



Financial Reporting Council

MOORE STEPHENS LLP

AUDIT QUALITY INSPECTION

JUNE 2018

The FRC

Our mission is to promote transparency and integrity in business.

transparency



We have responsibility for the public oversight of statutory auditors.

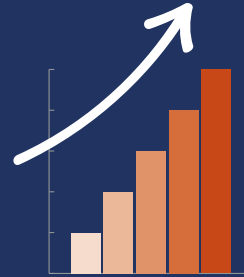
The FRC works with European, US and global regulators to promote high quality audit and corporate reporting.



AQR

We monitor the quality of UK Public Interest Entity audits.

+1.55	0.20%	+2.27%	-11.48%	POS	-3.2320
+3.10	0.21%	+2.83%	-15.93%	NEG	-3.9993
+3.65	0.14%	+2.42%	-17.67%	POS	-4.2421
+3.38	0.27%	+2.19%	-18.32%	NEG	-4.2083
+3.12	0.37%	+2.28%	-14.73%	NEG	-3.5708
+3.21	0.20%	+2.76%	-20.12%	NEG	-2.8339



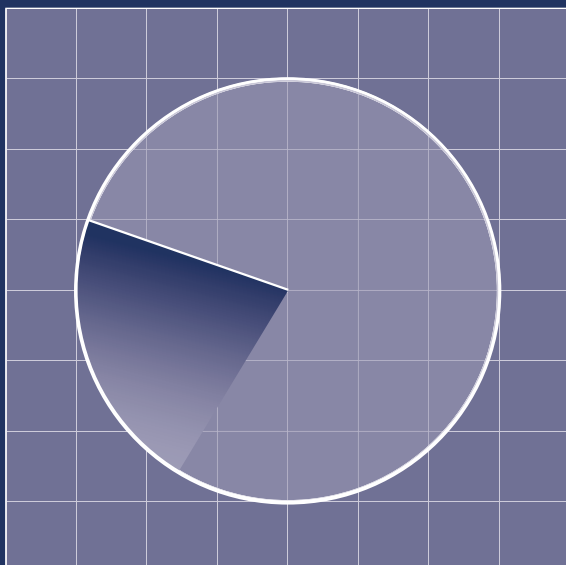
We promote continuous improvement in audit quality.

Our team of over 40 professional and support staff has extensive audit expertise to provide rigorous inspection of audit firms.



The Firm

Moore Stephens LLP has 24 audits within the scope of AQR inspection, none of which are in the FTSE 350.



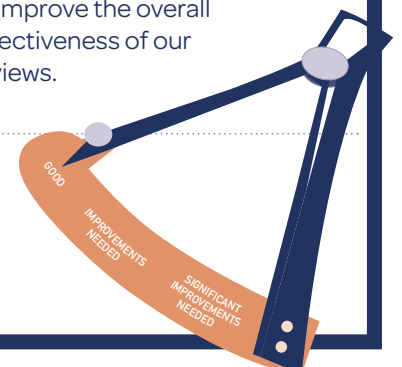
Our inspection process

There are around 2350 audits within the scope of AQR inspection. In total, we inspected 145 individual audits in 2017/18, including 5 at Moore Stephens.



We work closely with audit committee chairs to improve the overall effectiveness of our reviews.

We assess the overall quality of each individual audit reviewed.



Financial Reporting Council

Moore Stephens LLP

Audit Quality Inspection

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AQR's objective is to monitor and promote improvements in the quality of auditing.

AQR assesses the quality of audit work and policies and procedures supporting audit quality at firms which audit Public Interest Entities.

The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

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1 Overview

This report sets out the principal findings arising from the 2017/18 inspection of Moore Stephens LLP (“Moore Stephens” or “the firm”) carried out by the Audit Quality Review team (“AQR”) of the Financial Reporting Council (“the FRC”). We conducted this inspection in the period from January 2017 to January 2018 (“the time of our inspection”). This was the first year that the firm was within AQR’s full inspection scope¹. Going forward, we will inspect Moore Stephens annually and report publicly on our findings.

Moore Stephens is part of Moore Stephens International (“MSIL”) and Moore Stephens UK (“MSUK”). Moore Stephens is the largest firm within the MSUK grouping, with six offices. Our inspection and findings in this report only relate to Moore Stephens.

