



Financial Reporting Council

# GRANT THORNTON UK LLP

## AUDIT QUALITY INSPECTION

JULY 2019

---

# The FRC

Our mission is to promote transparency and integrity in business.

transparency



We have responsibility for the public oversight of statutory auditors.

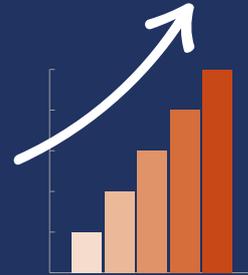
The FRC works with European, US and global regulators to promote high quality audit and corporate reporting.



# AQR

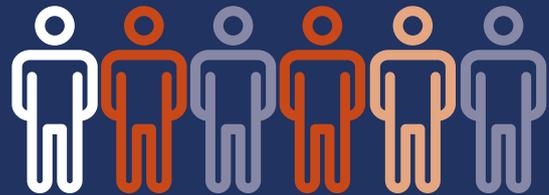
We monitor the quality of UK Public Interest Entity audits.

-1.55%	0.20%	+2.27%	-11.48%	POS	-3.2320
+3.20%	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
+3.02%	0.17%	+2.28%	-14.73%	NEG	-3.5708
+5.72%	0.20%	+2.76%	-20.12%	NEG	-2.8339



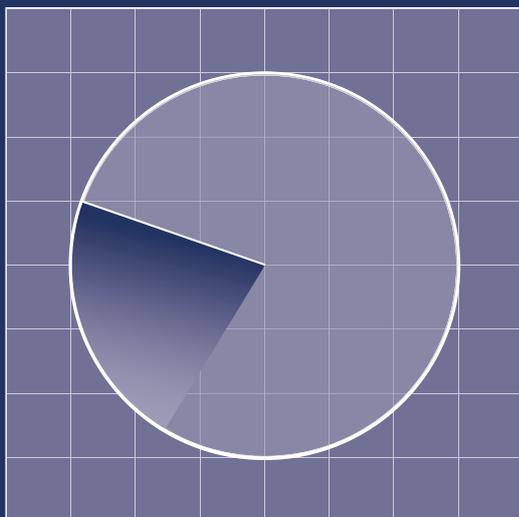
We promote continuous improvement in audit quality.

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



# The Firm

Grant Thornton UK LLP has 60 audits within the scope of AQR inspection, including 6 FTSE 350 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.

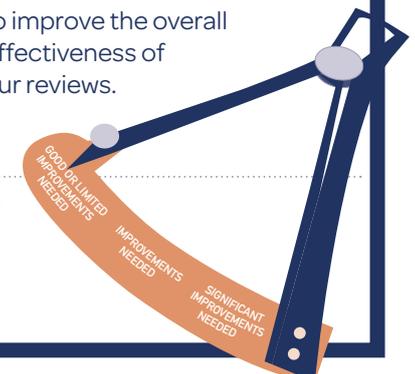
# Our inspection process

There are around 2300 audits within the scope of AQR inspection. In total, we inspected 160 individual audits in 2018/19, 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 the audit work inspected.



# Financial Reporting Council

## Grant Thornton UK LLP

### Audit Quality Inspection

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.

We consider whether action under the FRC's enforcement procedures is appropriate for all reviews assessed as requiring improvements or significant improvements. In practice, audits assessed as requiring significant improvement, and some of those assessed as requiring improvement, will be referred to the FRC's Case Examiner for consideration of further regulatory action. The Case Examiner will consider the most appropriate action, including Constructive Engagement with the audit firm or referral to the FRC's Conduct Committee for consideration of whether to launch a full investigation. This may result in a sanction being imposed and enforced against a statutory auditor and/or the audit firm in accordance with the FRC Audit Enforcement Procedure.

## Contents

<b>1</b>	<b>Overview</b>	<b>5</b>
<b>2</b>	<b>Key findings requiring action and the firm's response</b>	<b>11</b>
<b>3</b>	<b>Developments in the year</b>	<b>22</b>

This report sets out the principal findings arising from the 2018/19 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 February 2018 to February 2019 ("the time of our inspection"). We inspect Grant Thornton and report publicly on our findings, annually.

