

AUDIT INSPECTION UNIT

Appendix C – How we assess audit quality

We assess the quality of the audit work we inspect using the following four categories:

- Good (category 1);
- Limited improvements required (category 2A);
- Improvements required (category 2B); and
- Significant improvements required (category 3).

The assessments of the quality of the audits we reviewed in our public reports on individual firms combine audits assessed as falling within categories 1 and 2A.

These four categories have been used consistently since 2008, although there have been some minor refinements to the category descriptions over the years. They reflect our assessment of the overall significance of the areas requiring improvement that we have reported to the Audit Committee and the auditor. We expect the auditor to make appropriate changes to its audit approach for subsequent years to address all issues raised.

An audit is assessed as good where we identified no areas for improvement of sufficient significance to include in our report. Category 2A indicates that we had only limited concerns to report. Category 2B indicates that more substantive improvements were needed in relation to one or more issues.

An audit is assessed as requiring significant improvements (category 3) if we have significant concerns in relation to the sufficiency or quality of audit evidence, the appropriateness of key audit judgments or other matters identified. In such circumstances we may request some remedial action by the firm to address our concerns and to confirm that the audit opinion remains appropriate. We will generally review a subsequent year's audit to confirm that appropriate action has been taken.

We exercise judgment in assessing the significance of issues identified and reported. Relevant factors in assessing significance include the materiality of the area or matter concerned, the extent of concerns regarding the sufficiency or quality of audit evidence, whether appropriate professional scepticism appears to have been exercised, and the extent of non-compliance with Standards or a firm's methodology.

Our inspections focus on how selected aspects of a particular audit were performed. They are not designed to assess whether the information being audited was correctly reported. An assessment that an audit required significant improvements, therefore, does not necessarily mean that an inappropriate audit opinion was issued, the financial statements failed to show a true and fair view or that any elements of the financial statements were not properly prepared.

Equally, assessing an audit as requiring significant improvements does not necessarily imply that the conduct of the relevant audit firm, or one or more individuals within the firm, may warrant investigation and/or enforcement action by the FRC.