

GRANT THORNTON UK 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.

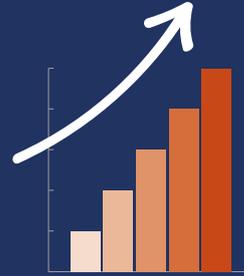
The FRC works with European, US and global regulators to promote high quality audit and corporate reporting.



AQR

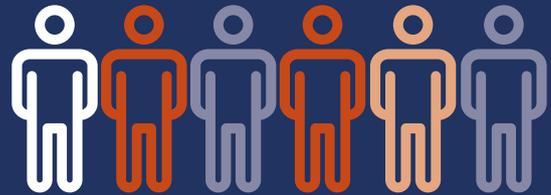
We monitor the quality of UK Public Interest Entity audits.

+135	0.01%	+2.27%	-11.48%	POS	-3.2320
+320	0.21%	+2.83%	-15.93%	NEG	-3.9993
+385	0.14%	+2.42%	-17.67%	POS	-4.2421
+338	0.27%	+2.19%	-18.32%	NEG	-4.2083
+322	0.27%	+2.28%	-14.73%	NEG	-3.5708
+521	0.00%	+2.76%	-20.12%	NEG	-2.8339



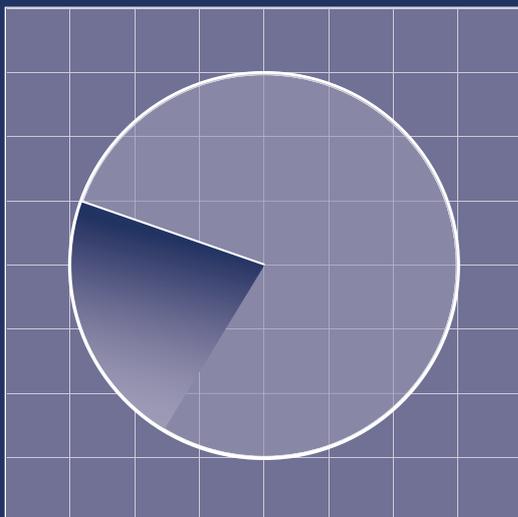
We promote continuous improvement in audit quality.

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



The Firm

Grant Thornton UK LLP has 76 audits within the scope of AQR inspection, including 3 FTSE 250 audits.



On 29 March 2018 the firm announced that it has taken the strategic decision to move away from tendering for statutory audit work in the FTSE 350. It will continue to serve its existing FTSE 350 clients.

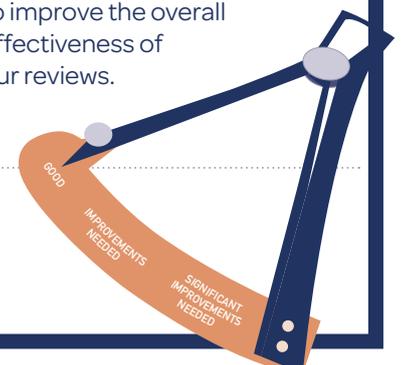
Our inspection process

There are around 2350 audits within the scope of AQR inspection. In total, we inspected 145 individual audits in 2017/18, including 8 at Grant Thornton.



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

Grant Thornton UK 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 Grant Thornton UK LLP (“Grant Thornton” 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”). We inspect Grant Thornton UK LLP, and report publicly on our findings, annually.

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, focusing on changes arising from the revised Auditing and Ethical Standards¹. We plan to enhance our monitoring of the six largest firms, including Grant Thornton, from 2018/19².

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

Our assessment of the firm’s performance

The results of our reviews of individual audits show some improvement from 2016/17, with six out of eight audits requiring no more than limited improvement. We also identified more instances of good practice arising from our reviews. We did, however, continue to identify findings in relation to the extent of challenge of management in relation to areas involving judgement, and the consideration of independence and ethics matters. These findings contributed respectively to two audits being assessed as requiring significant improvement. Aspects of these findings were different to those identified last year and the firm has developed actions to address them.

At the time of our review, the firm had made progress in revising its policies and procedures in response to the revised Ethical and Auditing Standards. Further improvements were, however, required to the firm’s systems and procedures in certain areas, including non-audit services approvals and the monitoring of personal financial interests. Since our last public report, which highlighted a number of findings related to auditor independence, the firm has maintained a strong focus on improving its procedures in this area, including recruiting further resource into its ethics function.

