



Financial Reporting Council

# What Makes a Good Audit?



November 2021

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# Contents



<b>Foreword</b>	<b>4</b>
<b>Key attributes of a good audit</b>	<b>6</b>
- Risk assessment and planning	8
- Execution	12
- Execution – Professional scepticism and challenge of management	14
- Execution – Specialists and experts	16
- Execution – Group oversight	17
- Execution – Consultation and oversight	18
- Completion and reporting	19
<b>Key attributes of a high-quality audit practice</b>	<b>21</b>
- Firm's quality risk assessment process	22
- Governance and leadership	22
- Performance monitoring and remediation	23
- Quality monitoring	25
- Resources – Resource planning and people management	25
- Resources – Appraisals and rewards	26
- Resources – Methodology and technology	27
- Information and communication	27

# Foreword



Sir Jonathan Thompson  
Chief Executive Officer, FRC

**It is vital that investors, financial markets and all those who depend on companies in the UK, can rely on the information they publish. Audit is key to assuring investors and others that company reports are both accurate and meaningful in setting out an entity's affairs and prospects and an important part of maintaining trust in the integrity of corporate Britain.**

The Financial Reporting Council is often asked what does a good audit look like? This paper sets out our views of the key elements that make up a good audit as a contribution to the debate within audit firms of how they should improve audit quality. As our inspections work has consistently demonstrated, standards of audit quality in the UK are not acceptable, with just 71% of inspected audits meeting the relevant standards. This is not just a UK phenomenon, but a global challenge.

This paper is primarily focussed on the activities of the audit firms and different sections may be of particular interest to different stakeholders. For example, audit committee chairs may be more interested

in the communication from their auditor on audit findings. Conducting a high-quality audit is not just about the audit itself, but just as much about how well the audit practice is run. Evidence from our work on individual audit inspections, as well as our thematic reviews of how firms operate elements of the audit practice and our audit firm supervision, gives us insight into best practice in these twin dimensions of delivering audit quality.

This paper sets out our views on what conducting a good audit should look like. We consider there are three key elements; risk assessment and planning; execution of the audit and completion and reporting. Delivery of the various aspects within these elements depends on a high performing audit practice. We consider there are six elements to achieving this; assessing firm quality risks; mindset, culture, governance and leadership; performance monitoring and remediation; quality monitoring; resources (including recruitment and training) and information and communications.

This paper sets out these nine elements, highlighting best practice we have seen in each. We also recognise that auditing

**Audit is key to assuring investors and others that company reports are both accurate and meaningful.**



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requires the application of judgement within a principles-based framework. It is not just a rules-based compliance exercise. As a result, it is vital that a good audit recognises the need for an audit team to not only have the necessary skills and experience but that it also approaches the engagement with the right behaviours and mindset.

The paper is relevant to audit in any sector (including the public sector). It should be used by the major firms to support their plans to improve audit quality, by challenger firms to help frame their considerations of audit quality as they move and/or expand into the PIE (or local audit) market and by audit committees to support their engagement with their auditors.

This paper does not attempt to cover all the elements of an audit that must be undertaken, but instead focuses on the areas where the good audits stand out. Although not part of this paper, we also recognise the important contribution that the management of the audited entity and those charged with governance can make to a robust and comprehensive audit. A well governed company, which reports transparently, and has clear and robust evidence that underpins that reporting, as well as effective internal controls are all important in underpinning a high-quality audit.

The FRC is committed to working with audit firms, and other stakeholders, to improve audit quality and, as a result, ensure better outcomes for stakeholders who rely on the accuracy and integrity of a company's financial performance and prospects. This paper does not provide a definitive answer to what a good audit looks like, but we hope this is a helpful contribution to inform the debate amongst all our stakeholders about what constitutes a good audit and a high performing audit practice, which are inextricably linked.

**It is vital that an audit team approaches the engagement with the right behaviours and mindset.**

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## Section A. Key attributes of a good audit

- 1.1** There are a range of procedures undertaken by audit firms and engagement teams before an audit commences, such as decisions to tender, accept (or continue) an audit engagement. These are important steps for both an engagement team and the audit firm. Every firm and team must ensure that they have no conflicts of interest or threats to independence that cannot be properly mitigated and that they only undertake audits for which they have the skills, capabilities and capacity to deliver to the required standards. There are also various preconditions for accepting an audit, without which an engagement cannot be accepted. These include management accepting their responsibilities for preparing financial statements, necessary internal controls and providing the auditor with information. Being clear on this from the beginning is important for delivery of a good quality audit.
- 1.2** The FRC defines high-quality audits as those that:
- provide investors and other stakeholders with a high-level of assurance that financial statements give a true and fair view;
  - comply with both the spirit and the letter of auditing regulations and standards;
  - are driven by a robust risk assessment, informed by a thorough understanding of the entity and its environment;
  - are supported by rigorous due process and audit evidence, avoid conflicts of interest, have strong quality management, and involve the robust exercise of professional judgement and professional scepticism;
  - challenge management effectively and obtain sufficient audit evidence for the conclusions reached; and
  - report unambiguously the auditor's conclusion on the financial statements.
- 1.3** An audit is a dynamic and complex activity with many inter-related activities. The requirements and obligations of an auditor in respect of each phase of the audit are set out in International Standards on Auditing (UK) (ISAs (UK)) and in the FRC Ethical Standard. Meeting the requirements in those standards is fundamental to a good audit, and full compliance with those standards is always expected. Figure 1 highlights some of the key aspects which, when done well, contribute significantly to the delivery of a good audit.

**Every firm and team must ensure that they have no conflicts of interest or threats to independence that cannot be properly mitigated.**

**The requirements and obligations of an auditor are set out in ISAs (UK) and in the FRC Ethical Standard.**

**Figure 1 – Key Aspects of the Audit Process**

<b>Risk assessment and planning</b> 	<b>Execution</b> 	<b>Completion and reporting</b> 
<ul style="list-style-type: none"> <li>Careful risk assessment</li> <li>Timely planning</li> <li>Knowledge and understanding</li> <li>Informed expectations</li> <li>Auditors responsibilities relating to fraud</li> <li>Appropriate resources</li> <li>Planning analytical review</li> <li>Planning the group audit</li> <li>Communicated to those charged with governance</li> </ul>	<ul style="list-style-type: none"> <li>Fieldwork must execute the agreed audit plan</li> <li>Appropriate oversight and direction</li> <li>Proportionate approach to higher risk engagements</li> <li>Audit documentation tells the story</li> <li>Professional scepticism and challenge of management</li> <li>Specialists and experts appropriately involved</li> <li>Sufficient group oversight</li> <li>Consultation and oversight</li> </ul>	<ul style="list-style-type: none"> <li>Assess that sufficient, appropriate audit evidence has been obtained</li> <li>Communicate matters of interest</li> </ul>

**1.4** We acknowledge the challenge posed to auditors that every audit is different and auditors must apply judgement within a framework of principles-based standards. The following material does not seek to set out all the requirements or areas of judgement within an audit, but we believe it will assist audit firms and others to understand our views on what constitutes a good audit.

## A.2 Risk assessment and planning

2.1 There are many aspects to the risk assessment and planning for an audit. Risk assessment is a dynamic process; the audit plan and approach may need to be revised because of factors which change the auditor’s risk assessment.

