



## **AUDIT INSPECTION UNIT**

# **PUBLIC REPORT ON THE 2007/8 INSPECTION OF GRANT THORNTON UK LLP**

**8TH DECEMBER 2008**

This report is issued by the Audit Inspection Unit of the UK's Professional Oversight Board ("the Oversight Board"), part of the Financial Reporting Council. It has been approved for publication by the Oversight Board.

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# 1 Scope, objectives and background information

## 1.1 Introduction

This report sets out the principal findings arising from the inspection of Grant Thornton UK LLP (“Grant Thornton” or “the firm”) carried out by the Audit Inspection Unit (“the AIU”) of the Professional Oversight Board (“the Oversight Board”), part of the Financial Reporting Council (“the FRC”), in respect of the year to 31 March 2008 (“the 2007/8 inspection”). Our inspection was conducted in the period from June 2007 to November 2007 (referred to as “the time of our inspection”).

It is based on the AIU’s more detailed private report on its inspection of the firm to the Audit Registration Committee (“the ARC”) of the Institute of Chartered Accountants in England and Wales (“the ICAEW”) with whom the firm is registered for audit purposes. The AIU currently inspects the largest audit firms, including Grant Thornton, annually<sup>1</sup>. The 2007/8 inspection was the AIU’s third inspection of Grant Thornton. The ARC considers whether audit registration should be continued for the firm following each inspection undertaken. The AIU’s 2007/8 report to the ARC, which was finalised in June 2008, recommended that the firm’s registration to conduct audit work should be continued.

This is the first year the AIU has reported publicly on individual firms. In the past the AIU issued an annual public report in which the principal findings arising from its inspections of the major audit firms in the UK were dealt with on an anonymous and aggregated basis.

The AIU exercises judgment in determining those findings which it is appropriate to include in its public report on each inspection, taking into account their relative significance in relation to audit quality, both in the context of the individual inspection and in relation to areas of particular focus in the AIU’s overall inspection programme for the relevant year.

The findings reported for each firm in any one year reflect a wide range of factors, including the number, size and complexity of the individual audits selected for review by the AIU which in turn reflects the firm’s client base. An issue reported in relation to a particular firm might also apply to other firms without having arisen in the course of the

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<sup>1</sup> The Companies Act 2006, as amended with effect from 6 April 2008 by the Statutory Auditors and Third Country Auditors Regulations 2007, requires that full scope inspections of those audit firms conducting more than ten audits within the scope of independent inspection (as determined by the Professional Oversight Board) are undertaken at least every three years.

AIU's inspection fieldwork at those other firms in the relevant year. Also, only a small sample of audits is selected for review at each firm and the findings may therefore not be representative of the overall quality of each firm's audit work.

All findings requiring action set out in this report have been discussed with the firm together with the firm's proposed action plan to address them. Appropriate action may have already been taken by the date of this report. The adequacy of the actions taken and planned will be reviewed by the AIU during its next inspection of the firm.

The Oversight Board undertook to publish all the reports for the 2007/8 cycle of inspections on a single date. The fieldwork at each firm is completed at different times during the year and comprehensive quality control procedures are applied before the AIU's private and public reports are finalised. As a result, there is necessarily a significant period of elapsed time between completion of the AIU's inspection fieldwork at firms and the publication of reports on the inspection findings.

The firm was invited to provide a response to this report for publication. The firm's response is set out in Appendix A.

The AIU acknowledges the co-operation and assistance received from the partners and staff of Grant Thornton in the conduct of the 2007/8 inspection.

## **1.2 Scope and objectives**

The overall aim of the FRC is to promote confidence in corporate reporting and governance. One of the strategic outcomes contributing to this aim is for the users of audit reports to be able to place a high degree of reliance on audit opinions, including whether financial statements show a true and fair view. The AIU's programme of inspections is designed to contribute to the achievement of this strategic outcome.