1 The firm was also included within the scope of our thematic review on Audit Firm Culture. 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](#)

2 [AFMA Press Notice](#)

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.

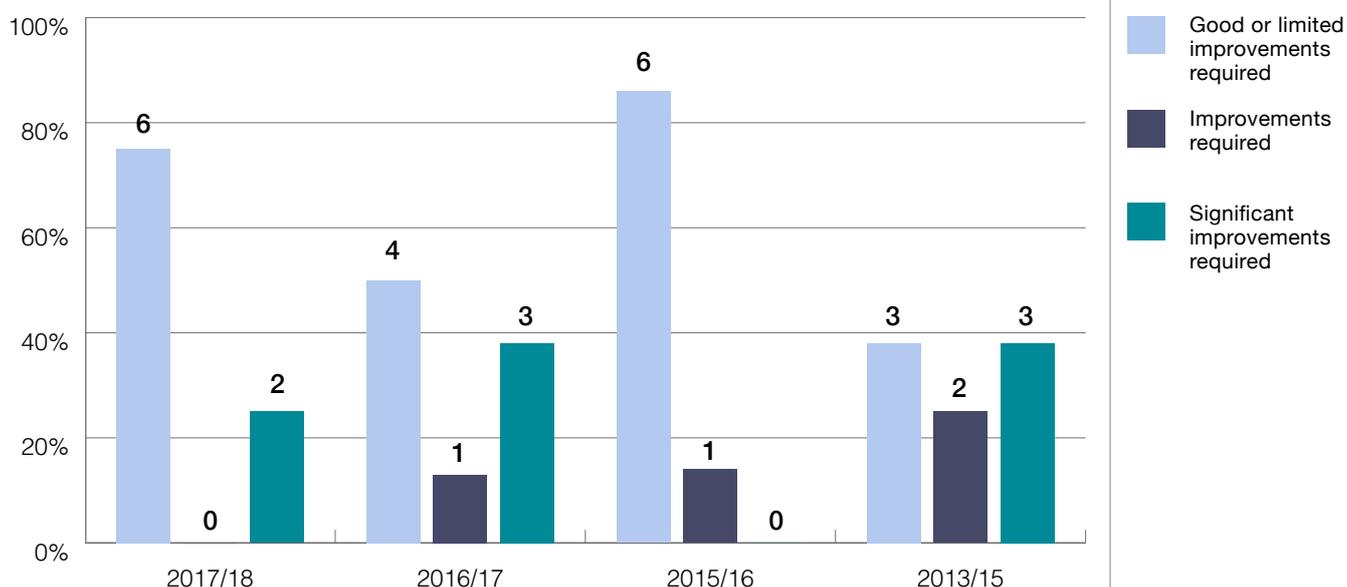
Our other key findings in the current year requiring action by the firm are set out below.

The firm should:

- Improve the audit of accounting policies and disclosures.
- Strengthen the effectiveness of the audit of revenue.
- Ensure more effective communication with Audit Committees.
- Provide more accurate descriptions of the audit procedures performed in the audit report.

Assessment of the quality of audits reviewed

The bar chart below shows the results of our assessment of the quality of the audits we reviewed in 2017/18, with comparatives for our three previous inspections³. The number of audits within each category in each period is shown at the top of each bar.



³ Changes to the proportion of audits falling within each category from year to year reflect a wide range of factors, which may include the size, complexity and risk of the individual audits selected for review and the scope of the individual reviews. For this reason, and given the sample sizes involved, changes from one year to the next are not necessarily indicative of any overall change in audit quality at the firm.

Good practice identified

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

- Asking the directors of an audited entity to delay publication of the accounts to allow more time for the audit team to obtain sufficient and appropriate evidence relating to going concern.
- Robust challenge of management on three audits in areas of higher risk.
- The firm has implemented mandatory consultation and special teams to address enhanced requirements in the revised auditing standards in relation to group audits.

More detailed comments on good practice, together with the firm's progress in response to our 2017 report, are set out in section 3.

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 report on Audit Firm Culture stated that, based on RCA undertaken through 2017, all firms covered by that review had improved their RCA since our 2016 thematic review. We also reported 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".

The firm has performed RCA in respect of our key findings and considered the outcome in developing the actions included in this report. We will continue to assess the firm's RCA process and encourage all firms to develop their RCA techniques further.

