



Financial Reporting Council



What Makes a Good...

Environment for Auditor Scepticism and Challenge

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1 Foreword

High-quality auditing is about having the right mindset and behaviours as well as having technical skills and expertise. A critical attribute of an auditor's mindset and behaviour is exercising professional scepticism and challenge when performing audits. The most significant quality issues identified by the Financial Reporting Council (FRC) over a number of years involve the inconsistent application of professional scepticism and challenge, resulting in the poor application of professional judgement. Displaying this mindset and behaviour forms the foundation of a high-quality audit.

This paper draws on evidence from our cross-firm work performed by the FRC's Audit Market Supervision ('AMS') team. As part of our supervisory approach to audit regulation, we set up AMS to take a cross-firm approach to areas of importance to audit quality and firm resilience. We recognise that as the regulator, our experiences and insight into the firms are unique. As an improvement regulator, by summarising our views on what we see and sharing this with the wider market, we can encourage the spread of good practices, leading to continual improvement in audit quality.

"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." FRC's 'What Makes a Good Audit'

The FRC issued Professional Judgement Guidance¹ in June 2022 to enhance the consistency and quality of professional judgement exercised by auditors. The guidance highlighted that professional scepticism is a key part of an appropriate auditor mindset, supporting the judgements made on an audit. It outlined the psychological factors and the range of biases that can hinder objective reasoning and challenge. It also outlined the factors that may be present in the environment of those making a judgement ('environmental factors') that can impact how easy or difficult it is to exercise scepticism and challenge in an appropriate manner.

In this paper, we set out the key attributes of a high-quality audit environment that enable professional scepticism and challenge in an audit, linking to the environmental factors outlined in the Professional Judgement Guidance. It describes what good looks like and provides examples of good practice in each area, identified from our supervision work. It also draws on insight from the FRC Culture Conference² held in 2021 and the 'Collection of Perspectives' publication³, highlighting that all parties in the audit ecosystem accept that there is more work to be done in this area. This paper is part of the series "What Makes a Good..." building on the well received '**What Makes a Good Audit?**' paper, providing further insight into how an audit practice can create a good environment for auditors to exercise professional scepticism and provide challenges to management.

1 Professional Judgement Guidance (June 2022). (https://www.frc.org.uk/getattachment/fff79ba1-3b5a-4c04-8f1e-eb8df3aacd40/FRC-Professional-Judgement-Guidance_June-2022.pdf)

2 FRC Conference Audit Firm Culture: Challenge. Trust. Transformation (June 2021). (<https://www.frc.org.uk/auditors/audit-firm-supervision/frc-culture-conference>)

3 Audit Firm Culture: Challenge. Trust. Transformation. A Collection of Perspectives (November 2021). (https://www.frc.org.uk/getattachment/fe2b0d35-aeb0-4d3c-8c96-cb04ac0f449d/FRC-Audit-Firm-Culture-Collection-of-Perspectives_December-2021.pdf)

Professional scepticism - definition⁴

An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

Professional scepticism must be exercised across the entire audit, although it may be particularly apparent when assessing management's judgements and estimates. Judgement involves the application of training, knowledge and expertise, and an auditor's judgement is significantly influenced by their mindset. Exercising judgement requires a mindset of professional scepticism and challenge and an environment that promotes auditors to exercise this mindset.

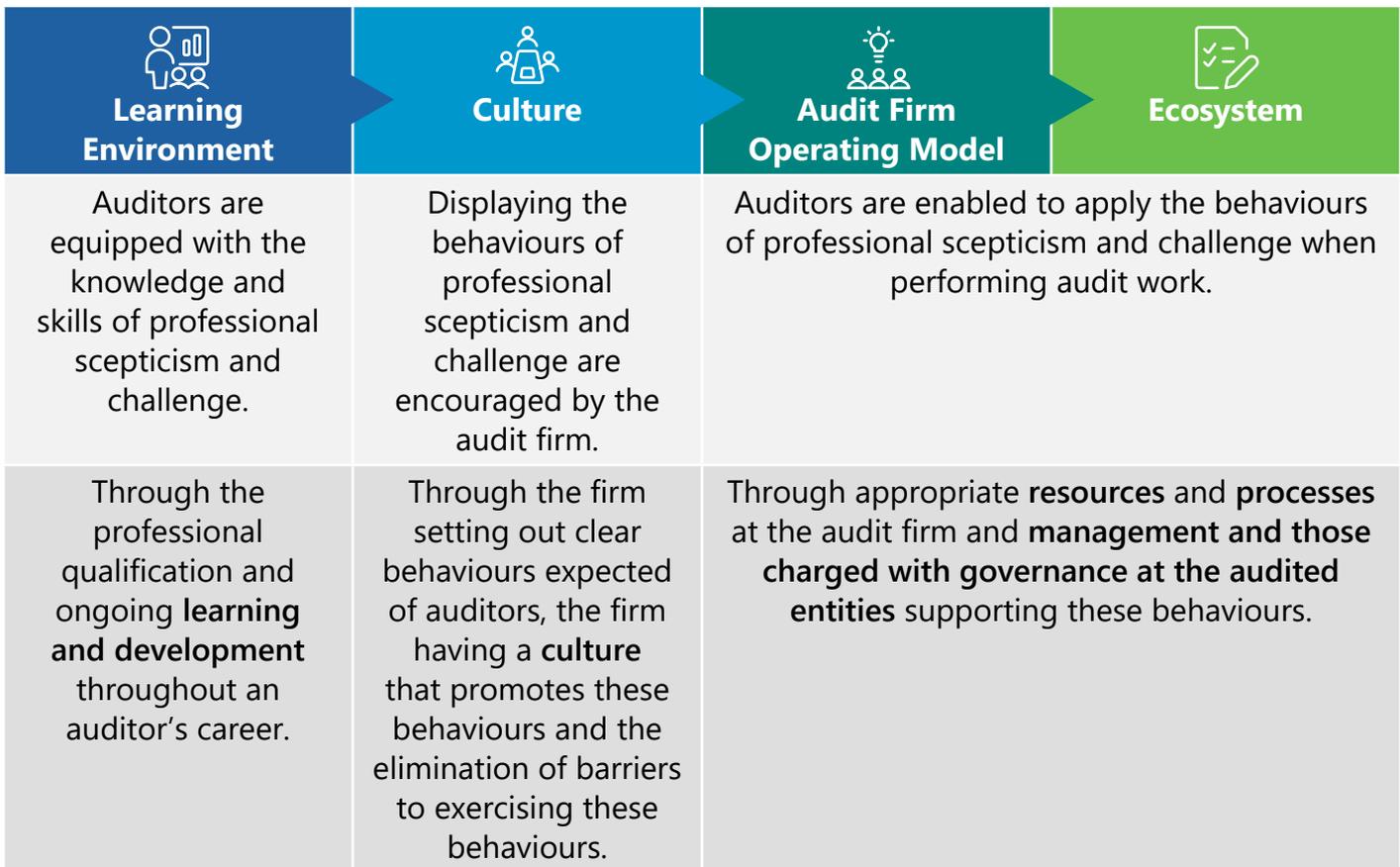
To gather evidence for this paper we engaged a third party to undertake focus groups at the audit firms, and they produced [an independent report](#). The focus groups uncovered some key drivers and barriers within the environment of the audit firm that either encourage or inhibit an auditor's ability to show scepticism and challenge during their day-to-day work on audit engagements. The findings from the focus groups were combined with our own analysis of information provided by the firms to form the basis for our good practice highlights.

