



FINANCIAL REPORTING COUNCIL

THE AUDIT QUALITY FRAMEWORK

FEBRUARY 2008

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One - Introduction

This Audit Quality Framework is designed to support effective communication between auditors, audit committees, preparers, investors and other stakeholders on audit quality.

The Framework has been prepared following extensive consultation on the FRC's publication, Promoting Audit Quality, issued in November 2006. The Framework is intended to be complementary to existing regulations and guidelines and promotes the following key drivers of audit quality:

- The culture within an audit firm;
- The skills and personal qualities of audit partners and staff;
- The effectiveness of the audit process;
- The reliability and usefulness of audit reporting; and
- Factors outside the control of auditors affecting audit quality.

The FRC hopes that the publication of this Framework will assist:

- Companies – in evaluating audit proposals;
- Audit Committees – in undertaking annual assessments of the effectiveness of external audits;
- All stakeholders – in evaluating the policies and actions taken by audit firms to ensure that high quality audits are performed, whether in the UK or overseas; and
- Regulators – when undertaking and reporting on their monitoring of the audit profession.

Pursuant to regulations to be made by the Professional Oversight Board¹, some audit firms will be required to prepare Transparency Reports. Such Transparency Reports will be a useful opportunity for such audit firms to differentiate themselves by setting out the steps that they are taking to achieve audit quality by reference to this Audit Quality Framework.²

The FRC recognises that audit quality is a dynamic concept and that the drivers and indicators of audit quality may change over time. It will therefore periodically update this Framework in the light of comments received. The first such review will take place in autumn 2008.

The Audit Quality Framework is supported by other publications, including statements, standards, guidance and discussion papers published by the FRC and its Operating Bodies. These are available on its website at: www.frc.org.uk.

¹ Directive 2006/43/EC on Statutory Audits of Annual and Consolidated Accounts came into force on 29 June 2006 and must be implemented by 29 June 2008. Regulations to be made by the POB are expected to come into force on 6 April 2008 and apply in respect of the accounts of the relevant audit firms relating to financial years starting after that date.

² It is not envisaged that the regulations for Transparency Reports will go beyond the requirements of the Statutory Audit Directive.

Two - Audit Quality Framework

Driver	Indicators
The culture within an audit firm	<p>The culture of an audit firm is likely to provide a positive contribution to audit quality where the leadership of an audit firm:</p> <ul style="list-style-type: none"> • Creates an environment where achieving high quality is valued, invested in and rewarded. • Emphasises the importance of 'doing the right thing' in the public interest and the effect of doing so on the reputation of both the firm and individual auditors. • Ensures partners and staff have sufficient time and resources to deal with difficult issues as they arise. • Ensures financial considerations do not drive actions and decisions having a negative effect on audit quality. • Promotes the merits of consultation on difficult issues and supporting partners in the exercise of their personal judgement. • Ensures robust systems for client acceptance and continuation. • Fosters appraisal and reward systems for partners and staff that promote the personal characteristics essential to quality auditing. • Ensures audit quality is monitored within firms and across international networks and appropriate consequential action is taken.

Driver	Indicators
The skills and personal qualities of audit partners and staff	<p>The skills and personal qualities of audit partners and staff are likely to make a positive contribution to audit quality where:</p> <ul style="list-style-type: none"> • Partners and staff understand their clients' business and adhere to the principles underlying auditing and ethical standards. • Partners and staff exhibit professional scepticism in their work and are robust in dealing with issues identified during the audit. • Staff performing detailed 'on-site' audit work have sufficient experience and are appropriately supervised by partners and managers. • Partners and managers provide junior staff with appropriate 'mentoring' and 'on the job' training. • Sufficient training is given to audit personnel in audit, accounting and industry specialist issues.

Driver	Indicators
The effectiveness of the audit process	<p>An audit process is likely to provide a positive contribution to audit quality where:</p> <ul style="list-style-type: none"> • The audit methodology and tools applied to the audit are well structured and: <ul style="list-style-type: none"> ◦ Encourage partners and managers to be actively involved in audit planning. ◦ Provide a framework and procedures to obtain sufficient appropriate audit evidence effectively and efficiently. ◦ Require appropriate audit documentation. ◦ Provide for compliance with auditing standards without inhibiting the exercise of judgement. ◦ Ensure there is effective review of audit work. ◦ Audit quality control procedures are effective, understood and applied. • High quality technical support is available when the audit team requires it or encounters a situation it is not familiar with. • The objectives of ethical standards are achieved, providing confidence in the integrity, objectivity and independence of the auditor. • The collection of sufficient audit evidence is not inappropriately constrained by financial pressures.

Driver	Indicators
The reliability and usefulness of audit reporting	<p>Audit reporting is likely to provide a positive contribution to audit quality where:</p> <ul style="list-style-type: none"> • Audit reports are written in a manner that conveys clearly and unambiguously the auditor's opinion on the financial statements and that addresses the needs of users of financial statements in the context of applicable law and regulations. • Auditors properly conclude as to the truth and fairness of the financial statements. • Communications with the audit committee include discussions about: <ul style="list-style-type: none"> ◦ The scope of the audit. ◦ The threats to auditor objectivity. ◦ The key risks identified and judgements made in reaching the audit opinion. ◦ The qualitative aspects of the entity's accounting and reporting and potential ways of improving financial reporting.

Driver	Indicators
Factors outside the control of auditors	<p>Factors outside the control of auditors which are likely to make a positive contribution to audit quality include:</p> <ul style="list-style-type: none"> • An approach to corporate governance within the reporting entity that attaches importance to corporate and financial reporting and to the audit process. • Audit committees that are active, professional and robust in dealing with issues identified during the audit. • Shareholders that support auditors, where appropriate, thereby increasing the likelihood that directors and management will comply with their obligations in relation to the preparation of reliable financial statements. • Reporting deadlines that allow the opportunity to carry out an audit without undue reliance on work performed before the end of the reporting period. • Appropriate agreed arrangements for any limitation of liability. • An audit regulatory environment that focuses on the drivers of audit quality.

Three - Contact details

The FRC recognises that audit quality is a dynamic concept and that the drivers and the indicators of audit quality may change over time. It will therefore periodically update this Framework in the light of comments received. The first such review will take place in autumn 2008. Comments for consideration in this review should be sent to p.george@frc-pob.org.uk by 30 June 2008.

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For general information about the work of the FRC, please see our website at: www.frc.org.uk

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