Firm's overall response and actions:

One of the three pillars of the Firm's purpose is building trust and integrity in markets and so we have a common goal with the FRC in promoting confidence in capital markets by a continuous focus on improved audit quality. We therefore welcome this report from the FRC.

We are pleased that the quality of the audits reviewed this year has improved on last year. We are also pleased with the positive comments received from the FRC on the various good practices identified during the inspection. Whilst there has been progress in the year under review, we recognise the need for continual improvement and acknowledge that we still have more to do to consistently achieve the standard we strive for. We continue to focus on taking timely actions in response to FRC findings.

The FRC has acknowledged the improvements that we have made within the Ethics Function during the period under review. We take independence and ethics very seriously and we have invested time and resource to get it right. We are continuing to improve our processes and procedures to meet our regulatory requirements; automation is playing a big part in this to make it as easy as possible for our people to get things right first time. We are improving our monitoring and reporting and have tightened up the consequences of non-compliance.

The Firm continues to work with the Grant Thornton International Limited network to update our audit methodology and software with implementation of our new approach scheduled for Autumn 2018. A key focus of the programme is the delivery of high quality audits.

Root Cause is now embedded into our policies and procedures. A Director of Root Cause was appointed in January 2017 with a manager appointed in March 2018. The firm is committed to implement actions to address learning points from internal and external reviews and to build on the strength of positive review outcomes.

We have already taken action to address many of the points raised in this report and remain committed to ongoing improvement.

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

Further strengthen the firm's policies and processes relating to auditor independence

The firm needs appropriate policies and procedures to safeguard auditor independence. A revised ES became effective during the year with enhanced requirements and stricter prohibitions.

Given the importance of auditor independence and the impact of the revised ES, in March 2017 we reviewed the arrangements for independence and ethics at the six largest firms. This approach allowed us to benchmark arrangements across the firms and share good practice. Our review focused on how the firm's policies and procedures address the revised ES requirements. We have also reviewed compliance with the previous Ethical Standards as part of our inspections of individual audits.

At the time of our review the firm had made some progress in addressing the requirements of the revised ES. However, improvements were required to the firm's policies and procedures due to the firm's late implementation of certain aspects of the revised ES.

Findings

We identified the following concerns:

- Non-audit service approval systems do not require audit partner approval before teams are able to charge their time or sufficient information to be provided in relation to threats and safeguards arising. On one audit there was insufficient evidence that the audit team had adequately considered all independence matters relevant to continuing a non-audit services engagement, including a change of circumstances during the audit. The audit firm did not identify that the non-audit service was prohibited in the following year under the revised ES. It subsequently decided to resign from the audit.
- Systems and processes relating to prohibited financial interests were not compliant in certain areas with the revised ES. In particular, the firm had not identified the individuals/categories of staff captured by the more extensive definitions, for example the expanded definition of "partners". The firm also needs to review where staff and non-equity partners have 'self-cleared' their financial interests as permissible.

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- The firm recommenced annual partner and staff compliance testing relating to prohibited investments in 2017. We considered the 10% sample of partners to be tested under the firm’s policy to be low. In addition, the firm’s testing policy did not address higher risk individuals such as partners with prior year violations, lateral hire partners or internally promoted partners.
 - The firm’s monitoring of partner and staff rotation requires a number of improvements. These include establishing the frequency and nature of monitoring processes and ensuring a complete population is used.
 - The firm needs to monitor communication of ethical and independence breaches to Audit Committees.
 - The firm had not developed a sufficiently formalised process to monitor compliance with audit firm rotation requirements for its PIE audits. This resulted in an audit client seeking and obtaining the FRC’s permission to extend the firm’s audit appointment beyond the maximum duration.

Firm's actions:

A key change made by the CEO in July 2016 was creating a new role of Head of Quality, Ethics and Excellence, (which included the role of Ethics Partner), demonstrating the increased emphasis placed on quality, risk management and ethics by the Firm. One of the first priorities of the incoming Ethics Partner was to further build and develop the Ethics Function to support the needs of the business.

We take independence and ethics very seriously and we have invested time and resource to get it right. We continue to improve our processes and procedures to make it as easy as possible for our people to get things right first time. We are improving our monitoring and reporting and have tightened firm's policy in relation to compliance.