We consider four key elements of a good environment for scepticism and challenge: the learning environment, culture and operating model of the audit firm, as well as the interactions that the audit firm has with parties in the wider ecosystem. This paper sets out these four elements, highlighting good practice in each.

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 complete answer as to what a good environment for scepticism and challenge looks like, but we intend for this to be a major contribution to inform the debate amongst all our stakeholders about this crucial aspect of mindset and behaviour that is inextricably linked to a high-performing audit practice and high-quality audit.

⁴ International Standard on Auditing (UK) 200 (Revised June 2016) (Updated January 2020), Overall objectives of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing (UK), paragraph 13 (l).

2 Overview



The diagram above sets out the four elements of a good environment for scepticism and challenge: the learning environment, culture and operating model of the audit firm, and the wider ecosystem. An auditor needs to be equipped with the skills and expertise necessary to exercise professional scepticism and challenge management, an audit firm needs to encourage these behaviours through a culture that promotes scepticism and challenge and enable auditors to apply these behaviours in the day-to-day audit work through the firm's operating model and processes. Other parties in the ecosystem, including the audit committee and management at the audited entity, also play a part in enabling this mindset and behaviour.

A **learning environment** that equips auditors with the knowledge and skills of scepticism and challenge will include:

- Training in behaviours alongside technical training
- Engagement based learning and coaching during an audit, built into an auditor's workload
- Training in soft skills that support desired auditor behaviours such as critical thinking and handling difficult conversations

An audit firm **culture** that encourages scepticism and challenge will include:

- An audit specific culture distinct from the multidisciplinary firm with a focus on specific desired auditor behaviours including scepticism and challenge
- The public interest role of audit as the cornerstone of an audit firm's culture
- Governance bodies with sufficient information to ensure adequate oversight of audit culture and behaviours
- Communication of expected auditor behaviours using a variety of formats
- Leadership continually and consistently championing expected auditor behaviours
- Alignment of reward and recognition with desired auditor behaviours
- Promotion of 'speaking up' under conditions of psychological safety
- A culture of continual improvement and learning from mistakes
- Engagement with employees, especially middle management, to become advocates of desired auditor behaviours

An audit firm **operating model** that enables scepticism and challenge must ensure:

- Sufficient and appropriate resource on every audit engagement with strong project management
- Effective use of specialists, experts and central technical teams to provide challenge in the most complex areas

An **ecosystem** that enables scepticism and challenge must include:

- An engaged audit committee that supports the audit team with challenge
- Management at the audited entity providing quality and timely information engaging with the auditors to facilitate challenge

Audit firms should use this paper to develop a greater understanding of the factors that create a good environment for scepticism and challenge. We have provided the Tier 1 audit firms with detailed firm specific findings and recommendations in relation to the good practice highlighted in this report. These firms are developing actions that will feed into their Single Audit Quality Plan to support their plans to improve audit quality. We will be holding roundtable discussions with Tier 2 and 3 firms to facilitate this continual improvement.

Audit committees and management at the audited entity can use this paper to develop a greater understanding of the role they play in enabling increased scepticism and challenge on an audit. Audit committees should be aware that we will be consulting soon on minimum standards for audit committees, demonstrating how expectations of all parties in the ecosystem are increasing.

Professional bodies will also be interested in this paper as they continue to develop their training and professional development.

3 Learning Environment

 Learning Environment	 Culture	 Audit Firm Operating Model	 Ecosystem
<p>Auditors are equipped with the knowledge and skills of professional scepticism and challenge.</p>	<p>Displaying the behaviours of professional scepticism and challenge are encouraged by the audit firm.</p>	<p>Auditors are enabled to apply the behaviours of professional scepticism and challenge when performing audit work.</p>	
<p>Through the professional qualification and ongoing learning and development throughout an auditor’s career.</p>	<p>Through the firm setting out clear behaviours expected of auditors, the firm having a culture that promotes these behaviours and the elimination of barriers to exercising these behaviours.</p>	<p>Through appropriate resources and processes at the audit firm and management and those charged with governance at the audited entities supporting these behaviours.</p>	

An auditor is equipped with skills, knowledge and expertise through a variety of means, including the professional qualification, ongoing professional development required by the professional bodies, the **training** provided by the audit firm and ongoing audit experience, including **on-the-job learning**.

This section considers how auditors develop their skills and knowledge in scepticism, challenge and judgement within the learning environment of an audit firm.

Training & Coaching

An audit firm provides its personnel with detailed formal training in the technical aspects of auditing. Equally important is **training in the behaviours and mindset** expected of auditors.

Skills such as critical thinking and handling difficult conversations are essential for developing the ability to challenge externally and internally. For junior auditors, skills such as verbal communication, teamwork and confidence in challenging are necessary foundational skills whereas skills in leadership, time management and working under pressure become more important as auditors progress in their careers.

It is important to bring the specific behaviours linked to high-quality audits to life with **interactive training**, calling out these behaviours explicitly and explaining what they mean in practice, for example, through the use of case studies, role play or scenario-based techniques.

Auditors are most likely to engage and learn from formal training programmes that encompass a variety of formats, whether delivered virtually or in person. This may be enhanced by keeping training sessions succinct and **'bitesize'** during busy periods so that auditors feel more able to attend.

Involving senior auditors in training, either by asking them to facilitate or simply to attend to help to field questions, emphasises to junior auditors that scepticism and challenge are positive behaviours supported and expected by the firm. Senior participation is particularly valuable when seniors share personal experiences and specific examples of where they have applied scepticism and challenge.

It is important to **monitor training attendance and evaluate learning outcomes** to ensure auditors are continuously and sufficiently equipped with the necessary technical knowledge and skills. Formal processes to collect feedback from training participants allows an audit firm to continually improve the format and content of training.

Behaviours are difficult to learn through purely theory-based training; **on-the-job coaching** is the most impactful way to teach auditors how to exercise scepticism and challenge effectively. Mentoring and coaching programmes tailored for different groups of auditors and at various critical career points assist individuals in establishing supportive personal working relationships, facilitate knowledge exchange and enable role-modelling of behaviours expected of an auditor.