Risk assessment and planning 	Execution 	Completion and reporting 
<ul style="list-style-type: none"> <li>Robust risk assessment</li> <li>Timely planning</li> <li>Knowledge and understanding</li> <li>Informed expectations</li> <li>Auditors responsibilities relating to fraud</li> <li>Appropriate resources</li> <li>Planning analytical review</li> <li>Planning the group audit</li> <li>Communicated to those charged with governance</li> </ul>	<ul style="list-style-type: none"> <li>Fieldwork must execute the agreed audit plan</li> <li>Appropriate oversight and direction</li> <li>Proportionate approach to higher risk engagements</li> <li>Audit documentation tells the story</li> <li>Professional scepticism and challenge of management</li> <li>Specialists and experts appropriately involved</li> <li>Sufficient group oversight</li> <li>Consultation and oversight</li> </ul>	<ul style="list-style-type: none"> <li>Assess that sufficient, appropriate audit evidence has been obtained</li> <li>Communicate matters of interest</li> </ul>

2.2 Good risk assessment and planning pays particular attention to the following attributes:

- Risk assessment** procedures should be based on the inherent (or gross) risk, i.e. before the operation of controls and without any preconceptions, for example about the integrity of management. The risk assessment must take account of the risk of management bias and be informed by the applicable legal and regulatory requirements. Auditors must also consider the external information sources available to them, for example concerns raised by investors or in the media, both individually and cumulatively. Audit planning must be appropriately tailored to the risks identified and those risks must be assessed at financial statement level or the assertion level to appropriately design the audit approach. The changes made in the revised (July 2020) ISA (UK) 315 Identifying and Assessing the Risks of Material Misstatement to enhance the risk assessment procedures will, if properly applied, further improve audit quality across the profession. Having performed the risk assessment, firms may identify that a particular audit is a “higher-risk engagement” and then the firm must provide additional and appropriate support to the audit team in mitigating the specific high risk factors identified. The firms should also engage with the entity to support it’s own risk mitigation developments.
- Planning must be performed on a **timely basis**, well in advance of the financial year end. There must be sufficient time for auditors to consider the risk assessment and design the appropriate audit procedures to address the risk and report their plans to those charged with governance. The best plans also make an allowance for the unexpected and will be adapted as the audit progresses. Where audit teams integrate part of their audit planning into their review of a company’s interim results, this may generate efficiencies, but the output from this planning should be revisited and updated for the purposes of the audit well ahead of the start of the final audit fieldwork, not least since an audit requires a different level of assurance to a review of interim results.

**Audit planning should be appropriately tailored to the risks identified.**

**The best audit plans also make an allowance for the unexpected and will be adapted as the audit progresses.**



Planning must be led by the audit engagement partner and include the key members of the audit team. Where required, engagement quality control reviewers also have an important role to play as the audit is planned and their timely involvement (including the scoping of such input) is also crucial. Planning for more complex areas of the audit may involve relevant specialists, key audit partners and others appropriate to the situation being considered. The best interactions with specialists involve a clear two-way understanding of the relevant risks, the extent and timing of their involvement (if any) and the expectations from both sides.

- A team's **knowledge and understanding** of a business and the environment it operates in must be tailored to the sector and the specific company. This knowledge needs to be distilled down to the relevant elements of the business model, the expected relationships and what the audit risks actually are. This can be challenging and the auditors must be mindful that a complex business model can result in an overly fragmented audit that is not focused on the right audit risks. Ultimately, a business prices its outputs based on its expected deployment of its people, processes and consumption of raw materials. It then has an expected working capital cycle derived from its key terms of trade. Understanding these core relationships is key to an effective audit.

Of equal importance is knowledge about the size and disposition of the populations (transactions and balances) to be tested and the level of judgement needed, and specialist knowledge required, if a sampling approach is being used. This critical understanding will direct the audit approach in terms of sampling approach, testing strategy and whether it is necessary to involve relevant experts, including, for example, examination of the entity's IT systems. Where such experts are used, the audit must be executed to ensure that sufficient time is given to the expert to complete their work and for the audit team to take account of their findings, including an understanding of the work of the expert and the impact of the findings on the audit opinion.

Developing approaches to the audit through the application of technology may replace the sampling approach and substitute more sophisticated analysis of all transactions in any given system. This requires very different skills in information analysis and exception examination. Further consideration on this topic is included in the FRC's guidance on [Addressing Exceptions In The Use of Data Analytics](#).

- The revisions recently made to ISA (UK) 240 (The **auditor's responsibilities relating to fraud** in an audit of financial statements) remind auditors that the inherent limitations of an audit 'does not diminish the auditor's responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement due to fraud'. Whilst the knowledge and understanding of the business model will drive certain audit risks, it is necessary to consider the risk of fraud particularly carefully. Fraud risks may differ substantially from the risks over normal business transactions.

Other revisions, such as enhanced discussion with those charged with governance over fraud risks, will help ensure that auditors consider the risk of material misstatement due to fraud appropriately. ISA (UK) 240 is already clear that auditors must, for example, be alert to the possibility of linked transactions which individually are below materiality but may be disguising a material fraud. The ISA also requires that the audit team, including the engagement partner, discuss (and record) the vulnerability of an entity to fraud (not just at a financial statement level) and how frauds may be perpetrated. This is essential to ensure that less experienced members of the team, who are more likely to be undertaking the audit work, are alert to potential "red flags".

**Auditors must be mindful that a complex business model can result in an overly fragmented audit that is not focused on the right audit risks.**

**It is necessary to consider the risk of fraud particularly carefully. Fraud risks may differ substantially from the risks over normal business transactions.**

- Planning includes ensuring that the audit team is **appropriately resourced** at all levels, considering both the skills necessary and the time needed. Firms also need to agree with the entity that sufficient time is provided to enable the audit to be completed to the appropriate standard. Any resourcing concerns must be flagged early to relevant audit firm leadership who must work with the engagement partner to ensure that the audit team has the necessary resources. More complex risk areas within the audit should have responsibility allocated to the appropriately experienced members of the team and, where necessary, the firm's specialists. Complexities in the resource model arise due to requirements around managed rotation and practicalities around staff availability and development needs. These are best considered and dealt with as early in the process as possible.

The best audits have a diverse team making the best use of new team members alongside those with greater experience and a team which encourages a culture of internal challenge at the planning stage and throughout the audit. Many good audits will embrace coaching the team to develop further. There are a vast range of other practical steps that audit firms can employ to plan for an audit. **Project management** is a key component of this – the audit team must: properly plan the resources it needs, have access to any necessary experts or specialists, and ensure that key members of the team such as the audit engagement partner and key audit partners have sufficient time set aside to undertake their work to the required high standard (including sufficient time for review and finalisation). The team should also plan for how to deal with unexpected issues that may arise, through timely involvement of the audit engagement partner and support from others, such as the engagement quality control reviewer or central teams. Whilst this is important for individual audits, it is also an attribute of a high-quality audit practice.

- Based on the audit team's sector knowledge and business understanding, audit teams must clearly record their **informed expectations** relating to several key financial metrics and key performance indicators (KPIs). The exact extent and detail for these expectations will vary depending on the entity and information available to the auditor. The basis for these auditor expectations must be explained and referenced to source material such as sector reports, benchmarking data and any key agreements or other data already obtained from management. This knowledge will be critical for performing the planning analytical review and potentially identifying when it may be necessary to challenge management. These expectations (including confirmation as to the veracity and reasonableness of any external data sources used), when combined with the other risk assessment and planning procedures, will form a bedrock for the audit approach and delivery plan.
- **Planning analytical review:** If completed with a narrow compliance mind-set to quickly move on to the fieldwork, this planning analytical review will have very limited value. If, however, the analytical review is completed well, using the principles in the ISAs (UK) to drive the work, it will add rigour to the audit, increasing both efficiency and effectiveness. An effective review will blend the team's knowledge, expectations and year-to-date management information to either confirm the preliminary risk assessment or identify counter-intuitive trends and relationships which may indicate a knowledge gap, a new risk or the possible signs of a fraud. The nature of these potential anomalies must be resolved before the start of fieldwork so that, either knowledge gaps are filled and the necessary additional information obtained, or the audit risk assessment and response is updated, the changes clearly documented and the impact on the planned audit procedures fully considered.