Our inspections of the major audit firms on which we report publicly comprise a review of the firms' policies and procedures supporting audit quality and a review of the quality of selected audits of listed and other major public interest entities that fall within the scope of independent inspection, as determined each year by the Oversight Board.

We review firms' policies and procedures in the following areas:

- Leadership, strategy and communications
- Performance evaluation, promotions and remuneration
- Other human resource matters

- Client risk assessment and acceptance/continuance
- Consultation and review
- Audit quality monitoring
- Independence and ethics
- Audit methodology

Our reviews of individual audits place emphasis on the appropriateness of significant audit judgments exercised in reaching the audit opinion as well the sufficiency and appropriateness of the audit evidence obtained.

Our inspections include, but are not restricted to, an assessment of compliance with the requirements of relevant standards and other aspects of the regulatory framework for auditing. These comprise the auditing standards and ethical and quality control standards for auditors issued by the FRC's Auditing Practices Board (APB)<sup>2</sup> and other relevant requirements under the ICAEW's Audit Regulations<sup>3</sup>. The standards referred to in this report are those effective at the time of our inspection or, in relation to our reviews of individual audits, those effective at the time the relevant audit was undertaken. (The APB issued revised Ethical Standards in April 2008 which are effective for audits of financial statements for periods commencing on or after 6 April 2008.)

We seek to identify areas in which improvements are, in our view, required to safeguard audit quality, including matters relating to compliance with regulatory requirements, and to agree an action plan with the firm designed to achieve these improvements. We also assess the extent to which the firm has addressed the findings and recommendations arising from its last AIU inspection.

While the AIU's public reports seek to provide useful information for interested parties, they do not provide a comprehensive basis for assessing the comparative merits of individual firms. Our inspections are not designed to, nor would it be possible to, identify all weaknesses which may exist in the design and/or implementation of the firm's policies and procedures supporting audit quality or in relation to the performance of the individual audit engagements selected by us for review and cannot be relied upon for this purpose.

We reviewed the quality of five individual audit engagements undertaken by the firm. These related to listed and other major public interest entities with financial year ends

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<sup>2</sup> International Standards on Auditing (UK and Ireland), APB Ethical Standards and International Standard on Quality Control (UK and Ireland) 1.

<sup>3</sup> The Audit Regulations are issued jointly by The Institute of Chartered Accountants in England and Wales, The Institute of Chartered Accountants of Scotland and the Institute of Chartered Accountants in Ireland.

between November 2006 and April 2007. Our reviews covered selected aspects of the audit only. In addition, we undertook one follow-up review to assess the extent to which our prior year findings had been addressed in the following year's audit.

The monitoring units of the professional accountancy bodies in the UK who register firms to conduct audit work are responsible for monitoring the quality of audit engagements falling outside the scope of independent inspection by the AIU but within the scope of audit regulation in the UK. Their work, which is overseen by the Oversight Board, covers audits of UK incorporated companies and certain other entities which do not have any securities listed on the main market of the London Stock Exchange ("a full listing") and whose financial condition is not otherwise considered to be of major public interest. All matters raised in this report are based solely on work carried out by the AIU.

This report has been prepared for general information only. The information in this report does not constitute professional advice and should not be acted upon without obtaining specific professional advice.

To the full extent permitted by law, the FRC, the Oversight Board, the AIU and their employees and agents accept no liability and disclaim all responsibility for the consequences of anyone acting or refraining from acting in reliance on the information contained in this report or for any decision based on it.

### **1.3 Background information on the firm**

The firm is a UK limited liability partnership. It is the UK member of Grant Thornton International, a global network of firms using common audit methodology and audit software.

The firm is organised on a multi-dimensional basis, the primary dimension being four market-facing business units, two of which deliver assurance services including audit from offices in over 30 locations nationwide. Technical Communities, including the one for assurance ('Assurance'), are responsible for technical standards and quality control mechanisms.