Audit firms need to allocate sufficient time to training and coaching to ensure consistent and effective delivery.

Good practice – training & coaching



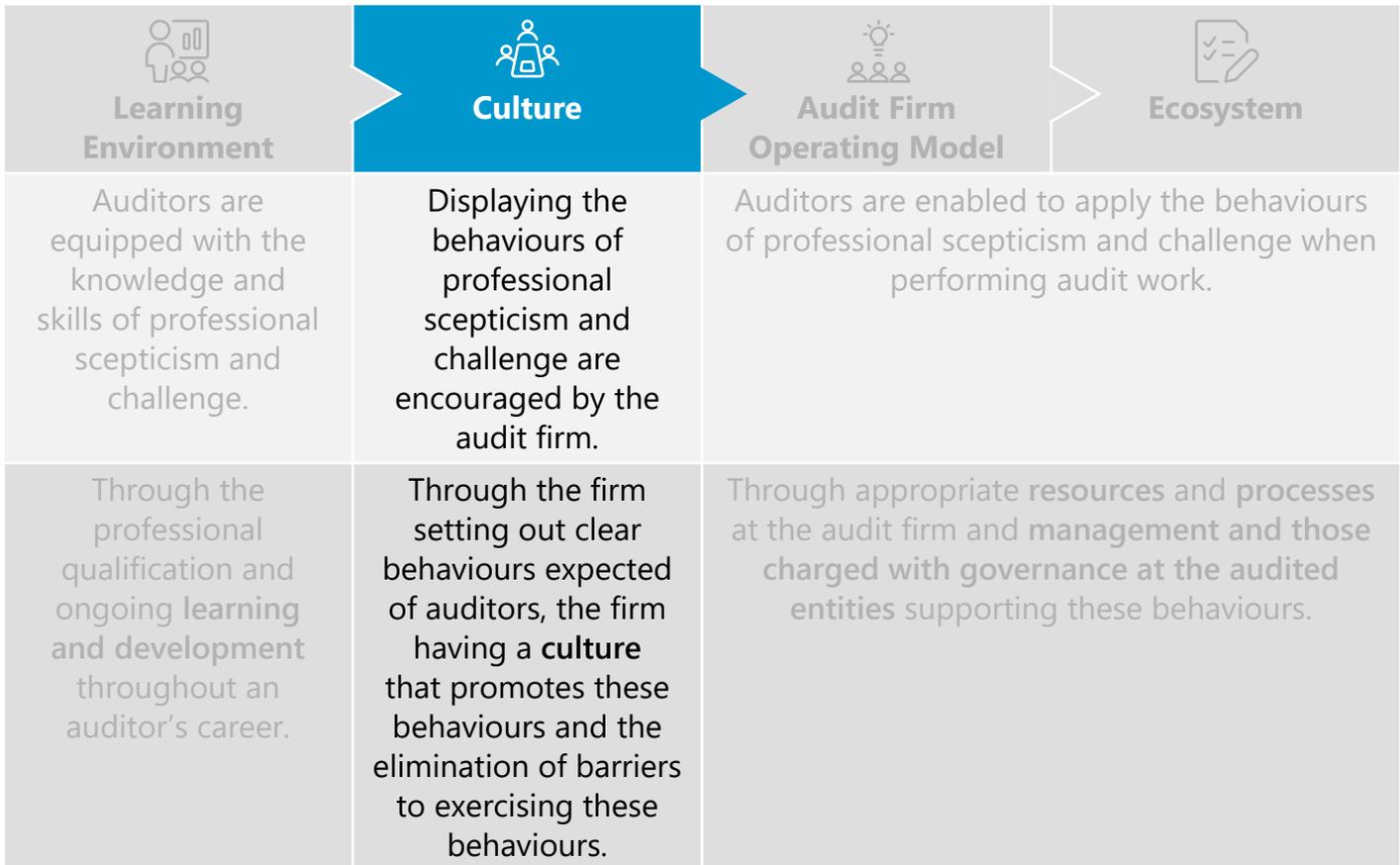
"One firm involved professional actors in simulating a challenging and biased audited entity management in a fictional case study, where auditors are required to work in teams to complete the mock audit."

"One firm introduced training modules focusing on the auditor mindset and behaviours associated with the behaviour of challenge, for example, avoiding confirmation bias and assessing alternative scenarios and conflicting evidence."

"One firm operates a structured on-the-job learning programme involving junior auditors delivering sessions on challenge whilst being mentored by senior grades. This allowed the junior grades to drive thinking and discussion around challenge, giving them more confidence and knowledge to apply challenge on engagements."

"A junior auditor recalled a memorable training session where the auditors running the session role played a difficult conversation with the audited entity. This included showing how such a conversation might play out, and the language auditors might use to effectively challenge management. Compared to being shown the theory and definition of effective challenge in a presentation format, this auditor felt that the role-play technique was more helpful as it meant they were able to visualise what effective challenge might look like in the real world."

4 Culture



An auditor's mindset of professional scepticism and challenge must be developed in an environment that promotes and nurtures this mindset. Audit firms need the right culture to drive the right behaviours, which in turn are necessary for high-quality audits. In particular, the need to be sceptical and challenge management must be embedded into every audit firm's culture so that these behaviours become 'the way things are done'.

Culture design

Behaviours

An audit firm should have the desired behaviours of challenging management and applying professional scepticism within their **cultural design** and have this aligned to their overall **purpose and values**. An audit firm with a culture focused on the public interest role of audit that encourages professional scepticism and challenge of management and where auditors feel safe and supported to exercise this mindset is one that will promote high-quality audit and deserved trust in the audit opinion.

An audit firm will decide on the critical audit behaviours that they wish to promote within the firm as part of their culture design and then seek to embed these behaviours through initiatives that are aimed to drive this desired behaviour. We have identified six factors that drive the behaviours within an audit firm – governance, leadership, communication, reward and recognition, working environment and people engagement.

In order to reduce the gap between the desired culture and the habitual behaviours as seen and lived by employees, an audit firm will ensure that each driver of behaviour promotes the desired behaviour and reduce or eliminate any factors that could discourage this desired behaviour.



An audit firm should give additional prominence to **audit specific behaviours** within their cultural design, including scepticism and challenge and the fundamental principles of integrity, objectivity and independence that underpin high quality audit. The culture within an audit practice is expected to differ from the culture in the multidisciplinary firm given this specific focus on auditor behaviours and the public interest purpose of audit. We anticipate that operational separation will facilitate this specific culture in the audit practice. Audit firms that are not operationally separating their audit practice need to consider different methods through which to create this focus on the desired audit specific behaviours.