**The team should also plan for how to deal with unexpected issues that may arise, through timely involvement of the audit engagement partner and support from others.**

**An effective planning analytical review will blend the team's knowledge, expectations and year-to-date management information.**

- When dealing with large groups, auditors must take particular care in **planning the group audit approach** and communicating that to the component auditors. Good quality audits apply the above attributes across the various components based on a clear shared understanding between the group and component teams particularly in determining which components are significant and the audit approach required. These will be demonstrated through ongoing, timely interactions and robust challenge from both the group and component audit teams, as well as including topco teams in the discussion with local management and those charged with governance.
- The audit approach must be clearly **communicated to those charged with governance**. When there is clear documentation of the detailed correspondence and discussion between the audit team, management and those charged with governance, it evidences that the audit plan is well understood by all. Communication of any changes to the approach, and the rationale behind those changes, also ensures that the audit approach is understood.

### What we have seen – risk assessment and planning



Examples of good practice included:

“The audit team held a two-day global planning event, with participation from management on both days. This enhanced audit planning by ensuring that the audit team was aware of business developments and significant transactions in the year and ensured that the timeline for deliverables by the group was agreed collectively.”

“The audit team tailored its group scoping to respond to fraud risks making good use of the business insights gained from management and the Audit Committee. The group audit team also incorporated elements of unpredictability into the audit procedures to a greater extent than is typically observed.”

“The journal entry testing across the group was thorough and well controlled; in particular the selection criteria used for journal entry testing and the communication of those detailed criteria as required procedures for the component teams. This ensured that the identified fraud risks associated with revenue recognition and management override of controls were appropriately considered across the group.”

**2.3** We have also seen some common shortcomings in planning, which auditors should seek to avoid:

- Each of the sub-components of planning had been treated as discrete activities completed by different people with limited cross correlation of information.
- Risk assessments were generic, theoretical and focused on the net risk, that is after the presumed application of a stated control and having regard to a view on management’s integrity.
- The absence of informed and rationalised expectations linked to the business model and sector norms for the company being audited.
- High level planning analytical review which did not consider the full financial reporting period, the risk of management bias and the inter-relationship of key data, key expectations and business processes.
- Fraud risk assessments which were biased towards journals testing and presumed that a detectable fraud would be individually material and affect the financial statements.

**This enhanced audit planning by ensuring that the audit team was aware of business developments and significant transactions in the year.**

**The group audit team also incorporated elements of unpredictability into the audit procedures to a greater extent than is typically observed.**

**2.4** In addition to the above, we have periodically heard in our discussions with audit committee chairs that audit planning had been completed just at the start of the fieldwork which led to a rushed process. Audit teams must allow the proper time for all the aspects of planning to ensure that there is a strong foundation for the rest of the audit process. It is encouraging that many firms are considering this through their Audit Quality Indicators (AQIs).

## A.3 Execution

**3.1** The execution of an audit plan is, of necessity, individually tailored to the facts and circumstances of the audit. There are a range of standards that need to be followed for every audit, or when particular approaches or tests are undertaken.

Risk assessment and planning 	Execution 	Completion and reporting 
<ul style="list-style-type: none"> <li>Careful risk assessment</li> <li>Timely planning</li> <li>Knowledge and understanding</li> <li>Informed expectations</li> <li>Auditors responsibilities relating to fraud</li> <li>Appropriate resources</li> <li>Planning analytical review</li> <li>Planning the group audit</li> <li>Communicated to those charged with governance</li> </ul>	<ul style="list-style-type: none"> <li>Fieldwork must execute the agreed audit plan</li> <li>Appropriate oversight and direction</li> <li>Proportionate approach to higher risk engagements</li> <li>Audit documentation tells the story</li> <li>Professional scepticism and challenge of management</li> <li>Specialists and experts appropriately involved</li> <li>Sufficient group oversight</li> <li>Consultation and oversight</li> </ul>	<ul style="list-style-type: none"> <li>Assess that sufficient, appropriate audit evidence has been obtained</li> <li>Communicate matters of interest</li> </ul>

**3.2** The fieldwork must comprise **execution of the agreed audit plan** following the ISAs (UK) and the FRC Ethical Standard, making use of the firm’s audit methodology, tools and other resources needed by the audit team. Good audits will demonstrate how the audit team have applied high-quality judgement to assess the evidence they have obtained. Such evidence should be both corroborative and contradictory. A robustly executed audit will utilise an appropriate variety of audit tools to provide an effective audit approach. We have seen examples where the audit team planned to undertake data analytics but during execution defaulted to the testing procedures performed in prior years or standard tests, without sufficient explanation and justification. Such occurrences may increase detection risk and should be avoided unless the actual approach used is at least as effective as the planned approach. Where there is a genuine need to vary the planned audit approach, the team must record the reason and have the change approved by the audit partner. Communications of changes in audit approach must be made to those charged with governance.

**3.3** The execution phase of the audit typically involves many members of the audit team working on various parts of the audit. The **oversight and direction** of the work of the audit team as a whole is critical. A well-structured team, with clear communication channels and frequent access to appropriately senior team members remains a common feature of good audits. This oversight will be dependent on the successful planning and risk assessment procedures, ensuring appropriate reliance on controls, including IT controls when applicable, and dealing promptly with the consequences of matters arising.

**Audit teams should allow the proper time for all the elements of planning to ensure that there is a strong foundation for the rest of the audit process.**

**Good audits will demonstrate how the audit team have applied high-quality judgement to assess the evidence they have obtained. Such evidence should be both corroborative and contradictory.**

- 3.4** Closely linked to oversight and direction is a **continued focus on project management**. Good audits will ensure that there is flexibility to respond to matters as they arise, so that the right resource is used on the right work at the right time. On good audits the engagement team communicates on a timely basis with those charged with governance when additional resource and/or time may be required to deliver the audit to a high quality.
- 3.5 Approach to higher risk engagements** – Beyond the normal level of input required of an audit engagement partner on any audit, the level of participation of the engagement partner should be greater for more complex, higher risk audits (as measured through an audit quality indicator for the percentage of partner time). Firms should pay particular attention to ensure that the audit engagement partner, engagement quality control reviewer and audit team have appropriate access to the necessary support of central functions and other specialists in the firm, such as tax specialists or actuaries, to maintain audit quality in such circumstances.
- 3.6** The **audit documentation** needs to provide an understandable and easy to follow narrative of the audit and the critical thinking of the team members. The audit file must be compiled in a way that allows an external reviewer/inspector to be able to understand and, if necessary, reperform the audit work. Assurance for an area can be fragmented and scattered across the audit file. Care needs to be taken to ensure this does not prevent a proper and holistic assessment of the audit findings. Sometimes it will be necessary for discrete tests to be performed. There needs to be a stand back mechanism built into the audit so the outputs from these discrete tests can be looked at in the context of the overall business model and circumstances of the entity. This approach ensures the team can identify contradictory results. This consideration needs to be reflected in the audit team’s recording of reasoning and supported by appropriate cross referencing.

**On good audits the engagement team communicates on a timely basis with those charged with governance when additional resource and/or time may be required to deliver the audit to a high quality.**

**There needs to be a stand back mechanism built into the audit so the outputs from discrete tests can be looked at in the context of the overall business model and circumstances of the entity.**

**The audit team structured its audit working papers in such a way to identify the key judgements, how they were challenged and how that challenge was concluded.**

#### What we have seen – execution



Examples of good practice included:

“The audit team identified the valuation of complex financial investments as a significant risk. They drew up a work paper which explained how they addressed the valuation risk for each different category of financial investment in each component and where the audit testing could be found.”

“The audit team undertook well-evidenced work in response to action points raised by the firm’s valuation team on the valuation of the audited entity’s pension liability, including work on membership data profile changes and mortality and salary increases assumptions.”

“In those areas which required the exercise of significant judgement by management, the audit team structured its audit working papers in such a way to identify the key judgements, how they were challenged and how that challenge was concluded. The approach adopted was particularly effective and helped provide clear context to the audit and the conclusions reached.”