For the year ended 30 June 2007, the firm's turnover was £315 million, of which £81 million related to Assurance<sup>4</sup>. The average number of partners was 240 and of other

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<sup>4</sup> As disclosed in the firm's annual report for the year ended 30 June 2007. An analysis of Assurance fee income between audit and non-audit fees is not publicly available.

professional and support staff was 3,059. At 31 December 2006, 96 partners and 8 senior employees were authorised to sign audit reports<sup>5</sup>.

The AIU estimates that the firm had 55 audit clients within the scope of independent inspection by the AIU as at the 2007/8 reference date of 27 February 2007. Of these audit clients AIU records show that 38 had a full listing or were listed on the AIM market of the London Stock Exchange<sup>6</sup>, including one FTSE 250 audit client.

The firm merged with RSM Robson Rhodes LLP ("Robson Rhodes") on 2 July 2007. The information given in the previous two paragraphs relates to the period before the merger took place.

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<sup>5</sup> As disclosed in the annual return to the ICAEW as at 31 December 2006.

<sup>6</sup> The firm also had other AIM listed audit clients below the threshold for inclusion within scope.

## 2 Findings

### 2.1 Overview

Our review of the firm's strategies and communications demonstrated the importance the firm places on audit quality. A major event for the firm in 2007 was the merger with Robson Rhodes. Based on our review of certain documents and discussions with senior management, we were satisfied that there was an appropriate emphasis on the importance of maintaining audit quality throughout the merger integration process.

We believe that the firm has policies and procedures in place in all relevant areas subject to our review that are appropriate for its size and the nature of its client base, although we have highlighted certain areas for improvement or enhancement in this report. In 2007, for the first time, audit partners were graded on the basis of audit quality. These grades will have an impact on audit partner remuneration in relation to the firm's financial year ending 30 June 2008. In our view this is a positive development.

In relation to reviews of individual audits, we have generally reported our findings by reference to significant matters arising on one or more audits. In view of the relatively small number of the firm's audits reviewed by us, it is not appropriate to report principally on the basis of themes arising or issues of a similar nature identified across a number of audits.

We were pleased to find an overall improvement in the quality of the five audits reviewed during this inspection compared to those reviewed last year, in particular in relation to the application of the auditing standards relating to audit risk and fraud.

We were generally satisfied, subject to our comments in section 2.4.3, with the basis on which significant audit judgments were made on the five audits reviewed by us. In our view, audit work was generally performed to a good or acceptable standard. The overall findings arising from our review of individual audits are set out in section 2.4; these include areas where improvements are, in our view, needed in order to enhance audit quality. In our view, two of the audits we reviewed, one of which related to an entity listed on a regulated market<sup>7</sup>, required significant improvements in certain areas.

The follow-up review we conducted showed that the issues we raised in the previous year had been addressed on that audit.

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<sup>7</sup> Within the meaning of Part VI of the Financial Services and Markets Act 2000.

The firm has implemented the majority of the recommendations we made in our prior year reports. A number of the issues that remain outstanding should be resolved by the introduction of the firm's new audit software platform which will be applied to audits of financial statements for periods ending on or after 31 December 2008. The firm intends to implement all the other outstanding prior year recommendations in 2008. Overall, we were satisfied with the progress made.

The principal findings arising from our review of the firm's policies and procedures supporting audit quality and the quality of the individual audits selected by us for review are set out below under three broad headings: quality control (section 2.2); independence and ethics (section 2.3); and audit performance (section 2.4).

## **2.2 Quality control**

This section covers our review of the following aspects of the firm's system of quality control for audit engagements:

- 2.2.1 Leadership, strategy and communications
- 2.2.2 Performance evaluation, promotions and remuneration
- 2.2.3 Other human resource matters
- 2.2.4 Client risk assessment and acceptance/continuance
- 2.2.5 Consultation and review
- 2.2.6 Audit quality monitoring

### ***2.2.1 Leadership, strategy and communications***

#### *Leadership*

The day to day management of the firm is the responsibility of the National Leadership Board whose activities are monitored by the Partnership Committee. The National Leadership Board is chaired by the Chief Executive Officer. His responsibilities include ensuring the firm operates within the Statement of Principles established by the Partnership Committee. The Statement of Principles includes objectives relating to quality.