Purpose

Establishing the audit firm's overall **purpose** is crucial in order to align its values and encourage behaviours with a common cause. A culture that is 'purpose-led' has the ability to inspire and drive actions that are aligned to desired outcomes as a collective team effort. The central purpose of an audit is to foster trust in markets, and this public interest role of audit should be the cornerstone of an audit firm's purpose. Employees need to be able to connect their day-to-day work with the purpose of the audit firm. In this way, purpose can serve as a powerful 'north star' for employees, reinforcing behaviours correlated to high-quality audits and improving audit quality.

Good practice – culture design



"Three firms have designed a set of desired audit-specific behaviours for their audit practice, all of which include the desired behaviour of challenge. Another firm is translating the global networks' behaviours specifically for the UK audit practice."

"One firm has defined a gold standard set of audit specific behaviours for each grade to be assessed against annually, which include professional scepticism and challenge, quality and collaboration."

"One firm has designed an initiative to focus on the purpose of audit, highlighting the public interest purpose and how auditors can link their day-to-day work to this purpose."

Drivers of behaviour

Governance

Developing and maintaining a culture that promotes the delivery of high-quality auditing is driven by strong governance, which emphasises the importance of quality and the expected behaviours of auditors.

Those charged with the governance of the firm have a responsibility to understand behaviour throughout the firm and to challenge where they find misalignment with the firm's desired culture or need better information. The firms' various **governance bodies** must devote sufficient resources to evaluating culture and consider the information they need in order to have adequate oversight of culture and auditor behaviour.

Over recent years, all larger audit firms have strengthened their governance through the appointment of a range of **independent non-executives (INEs) and audit non-executives (ANEs)** with a broad range of experiences. As outlined in The Audit Firm Governance Code 2022⁵, a firm's INEs and ANEs have an important role in observing, governing and constructively challenging the firm's culture, ensuring the firm's prevailing culture is underpinned by its desired values and behaviours.

5 Audit Firm Governance Code (April 2022). (https://www.frc.org.uk/getattachment/5af7cdb7-a093-4da8-94d7-f4486596e68c/FRC-Audit-Firm-Governance-Code_April-2022.pdf)

The Ethics Partner is responsible for ensuring that audit leadership instils the necessary culture and behaviours throughout the audit firm and for providing all auditors with a safe passage to speak up when they see unacceptable behaviour. The **ethics function** should be sufficiently resourced in order to undertake both the behavioural and compliance aspects of their role and to drive improvement, with clear reporting lines to those charged with governance.

Good practice – governance



“Two firms have a specific committee focused on overseeing and monitoring the progress of their culture programme, and the output of this committee is presented to the senior management and governance bodies.”

“INEs at one firm had meetings with employees to understand the prevailing culture in audit, creating a safe environment to promote an open and frank dialogue between INEs and employees. The information gathered was then analysed and reported back to the audit executive anonymously.”

“One firm’s Head of Culture meets with the INEs on a monthly basis to provide an update on people-related matters and the status of the audit culture change programme for which the INEs provide challenge, support, feedback and oversight.”

Leadership

The FRC’s Audit Culture Thematic Review published in 2018⁶ highlighted the importance of alignment and consistency of audit leadership behaviours – how leaders communicate through words and actions is essential. Leaders are seen as the **role models** of a firm and employees in a firm replicate what their leaders do and see as their ‘acceptable behaviours’. A culture of scepticism and challenge needs to be encouraged by senior audit leadership who lead by example and model positive behaviours. As role models, engagement partners should facilitate challenge from audit team members and provide unreserved backing and support in meetings where difficult conversations or challenges of management are needed.

Audit firms often have different **subcultures**, reflecting the different leadership styles of partners. Whilst retaining the authenticity of an individual’s unique style of leadership is important, there needs to be a minimum standard of behaviour across all leaders to ensure consistent quality outcomes.

Recognition from leadership drives the team’s morale and builds the audit team’s confidence. Leaders can deliver **‘softer’ recognition** such as praising junior auditors directly, or calling them out in team meetings for quality-related behaviours, in order to reinforce a culture that is focused on quality and in which scepticism and challenges are expected and encouraged.

Partners have a key role in driving scepticism and challenge in the way that they embed audit firm-wide messages on a day-to-day basis. **Communicating the priorities of the audit**, from the initial meeting and then throughout (e.g. quality vs deadlines), is key to audit managers and junior auditors feeling confident that they should be prioritising quality, scepticism and challenge.

6 Audit Culture Thematic Review (May 2018). (<https://www.frc.org.uk/getattachment/2f8d6070-e41b-4576-9905-4aeb7df8dd7e/Audit-Culture-Thematic-Review.pdf>)

It is crucial that leadership's messaging around scepticism and challenge is **consistent and sustained even in the midst of workload pressure** and **hybrid working arrangements**, which could act as barriers to auditors demonstrating these behaviours.

Good practice – leadership



"Most firms reported strong leadership backing when faced with difficult management at audited entities. This included the involvement of the Head of Audit when a difficult conversation was warranted."

"One firm is trialling a new initiative for partners that uses psychometric assessment tools to help partners identify how their personality may be conducive to, or inhibit, audit quality, including an increased awareness of how their behaviour may change under pressure."

"Many auditors referenced partners, directors and senior managers that have clear 'open door policies', including formal and informal routes of contact (i.e. direct messages as well as emails), as being the key conduits for how scepticism and challenge are talked about within firms."

Communication

Culture change can be achieved by getting the language and communication right. Audit firms should clearly **communicate the acceptable and expected auditor behaviours** with consistency in messaging and signalling.

Communications which are grounded in **specific, real-life examples** are considered to be most effective. In particular, storytelling and sharing real-life examples of high-quality and more challenging audits is one of the most effective means of identifying potential improvements and lessons.

Formal written communications about audit quality and values should contain **specific links to the desired auditor behaviours** with concrete examples of how to achieve and enact them in practice. Using a **variety of channels** and techniques will optimise the impact of key messages, as auditors may have differing preferences for how they like to receive messages.

Demonstrating commitment to the desired audit behaviours should not be a one-off exercise. Messages need to be **continually reinforced** through a variety of written, verbal, formal and informal communication methods, for example, giving informal praise to auditors for demonstrating these behaviours.

'Top down' **communication from audit leaders** is critical to instilling key messaging into engagement teams regarding the importance of scepticism and challenge. Audit firms' leadership must drive communications through words and actions, including active role modelling, to demonstrate their commitment to supporting all auditors in exercising challenge and discussing and learning from mistakes without fear.

Good practice – communication



“Some firms use storytelling within their communications to show how the desired values and behaviours in audit have been demonstrated and made a difference in practice.”

“Some firms introduce specific prompts to enact the audit behaviours during engagements, such as standard meeting agenda items, ‘step back’ meetings and ad-hoc prompts throughout the engagement to assess the critical audit behaviours.”

“One firm writes a series of ‘bitesize bulletins’ spotlighting auditors from various grades who had challenged management to showcase what challenge looks like in action.”