“The audit team obtained direct confirmations from customers to verify that revenue for major contracts for the first ten months of the year had been appropriately recognised.”

- 3.7** There are some specific aspects of execution that can be particularly challenging, but where we have nonetheless seen examples of good practice. These are explored in more detail in the following sections.



## A.4 Execution – Professional scepticism and challenge of management

- 4.1** Auditors must ‘stand back’ and evaluate the overall audit evidence obtained. Recent revisions to various ISAs (UK) have included specific requirements<sup>1</sup>. **Professional scepticism** must be exercised across the entire audit, although it may be particularly apparent when assessing management’s judgements and estimates. Audit procedures should be performed in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory. The auditors must consult appropriately when carrying out the audit of complex areas. They should persist in **challenging management** if management do not address the auditor’s concerns. Those charged with governance also have a part to play in challenging management. Auditors must also challenge management where the auditor considers that management should be using its own experts to support specific disclosures in the accounts. Relevant matters must always be brought to the attention of those charged with governance. Ultimately this may lead to a decision on modifying the audit opinion, including additional material within the auditor’s report, whether to sign the report at all or, in extreme cases, resigning from the engagement.
- 4.2** Although the audit opinion is ultimately signed by one person, auditing is a team-based activity. To ensure information is shared effectively, critical views must be aired and shared in a **transparent** way. To enable more junior members of the audit team to learn, team members need to feel **empowered** to ask questions and challenge internally. It is incumbent on the audit engagement partner to both seek and deal with internal (and external) challenge. This all enhances the robustness of the audit and develops the team members.
- 4.3** Auditors have different obligations when it comes to other information included within the Annual Report. This obligation is explained in detail in ISA (UK) 720 but broadly requires reporting on whether the other information is materially misstated based on the auditor’s knowledge obtained from the audit. The length and breadth of the narrative section of an annual report continues to become more comprehensive and, in addition to a range of qualitative information, includes alternative performance measures. Audit firms consider whether the **narrative reporting** is “fair, balanced and understandable” and whether it complies with, for entities that are required to follow, the UK Corporate Governance Code and FCA Listing Rules. This sometimes appears to be based on a checklist with insufficient challenge. Whilst this may not be an area of major focus, we do, where necessary, expect auditors to **challenge management** over whether their narrative reporting meets the criteria of fair, balanced and understandable, and to support the drive for clearer reporting, and not simply tick off a compliance report. To enhance transparency of the audit process, audit teams should also be referring to such challenge in their feedback to those charged with governance, as well as challenging audit committees on the contents of their reports (where appropriate).

Auditors must ‘stand back’ and evaluate the overall audit evidence obtained.

To enable more junior members of the audit team to learn, team members need to feel empowered to ask questions and challenge internally.

<sup>1</sup> Examples include: ISA (UK) 220 (November 2019) Quality control for an audit of financial statements, paragraph 17; ISA (UK) 315 (July 2020) Identifying and Assessing the Risks of Material Misstatement, paragraph 36; ISA (UK) 540 (December 2018) Auditing Accounting Estimates and Related Disclosures, paragraph 34; ISA (UK) 570 (September 2019) Going Concern, paragraph 18-1(b)

**4.4** Professional scepticism can be a difficult thing for auditors to achieve and the challenge of management can be difficult for audit teams to pursue. It is, however, a fundamental requirement of every audit and both must be fully documented on the audit file. The ability to be sceptical and challenge management must be embedded into every audit firm's culture and mindset. Firms, therefore, need to apply behavioural change techniques (alongside technical developments in audit process or methodology) to embed this behaviour into the culture of the firm. We expect firms to have the desired behaviour of challenging management and applying professional scepticism within their cultural design and have this aligned to their overall purpose and values. Audit firms must clearly communicate the expected behaviours to staff, aligning incentives with desired behaviour and eliminating any skewed incentives. Firms must then continually assess the behaviours using cultural assessment techniques and create (or eliminate) any drivers of behaviour accordingly.

#### What we have seen – challenge of management and professional scepticism



Some examples of the better practice we have seen includes:

"The audit team's approach to areas requiring a high level of judgement and industry knowledge was of good quality and involved robust challenge of key management assumptions, including effectively utilising the firm's technical team and internal specialists (travel and leisure, valuations, actuarial and pricing specialists)."

"There was good evidence of the audit team challenging the assumptions used by management in the division goodwill impairment model and the method used by management to apportion the goodwill between discontinued and retained operations."

"The audit team's evaluation of management's going concern assessment included robust challenge of the completeness and accuracy of the disclosures made regarding a material uncertainty related to the group's ability to continue as a going concern, including the appropriateness of management's downside scenario."

"The audit team undertook extensive procedures relating to going concern and evidenced their conclusions clearly. They engaged the actuarial specialists who challenged management's going concern assumptions from a regulatory solvency perspective and prepared a report for the engagement partner setting out their findings. In addition, the engagement partner had meetings with senior management to challenge their assumptions and discuss alternative scenarios, all of which was clearly documented. Taken together, this represented a clear summary of the audit team's challenge and the procedures they undertook to assess the entity's ability to continue as a going concern."

"The audit team presented its audit approach and findings in a way which clearly demonstrated the effective exercise of professional scepticism and consequent challenge of management in respect of key audit areas. This was demonstrated further when the audit partner delayed signing the audit opinion until sufficient and appropriate audit evidence had been provided."

"The audit team's planning, audit procedures and basis for conclusions were clearly corroborated and commensurate with the entity's risks. This allowed the audit team to demonstrate considerable challenge of management, including the assessment and judgemental audit differences identified. Furthermore, the audit partner delayed signing the audit opinion until all outstanding items were cleared and audit adjustments were finalised."

**The ability to be sceptical and challenge management must be embedded into every audit firm's culture and mindset.**

**The engagement partner had meetings with senior management to challenge their assumptions and discuss alternative scenarios, all of which was clearly documented.**

**The audit partner delayed signing the audit opinion until sufficient and appropriate audit evidence had been provided.**

## A.5 Execution – Specialist and experts

- 5.1** Relevant audit **specialists or experts** should be brought into the audit team to ensure it has sufficient expertise to assess the risks or to design and perform procedures responsive to the risks. The range of experts and specialists is very broad and their use will be dependent on the facts and circumstances, but might include: restructuring specialists for going concern assessments; tax experts to assist with auditing complex taxation matters; valuers to support with the audit of property valuations; actuaries for insurance or pensions considerations; financial modellers to understand a client’s models; IT specialists undertaking computer assisted audit techniques (CAATs) in, for example, the audits of retail companies; and forensic specialists to understand the potential impact on the audit of a fraud.
- 5.2** Where an audit team is including a specialist as part of the team, their work will be integrated with the audit team’s other work as required under ISAs (UK). Good audits will ensure that they are included in all key phases of work and are able to sufficiently challenge management and share their findings with the wider audit team. Where an auditor’s expert is used there must be clear documentation of the advice requested and the advice received. The division of work between the core audit team and the experts or specialists needs to be clear to all parties and fully evidenced in the audit documentation to ensure that all relevant audit procedures are completed and any relevant findings are appropriately resolved. The audit team must have a clear understanding of the work done by the experts (including the data sources and the assumptions used).

Where an auditor’s expert is used there must be clear documentation of the advice requested and the advice received.

### What we have seen – specialists and experts



The quality of specialists and experts involvement is varied across audit engagements. The following represent examples where there was good involvement and clear documentation:

“The involvement of the auditor’s valuation experts in the audit of the purchase price allocation (for acquisitions in the year) was of a high standard. There was good evidence of their, and the audit team’s, discussions with and the challenge of management’s experts.”

“There was good integration of the tax specialists in the group audit team with other tax experts. This enhanced the level of challenge around the tax provisions and the implementation of accounting changes arising from recent international guidance on uncertain tax treatments.”