## *Strategy*

The firm's strategic objectives include focusing the business on its chosen markets and delivering high quality service and value to its clients. One of the firm's values is to provide a robustly independent view.

At the time of our inspection, the overall objective of the firm's Assurance practice included demonstrating technical excellence and developing and retaining quality people but there was no explicit reference to audit quality. We understand that the Assurance strategy has been updated in 2008, following the merger with Robson Rhodes in July 2007, with audit quality an explicit and integral part of it.

## *Communications on audit quality*

We reviewed a selection of key communications from the firm's leadership and the leadership of Assurance to audit personnel relating to audit quality. From these it is clear that audit quality is regularly emphasised, both explicitly and implicitly.

### **2.2.2 Performance evaluation, promotions and remuneration**

#### *Performance evaluation*

Appraisals are carried out twice a year for staff and once a year for partners. The process includes annual rating of performance in relation to various personal, business and client service attributes. There is guidance on how certain of these attributes should be assessed from the standpoint of audit quality. No overall performance rating is determined. In addition, performance against business objectives set at the last review is assessed, business objectives are established for the next period and a personal development plan is agreed.

We reviewed a sample of appraisal forms for audit partners and managers. We found that they had been completed to a satisfactory standard. However, we also found that the appraisal process was not being completed on a timely basis in all cases. We understand that the timely completion of appraisals has been included as one of the national audit quality measures introduced in 2008/9.

#### *Promotion to partner*

The process for promotion to partner includes the preparation of a sponsoring partner's report, candidate self assessment, psychometric testing and interviews, including a

technical interview. We reviewed the supporting documentation for a sample of audit partner promotions and concluded that it had been properly completed.

#### *Remuneration*

In 2007 audit partners were graded for the first time in relation to audit quality and these grades will impact on audit partner remuneration in respect of the financial year ended 30 June 2008. In our view this is a positive development, as is the intention to continue development of the process.

The salary review process for staff is not directly linked to the appraisal process. We understand that the firm intends to introduce audit quality measures into the audit director and manager remuneration review process.

### **2.2.3 Other human resources matters**

#### *Audit training and technical communications*

A full range of technical and personal skills training is provided to Assurance personnel. In addition the firm disseminates technical material during the year by way of a series of technical bulletins. We reviewed several technical bulletins and some course outlines and were satisfied with the content of them.

Technical updating in audit and accounting matters, changes in audit methodology and areas identified as needing improvement is given by way of national training courses in the autumn, supplemented by six monthly updates provided by an external provider. Attendance at these courses by audit partners, managers and qualified staff is mandatory. Attendance at training events is monitored locally. For certain critical courses, attendance is also monitored and followed-up centrally.

#### *Credit crunch communications*

Audit personnel have been alerted to, and received guidance on, the audit risks arising from the credit crunch and the need to address issues arising appropriately. This guidance was appropriate to the firm's client base and provided in a timely manner.

#### *'Badging' of audit partners*

Partners are allocated to audit clients on the basis of, inter alia, their knowledge and experience. For certain categories of higher risk audit clients - listed companies, charities

and not-for-profit bodies, pension schemes and professional practices - partners are 'badged', that is licensed, to act on those audit clients. In our view, this licensing approach contributes to audit quality.

#### **2.2.4 Client risk assessment and acceptance/ continuance**

Firms are required to have policies and procedures in place to provide them with assurance that client integrity, compliance with ethical requirements and their competence, capabilities and resources are considered before they decide whether to accept or continue an audit engagement<sup>8</sup>.

At Grant Thornton, each audit client is allocated a risk category, largely reflecting its public profile. These risk categories determine the nature of the acceptance approval, the required 'badge' of the audit partner, the need for and required 'badge' of the review partner and the level of tax department involvement.