Reward and Recognition

Mechanisms for reward and recognition include appraisals, remuneration, in-year rewards, and promotions. Where these are **appropriately aligned**, they can be used to encourage desired behaviours, including professional scepticism and challenge.

Appraisals that specifically reflect on audit behaviours and quality outcomes show the value placed on these and encourage individuals to reflect on how they can and do achieve these.

Timely in-audit verbal as well as written **feedback**, focused on key behaviours and outcomes, shows individuals how their performance compares to desired auditor behaviours and using feedback in appraisals shows that it is valued. Requesting feedback for all significant pieces of work and encouraging honest upwards feedback to senior auditors and partners also increases accountability.

Differentiating between individuals, using **performance and quality ratings** or detailed appraisal discussions, based on achievement of audit quality and desired behaviours, motivates individual achievement.

Remuneration is an effective tool for increasing scepticism and challenge when it is clearly based on audit quality and desired behaviours, reflecting positive and negative performance, and where the impact of audit quality is significant compared to other contributors to reward. Making bonuses and pay rises contingent on a minimum standard of audit quality also shows that good performance in other areas is not enough. Rewarding the positive is more motivating than solely punishing the negative.

In-year financial and non-financial rewards can also effectively motivate and increase awareness of desired audit behaviours. Ad-hoc schemes, where auditors receive small rewards or formal praise for demonstrating desired behaviours encourage increased awareness of such behaviour, and a culture of continuous recognition and positive reinforcement. Structured schemes to nominate auditors or audit teams for awards call out examples of desired auditor behaviours and publicise role models. These schemes are most effective when they are clearly designed to reward audit quality and desired auditor behaviours rather than hours worked and where they encourage senior auditors to show appreciation for audit quality and desired auditor behaviours.

Promotions drive pay progression, show who is valued, impact who remains within the firm, and should align with the firm's desired auditor behaviours and quality outcomes. Feedback, quality metrics, interviews, technical assessments, and internal reviews of audit work are valuable inputs. Using scenarios to test skills and auditor behaviours, including a willingness to challenge, makes interviews more effective. Collecting 360-feedback on attainment of desired auditor behaviours, drives a focus on audit quality. Where the rationale for promotion decisions is transparent it helps embed the firm's desired audit behaviours.

Reward and recognition processes can also promote a culture of **continual improvement** by rewarding behaviours that contribute to continual improvement, for example learning from mistakes, proactively improving skills, sharing challenging experiences with others, and contributing to or starting initiatives to prevent issues from recurring.

Good practice – reward & recognition



"One firm runs annual 360-feedback for all audit managers and above, with anonymous feedback on the firm's values, including integrity, quality, and coaching. Feedback reports are then used in appraisal and promotion processes."

"One firm uses audit quality self-assessments that require commentary on quality metrics and behaviours of challenge and integrity."

"Many firms use a combination of reward mechanisms to reward auditors behaviour, including bonuses linked to quality metrics, quarterly awards for exceptional behaviours, collegiate nominations for ad-hoc small bonuses, and non-financial recognition".

"One firm uses robust technical promotion interviews with required technical and ethical scenarios. Another firm has introduced external technical assessments for manager and senior manager promotions."

"One firm mandates a manager assessment centre for promotion, in audit with a simulated file review, technical scenarios, tests on risk management, accounting and auditing and technical presentations."

Working Environment

The working relationships within an audit team set the **behavioural foundation** for auditors to challenge management during an audit. An effective working environment in an audit team is one where auditors feel comfortable sharing concerns and asking challenging questions without the risk of repercussion or embarrassment.

It is important to create a work environment where audit findings can be escalated by all auditors in a **safe environment**, where auditors feel they are being included in a team and where there is sufficient time for the team members to support each other, discuss and resolve findings before an audit is signed off.

Mechanisms that lend themselves to **flatter hierarchies**, such as open-plan office spaces, create a good environment for challenge and help to create a sense of team culture. Junior auditors can learn from seeing rather than being told and feel more compelled to approach their seniors within a culture of psychological safety.

Senior auditors should promote the art of learning from mistakes and encourage a culture of **continual improvement**. The more confident auditors feel about challenging themselves, the more likely they will learn from mistakes and therefore make continual improvements. This is a powerful means to get exceptional results, particularly when a firm's audit engagement partners lead by example.

Audit firms need to create the right environment for scepticism and challenge within a **hybrid working** context. This includes firms identifying factors that may be more difficult in a hybrid working environment (for example, how to challenge when not face to face; how to best learn from others when not physically together) and developing effective ways of working to overcome these potential barriers.

The nature of audit itself has also become more complex, requiring greater interdependence and, therefore collaboration between individuals in a team. Where work environments (e.g. remote working or individual partner offices) lead to auditors working more independently and in siloes, this can create fewer **opportunities for collaboration** and team discussion if auditors do not adapt their working styles and practices accordingly.

Good practice – working environment



"Some firms introduced virtual audit rooms on audit engagements during the pandemic, aimed at providing team members with an open channel to receive support and coaching. This created an inclusive audit team environment, regardless of where colleagues were based, helping team members feel supported and included."

"One firm engaged a third party to conduct a survey evaluating the behaviour of speaking up within its audit practice, including asking whether or not auditors feel comfortable about speaking up when working in teams."

"One firm initiated a series of podcasts, in which one episode of the series invited a Partner in the firm's audit practice to share examples of mistakes they had made during their careers and what they had learnt from them."

"One firm offers bite-size training sessions to auditors focused on assisting them in understanding the importance of self-evaluation and how to embrace feedback in supporting continual improvement."

People Engagement

Engaged employees feel connected to the goals and purpose of the firm, setting the right environment for them to deliver increased audit quality and the specific behaviours of scepticism and challenge.

An audit firm can engage with employees through initiatives such as 'people forums' or 'culture champions'. These initiatives enable firms to understand the **views of their workforce** as well as being a forum to **reiterate leadership's messages** in more relatable ways and mitigate the risk of messages being misinterpreted or lost as they are communicated further down the hierarchy.

Managers are a grade that junior auditors typically look up to and mirror behaviours from. A culture initiative will have more success when managers are engaged and therefore become advocates of the desired behaviours that an audit firm expects of its auditors. Increasing leadership's **engagement with middle management** will empower auditors in this critical position to be owners of change in audit teams and within the audit practice.

Good practice – people engagement



"One firm implemented a series of initiatives aimed at empowering the middle management to be enablers of audit culture change, recognising their role as important in setting the right tone and maintaining the right culture on the ground where audits are delivered."

"One firm developed a network of around 100 culture champions across their audit practice business units, offices and teams. Their role is to support auditors in implementing the audit behaviours through activities, campaigns and other initiatives. They provide feedback to the central team from teams on the ground and provide insight as to further opportunities to embed the behaviours or any perceived barriers they may have identified."