“The interaction between the core audit team and the firm’s specialists was performed to a high standard. In particular the inclusion by the audit team of valuation specialists, the firm’s UK chief economist and tax specialists, enhanced the assessments made in respect of the Key Audit Matters. Their work provided a specialist assessment of the key assumptions such as discount rates, estimated remaining useful lives, margins applied to intercompany loans, and management’s approach to forecasting the impact of COVID-19. In each case, the core audit team performed a thorough evaluation of the results of the work performed by the specialists.”

“The audit team engaged actuarial specialists to assist in the audit of the insurance contract liabilities. The actuaries evidenced clearly the areas in which they relied on work performed by the core audit team. These included matters such as confirming the appropriateness of the expense assumption, the completeness and accuracy of data used in actuarial modelling, the review of new reinsurance agreements and confirmation that aspects of the work were consistent with the core audit team’s understanding. On each of these matters, the audit team provided responses and file references to where the work was recorded. This contributed to a well-integrated and well-coordinated audit of the insurance contract liabilities.”

## A.6 Execution – Group oversight

- 6.1** For a group audit, better quality audits have particularly close contact with the component audit teams to deal with issues that may arise at the component level. These are clearly documented on the group audit file and demonstrate the **supervision and oversight by the group audit team**, as well as relevant challenge of the component auditors, or by the component auditors of local management. ISA (UK) 600 has several detailed requirements that need to be complied with to demonstrate appropriate group oversight and to ensure that the group audit file contains the evidence necessary to support the group audit opinion.
- 6.2** In addition, the group auditor, and any engagement quality control reviewer, has a range of specific responsibilities, for example over the consolidation process, and, in a good quality audit, these are clearly documented on the audit file. The nature, timing and extent of those procedures will vary with the risk of material misstatement the auditor has assessed, but a well-explained and clearly evidenced consolidation process will bring together the story of the group audit and where the audit work was focussed for the group team and the various component audit teams. There are also different obligations placed on the auditor depending on whether a component is assessed as significant by the group auditor (as per [FRC guidance note SGN 02/18](#)).<sup>2</sup>

### What we have seen – group oversight



Some examples of good practice we have seen include:

“There was good evidence of the group audit team’s oversight of, and involvement in, the work of the component auditors (for example, the comprehensive business information included in the group instructions and the review of certain key audit working papers for a significant component).”

“The group audit team’s evidence of its involvement in and oversight of the component auditors was of a high standard, in particular:

- Detailed evidence of the review of component auditors’ working papers and the group audit team’s site visits; and
- Robust and informed challenge of management’s expert in relation to the audit of rental fee claims.”

“The group audit team requested component auditors to complete detailed review templates in relation to the audit of component cash flow forecasts used in the goodwill impairment models which provided granular challenge on each of the key assumptions used in the cashflow forecast.”

The group audit team’s oversight of, and involvement in, the component auditor’s work over prepaid revenue was of a good standard. In particular, the group audit team:

- attended walkthroughs of the financial process with the local component auditor and management; and
- reperformed procedures at a group level that assessed the design and implementation of controls.

**A well-explained and clearly evidenced consolidation process will bring together the story of the group audit and where the audit work was focussed for the group team and the various component audit teams.**

<sup>2</sup> <https://www.frc.org.uk/getattachment/b3158e0c-5fd8-4439-89aa-b5f4ee341bf7/Staff-Guidance-Note-0218-Group-Guidance-Nov-2018.pdf>

## A.7 Execution – Consultation and oversight

- 7.1** A regular part of a good quality audit involves **consulting with others**. The engagement quality control review is part of a firm’s processes to provide an ‘objective evaluation of the significant judgements made by the engagement team and the conclusions reached in formulating the report’ as required by ISQC (UK) 1 and ISA (UK) 220. Appropriate consultation is seen as a strength of an audit team, to support the team when reaching a conclusion over significant technical, ethical or other matters.
- 7.2** All the firms we inspect on an annual basis have clear requirements on when mandatory **consultation** and additional **oversight**, for example beyond an engagement quality control reviewer, is required. Other situations do arise when consultation and additional oversight would be beneficial. Examples may include:
- New or unexpected business relationships;
  - Unexpected audit testing results;
  - Concerns over emerging ethical matters;
  - When there is limited evidence in support of a critical management judgement or estimate;
  - If judgements are more challenging due to heightened uncertainty;
  - Increased reporting pressure; and
  - When the senior members of the audit team, notably the audit engagement partner, have, quite rightly, become closely involved in the detail of a key issue.
- 7.3** Audit teams must have the confidence to consult and request additional oversight if circumstances warrant. It is always preferable to consult than to simply carry on and justify a poor decision later.
- 7.4** Where consultation and oversight occur (whether formal or informal), it is essential that those consulted are provided with sufficient information and time to enable the product of the consultation to be of value. There must be a clear record of the consultation input and how it impacted the audit. The record must show how the audit team reached its initial conclusions and how the challenges, for example from the central technical team, were dealt with and how any matters arising were subsequently resolved.

**Audit teams should have the confidence to consult and request additional oversight if circumstances warrant.**

### What we have seen – Consultation and oversight



Some examples of good practice we have seen include:

“The audit team’s engagement with the technical panel was of a high standard and demonstrated a robust two-way challenge.”

“The audit team requested a technical panel to consider the going concern conclusion, going beyond the requirements of the firm’s policies and procedures.”

“The audit team consulted with an internal technical panel as part of its work on going concern. The challenge and discussions arising from the panel led to the audit team performing additional sensitivity analyses over post-year end performance for certain parts of the business.”

“The audit team’s work over the significant risk was considered to be of a high standard. In particular, this included challenge of management’s estimate, consultation with the technical team on management’s estimate and steps taken by the audit team to narrow down their range of reasonable estimates as far as possible.”

*Continued*



“The greatest benefit to the quality of the audit being delivered was felt through the early review of key areas of planning by the EQC reviewer. This was a multi-site audit spanning a number of geographies and utilising input from a number of member firms. Achieving early input on key areas such as engagement risk, independence and determination of materiality was key in helping plan and communicate these issues to component teams and avoiding late surprises from reviews.”

7.5 We have also highlighted the good work undertaken by audit teams around going concern as a result of the COVID pandemic - [Phase 1 \(June 2020\)](#) and [Phase 2 \(November 2020\)](#).

## A.8 Completion and reporting

8.1 The **completion and reporting** phase of the audit plan is the opportunity for the audit team to ensure that all the required procedures have been completed and that the reporting obligations (to management, those charged with governance and through the auditor’s report) are undertaken appropriately. The requirements at this stage are more similar for every audit than previous phases.

Risk assessment and planning 	Execution 	Completion and reporting 
<ul style="list-style-type: none"> <li>Careful risk assessment</li> <li>Timely planning</li> <li>Knowledge and understanding</li> <li>Informed expectations</li> <li>Auditors responsibilities relating to fraud</li> <li>Appropriate resources</li> <li>Planning analytical review</li> <li>Planning the group audit</li> <li>Communicated to those charged with governance</li> </ul>	<ul style="list-style-type: none"> <li>Fieldwork must execute the agreed audit plan</li> <li>Appropriate oversight and direction</li> <li>Proportionate approach to higher risk engagements</li> <li>Audit documentation tells the story</li> <li>Professional scepticism and challenge of management</li> <li>Specialists and experts appropriately involved</li> <li>Sufficient group oversight</li> <li>Consultation and oversight</li> </ul>	<ul style="list-style-type: none"> <li>Assess that sufficient, appropriate audit evidence has been obtained</li> <li>Communicate matters of interest</li> </ul>

8.2 The completion stage of an audit is a final opportunity to stand-back and assess the level of work performed against the audit plan and ensure that **sufficient, appropriate audit evidence** has been obtained in support of the conclusions and judgements drawn by the auditor. This will culminate in the reporting to those charged with governance and ultimately the auditor’s report. A good audit will have had two-way dialogue with those charged with governance throughout the process, but nevertheless will also communicate about the audit as a whole, including the assessed risks (and any changes to them); the work done and matters arising against those risks; findings from other areas of audit work; a summary of the adjusted and unadjusted misstatements identified; matters relating to independence; and relevant conclusions.