For each new client or assignment, the acceptance process includes a risk assessment, consideration of independence and conflicts of interest and approval is required from the Office Managing Partner and, in certain cases, a more senior level in the firm.

The audit partner is required to formally consider client retention at the planning and completion stages of the audit. Depending on the risk assessment generated by the automated process, the continuance decision may need to be approved at a higher level in the firm.

We reviewed the firm's client risk assessment and acceptance and continuance policies, procedures and documentation, including a sample of completed audit acceptance and continuance forms, and considered them to be appropriate.

#### **2.2.5 Consultation and review**

##### *Engagement quality control review*

Firms are required to have policies and procedures in place requiring an engagement quality control review to be undertaken for all audits of financial statements of listed entities and other audits meeting specific criteria<sup>9</sup>.

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<sup>8</sup> International Standard on Quality Control (UK and Ireland) 1, paragraph 28

<sup>9</sup> International Standard on Quality Control (UK and Ireland) 1, paragraph 60

An independent review partner, equivalent to an engagement quality control reviewer, is assigned to the audits of publicly traded entities, unit trusts and open-ended investment companies. The independent review partner is required to have no contact with the client.

A review partner (who performs a similar role to an independent review partner but who may have contact with the client) is assigned to most of the firm's other audits in higher risk categories.

We reviewed the evidence of application of the independent review partner and review partner procedures as part of our review of individual audits. There were no issues arising from our review.

#### *Pre-issuance technical reviews*

The financial statements of listed audit clients and all other entities within the AIU's scope are subject to a technical review by someone independent from the audit team before they are issued.

The review is performed before the issue of the preliminary announcement. All major points are cleared before the preliminary announcement is made or, if a preliminary announcement is not required, before the financial statements are approved.

The pre-issuance technical reviews relating to the individual audits reviewed by us were performed satisfactorily.

#### **2.2.6 Audit quality monitoring**

Firms are required to have monitoring procedures in place, including reviews of a selection of completed audit engagements, to provide them with assurance that their system of quality control is adequate, operating effectively and complied with in practice. Such monitoring is required to be undertaken at least annually.<sup>10</sup> The firm refers to these monitoring procedures as the National Audit Review ('NAR') and this terminology is used in this report.

Under the NAR, each office is reviewed every three years or more often if deemed necessary. At least one audit for each audit partner or employee in those offices who is authorised to sign audit reports is selected for review, together with an audit for each

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<sup>10</sup> International Standard on Quality Control (UK and Ireland) 1, paragraph 74 and the ICAEW's Audit Regulations.

person newly authorised to sign audit reports located in other offices. The NAR focuses on the quality of the audit work of the offices under review but also covers the application of certain office procedures. Audits are graded 1 ('Poor') to 5 ('Excellent'), with 3 being 'Standard expected'. The main fieldwork of the NAR is carried out in September and October by senior audit personnel independent of the office under review. The findings of the NAR are disseminated to the audit practice by way of various media.

The NAR is a UK process independent of the audit quality monitoring carried out by Grant Thornton International ('GTI') on member firms. A GTI review of the UK firm is carried out periodically; the most recent review took place in January 2007 and comprised the review of four audits and focus group meetings with audit staff from two offices.

The 2006 NAR covered six offices/ business units and all personnel signing audit reports and audit managers in those offices. In total 91 audits were reviewed. At the time of our inspection the 2007 NAR was underway.

Based on our review of the NAR process and supporting documentation, we considered that the 2006 NAR appeared to have been well planned and, on the whole, well executed, that follow up actions in respect of the offices reviewed were appropriate and that the findings arising had been disseminated to the audit practice in a timely manner. However, we found that, in some respects, the design and application of the process could be improved, in particular in relation to the grading of audits and the review of office procedures. Action has since been taken to address our findings.