Progress since March 2017

The FRC review was completed in March 2017 based on our systems, policies and procedures at February 2017. Since then, we have made significant progress. We believe that we now have appropriate policies, procedures, systems and monitoring in place but are making further improvements to make it easier for our people to comply with the revised ES. We highlight certain key improvements below.

Non-audit services

Our new finance system will better integrate with our other systems, allowing enhanced reporting and monitoring, we are upgrading systems for consideration of non-audit services provided to audit clients and fees charged and we have introduced a new Query Management System.

Until these systems are fully operational we have:

- mandated consultations with the Ethics Function for non-audit services to listed audited entities;
- enhanced monitoring of non-audit services for higher risk audits; and
- updated the take on process in respect of ethics considerations.

Prohibited financial interest

The Firm recognises that we had not identified all individuals/categories of staff that should be considered "partners". However, all the people affected were already required to record their interests in our system as "non-partners"; we have confirmed their financial interests are permissible under the revised ES and the system has now been updated to change their classification.

Firm's actions:

Personal independence

The percentage quoted for the internal audit sample was the minimum requirement set out in the Grant Thornton International policy. At the time of the FRC visit, we had not planned the scope of the testing for the internal audit. The actual testing in September 2017 was 34% of partners (20% of existing partners and all new lateral hire and internally promoted partners in the year). We acknowledge that our testing only included prior audit violations if selected as part of the 20% of existing partner sample. Significant progress has been made against any remaining actions highlighted in last year's report.

The resources for monitoring of personal independence have been increased and a rolling assurance programme implemented which exceeds the minimum level for audit set out in the Grant Thornton International policy.

The Firm's policies and procedures have been updated to make sanctions clearer and stronger. From early 2018, Ethical Standard breaches, including those resulting from financial interest breaches, incur direct fines for equity partners and likely disciplinary measures for non-equity partners.

Firm's monitoring of rotation

The Firm has two databases for monitoring rotation periods:

- an independence database; and
- a secondary database for higher risk clients.

Both databases were updated to reflect the revised ES from June 2016 for the revised definition of key audit partners and the additional category of key partners involved in the engagement.

Communication of ethical breaches to audit committees

The Ethics Function commenced monitoring of communication of ethical breaches in March 2017. The first monitoring exercise considered the communication of all ethical standard breaches reported between March 2016 and September 2017 and this process will continue.

Rotation requirements for PIEs

All the Firm's PIE audits were listed on a central record from September 2016. This record took account of legacy auditor time in office. Monitoring commenced in October 2017. We identified one PIE where firm rotation was overdue (due to service of a legacy firm) and the FRC granted an extension after an application by the client.

Individual audit reviews

Improve the extent of challenge of management in relation to areas of judgement and those subject to management bias

Uncertain estimates and balances measured at fair value are subject to management judgement and potential bias. Auditors need to challenge management and apply professional scepticism when auditing these transactions, balances and related disclosures.

Given the potential impact on the financial statements, we considered this area on every audit we reviewed and identified instances where the extent of challenge by audit teams was inadequate.

Whilst we identified some examples of robust challenge, we identified the following concerns relating to the extent of the audit team's challenge of management, or evidence thereof, on one or more audits:

- Insufficient evidence that the audit team appropriately assessed the risk of management bias in relation to segmental disclosures, given negotiations to dispose of a key part of the business were affected by the allocation of operating expenditure and were taking place at the same time as the audit.
- Insufficient scepticism and challenge of management over changes made to cash generating units and the allocation of goodwill.
- A lack of scepticism following management's request for the audit team to not confirm balances and other details directly with one of the group's banks.
- Insufficient evidence that the audit team challenged management using the auditor's expert's findings and, in particular, considered the appropriateness of the discount rates used.
- Insufficient challenge of management with regard to the impairment of property, with an insufficient consideration of the key valuation assumptions.

Firm's actions:

We are pleased that the FRC identified some areas of good practice relating to challenge of management. However, we acknowledge that we now need to focus on improving the consistency of the extent of challenge.

Our root cause analysis identified that, whilst the audit team was challenging management in relation to areas of judgement and those subject to management bias, they were not always effective in that challenge.

To improve the consistency of the effectiveness of challenge of management we will:

- continue to deliver training to audit teams on how to complete and document effective challenge of management;
- run training for EQCRs and the National Quality Standards Team on how to review audit files to assess the effectiveness and evidencing of the challenge of management; and
- facilitate a discussion session for Engagement Leaders where effective challenge of management can be shared amongst the Engagement Leaders.