The greatest benefit to the quality of the audit being delivered was felt through the early review of key areas of planning by the EQC reviewer.

The completion stage of an audit is a final opportunity to stand-back and assess the level of work performed against the audit plan and ensure that sufficient, appropriate audit evidence has been obtained in support of the conclusions and judgements

- 8.3** A good audit does not shy away from explaining the challenges along the way, and many of the areas communicated will link through to the key audit matters in the audit report. The key audit matters included in extended audit reports is the opportunity for the auditor to explain to wider stakeholders those items which were of most significance in the audit. A good key audit matter will be clear and concise, and help stakeholders understand what the auditor did, found, and importantly areas of significant auditor judgement.
- 8.4** Where we raise significant findings over the audit completion process, these are likely to be symptomatic of an over-running audit, where issues identified by the audit team are being resolved at a very late stage. The completion and reporting stages of an audit have several specific requirements (including appropriate file closure) and a good audit will always comply with those requirements. For example, auditors must **communicate other matters of interest** to those charged with governance in a timely way, including governance concerns, deficiencies in controls, aggressive assumptions and estimates and insufficient disclosures. Auditors must also include appropriate procedures and sufficient time to consider subsequent events after the date of the balance sheet.
- 8.5** Some firms report graduated findings, indicating the extent of any estimation bias in key areas of the audit. This helps to provide audit committees with greater assurance on the assumptions and assessment. Reporting graduated findings facilitates more effective communication with those charged with governance. We recommend this approach to audit firms and support continued developments in this area.
- 8.6** Our [Audit Quality Practice Aid for Audit Committees](#) provides an overview of the typical areas of judgement that auditors should be reporting to audit committees.
- 8.7** Where teams find themselves in a very time-pressured environment, they must seek to obtain more resource, or delay completion of the audit. If, on occasion, an audit report is delayed to ensure that there is sufficient time to consider the evidence (particularly, technically challenging aspects) and record the auditors' reasoning, then that is a necessary step to ensure that the provision of information to the public is of the appropriate quality. We have seen several examples where audit teams have appropriately delayed their reporting. This is never an option that audit firm's take lightly but it can be an important factor in ensuring the delivery of a high-quality audit.

Some firms report graduated findings, indicating the extent of any estimation bias in key areas of the audit.

We have seen several examples where audit teams have appropriately delayed their reporting.

### What we have seen – Completion and reporting



Some examples that we would like to see more often include:

“There was good evidence of the audit team consulting within the firm on judgements around the transaction. The audit team delayed signing the auditor’s opinion until all matters raised in the consultation process had been satisfactorily resolved.”

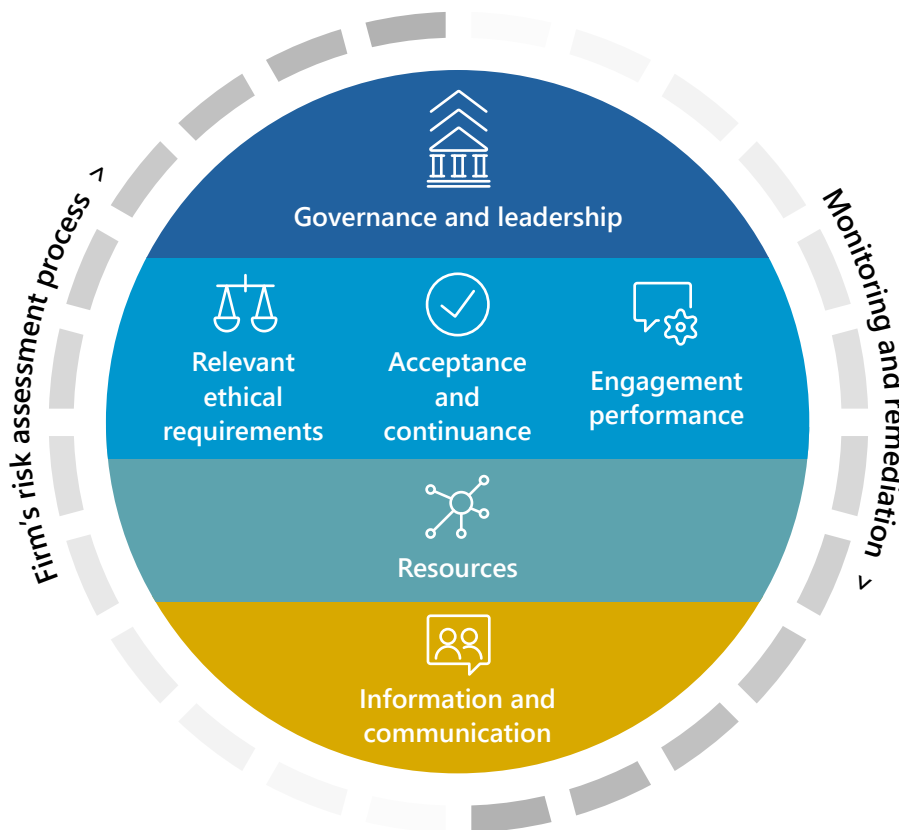
“The valuation of level three investments requires the exercise of considerable judgement which increases the susceptibility to management bias. The audit team presented graduated findings in its report to the Audit Committee, differentiating between those investment valuations considered to be optimistic, balanced and pessimistic. Such presentation provided context to the audit team’s findings and aided effective two-way discussion with the Audit Committee.”

“The use of graphics in the reports to the Audit Committee, notably in relation to going concern, key assumptions, and the valuation of certain assets, aided the communication of complex issues which required the exercise of significant judgement. In addition to providing a clear bridge between the audit findings and the audit report, it promoted effective two-way communication with those charged with governance.”

## Section B. Key elements of a high-quality audit practice

- 9.1** Section A looked at the good audits from the perspective of an individual audit. To a certain extent, this includes engagement performance, acceptance and continuance, the relevant ethical requirements and the resources made available to the audit team. This section will look at the remaining elements of this system of quality management at the audit practice level.
- 9.2** The actions taken at the firm and audit practice level make a fundamental difference to the conduct of any individual audit. Choices about methodology, technology, resourcing, risk management and quality management are made at the firm or audit practice level, sometimes on a global basis. Section B explores these areas where we have some evidence of good practice. Our continually developing work supervising audit practices will provide more evidence over time of what factors are most important and we will continue to publish cross firm reviews in this area to stimulate best practice across audit firms, as we did, for example, on Audit Quality Indicators in 2020.
- 9.3** A system of quality management operates in a continual and iterative manner and is responsive to changes in the nature and circumstances of the firm and its engagements. It also does not operate in a linear manner. ISQM (UK) 1 (effective for the audit of periods beginning on or after 15 December 2022) introduces a new approach to quality management at the firm level that emphasises the responsibility of firm leadership for proactively managing quality, while at the same time being scalable to deal with differences in the size of firms and nature of the services they provide. The key components of a system of quality management are shown in Figure 2 and explored in this section.

**Figure 2: The Key Components of a System of Quality Management**



**ISQM (UK) 1 introduces a new approach to quality management at the firm level that emphasises the responsibility of firm leadership for proactively managing quality.**

## B.10 Firm's quality risk assessment process

- 10.1** Many firms already undertake **risk assessment** of their quality arrangements on a standalone basis. Under ISQM (UK) 1 and 2, such a risk assessment becomes a requirement and firms will need to consider a more integrated approach and a tailored system of quality management that is suitable to the particular firm and the services that it provides. We look forward to seeing the improvements in audit quality as a result of firms establishing quality objectives, identifying and assessing quality risks and implementing responses to those quality risks. Firms will already have considered aspects of this in their processes over acceptance and continuance and the relevant ethical requirements.
- 10.2** We anticipate that the sooner a firm implements this formal quality-driven approach, the sooner quality improvements will arise. Early adoption of ISQM (UK) 1 is strongly encouraged.