## **2.3 Independence and ethics**

### ***2.3.1 Ethical policies and consultation***

Firms are required to have policies and procedures in place designed to achieve compliance with the Ethical Standards issued by the Auditing Practices Board together with relevant ethical pronouncements issued by the professional body with which the firm is registered. The firm's independence and ethical policies are based on, and have been mapped to, the requirements of the Ethical Standards.

There is a prescribed process of consultation, starting at the local level, for audit personnel. There is, however, no comprehensive database of ethical queries directed and responded to by the national function. In our view, there are benefits in maintaining such

a database. The firm is planning to introduce a common recording system for the National Ethics function in 2008.

### **2.3.2 *Compliance monitoring procedures***

There are three main strands of central ethical compliance monitoring for Assurance personnel.

The Annual Regulatory Statements and Declarations made by individual partners and staff include completion of fit and proper and independence questionnaires. Any exceptions reported by individuals in Assurance are reviewed by their Office Managing Partner and by the central Compliance function. Our review of the process for the year ended 30 June 2006 highlighted no significant issues.

In 2007 Office Managing Partners were requested for the first time to submit an Annual Ethics Compliance Report on ethics and independence procedures performed locally. These reports were being received by the National Ethics function as we were completing our 2007/08 inspection fieldwork. We will review the effectiveness of the process and the findings as part of our next inspection.

The Global Independence System ('GIS') records the quoted audit clients of GTI member firms and the quoted parent companies of significant subsidiaries that are audit clients of GTI member firms, together with the financial interests of partners and managers of GTI member firms. GIS is used by the National Ethics function to monitor compliance by the firm's partners and managers with the firm's independence requirements relating to financial interests.

### **2.3.3 *Rotation policies and monitoring***

Firms are required to have policies and procedures in place to monitor the length of service of partners and senior staff on individual audit engagements, assess any threats arising to auditor objectivity and implement appropriate safeguards. This reflects the need to avoid auditor independence being compromised by the familiarity threat arising from a long period of service in a senior role. For listed company audits, the engagement partner and engagement quality control reviewer are required to rotate after having served for a maximum period of five years and key audit partners (KAPs) are required to rotate after seven years.<sup>11</sup>

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<sup>11</sup> APB Ethical Standard 3, paragraphs 5, 6, 12 and 16. "Key audit partners" are partners other than the audit engagement partner responsible for key audit decisions or judgments.

The firm's policies comply with these requirements but, in our view, the firm should review two of its policies in the light of the principles underlying the Ethical Standards.

Firstly, the firm does not require rotation of the engagement partner on the audits of unlisted public interest entities (other than unit trusts and open-ended investment companies). The firm considered that its policy to have review partners on the audits of most unlisted clients in its higher audit risk categories is an adequate safeguard.

Secondly, periods of involvement with an audit client at different levels of seniority are not aggregated for the purposes of assessing threats arising from long association with the client and the need to apply safeguards.

The firm had identified no one who falls into the categories of either KAPs or other partners and staff in senior positions on audits. There was little guidance available in the firm on their identification.

The firm is reviewing its policies and guidance in the light of the revised Ethical Standards.

In order to monitor compliance with rotation and other long association policies, National Ethics maintains a central spreadsheet of relevant details relating to audit clients in the higher audit risk categories, based on information provided by Office Audit Partners. We understand that the firm intends to establish a single rotation database accessible by all users in place of the existing office level and national spreadsheets. We believe such a rotation database would improve the efficiency and effectiveness of compliance monitoring.

Long association with audit clients in the low risk category is monitored locally.

## **2.4 Audit performance**

This section covers findings arising from our review of the firm's audit methodology and our review of individual audits. Our findings are set out under the following headings:

- 2.4.1 Audit methodology
- 2.4.2 Assessing and responding to risk
- 2.4.3 Audit evidence and related judgments
- 2.4.4 Communicating with Audit Committees
- 2.4.5 Audit finalisation

Any findings relating to quality control and independence are covered in sections 2.2 and 2.3 respectively.