5 Audit Firm Operating Model

 Learning Environment	 Culture	 Audit Firm Operating Model	 Ecosystem
Auditors are equipped with the knowledge and skills of professional scepticism and challenge.	Displaying the behaviours of professional scepticism and challenge are encouraged by the audit firm.	Auditors are enabled to apply the behaviours of professional scepticism and challenge when performing audit work.	
Through the professional qualification and ongoing learning and development throughout an auditor's career.	Through the firm setting out clear behaviours expected of auditors, the firm having a culture that promotes these behaviours and the elimination of barriers to exercising these behaviours.	Through appropriate resources and processes at the audit firm and management and those charged with governance at the audited entities supporting these behaviours.	

Audit firms must have an operating model that enables auditors to exercise professional scepticism and challenge appropriately. Specifically, they need to have adequate **time and resources available** for the audit engagement, and **processes** in place to enable auditors to exercise professional scepticism and challenge appropriately.

Resources and Project Management

Adequate and appropriate resources are key to audit quality, challenge, and professional scepticism, as auditors need time and mental capacity to critically review audit evidence and hold discussions.

Good **resource management** ensures that audit engagements have the right auditors doing the audit at **the right time**. Tracking auditors' experience and skills enables better resource allocations. Review of the resource budgets centrally and by the audit partner, with consideration of milestones, firm policies, and timelines agreed with management, ensures audit budgets remain realistic.

Effective **project management** drives timely audit work and partner/manager engagement, mitigating the risk of identifying issues late, when auditors feel less able to challenge or perform additional work. Timely senior auditor engagement during planning allows work to be performed right the first time. Good project management also ensures entity management keeps to agreed schedules to ensure sufficient time for review and challenge.

Audit firms facilitate good project management by setting and monitoring **milestones** for when audit phases, like planning, need to be completed, issuing guidance on when to perform and complete different audit procedures, providing training and tools to empower audit teams to keep themselves and management to timelines, and supporting auditors to push back audit deadlines where management deliverables were late.

Audit firms identify individuals under **excessive pressure** by prospective review of work portfolios and, retrospective monitoring of hours worked, with follow up of outliers. This requires realistic expectations of what hours can be worked without compromising audit quality and ensuring that follow-up of outliers considers risks to audit quality as well as individual wellbeing. Monitoring hours requires recording all hours, despite any commercial pressures to under-record.

Good practice – resource & project management



“One firm mandates milestones for all audits for planning, pre-year-end testing, and controls testing to drive completion of 30% of audit hours before year-end. Other firms use multiple milestone programs, so the timing and number of milestones vary based on audit size.”

“Most firms run a weekly report to monitor audit hours charged, with one firm using pre-defined thresholds and a central tracker in order to identify and follow-up on outliers.”

“Some firms use project management centres of excellence to provide dedicated project managers for large audits and project management resources. Some firms mandate training for all auditors on project management tactics.”

“Some firms have a central oversight of the progress on the highest risk audits to monitor additional resourcing needs.”

“Some firms mandate full team discussions at set points in the audit to drive timely debate of key judgements.”

Audit Firm Processes

Audit firm processes can prompt and enable scepticism and challenge throughout the audit. These include hot reviews, engagement quality control reviews (EQCRs), consultations, use of specialists and centres of excellence, and sharing market and industry knowledge between auditors.

Hot reviews of ongoing audits, by centrally allocated reviewers, support audit quality and challenge by involving experienced auditors, with a fresh perspective, as an additional reviewer or as a coach to challenge audit judgements and probe for potential biases. Hot reviews are most effective when they are timely and focused on higher-risk audits and the riskier and more judgemental audit areas. Using specialists on hot reviews facilitates the challenge of complex areas. Challenge panels, where central technical partners and specialists review the risks, procedures, and judgements on ongoing audits, also strengthen hot reviews.

EQCRs review public interest and higher risk audits to challenge the audit risks, procedures, and judgements, focusing on complex areas. This is most effective when firms promptly identify where EQCRs are needed, allocate EQCRs based on skills, seniority, and independence from the audit team, train EQCRs on hot topics and recent quality findings, and provide appropriate guidance and work papers. Robust EQCR workpapers drive evidencing of the judgements reviewed, the challenges raised, the resolution of these challenges, and discussions with the audit team.

Promoting a culture of **consultation** with central technical teams encourages scepticism and challenge. This is supported by guidance on when, and with whom, to consult. Required consultations in areas of recent audit quality findings can drive improvements. Analysis of consultations raised can identify where additional guidance or support is needed.

Audits can be enhanced by using a **wide range of specialists and experts**, who can advise the audit team or perform audit procedures based on their in-depth technical knowledge and skills in particular areas. Consulting with specialists enables challenge of management, particularly when management use specialists or has technical experience that the audit team do not. Effective engagement is driven by guidance on when, and to what extent, to involve a specialist or expert, based on the particular audit, the skills of the audit practice, and areas of recent audit quality findings.

Centres of excellence perform audit procedures across numerous engagements. Using them for complex or judgemental areas allows better benchmarking between entities, enables challenge, and avoids auditors performing procedures where they lack experience and skills. Centres of excellence can also issue guidance and resources.

Sharing market and industry knowledge within the audit practice increases access to evidence, benchmarking, and good practice that can drive the challenge of management's judgements. Access to external data, e.g., analyst reports, industry analysis/forecasts, and market financial data, enables identifying contradictory evidence to encourage professional scepticism. External data sources are most useful when auditors receive training on how to use them.

Good practice – audit firm processes



“One firm requires hot reviewers to focus on the culture of challenge, using an aide memoir covering types of bias, red flags that could indicate insufficient challenge, and reminders of what evidence of challenge is expected.”

“One firm runs thematic hot reviews on focus areas, e.g. management estimates, to identify themes and concerns.”

“One firm requires hot reviews for all new Public Interest Entity (PIE) audits and all PIEs every three years, focused on areas of historical findings. Another firm holds planning and concluding challenge panels for high-risk audits, to challenge the audit team's planned approach and key judgements, particularly for areas where a higher degree of scepticism and challenge is needed”

6 Ecosystem

 Learning Environment	 Culture	 Audit Firm Operating Model	 Ecosystem
<p>Auditors are equipped with the knowledge and skills of professional scepticism and challenge.</p>	<p>Displaying the behaviours of professional scepticism and challenge are encouraged by the audit firm.</p>	<p>Auditors are enabled to apply the behaviours of professional scepticism and challenge when performing audit work.</p>	
<p>Through the professional qualification and ongoing learning and development throughout an auditor's career.</p>	<p>Through the firm setting out clear behaviours expected of auditors, the firm having a culture that promotes these behaviours and the elimination of barriers to exercising these behaviours.</p>	<p>Through appropriate resources and processes at the audit firm and management and those charged with governance at the audited entities supporting these behaviours.</p>	

Achieving a high-quality audit requires a well-functioning ecosystem of internal and external stakeholders, and all parties in the ecosystem have a crucial role to play, including shareholders, management and those charged with governance.

