperwork required for the partner admission process.

The guidance note for candidates and sponsors for internal partner admissions, which includes information about the process we use in making these decisions, is attached at Annex 5.2.

6. Can you tell me how audit staff remuneration and progression is affected by audit quality issues and can you provide examples, such as appraisal forms, of how this is captured for each audit staff group (c.g. audit partners and audit managers)?

All partners and staff who are involved in the delivery of audits must set a quality objective for each year and assess their performance against this.

The standard quality objectives for grades below partner are set out in Annex 6.1.

For partners the quality requirement is included in the standard template which they complete when setting objectives or goals and in self assessment forms. This template can be found at Annex 6.2.

At the year end, all partners and staff have to self assess their performance using the standard template.

For grades below partner, this is the Individual Contribution & Impact form (attached at Annex 6.3). This self assessment is then reviewed and discussed with the individual by the person's manager. Decisions regarding financial compensation based on the individual's performance are subject to a process of further management discussions and moderation.

For partners involved in audit, in addition to using the template (included at annex 6.2), they are expected to use the further guidance for partners involved in the delivery of external audits, which covers the Revised Ethical Standard 2016, audit quality reviews, assessing the quality of audit work, evidencing technical competence and professionalism scepticism (document attached at Annex 6.4).

Partners and directors who are audit engagement leaders are also subject to internal and external independent audit quality reviews. The results of these reviews form part of the partner's or director's performance assessment.

These assessments will consider a number of factors including: the delivery of audits of 'exceptional quality'; using the findings of key performance indicator reviews; and evidence that the individual has regularly updated the firm's internal systems on a timely basis.

7. Can you confirm that you will be collating and publishing your pay ratios and pay quartiles in respect of gender and BAME next year, and, if you already have this information, can you provide me with this?

I can confirm that we will publish pay gap information for gender and BAME staff, including data on pay ratios and pay quartiles, for the financial year ending 30 June 2019.

In our digital annual report (for the financial year ending 30 June 2018), which you can find [here](#), and our Diversity pay report, which you can find [here](#), we published the pay ratio between average partner profits and average employee reward.

In 2014 we were one of the first firms to start voluntarily publishing our gender pay gap and in September 2017 we were again one of the first firms to voluntarily publish our ethnicity pay gap as a further step in driving transparency and accountability on diversity and inclusion in our business.

In 2018 our Chief People Officer Laura Hinton gave evidence to the BEIS Committee where we outlined our clear action plan aimed at driving real progress in this area.

8. Do your internal reviews of audits change audit outcomes and can you provide examples?

We undertake a number of internal reviews of our audits. Some are done after the audit is completed and some are undertaken as the work is being performed.

For reviews that are performed as the audit is progressing we are able to help the team with their approach and consider findings of their work on a real time basis, focussing in particular on key judgmental areas. Trying to ascertain whether that assistance changed the course of the audit itself is difficult to establish with certainty as the audit team may well have undertaken the work irrespective of the review team's comments. However, there have been some examples over the years of times where we have required a team to undertake more work, such as:

- the extent of work over going concern;
- additional testing being required over receivables following some control failures being identified; and



- following review comments, the engagement leader visited an overseas component that they had not originally planned to visit that year.

For reviews undertaken after the audit is completed, any observations as to improvements that could be made are implemented by the engagement team in the subsequent year's audit. Given the number of such reviews conducted (for example, 136 in FY18) there are many examples year after year where those actions improve the quality of the subsequent years' audits. Such improvements range from simply enhancing explanations and documentation on the audit file through to undertaking more, or different, testing.

9. Please list the technology you share with your network's member firms in other countries.

I am attaching, at Annex 9.1, a list of the technology that the UK firm shares with other firms within the PwC network.

In addition to the technology identified in Annex 9.1 there are in excess of 100 additional technological systems that are shared globally across the PwC network. These systems include the Google suite of applications and Workday (the firm's principle Human Resources system). For audit, this includes systems that deal with acceptance and continuance for audit engagements as well as the Aura system (the firm's audit working paper system).

I hope all these responses are helpful but please let me know if you require any further information or clarification.

Yours sincerely,

A handwritten signature in black ink that reads 'Kevin Ellis'.

Kevin Ellis
Chairman and Senior Partner