#### ***2.4.1 Audit methodology***

The firm uses the audit methodology developed by GTI. The firm is actively involved in its development. Following the introduction of International Standards on Auditing (UK and Ireland), the firm tailored the audit methodology and the associated audit software to reflect the additional requirements of the UK standards. In our view, the firm's audit methodology and associated audit software, if properly applied, are generally sufficient to facilitate compliance with the requirements of auditing standards.

The audit software used by audit teams to document, evaluate and test internal control systems is not an integral part of the main audit software. A project is currently underway to integrate the two applications as part of the development of a new audit software platform which is planned for release in 2008.

#### ***2.4.2 Assessing and responding to risk***

Auditing Standards require the identification and assessment of the risks of the financial statements being materially misstated, including which of these risks require special audit consideration (such risks are termed "significant risks")<sup>12</sup>. A proper assessment of the significance of identified risks is important to ensure that audit work planned and undertaken is sufficiently focused on higher risk areas of the audit.

While we noted an overall improvement in the audit work carried out in this area, we identified two recurring issues as described below.

The process used to identify significant risks focuses on standard transaction cycles. We found, firstly, that the design and implementation of controls over significant risks outside the standard transaction cycles were not evaluated in all cases, such as those related to provisions, fair value processes and the carrying value of goodwill in respect of business acquisitions.

Secondly, we found that the implementation of controls over significant risks arising in standard transaction cycles was not evaluated in certain of the audits we reviewed. This issue appeared to arise mainly because the evaluation of the design and implementation

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<sup>12</sup> International Standard on Auditing (UK and Ireland) 315, paragraphs 100 and 108

of controls was not an integrated process; this should be addressed by the new audit software platform due to be launched in 2008.

### **2.4.3 *Audit evidence and related judgments***

We were, subject to our comments below, generally satisfied with the basis on which significant audit judgments were exercised on the five individual audits reviewed.

#### *Quality of audit strategy and sufficiency of audit evidence in key areas*

We had particular concerns about elements of the audit evidence and related judgments in two audits. In the first of these audits, in our view the audit strategy regarding the audit of the key area of stock was unclear. In addition, we considered that the audit evidence obtained and included in the audit working papers in relation to this area and the other key area of revenue was insufficient.

In the second of these audits, we had concerns about the adequacy of the audit evidence on file in respect of a significant acquisition in the year, including the basis for reliance on other auditors, and in respect of the carrying values of intangible fixed assets.

#### *Consideration of acceptability of accounting treatment*

In one audit, although the quality of the audit work was otherwise of a good or acceptable standard, in our view there was insufficient evidence on the audit file regarding the basis of an audit judgment relating to the acceptability of the accounting treatment adopted on transition from UK GAAP to IFRS in relation to the fair valuation of certain assets.

#### *Analytical procedures*

In two audits where analytical procedures were performed to obtain audit evidence in relation to revenue, audit expectations and acceptance thresholds were not sufficiently established or justified.

#### *Using the work of an expert*

When using work performed by an expert, the auditor should obtain sufficient appropriate audit evidence that such work is adequate for the purposes of the audit. We found shortcomings relating to the use of the work of an expert on four audits, the nature of which was different in each case.

#### **2.4.4 *Communicating with Audit Committees***

Auditing Standards require the auditor to communicate matters of governance interest arising from the audit with those charged with governance of the entity. Such communications will usually take place with an Audit Committee or similar body acting on behalf of the Board<sup>13</sup>. Appropriate communication with the Audit Committee or other relevant governance body contributes to the quality of the audit and assists both parties to discharge their responsibilities effectively.

We found that the reporting to Audit Committees in respect of the audits reviewed was generally of a satisfactory standard. However, we considered that there was scope for improvement to the firm's guidance and templates for reporting to Audit Committees.

#### **2.4.5 *Audit finalisation***

Audit finalisation procedures include a final analytical review of the financial statements as a whole, a review of events occurring after the end of the financial year that may require adjustment of, or disclosure in, the financial statements ("subsequent events") and consideration of the appropriateness of the going concern assumption in preparing the financial statements.