This section considers the role of the audit committee and management.

Audit Committee

A key driver to fostering a good environment for an auditor to exercise scepticism and challenge is having an engaged and experienced audit committee. A **strong audit committee** is one that consists of members with a broad range of skills and experiences, and strong financial literacy and expertise in order to provide different perspectives and actively engage in granular conversations related to the audit. Audit committee members also need an overriding focus on the purpose of the audit and the behaviours that lead to a high-quality audit.

An audit committee that is **independent** from both the audited entity and the audit firm is key to facilitating an effective relationship between an auditor and an audited entity. This supports constructive challenge between the auditor and management of the audited entity to be upheld and holds both the auditor and management of the audited entity accountable, for example, when management is unable to deliver quality documentation on a timely basis or when the auditor fails to adhere to the audit milestones.

It is important to have adequate audit committee involvement in the **planning stage** of the audit. A well-planned audit reaps many benefits, including improved audit efficiency and ensuring that audit efforts are directed at the most significant areas where there is an increased need for scepticism and challenge. A core set of audit quality objectives, desired behaviours and expected outcomes for each phase of the audit can be agreed at the start of the audit. A good audit plan will also include consideration of how unexpected matters arising during the audit or changes to the audit plan will be managed. This ensures that the plan is dynamic and can respond appropriately to changes during the audit and is particularly important in enabling scepticism and challenge.

Effective and well-timed **communication** between the auditor, management and the audit committee is vital in enabling adequate scepticism and challenge during the audit. Communication is enhanced when the audit committee agree the formal and informal means of communication with the auditors at the start of the audit, including the plan for how any unexpected matters arising can be escalated in a timely manner. This communication provides a strong foundation for establishing an effective working relationship between the auditor, management and the audit committee.

Audit firms need to give **clear messages** to audited entities about their robust commitment to audit quality, independence, scepticism and challenge. This enables management and audit committees to understand what is expected from them and what the audit process will involve. This also enables audit firms to outline the distinction between providing a 'service' to an 'audit client' and performing an independent audit in the interests of shareholders and the wider public.

An audit committee should set clear **expectations** and boundaries of what is desired of an auditor in order to deliver a good quality audit, laying out the extent of constructive challenge that stakeholders expect to see between the audit firm and the audited entity's management. At the audit completion stage the audit committee can then assess the extent to which this constructive challenge has been evident.

Appropriate resourcing is key to enabling scepticism and challenge during an audit, therefore an audit committee that asks questions about the resourcing of the audit will obtain valuable information on this vital contributor to audit quality. Understanding the audit resourcing allows the audit committee to understand, and if necessary, question the time that is spent on the higher-risk and key judgement areas where there is likely to be more challenge. For example, the audit committee may ask questions to understand the extent of use of specialists on complex technical areas or overall partner hours to assess the quality of direction and supervision by the partner.

Audit committees can take actions to understand the **extent to which there has been effective challenge during the audit**, for example by asking the audit partner to talk about any conflicts with management and how these conflicts have been resolved. Audit committees can also interact and engage with the audit team performing the work to obtain valuable real-time insight into their audit findings and the extent to which management have been cooperative. The audit committee, non-executive directors and auditors would normally meet privately at least annually. These meetings allow the audit committee to ask questions on matters that might not have been specifically addressed in the formal part of the audit committee meeting and allow the auditor to provide candid feedback to the audit committee.

When the auditor presents their final report towards the end of the audit, the audit committee has an opportunity to ask many **probing questions** to allow the auditor to demonstrate that they have applied adequate professional scepticism and challenge in the appropriate areas of the audit. Asking questions on the key accounting, auditing or reporting matters that were discussed between the auditor and management, including whether there were any disagreements and how they were resolved, allows the audit committee to gain a greater understanding of the nature and level of challenge during the audit.

Audit firms performing **first-year audits** have an opportunity to set clear expectations of the audit committee and management from the outset. They should outline their audit firm culture and audit approach with a focus above all on audit quality and behaviours, including challenge. First-year audits can present a particular challenge for incoming audit firms who need to get up to speed quickly with risks and areas of complexity but may be incentivised to demonstrate a 'smooth audit process' to the audited entity, reinforcing their decision for the appointment.

Providing multi-directional or '**360-feedback**' is crucial to facilitate continual improvement and provoke constructive discussion between the audit firms, management of audited entities and audit committees. Questions should focus on audit quality and behaviours, in particular professional scepticism and challenge, rather than the commercial relationship between the audit firm and audited entity. Formal feedback mechanisms and timing should be agreed upon at the start of the audit, with informal feedback provided as necessary throughout the audit. The use of engagement level Audit Quality Indicators can provide a mechanism for monitoring and prompting discussion of a number of the factors that contribute to enhanced scepticism and challenge.

Management

Management at the audited entity has a key role in providing **quality and timely information** to the auditor during an audit. If information is not of high quality, it can make it more difficult for an auditor to exercise the challenge effectively. Equally, poor quality information or delays in the auditor receiving the information can lead to inefficiencies in the audit process and constraints on an auditor's time. During the planning stage of the audit it is important for the audit firm to clarify the deliverables needed from management and establish a common understanding of the expected quality of these deliverables.

It is crucial that management are **open to challenge** during an audit and respond promptly to queries and information requests. This enables auditors to effectively project manage the audit, meet audit milestones and perform a robust quality audit. When management at the audited entity are cooperative, behave respectfully, actively listen and do not put auditors under undue pressure, this creates a good environment for scepticism and challenge and facilitates a high-quality audit.

The interactions between management and the audit team can also be enhanced by management understanding and fully promoting the **public interest purpose** of the audit. With the public interest purpose at the forefront of their mind, management will view audit less as a 'client / service provider' relationship and more as a means for maintaining trust in company reporting.

Acceptance and continuance procedures should include an assessment of the quality of management at the audited entity including the extent to which directors are open to challenge and value audit quality. Where the audit firm has any concerns, these should be raised with the audit committee and appropriate action taken.

Good practice – audit committees & management



“Some firms conducted post-audit interviews to collect feedback from audited entities’ management and audit committees focusing on audit quality, effective challenge and the delivery of audit and project management.”

“One firm created an audit committee effectiveness framework to enable the self-assessment on the effectiveness of the audit committee.”

“One firm produced a guidance video to outline what audited entities’ management should expect from the audit process, including scepticism and challenge.”

“One firm invited an experienced Audit Committee Chair to share perspectives on what effective challenge of management by auditors means to them in its annual audit training to the post-qualified auditors.”