The good practice that was identified by the FRC will be upheld to the audit practice as examples of good practice and will also be reflected in the quality grading for those partners involved in the engagements.

Improve the audit of accounting policies and disclosures

Investors and other users of financial statements rely on preparers to apply the disclosure requirements of accounting standards appropriately, to provide consistency, comparability and to gain a proper understanding of the entity's results and risks. Audit teams should evaluate the appropriateness of the disclosures made and whether material transactions and balances are reported in accordance with the relevant accounting framework, for example International Financial Reporting Standards.

We reviewed the audit of certain financial statement disclosures on each audit inspected and identified the following issues on one or more audits:

Accounting policies

In one instance the audit team had obtained insufficient evidence of the application of accounting policies and requirements relating to an impairment reversal.

Disclosures

There were four instances where the audit team had obtained insufficient evidence to support disclosures in the financial statements. In two cases, these related to segmental reporting disclosures, one related to the classification of entries in the cash flow statement and one to the disclosure of dividends declared.

Principal risks

One audit team did not ensure that the key additional risk disclosures identified by their external legal expert and agreed with management, had been included in the annual report's principal risks prior to signing the audit report. On the same audit, the audit team's tax specialist identified certain transfer pricing risks, but there was insufficient consideration as to whether these were adequately addressed in the relevant principal risk disclosures.

Firm's actions:

The Firm recognises that accounting policies and disclosures are vitally important within the financial statements.

Our root cause analysis identified that audit teams had devoted their time and audit effort on the primary statements and not spent sufficient time considering the accounting policies and disclosures.

The topic of audit of disclosures has been a regular topic on our monthly Talking Technical sessions. Also, we continue to integrate audit and financial reporting learning and as part of that, the audit of disclosures is often an element of the learning.

In December 2017, our quarterly training was focussed on final review of the financial statements.

We note that the new audit methodology has a greater focus on the audit of disclosures and is due for release in the Autumn of 2018.

Strengthen the effectiveness of the audit of revenue

Revenue is an important driver of a company's operating results and is often identified as a key performance indicator on which investors and other users of financial statements focus. It may be open to manipulation as a result and auditors need to evaluate and address fraud risks in relation to revenue recognition.

We reviewed the audit of revenue on each audit inspected and identified the following issues on one or more of these audits:

- There was insufficient evidence of the audit team's consideration of the revenue recognised on a material contract.
- The audit team's risk assessment and conclusion for promotional income was inadequate, with insufficient evidence obtained as a result.
- The audit team placed inappropriate reliance on IT general controls over revenue as their testing identified certain controls which were not operating effectively and insufficient compensating procedures were performed by the auditor to mitigate appropriately the weaknesses identified. There was also insufficient evidence that the audit team considered whether the basis used for selecting revenue items to test was appropriate and whether the sample size should have been further increased due to the key control deficiencies.

Firm's actions:

The Firm recognises that revenue is a key element of financial statements.

Our root cause analysis identified that audit teams had focused their time and audit effort on the higher risk matters in the audit of revenue and not spent sufficient time considering lower, but still important, risk areas.

We will be providing training to the whole of the audit practice on our new audit methodology commencing in July 2018. One of the key aspects of that training will be the identification of risks, particularly in relation to revenue, and how to develop an appropriate response to that risk. A number of enhancements to our guidance will accompany the release of the new methodology.

We have already issued guidance and e-learning on the new revenue standard IFRS 15 "Revenue from Contracts with customers" and run workshops with the office's nominated IFRS 15 experts.

We are developing training specifically for IT general controls, which will be delivered between May and July 2018. The training for the new methodology will consider the audit of IT general controls and the implication for the audit when such controls are not operating effectively.

Ensure more effective communication with Audit Committees

Audit Committees have an important role in overseeing the financial reporting process, including assessing the effectiveness of the audit. Auditors need to provide high quality communications to Audit Committees in order for them to be able to discharge their governance responsibilities.

We reviewed the communications with Audit Committees on all the audits reviewed. We identified the following areas where the communications should have been improved, on one or more audits:

- There were eight areas within three audits where the audit findings were not adequately communicated to the Audit Committee. These included insufficient communications on: key audit areas, significant IT control deficiencies, changes in approach and risk assessment, not sending a bank confirmation and unadjusted misstatements.
- On one audit there was insufficient time between the final Audit Committee meeting and the audit report being signed to allow for all outstanding matters to be satisfactorily resolved and further reported if needed. In particular, there was no evidence of subsequent communications, before the audit report was signed, relating to a significant taxation risk and a key legal disclosure that had not been satisfactorily addressed.