Our report focuses on the key areas requiring action by the firm to safeguard and enhance audit quality. It does not seek to provide a balanced scorecard of the quality of the firm’s audit work. Our findings cover matters arising from our reviews of both individual audits and the firm’s policies and procedures which support and promote audit quality.

We are grateful for the co-operation and assistance received from the partners and staff of the firm in the conduct of our 2017/18 inspection.

Our assessment of the firm’s performance

The results of our reviews of individual audits showed that three of the five audits required no more than limited improvements. The firm has subsequently resigned from one of the other two audits due to its fee proposal not being accepted by the company’s Board.

The firm has taken action to improve its firm-wide policies and procedures in response to our inspection findings. Further improvements to its quality control systems and arrangements are required.

The firm had made progress in revising its policies and procedures to address the new requirements of the revised Ethical Standard. At the time of our review, improvements were required in certain areas including personal independence systems and monitoring.

Key findings in the current year requiring action

Further details of all our key findings are given in section 2, together with the firm’s actions to address them.

¹ We inspect all UK audit firms that undertake PIE or large AIM/Lloyd’s Syndicate/Listed Non-EEA audits. Larger firms are inspected annually, while other firms are generally inspected once every three years.

Our other key findings in the current year requiring action by the firm are set out below.

Review of firm-wide procedures

The firm should:

- Enhance its acceptance and continuance procedures.
- Set out more clearly the relationship with other network firms in its transparency report and on its website.
- Strengthen its procedures for the review and approval of non-audit services and its response to identified ethical breaches.
- Improve its staff appraisal processes.

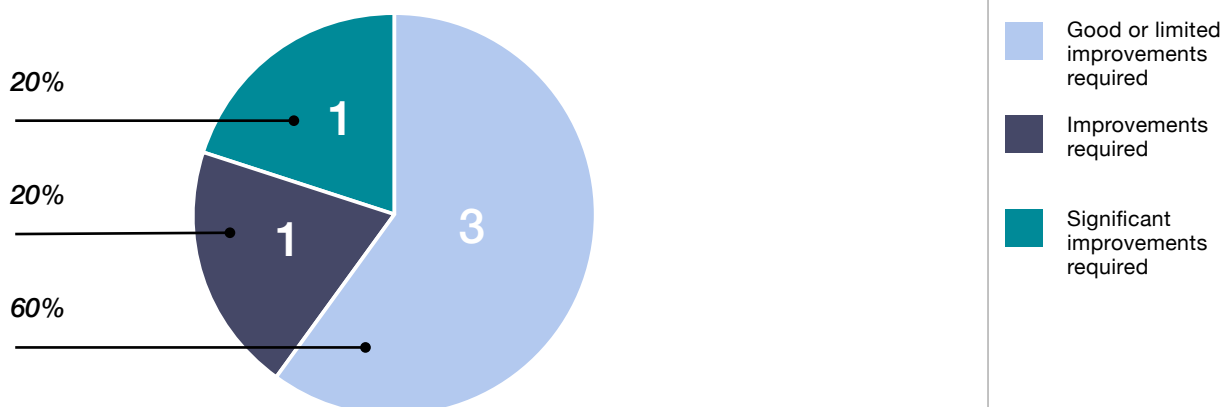
Individual audit reviews

The firm should:

- Ensure that IT audit considerations are assessed appropriately and computer assisted audit techniques (CAATs) applied effectively.
- Strengthen its audit approach in relation to defined benefit pension scheme assets and membership data.
- Improve the quality of evidence obtained from its actuaries in relation to areas of judgement.

Assessment of the quality of audits reviewed

The pie chart below shows the results of our assessment of the quality of the five audits we reviewed in 2017/18.



Good practice identified

Examples of good practice we identified in the course of our work include the following:

- Targeted independent compliance reviews for audits of group financial statements.
- Expertise in the audit of insurance sector entities.

Root cause analysis

Thorough and robust root cause analysis (RCA) is necessary to enable firms to develop effective action plans which are likely to result in improvements in audit quality being achieved.