## B.11 Governance and leadership

- 11.1** Developing and maintaining an environment and culture for the delivery of high-quality auditing is driven by clear governance and leadership, which emphasises the importance of quality and the expected behaviours of the audit engagement team. Over recent years many audit firms have strengthened their culture, governance and leadership through the appointment of a range of independent non-executives, increasing the influence of the Head of Audit, strengthening both the technical teams and the role and resources of the Ethics function and the Ethics Partner.
- 11.2** As part of our focus on leadership and governance, we have set out our expectations of the experience, skills and attributes of candidates for the key roles of Independent Non-Executives, Heads of UK firm, Chairs, Heads of Audit and Ethics partners at the major firms. In a **pre-appointment meeting**<sup>3</sup> we assess how well we believe appointees meet these criteria and feed this back to senior management of the firm.
- 11.3** Senior leadership must live and drive the right values, ethics and behaviours that support high audit quality throughout the firm. There must be a clear link between remuneration/promotion and audit quality. Learning from audit inspections (internal and external) must be shared across the audit practice and understood, including the sharing of good practice identified within the firm or from external reviews. There must also be an emphasis on the public interest role of audit. At the larger firms, Independent Non-Executives (INEs) already have an important role to play in holding leadership to account for improving audit quality and for driving an appropriate culture and mindset within audit.

### What we have seen – Governance and leadership



Examples of good practice that we have seen include:

“The INEs at one firm held a series of culture meetings with people at all levels across the business. They gained valuable insight into the culture on the ground which they were able to draw on when challenging the leadership, including identifying a misaligned culture in a small number of teams.”

*Continued*

**Early adoption of ISQM (UK) 1 is strongly encouraged.**

**Senior leadership must live and drive the right values, ethics and behaviours that support high audit quality throughout the firm.**

**There must be an emphasis on the public interest role of audit.**

<sup>3</sup> <https://www.frc.org.uk/auditors/audit-firm-supervision-and-audit-market-supervision/pre-appointment-meetings>

"The audit firm undertook a culture program to define the behaviours that drive the delivery of high-quality audit. These behaviours are specific to the UK audit practice and underpin a firmwide global purpose and values. This demonstrates how a firm can align a global, firmwide culture with the specific behaviours needed within the audit practice that, above all else, promote the delivery of high-quality audits."

"The Head of Audit signs-off each root cause review."

"Firms have involved their Boards and the INEs in the setting and review of AQIs. Two firms have mapped their AQIs to their risks."

"Monitoring of the AQIs by the firm's INEs and the Board"

"Most firms are preparing a consolidated reporting pack with detailed analysis of trends and their underlying drivers. Some firms are reporting on actions taken to address issues arising in the previous reporting pack."

## B.12 Performance monitoring and remediation

**12.1** An effective quality management system needs an effective feedback loop to monitor performance of the audit practice. **Effective monitoring and remediation** must be appropriately designed to respond to the quality risks identified by the firm. Where findings are identified, for example from root cause analysis (following internal and external quality reviews), quality improvement plans, market developments or a substantiated complaint, deficiencies identified should trigger decisive corrective action. A high-quality audit firm will have granular oversight of this process and ensure that the actions are appropriately communicated within the firm.

**12.2** There may be other key inputs into the feedback loop for example:

- The perspective of external stakeholders;
- Financial and non-financial relevant audit quality indicators (AQIs) which we explored in May 2020<sup>4</sup>;
- Evolution in the firm's audit practice to normalise developments in good practice and to respond to innovation;
- Indicators of behaviour derived from the firm's culture assessment; and
- Key messages from staff engagement (e.g. surveys) can also provide useful feedback and intelligence.

**12.3** The culture of the firm needs to embrace improvements, foster quality and generate ideas from across the audit practice: avoiding the 'status-quo' or 'group-think'. It is important to create a culture of trust, whereby people are encouraged to openly talk about mistakes and learn from them. A diverse and open culture of challenge and continuous improvement, from across the spectrum of the firm's people and experiences, and considering external stakeholders will assist firms on this journey.

**It is important to create a culture of trust, whereby people are encouraged to openly talk about mistakes and learn from them.**

<sup>4</sup> [https://www.frc.org.uk/getattachment/3d773d0b-04ec-4f03-ae53-78231f356807/AQTR\\_AQI\\_Final.pdf](https://www.frc.org.uk/getattachment/3d773d0b-04ec-4f03-ae53-78231f356807/AQTR_AQI_Final.pdf)



## What we have seen – Monitoring and remediation



### Root Cause Analysis (RCA):

“The RCA dashboard tool allows the firm to look at themes across sub-components of the RCA population. Effective assessment of the aggregate information within the tool has enabled further targeted thematic RCA analysis (e.g. thematic RCA on cash-flows, lead to identification of knowledge gap.)”

“The continual nature of the approach allows RCA activities to be performed using multiple sources of quality issue/ findings, (for example through AQI monitoring and feedback from the in-flight reviews). A new process has also been established for identifying and tracking issues that brings together sources of intelligence and data.”

“There is clear governance over the RCA findings, which are input into wider quality control processes and reported regularly to relevant governance bodies.”

“The firm uses a dedicated RCA review team and established taxonomy. The core RCA team is experienced and has received RCA, psychology, and behavioural training. Additional resources to support the RCA team are drawn from a pool of experienced partners and senior staff who have also received RCA training. The firm uses an established risk factor classification system which enables a consistent approach with a clear trail from the underlying finding to the causes and actions.”

### Audit Quality Indicators:

“On a large group audit, audit quality milestones have effectively been used as an audit quality indicator and project management tool. This was the second year where audit quality milestones (AQMs) were used on the engagement and where AQMs were met in all instances. Overall, the AQMs assisted the team in improving quality on the basis that they highlighted issues much earlier, with focus being placed on addressing these in a more timely fashion.”

“In addition to enhancing audit quality and an improved client relationship, the AQMs have a positive impact on staff wellbeing - the more efficient the team are before year-end, the better the team well-being over busy season, with significant amounts of work being frontloaded, providing the team with breathing space and time to focus on finalising and delivering a high-quality audit.”

“On another, mid-sized engagement, the benefit of using AQMs was experienced in the planning of the audit, particularly when setting materiality and planning controls testing. The early identification and communication of control deficiencies also improved the client relationship. The use of AQMs also encourages the early involvement of specialists and the EQCR team which assists in avoiding any late surprises.”

## B.13 Quality Monitoring

- 13.1** In line with auditing standards requirements, all firms have established a quality monitoring process that inspects, on a cyclical basis, at least one completed engagement for each engagement partner, sometimes referred to as 'cold reviews'. Firms are also implementing 'hot reviews' which are performed whilst the audit is in progress. **Hot reviews act as a preventative control** and aim to provide 'real-time' assurance, to identify and share common themes and challenges and to assist teams in complex and judgemental areas.
- 13.2** Due to the recurring nature of some quality review findings by internal and external (including regulatory) inspections the firms should re-evaluate the effectiveness of their overall monitoring approach, including hot reviews, and assess how it integrates with the other elements of the quality control system in order to effectively and sustainably remediate the recurring deficiencies.