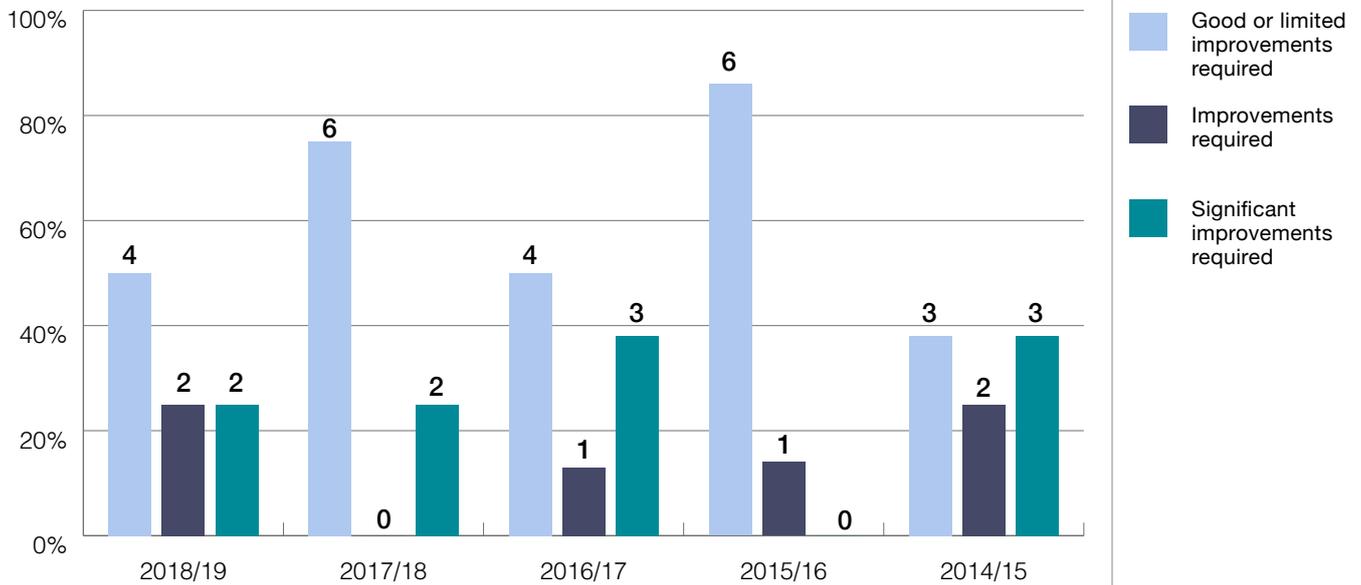
Our report focuses on the key areas requiring action by the firm to safeguard and enhance audit quality. It does not seek to provide a balanced scorecard of the quality of the firm's audit work. Our findings cover matters arising from our reviews of both individual audits and the firm's policies and procedures which support and promote audit quality. This year, our firm-wide work, performed on a three year cycle, focused on internal quality monitoring, engagement quality control reviews and independence and ethics.

Our priority sectors for inspection in 2018/19 were general retailers; oil and gas producers; support services companies; and financial services. Of the 139 audits that we reviewed in the year across all firms (excluding Local Audit inspections), the number in priority sectors was: General retailers (11); Oil and Gas producers (7); Support services (13); and Financial services (34).

We also paid particular attention to the following areas of focus: changes in auditor appointments; audit of fair value investments (including goodwill impairment); the use of auditor's experts and specialists; and the audit of controls.

## Our assessment of the quality of audits reviewed

### Grant Thornton



Changes to the proportion of audits falling within each category reflect a wide range of factors, including the size, complexity and risk of the audits selected for review and the scope of individual reviews. Our selections, which are primarily risk-focused, are also informed by the priority sectors and areas of focus referred to above. For these reasons, and given the sample sizes involved, changes from one year to the next cannot, on their own, be relied upon to provide a complete picture of a firm's performance and are not necessarily indicative of any overall change in audit quality at the firm.

Any inspection cycle with audits requiring more than limited improvements is a cause for concern and indicates the need for a firm to take action to achieve the necessary improvements.

---

## 1 Overview

The FRC set a target for the firms that at least 90% of FTSE 350 audits should be assessed as requiring no more than limited improvements by the end of the 2018/19 inspection cycle. Regrettably, no firm inspected this year achieved the target.

As a result, we will, for 2019/20:

- Continue to measure firms' audit quality against the 90% FTSE 350 target and expect all firms to meet that target.
- Extend the 90% target to all other audits within the scope of our inspection.