Our thematic review report on Audit Firm Culture² stated that firms should seek to develop their RCA techniques “to identify the behavioural or cultural factors that contributed to either good or poor quality outcomes”.

We will continue to assess the firm’s RCA process and encourage all firms to develop their RCA techniques further.

² The report, published in May 2018, sets out how audit firms are seeking to embed a culture which supports high quality audit: [Audit Culture Thematic Review](#)

Firm's overall response and actions:

We appreciate the insight provided by the AQR on the quality of the firm's audit work and our firm-wide policies and procedures. The firm is committed to safeguarding and enhancing audit quality and is implementing the AQR team's required improvements.

During the period covered by the inspection, we have rolled out our Root Cause Analysis process including both specific audit file review findings as well as those relating to our firm-wide policies and procedures. Some of the key steps undertaken leading on from our learning outcomes are noted below.

For the firm's year ending 30 April 2018 the firm has been following a bespoke monitoring program for the firm-wide ISQC 1 review. This marks an upgrade from previous practice of using a commercially available checklist and it has already provided a valuable insight.

The firm has for some time now been embarked on an upgrade of its IT systems and this has seen an improvement in the level of management information available and its speed of access. These enhancements will allow us to interrogate information and monitor compliance with firm-wide policies and procedures more effectively.

The interviews underlying root cause analysis for file reviews are conducted in a spirit of openness with a no-blame culture. We need the interviewees to speak openly in order to get the most from the process. The file selection process covers the spectrum of file gradings in order to try to identify both positive and negative action points. By reviewing a widely based sample of audits we believe we can identify appropriate action points.

The root cause analyses which we have undertaken have covered the audit of revenue and related IT matters and the audit of pension assets and membership data. The quality of evidence obtained from the firm's actuaries was not an issue that arose on any audit files that were subject to root cause analysis.

In relation to revenue and IT matters, some of the root causes were very specific, such as changes to systems during the period being audited and the lack of experience of the audit team in dealing with the use of IT specialists. However, more generally we have identified a lack of communication between computer audit specialists and audit partners and staff, leading to a lack of understanding of the respective role of each with the potential to lead to omissions or inefficiency.

In relation to pension schemes, our approach has previously stressed the importance of dealing with the actuarial assumptions underpinning the liability with insufficient weight given to dealing with scheme assets and the membership data that has been provided to the actuary.

Given this was the firm's first inspection under an annual cycle there were no real expectations against which to measure the inspection results. Whilst we are pleased with certain aspects, for instance the undoubted experience the firm has in auditing its insurance clients, other file review findings are somewhat disappointing.

Recruitment of strategically important quality posts is well underway. This reflects our commitment to audit quality.

2 Key findings requiring action and the firm's response

We set out below the key areas where we believe improvements are required to enhance audit quality and safeguard auditor independence. We asked the firm to provide a response setting out the actions it has taken or will be taking in each of these areas.

Review of firm-wide procedures

Network structure

Given the firm's interaction with other firms in the MSUK network in the provision of audit services, it should establish appropriate policies and procedures to ensure that audit quality and independence are safeguarded.

Full and clear information on the nature of the firm's relationship with its network is essential to stakeholders in providing transparency on the nature and scope of the services provided by the firm.

The firm's relationship with MSUK

MSUK is a grouping of independent firms with 37 offices which, in most cases, operate under the Moore Stephens name. MSUK also differs from the UK grouping of firms shown on the MSIL website (i.e. the latter excludes firms in the Republic of Ireland, Jersey, Guernsey and the Isle of Man).

There is limited information on the MSUK website explaining the nature of the relationship between the firms within MSUK. The majority of publications on the website appear to relate to the firm, rather than other MSUK firms. Most users of the website are therefore unlikely to be aware of the difference between the firm, which only has six offices, and the remaining 31 offices within MSUK.

Staff independence considerations across MSUK

The firm relies on the other MSUK firms' procedures to assess compliance with all ethical and independence requirements for staff from those firms working on the firm's audit engagements (either as part of the engagement team or as a component auditor).

Acceptance and continuance

The "objective, reasonable and informed third party test" in the Ethical Standard requires a firm to ensure that its acceptance and continuance procedures for audit and non-audit services take account of all relevant services across network firms. The firm currently does not have a policy on client acceptance matters which takes account of the work of other MSUK firms.