We found that such procedures had generally been performed to a good or acceptable standard. In two audits, however, we identified issues over the quality, timing and evidencing of the review of subsequent events performed.

8 December 2008

END OF REPORT

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<sup>13</sup> International Standard on Auditing (UK and Ireland) 260, paragraph 11

## **Appendix A – Firm’s response**

**The firm’s response is on the following page.**



Audit Inspection Unit  
Aldwych House  
71-91 Aldwych  
London  
WC2B 4HN

24 November 2008

Dear Sirs

**Grant Thornton UK LLP**  
Grant Thornton House  
Melton Street  
London NW1 2EP

T +44 (0)20 7383 5100  
F +44 (0)20 7383 4715  
DX 2100 EUSTON  
[www.grant-thornton.co.uk](http://www.grant-thornton.co.uk)

### Public report on the 2007/8 inspection of Grant Thornton UK LLP

We write to provide our response to the Audit Inspection Unit's (AIU's) Public Report on the 2007/8 inspection of Grant Thornton UK LLP (the Report).

We are very pleased that the Report concludes that the firm has policies and procedures in place in all areas reviewed that are appropriate for the firm's size and the nature of the firm's client base and that the audit work on the files reviewed was generally performed to a "good or acceptable standard". However, we recognise that the Report identifies areas where improvements could be made. In respect of the audit files reviewed, none of the findings resulted in a change in our original overall audit conclusions nor did they affect our audit reports on the clients' financial statements.

A number of the issues raised in the Report reflect the fact that accounting, auditing and ethical standards are subject to frequent change and are often highly complex. In particular, there is a critical need to apply professional judgment when performing audit procedures and reaching audit conclusions, particularly on the extent and nature of audit testing, and maintaining appropriate documentation. The fact that professional standards are subject to frequent change means that at any point in time partners and staff face a number of new requirements and challenges. In many cases, the professional judgments of reasonable and highly competent people will differ.

While we may not always agree with the characterisation in the Report of our audit work or related documentation, nonetheless we have carefully considered each of the findings in this regard. In certain cases we agreed to perform additional procedures or improve aspects of our audit documentation in the following year's audit in response to the inspection comments. In other cases, we concluded that no specific actions were necessary. We continuously review our audit processes and the way in which they are applied in practice: the findings of our internal audit quality monitoring programme, reviews performed by Grant Thornton International and reviews performed by audit regulators (including the AIU, the QAD and the PCAOB) all provide valuable insights into areas where changes may need to be made.

As noted in section 2.1 of the Report, the relatively small number of Grant Thornton's audits that the AIU reviewed make it inappropriate for the AIU to report principally on the basis of themes arising or issues of a similar nature identified across a number of audits. Therefore we believe that the findings should neither be viewed as being representative of the quality of the entire population of audits that fall within the scope of AIU inspections nor as providing a basis for forming conclusions about the quality of the much larger population of Grant Thornton's audits in general.

The Report summarises the findings of AIU fieldwork performed during the summer of 2007, which reviewed audit work that had been carried out in late 2006 and the first half of 2007. As a result, we have already developed and implemented additional guidance, updated our operating policies, enhanced our monitoring arrangements or enhanced our training programmes (as appropriate) to address the findings set out in the Report and also to respond to changes in professional requirements that have occurred since 2007. These changes have been applied in the latter part of 2007 and in 2008.

Yours faithfully

A handwritten signature in blue ink that reads "Grant Thornton UK LLP".

Grant Thornton UK LLP

**Chartered Accountants**

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**FINANCIAL REPORTING COUNCIL**

**5TH FLOOR**

**ALDWYCH HOUSE**

**71-91 ALDWYCH**

**LONDON WC2B 4HN**

**TEL: +44 (0)20 7492 2300**

**FAX: +44 (0)20 7492 2301**

**WEBSITE: [www.frc.org.uk](http://www.frc.org.uk)**