**Stakeholders rightly demand high quality work on all audits and they would expect, we believe, that all audits subject to our review should require no more than limited improvements. We will therefore, for 2020/21 onwards, set a new target for audit firms that 100% of audits should require no more than limited improvements.**

All the firms reviewed have performed root cause analysis and identified a number of themes relating to why the audits we inspected did not always meet the required standard and why certain findings recur over a number of years. These themes, across the firms inspected, include insufficient scepticism and weaknesses in project management or resourcing. In addition, the analysis also highlighted inconsistent execution of firms' audit methodologies and quality control procedures. Firms' actions should be targeted and responsive to the findings from their root cause analysis to achieve the required improvements in audit quality.

We will continue to take robust action for all reviews assessed as requiring improvements or significant improvements. To date, for the past two inspection cycles, we have referred 16 audits, across all firms inspected, to the Case Examiner for consideration of further enforcement action. In these cases, we further scrutinise the root cause analysis undertaken by the firm and the actions taken by the firm in response to our findings and consider what additional action we can take to ensure audit quality.

### Key findings for Grant Thornton

We assessed four out of eight audits as requiring more than limited improvements, compared with two of eight in 2017/18. We have assessed ten of the 39 audits that we have reviewed over the past five years as requiring significant improvements. This percentage (26%) is markedly higher than any other firm we have inspected over the period. This level of audit quality is unacceptable.

The quality of the audits inspected in the year, and indeed the overall lack of improvement in quality over the past five years, is a matter of deep concern. We have therefore required the firm to prepare and implement a detailed action plan to undertake an overhaul of its audit practice to improve quality.

---

The firm has made senior management changes in the past year and must now take urgent action to enable audit teams to improve audit quality significantly. The firm has recognised that the quality of its audits must improve and has shared details of the actions it intends to undertake. We have met the firm on a number of occasions to discuss the plan. We do not consider that the plan is, at present, sufficiently developed or detailed to deliver the firm's objectives.

The new LEAP audit platform may lead to some improvements. We do not believe, however, that the firm will achieve the required step change in quality without additional governance changes and rapid introduction of new quality control processes. We also note that the firm's proposed action plan will not affect the quality of any audits inspected in our 2019/20 cycle.

We will increase the number of GT audits to be inspected for 2019/20 by 25% (from eight to ten) and closely monitor the implementation of the firm's quality improvement plan along with details of how it will monitor the success of quality initiatives over both the short and longer term.

In March 2018, the firm announced that it had made a strategic decision to cease tendering for audits of FTSE 350 entities. We understand that the firm's position has not changed. The firm continues, however, to audit a significant number of Public Interest Entities (PIEs) within the scope of our inspections. The firm has in recent years accepted a number of higher-risk audit appointments. Our review findings for some of these audits raise questions over whether the firm has the present capacity and capabilities to audit such entities to an appropriate standard.

Our key individual review findings related principally to the need to:

- Urgently improve the extent and rigour of challenge of management in areas of judgement.
- Improve the consistency of audit teams' application of professional scepticism.
- Strengthen the effectiveness of the audit of revenue.
- Improve the audit of going concern.
- Improve the audit of the completeness and evaluation of prior year adjustments.

We had no significant findings arising from our firm-wide work on internal quality monitoring, engagement quality control reviews and independence and ethics.

We note that a number of the firm's agreed actions relating to our independence and ethics findings are ongoing and their completion should remain a key focus for the firm.

Given our key individual review findings noted above, this would indicate that the firm's quality control procedures have not been sufficiently effective to achieve the necessary improvement in audit quality.

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

---

## Good practice identified and developments in the year

We commonly identify examples of good audit work in our reviews that firms can disseminate across their practice to improve audit quality. We also include individual examples in our inspection reports sent to Audit Committees. We identified no such examples of good practice that we considered should be reported to the Audit Committees on the eight reviews in this inspection cycle. Firm developments in the year 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.

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.

Given that no firm this year has met the FTSE 350 target, firms need to re-appraise whether their RCA accurately identifies the causes of our inspection findings and whether their actions are properly linked to those causes. In particular, the firms should increase their focus on systemic issues behind the findings as well as the findings on each individual audit.

### Firm’s overall response and actions:

We recognise audit is a critical part of our economy and society. It is an essential service through which shareholders, employees, customers and wider society can be assured the businesses we audit are trading as they claim to be.

We welcome this Public Report which provides important external scrutiny to help inform the changes we are making to audit at Grant Thornton.

We are disappointed that the focus we have given to audit quality in previous years has not resulted in the improvement we hoped for. As such, as detailed in our Audit Improvement Plan (AIP) which we started to develop in late 2018, we are now embarking on a root and branch change programme to ensure that our 2021 report meets the FRC target of audits being at a standard of good (or with limited improvements). We are committed to this as a goal and are working closely with the FRC to achieve this.