Transparency Report

The firm's Transparency Report is available on the MSUK website. The Report contains limited information about the firm's structure and its relationship to MSUK, but it does refer to its six offices. We also note that the website does not refer to the Transparency Report of Scott Moncrieff (another MSUK firm). With the current level of disclosure, the firm's Transparency Report could be construed inappropriately as being the transparency report for MSUK as a whole.

Firm's actions:

MSUK is an umbrella organisation sharing the cost of certain activities including training and the Professional Standards Review function ("PSR") on behalf of Moore Stephens International Limited ("MSIL"). MSUK is not considered to be a network entity for the purposes of the Ethical Standard. We will clarify that each UK firm, including MS LLP, is an independent member firm of MSIL.

We accept that MS LLP's position within the grouping of UK firms may be unclear to website users. Where appropriate, we will clarify which web content relates to which firm. The firm will ensure that the MSUK website is consistent with the MSIL website in terms of locations covered.

We recognise that the Transparency Report may be thought to cover all Moore Stephens UK operations. We will amend the related links through our website accordingly and will strengthen the introduction to the Transparency Report to emphasise its scope. Reference to any other appropriate Transparency Reports will be made.

MS LLP's use of partners and staff from other Moore Stephens UK firms is limited. The more common arrangement is for another Moore Stephens UK firm to act as component auditor. The Compliance department monitors such audits through its ISA 600 reviews (as recognised elsewhere in this Report).

The firm's independence documentation will request consideration of whether other Moore Stephens UK firms will be used either:

- (a) using their staff as agent; or
- (b) using the firm as a component auditor.

In either case, persons involved in the audit from other Moore Stephens UK firms will be required to complete the MS LLP Annual Compliance Declaration.

Independence and Ethics Procedures

The Ethical Standard (“ES”) requires the firm to establish policies and procedures to ensure that the firm, and all those in a position to influence an audit, act with integrity, objectivity and independence. Furthermore, Auditing Standards require the firm to establish policies and procedures to provide reasonable assurance that the firm and its personnel comply with relevant ethical requirements.

The firm had made progress in updating its policies and procedures to address the new requirements of the revised ES. At the time of our review, improvements were required in the areas set out below.

Independence considerations – assessment of breaches

Our review identified independence breaches, mainly in relation to the provision of non-audit services to several non-PIE entities. The firm’s internal review procedures had also identified these breaches. There was insufficient evidence to support the conclusions of the firm’s ethics function in relation to the breaches identified.

Gifts and hospitality

The firm’s testing of staff compliance with its Gifts, Hospitality and Expenses policy revealed instances where authorisation was lacking or the level of gifts and hospitality not adequately evidenced.

Personal independence – systems and monitoring of compliance

The revised ES introduced more stringent prohibitions in relation to partner and staff financial interests. The firm’s formalised system to record such interests is heavily reliant on individuals managing their financial affairs appropriately. The firm also does not have a process to test financial interests held by partners and staff, instead relying on their annual independence declarations.

Firm's actions:

The Compliance department had detected the breaches in the course of its file reviews and firm-wide ISQC 1 procedures. There were six examples of involvement in accounts preparation where there was no evidence of the ethical safeguarding review. Such reviews had been planned and it is for this reason that this failing was recorded as being inadvertent. We will make conclusions more detailed for each entry in the Ethics Log.

None of the examples identified related to a PIE or listed entity. The Compliance department cold reviewed the audit files for four of the six engagements and carried out a retrospective review of the financial statements of the other two entities. No major issues were noted with the financial statements for any of the six entities.

The firm's independence documentation has a prompt to consider which of client's management are considered to be informed management in relation to each non-audit service.

The need for independent safeguarding review continues to be a firm requirement and is regularly covered on training courses. It has very recently been addressed by means of a Top 10 Ethics Points reminder to all partners and managers across the firm, not just those in Audit service line.

The firm has now separated the gifts and hospitality limits with the gifts limit being reduced to £50. The Ethics Manual has been updated and the change was included in the Top 10 Ethics Points reminder.

We consider that our current processes are adequate to identify any likely issues in relation to partner and staff financial interests given the limited number of listed audit clients at present.