“At one firm, the audit committee chair asked for a discussion with the engagement team, without the senior leadership of the team, to understand the culture of the team and how they demonstrated the behaviours. During the discussion the audit committee chair asked lots of questions about how the team challenged management, the areas of challenge, and how the team challenged themselves on the audit approach.”

Appendix 1: Tier 1, 2 and 3 Audit Firms

The seven audit firms defined as being Tier 1 are:

BDO LLP ("BDO")	KPMG LLP ("KPMG")
Deloitte LLP ("Deloitte")	Mazars LLP ("Mazars")
Ernst & Young LLP ("EY")	PricewaterhouseCoopers LLP ("PwC")
Grant Thornton UK LLP ("GT")	

Tier 2 & 3 Firms as defined by the FRC for 2022/23 are:

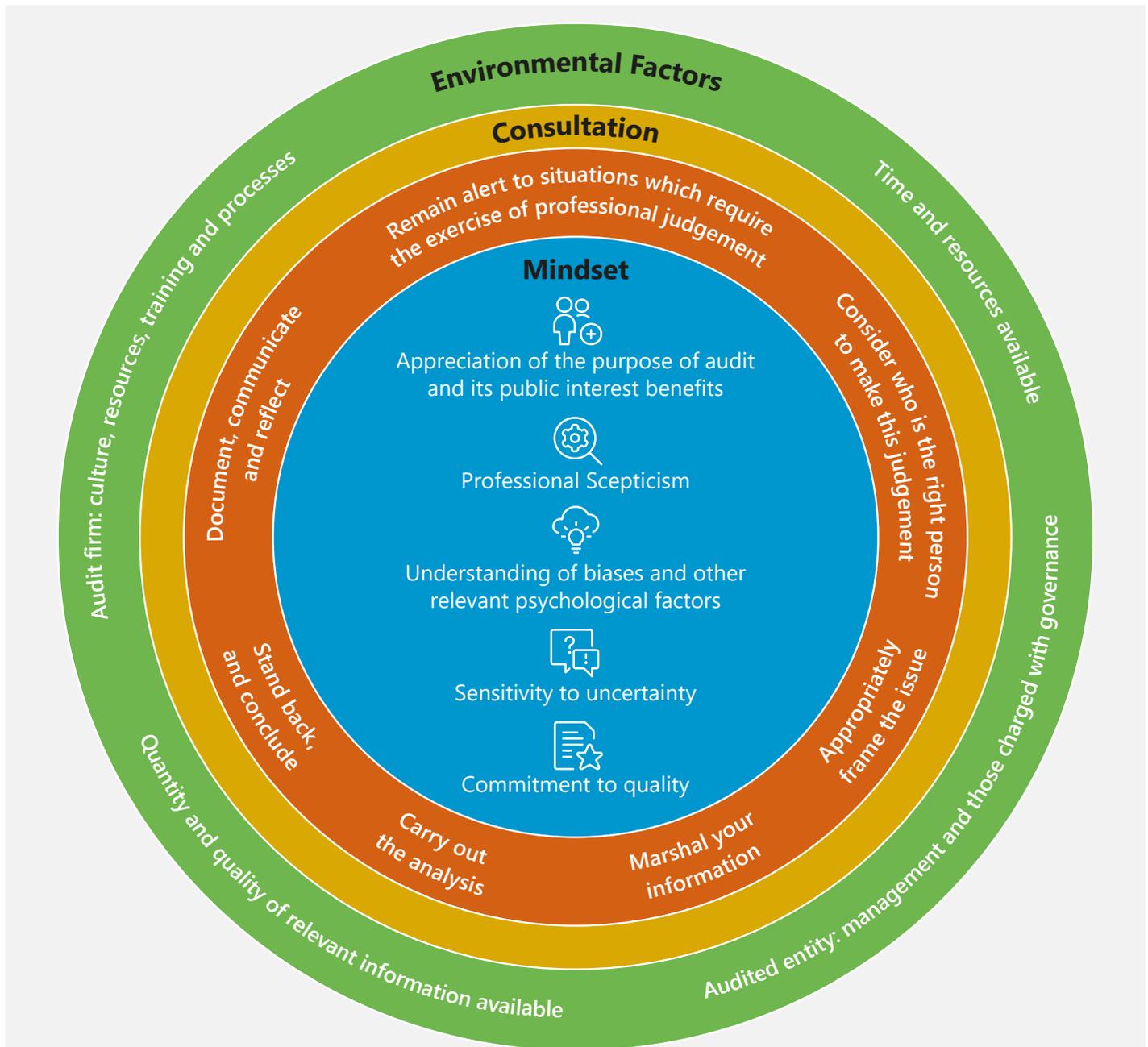
Crowe U.K. LLP	Gerald Edelman LLP
Haysmacintyre LLP	Hazlewoods LLP
Macintyre Hudson LLP	Jeffreys Henry Audit Limited
PKF Littlejohn LLP	Johnsons Financial Management Ltd
RSM UK Audit LLP	UHY Hacker Young LLP
Anstey Bond LLP	Johnston Carmichael LLP
Beever and Struthers	Kreston Reeves LLP
Begbies	LB Group Ltd
Bennett Brooks & Co Limited	Moore Kingston Smith LLP
Bright Grahame Murray	RPG Crouch Chapman LLP
BSG Valentine (UK) LLP	Price Bailey LLP
CBW Audit Limited	Royce Peeling Green Ltd
Deloitte (NI) Limited	Shipleys LLP
Edwards Veeder (UK) Limited	

Appendix 2: Glossary of terms

Throughout this paper, the phrases that follow are used regularly and have the following intended meanings:

Term	How this term should be interpreted
Senior auditor(s)	Experienced auditors in senior roles, typically at director or senior manager level.
Audit Manager(s)	Auditors with several years of experience, typically at assistant manager and manager level.
Junior auditor(s)	Auditors with one to three year's of experience, typically at associate or senior associate level.
Independent Non-Executive (INE)	An elected individual who represents the public interest and provides counsel and challenge in respect of a firm's activities from that perspective. This means acting for the benefit of the common good, not necessarily in the interests of the firm's owners (the partners), although those interests may often be aligned. INEs generally do not have voting rights or make decisions.
Audit Non-Executive (ANE)	An elected individual who shares the same remit as an INE, but focuses on the audit practice only.

Appendix 3: Professional Judgement Guidance



This framework consists of four main components:

Mindset – An appropriate mindset for auditors exercising professional judgement;

Professional Judgement Trigger and Process – A suggested professional judgement process, together with a reminder to remain alert to situations which may require professional judgement;

Consultation – Effective communication with a range of relevant parties; and,

Environmental Factors – Factors that may be present in the environment of those making a judgement, that can impact on how challenging it is to exercise professional judgement in an appropriate manner.



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