### What we have seen – quality monitoring



- Effective integration of the firm's internal quality monitoring programme into the firm's wider audit quality programme with more risk-focused reviews, particularly consideration of issues arising from regulatory reviews.
- Development of hot review procedures on audits, including health checks, diagnostics and in-flight reviews to monitor and enhance audit quality throughout the audit.
- Focused and regular monitoring of consultations on high-risk entities

## B.14 Resources – Resource planning and people management

- 14.1** People are key to performing high-quality audits. Audit firms need to **attract and retain the highest quality talent**. It is essential that firms have sufficient, suitably trained and experienced staff to service their existing portfolio and support growth plans, both in terms of client numbers and sector expertise.
- 14.2** Most audits, particularly after the first year, have an expected workflow profile. Operational information should be proactively shared and consolidated to ensure that there is sufficient resource to meet the expected workflows. Despite the best planning, some challenges and unexpected events do arise, so it is important to have sufficient capacity to manage these reasonable extra demands of an active client portfolio. We have already discussed the importance of this as part of the engagement perspective in "Risk assessment and planning" above.
- 14.3** Operationally, audit partners and directors need to play their part in challenging and resisting unreasonable pressures added by the management teams of the audited companies. This can best be avoided by early and proactive engagement with management regarding the timetable and milestones, so firms and management can work together to deliver a high-quality set of audited financial statements. Effective audit project management will support the effective use of resources and there should be an effective mechanism for audit engagement partners to flag resourcing concerns (both over capacity and capability).

Firms should re-evaluate the effectiveness of their overall monitoring approach, including hot reviews, and assess how it integrates with the other elements of the quality control system.

People are key to performing high-quality audits.

It is important to have sufficient capacity to manage the reasonable extra demands of an active client portfolio.

## What we have seen – resources and people



There are a variety of approaches – many firms centrally monitor project management and some have detailed milestones for all types of audit engagements.

An example of good practice we have seen is:

“For a significant new PIE client, a firm noted that initial project milestones had been missed. This led the firm to review the situation and staffing in detail. As a result of this intervention, further resources were identified to support the audit, including an experienced partner who worked almost full time with the main component audit team. This audit then achieved a good rating in an AQR external quality review.”

### B.15 Resources – Appraisals and rewards

- 15.1** Audit firms rightly seek to retain and develop their best people. To embed a culture where good quality audits are the expected norm, the audit practice must be **rewarded for delivering high-quality audits**, and for showing the behaviours that align to the culture of the audit firm. This is embedded in UK law, which requires firms to have reward and remuneration policies which will support the delivery of high-quality audit
- 15.2** How an organisation incentivises its staff will drive behaviour and shape its culture. Financial incentives are an important motivator of behaviour but recognition and other non-financial motivators also play a valuable role in shaping behaviour. It is, therefore, essential that audit firms align their reward and performance management framework to the delivery of high-quality audit. Good quality outcomes should be rewarded and recognised just as financial and non-financial sanctions taken where breaches arise or low-quality audit work is produced.
- 15.3** In recent years we have seen firms vary and enhance their appraisal and rewards system and increase the level of transparency. Often, financial reward of the most senior people at the firm will be linked to achieving quality outcomes. Firms need to ensure that the element of reward that is linked to the delivery of high-quality audits is significant enough to drive the appropriate behaviours and that the other inputs into reward decisions do not outweigh the element linked to achieving high-quality outcomes.
- 15.4** The importance of quality must be built into the performance management framework of auditors at all levels within the firm. This must include a focus on the behaviours that are most directly correlated to producing high-quality audit. Objectives must be clearly linked to audit quality and then performance against these objectives assessed on a continual basis, with appropriate metrics and management information.
- 15.5** It does take time to change behaviours and develop an appropriate and effective culture. The full benefits of these changes have not yet been seen and firms must keep the effectiveness of the appraisal and rewards system under review.
- 15.6** We have recently published our [Culture Conference Summary](#) on some of the themes discussed at the conference. These ideas do not necessarily represent the FRC's views but provide some further perspectives for ongoing discussions and debates on audit firm culture as one of the key drivers of audit quality.

**It is essential that audit firms align their reward and performance management framework to the delivery of high-quality audit.**

## What we have seen – appraisals and rewards



Examples of good practice that we have seen include:

“The audit firm demonstrated a clear link between audit quality and partner remuneration with audit quality results incorporated into long-term remuneration for partners, in addition to the in-year variable pay.”

“The audit firm integrated the key audit behaviours into the performance evaluation forms for all audit staff”

## B.16 Resources – Methodology and technology

**16.1** All firms we review have invested significantly in their audit methodology and technology and continue to do so. There are varying programmes focussed on standardisation, consistency, and audit support tools such as data analytics. Many also make use of project management and work-flow management tools. A consistently applied methodology and the use of technology, understood and delivered by appropriately trained people, is a key element of delivering high-quality audits.

**16.2** A good audit will be **supported by a robust platform** that may include some of the following features:

- Connects the planning phase of the audit to the actual work performed;
- Enables appropriate review and quality control;
- Enables workflow and project control;
- Eliminates unnecessary complexity;
- Promotes the benefits of using a consistent audit methodology; and
- Supports the audit team in meeting the requirements in ISAs (UK) but in a way that does not detract from critical thinking and professional scepticism. Allows scalability of the audit approach through functionality and tailoring of audit procedures.

## What we have seen – Methodology and Technology



The firms all have a variety of audit methodologies and make different uses of technology across their audits. These share an understanding of the ISA (UK) requirements and have a detailed mapping between the requirements of auditing standards.

There is a large range of good practice in firm’s methodology, although the nature of a methodology is that it cannot cover all scenarios and has been designed to best suit the firm concerned, the tools that they use and the audits that they undertake.

## B.17 Information and communication

**17.1** Supporting the culture of high-quality in audit necessitates a significant investment in training of people in the audit practice that is supported by high-quality information and communication over relevant matters auditors need to know and actions that auditors need to take.

- 17.2** The firms that we review have extensive information that is made available to auditors in a variety of ways, systems and formats. Firms regularly communicate with their auditors and look to ensure that their staff have appropriate knowledge and skills for their roles. This is supported by access to central teams with in-depth knowledge over auditing, accounting and other relevant matters.
- 17.3** All of the firms we review on an annual basis have well established training courses and training material. The importance of this training is clear to the firms.
- 17.4** Historically training has been biased towards technical training but there is a shift towards including soft skills and critical thinking training to assist with critical areas such as challenge of management and the audit of key judgements. There continue to be several findings from the various FRC reviews undertaken that suggests that firms need to periodically reassess the scope and depth of training in these critical areas. As firms transition to the more formal quality-driven approach under ISQM (UK) 1 the feedback to training and communication will need further consideration.
- 17.5** A high-quality audit practice will also have a high degree of open and candid engagement with the regulator on significant issues. This includes making sure there are robust and effective plans in place to improve audit quality and regular reporting of progress internally (and to the regulator) on delivering against such plans.

**Firms regularly communicate with their auditors and look to ensure that their staff have appropriate knowledge and skills for their roles.**

**The importance of training is clear to the firms.**

#### What we have seen – Information and communication



We noted from our review of some firms root cause analysis that the scope of training is changing to include critical thinking and softer skills on dealing with challenge.

As part of our review of audit methodology and training, we identified several areas of good practice:

“The firm provides extensive experienced hire training that includes scenarios and case studies to prepare the individual for their new role.”

“The firm mandates training at the milestone of becoming a manager and on completion of one year in the role. This training is a good addition to the annual update training provided to all qualified auditors.”

“The firm achieves a very high completion rate for mandatory training and has clear consequences for individuals that do not attend, including a process for identifying repeat offenders.”

“An analysis of post course assessment results to identify difficult topics: the firm has a process to analyse how often individual questions are answered incorrectly to identify topics that course attendees found difficult.”

“Monitoring the number of attempts an individual takes to pass a post course assessment: the firm monitors the number of attempts an individual takes to complete post course assessments. When the number exceeds a pre-set threshold an action plan is agreed with the individual and monitored.”

“The frequency and quality of ongoing communications to partners and staff on methodology and guidance: the firm regularly issues guidance on new auditing and accounting standards and refreshers on existing standards that are of a high standard.”





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