In addition any new listed audit clients are advised to the firm by email by the Audit Compliance Principal. Were there to be a failure to disclose on the firm's Annual Compliance Declaration ("ACD") this would clearly need to be treated as a serious breach of trust. Additionally, we undertake to have partners and audit staff confirm their financial independence some six months after their ACD. Thus declarations of financial independence will be made biannually and updating of the Prohibited Investment List will be made to fit this timeframe. We will introduce procedures to test financial interests held by partners and staff within our firm-wide review program.

Quality control policies and procedures

An effective system of quality control ensures that the firm and its personnel comply with professional standards and applicable legal and regulatory requirements.

The firm has made progress in updating its policies and procedures to address the requirements of ISQC 1 (the standard dealing with firms' responsibilities for establishing systems of quality control). However, at the time of our review, improvements were required to the firm's quality control procedures in a number of areas.

Overall policies and procedures

The firm had not fully:

- Documented its policies and procedures and communicated these to its staff in the form of an audit procedures manual.
- Formalised monitoring procedures to ensure that key audit partners have sufficient resources to carry out their work in accordance with professional standards.
- Implemented a system to monitor and evaluate the adequacy and effectiveness of the firm's systems and internal quality control mechanisms.

Engagement quality control review

We also identified, in one review, an instance where the engagement quality control reviewer ("EQCR") did not maintain professional objectivity, as they were involved in the provision of non-audit services to the audited entity.

Firm's actions:

The current version of the audit manual of Moore Stephens International Limited, with which every member firm is required to comply, has been in issue since 2016. The version fully amended to reflect UK requirements and the firm's audit software has been approved and was issued in April 2018.

We have a formal procedure and system to ensure appropriate staffing on all of our audit client engagements and staff portfolios are assessed accordingly. We will include in our firm-wide review program, procedures to monitor budgeting and allocation of staff.

A project plan has been drawn up to provide a roadmap and work underway to achieve full compliance with ISQC 1 requirements with effect from 31 December 2018.

New procedures have been added to ensure that no work is performed by an EQCR for a client where they undertake such a role. This procedure also ensures that no work previously undertaken for the client could impact their independence on future engagements. This is now included within the independence documentation required for all audits of PIE entities.

Staff appraisal processes

Staff performance appraisals, including assessment against relevant objectives, are important to ensure that individuals understand and are held to account for how they contribute to achieving high quality audits.

We reviewed a sample of staff appraisals completed in 2017. The firm should improve the effectiveness of its staff appraisal processes by:

- Making a clear link between the assessment of audit quality and the assessment of an individual’s overall performance. In the sample of staff appraisals reviewed, it was disappointing to note that audit quality did not appear to have a direct impact on appraisal gradings.
- Enhancing controls to ensure the timely completion of staff objectives. The majority of the sample reviewed did not include specific performance objectives.

Firm’s actions:

We will be requiring that staff objectives in the appraisal process for the coming year include audit quality objectives.

We will be adding an audit quality section to our staff appraisal system requiring all audit staff to assess the impact of audit quality activities that they have taken part in over the last year (including internal and external file reviews), and an assessment of their quality performance.

Individual audit reviews

Revenue audit procedures

Revenue is usually a key area of focus for investors and other users of the financial statements.

For entities with a high volume of automated revenue transactions, IT systems, including IT general controls, are central to supporting the complete and accurate processing of transactions. As part of an effective audit strategy, the auditor should therefore appropriately evaluate and understand the IT environment and IT general controls (“ITGCs”).

We reviewed the audit of revenue in all of the audits that we inspected including, where applicable, relevant IT considerations. In two of the audits that we reviewed, the firm used computer assisted audit techniques (“CAATs”) to provide substantive audit evidence.

We identified the following issues:

- In one audit, CAATs were inappropriately designed. The procedures did not agree the sample data to third party information or reconcile sales data to cash received.
- In one audit, the IT environment was not appropriately assessed, resulting in weaknesses over the reliability of data used in the CAATs testing.
- Appropriate procedures were not performed concerning the integrity of key IT reports used in the substantive testing of revenue.