Firm's actions:

We aim to have high quality effective communication with Audit Committees.

Our root cause analysis identified that:

- whilst the audit team were communicating matters arising, they were in insufficient detail to enable the Audit Committee to obtain a full understanding without other assumed knowledge; and
- project management of the audit did not consider the time needed to obtain key information, complete key audit areas and report the results to the Audit Committee before the audit report was signed.

To improve the effectiveness of communication with Audit Committees we will:

- complete training for audit teams on how to document and maintain effective communication with Audit Committees;
- complete specific training for EQCRs and the national Quality Standards Team on how to review audit files to support effective communication with Audit Committees;
- complete project management training; and
- facilitate a discussion session for Engagement Leaders where effective communication with Audit Committees can be shared amongst the Engagement Leaders.

Provide more accurate descriptions of the audit procedures performed in the audit report

Extended audit reports have improved the transparency of the audit so that investors and other users of the financial statements are informed of the audit approach taken to respond to the reported audit risks. The accuracy, or precision, with which certain procedures were described continues to require improvement in some cases. Auditors need to avoid ambiguity and accurately describe the procedures performed to provide users with an appropriate understanding of the audit.

We reviewed the audit reports on five of the audits reviewed and identified the following issues on three of those audits:

- The description of the auditor's procedures in relation to going concern did not include key procedures performed by the auditor relating to material uncertainties.
- The auditor's report incorrectly stated that two areas of focus were significant risks.
- The description of the auditor's procedures implied that the testing of revenue IT general controls concluded that they were operating effectively, which was not the case.

Firm's actions:

We understand the importance of providing accurate descriptions of the audit procedures performed in the audit report.

Our root cause analysis identified that whilst there are appropriate policies procedures and templates:

- audit teams had not fully completed the audit reports for technical review; and
- the audit reports were presented late in the audit for technical review.

To improve the description of the audit procedures we will or have:

- revised our guidance on audit reports which was published in June 2017. Updates to that guidance has been made since that date as we learned lessons from submitted reports;
- put in place mandatory training for all managers and partners working on Public Interest Entities. This training was completed by 31 December 2017;
- reinforced in our quarterly training session the importance of early review of audit reports by the technical department;
- introduced in April 2018 a more formalised review process to ensure that sufficiently complete audit reports are submitted for review with an appropriate amount of time before the audit report is to be issued;
- required further documentation to accompany the submission of the audit report; and
- complete specific training for EQCRs and the national Quality Standards Team on reviewing audit reports.

3 Good practice examples and developments in the year

Good practices

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.

Review of firm-wide procedures

Response to the revised Auditing Standards

The firm has made good progress in addressing the new requirements of the revised Auditing Standards, including updating the firm's policies and procedures.

Under certain circumstances where access to component audit work papers is restricted, the revised Auditing Standards require reporting to the relevant regulator (including the FRC). The firm requires an internal consultation when access issues arise that may require reporting to a regulatory body. In addition, the firm set up a specific team to assist group audit teams with managing access to working papers in China.

Individual audit reviews

Examples of good practice we identified on individual audits include:

- The audit partner required the directors to delay publication of the accounts to allow further audit evidence to be obtained regarding the entity's going concern status. This is particularly noteworthy given that the company's shares were suspended as a result of missing their reporting deadline and non-compliance with the listing rules.
- The audit team demonstrated a good level of challenge regarding an investment property's valuation.
- The audit team identified the potential need to separate an embedded derivative and challenged management in relation to this.
- The audit team obtained a detailed understanding of the facts and circumstances of a disposal of part of the group, challenged management on the status of this and considered the impact on the financial statements.
- The audit team performed a thorough risk assessment relating to going concern, which identified areas of significant judgement.

Developments in the year

Since our last annual report, which highlighted certain findings related to auditor independence, the firm has recruited further resource into its ethics function and continues to maintain a strong focus on improving its procedures in this area. It held an ethics roadshow during 2017 and has implemented new disciplinary arrangements for non-compliance and other new procedures (for example, regarding non-audit services consultations and enhanced monitoring).

Audit Quality Review

FRC Audit and Actuarial Regulation Division

June 2018

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