- In the other audit where CAATs were applied, the audit team did not specify the planned scope, objective and deliverables to be provided by the IT specialist. The audit team also failed to record its assessment of the specialist’s key findings.
- Analytical review procedures were often used to obtain substantive audit evidence in relation to revenue. These procedures were sometimes ineffective as they were not performed with appropriate precision.

Firm’s actions:

In relation to one audit where major issues were identified, the planned work on the audit of revenue was appropriate, but changes were made to the work planned during the audit that resulted in the work ultimately undertaken not fully meeting the objectives of that work. The lack of communication that we mentioned when dealing with the outcome of our root cause analysis meant that this issue was not identified on a timely basis during the course of the audit. To deal with such issues, the firm’s computer audit specialists and the corporate audit department have discussed an integrated approach so that both sides are aware of their respective responsibilities. We are also considering closer integration of our computer audit department with corporate audit.

We have included substantive analytical procedures in our audit quality training. This has stressed the requirements of ISA 520 in relation to ensuring that the procedures performed meet the standards required. Some analytical procedures are used as part of an extended risk assessment, with no reliance placed upon them as audit evidence. We have stressed the need for this to be made clear in audit working papers so that such procedures are not interpreted as substantive analytical procedures.

Defined benefit pension scheme balances

The management of pension funds by independent custodians can present challenges for auditors in auditing scheme assets. Audit procedures should provide sufficient assurance over asset valuation and ownership.

We identified a number of concerns relating to the work performed on defined benefit pension scheme balances. In particular:

- Inconsistent work performed over the valuation and ownership of scheme assets, including: failure to obtain confirmations directly from the custodian; sole reliance on confirmations; failure to obtain control reports from custodians or investment managers; and a lack of independent testing of asset values.
- Insufficient evidence of procedures performed in relation to the accuracy and completeness of membership data.

Firm's actions:

We have covered matters identified in relation to pension scheme assets and data in our audit quality training. We accept that our work has tended to concentrate on the actuarial assumptions underpinning the liability with insufficient consideration given to the assets, or to the data that has been provided to the actuary in relation to membership. We have now told all audit partners and staff that the approach needs to be more balanced and demonstrate appropriate consideration of all aspects of the pension balances.

Occupational disease class of technical reserves

Occupational disease reserves are an area of significant estimation and judgment. Auditors should ensure that their experts perform adequate procedures to assess whether these have been appropriately valued.

We reviewed the valuation of technical reserve provisions in three out of the five audits inspected, with no significant findings noted in respect of the general reserves. The following issues were identified specifically in relation to the occupational disease ("OD") class of technical reserves for two of the audits reviewed:

- There was insufficient evidence to support the actuaries' conclusion that the OD technical reserve provisions were reasonable.
- There was insufficient challenge of management in relation to the appropriateness of the OD reserve provisions.

Firm's actions:

In each case the requirement was to express an opinion on the technical reserve as a whole, not on its individual component parts. The OD reserves comprised 8.7% and 7% of the total technical reserves for these two audits. Nevertheless, we recognise this point and we will ensure that all assessment as to methodology and assumptions regarding technical reserve provisions are fully documented on the current audit file each year, including any reassessment of work performed in prior years.

We will continue to monitor the actual claims experience incurred against the modelled expectation. If there is continued or material divergence from the expected outturn, we will consider the need for further action and review of the OD reserves in the context of the technical provisions as a whole. Where such a change is identified, we will be seeking further assessment prior to the completion of the audit and where appropriate request update of the model.

3 Good practice examples

We set out below the key areas where we noted examples of good practice, either from our review of audit work on individual engagements or from our review of firm-wide procedures.

Firm-wide procedures

For a sample of audits, the firm conducts targeted reviews of compliance with the Auditing Standard covering special considerations applying to the audit of groups. The purpose of these reviews is to provide independent oversight of group planning aspects where significant components are not audited by the firm.

Individual audit reviews

The firm has expertise in the insurance sector. In one of our reviews this was reflected in the team's overall understanding of the systems and controls in relation to key areas of the audit. This enhanced the overall quality of audit evidence obtained in the areas of premiums and technical reserves.

Audit Quality Review

FRC Audit and Actuarial Regulation Division
June 2018

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