The steps we take in addressing audit quality across our AQR population clients will also be extended to all audit work we perform such that all of our audits, regardless of size/complexity meet the highest standards set by the FRC.

Our AIP will achieve our goals through investment (in people, additional training and technology) and an additional level of governance through our new Audit Quality Board such that our audit practice is strengthened to one which is specialist and technology-enabled and is valued by our people, our clients and our regulators.

---

However, we know that if we are to achieve this, the firm needs to address the root causes of the inconsistencies in audit quality over the past five years. The AIP will transform our approach to ensure all of our audit work will demonstrate consistent high quality in future. The current leadership of the firm is wholly committed to achieving this objective.

The AIP has the support of the entire UK firm and is actively supported by Grant Thornton member firms.

**The key elements of our AIP include:**

- Appointing a **Head of Audit** with a renewed remit and a role on the firm's Strategic Leadership Team. This is a full-time leadership role; the focus will be driving the AIP, hence delivering a marked improvement in audit quality, and ensuring the changes arising from the root cause analysis are embedded across the audit practice.
- Creating a new **Audit Quality Board** with powers to hold the Leadership of the firm to account if it believes audit quality is not receiving appropriate investment, and that lessons from inspections are not being addressed. This Audit Quality Board will include the appointment of an independent industry expert as non-executive.
- Commissioning an **independent assessment** of audit at Grant Thornton as an audit firm to be led by a senior individual with no previous connection with the firm, to scrutinise our approach to audit and make ongoing recommendations for further change and improvement which we will respond to and share with our regulator.
- Enhancing the requirements on how the firm assesses quality for all engagement leads.
- Changing the way in which we reward our audit practitioners so that remuneration is more clearly linked to quality.
- Creating **two initial centres of excellence** for our most complex audit work in London and Birmingham. They will be the hubs for all our major public interest audit work. We will also make sure that our people who work on AQR audits specialise: an aspiration that by 2021 engagement leads, managers and their in-charges will dedicate 80% of their work exclusively to these complex cases. Should market conditions change such that we would start to tender for work in the FTSE 350, these centres will ensure we have the depth of specialism required.
- The member firms investing £60m in our new audit methodology and software platform with ongoing investment in technology to better analyse data.
- The firm to invest £7m in people and technology over the coming year, including the creation of a new Audit Quality Academy.
- Committing to transparency: an abridged version of the AIP will be available for everyone to scrutinise and we will be publishing an annual update on our progress in delivering it.

---

These changes matter because audit is a fundamental part of a public accounting organisation. Furthermore, the sector needs challengers. Whilst we made the decision last year to cease tendering for FTSE 350 audits, we will now await the Government's response before acting upon the detail of the Competition and Markets Authority's conclusions and their implications and opportunities for our firm.

As a responsible challenger, we accept our public interest responsibilities to raise standards and lift the quality of our own work. This responsibility extends across all audit work, not just for Public Interest Entities or FTSE 350 companies.

### Ensuring the effective use of resources across the firm

The delivery of the AIP means our people will have the time to stand back, exercise professional scepticism and challenge management more consistently, two areas identified by the FRC where the firm needs to make improvements to deliver a quality audit.

During Summer 2019 we will review our engagement with those companies we audit on a case by case basis. We want to deliver an excellent service to these bodies, leveraging our sector expertise, working with businesses who share our values and who are properly equipped to help us execute quality audits. If our focus on quality requires us to consider whether to resign from certain audit engagements, we will not hesitate to do so.

### Further investment in our capabilities

During the second half of 2018 we rolled out our Grant Thornton LEAP methodology across the firm to equip our auditors with a class-leading audit approach. We have also invested in data ingestion and analytics tools which automates and improves the way we work with companies' finance teams, significantly enhancing our data analytics capabilities. To avoid distractions of a new software platform we built a LEAP methodology tool on an established and familiar software platform. Since the period under review, we have released a suite of 140 template audit workpapers to drive consistency, quality and effectiveness. We will continue to create standardised workpapers, particularly focused on the highest risk areas of audit, to help ensure teams deliver work of the highest quality.

### Increasing oversight

In addition to those measures set out above, we are also introducing a new **Audit Operational Board**, comprising senior audit partners drawn from the audit practice. This Board will oversee how the AIP is implemented on the ground, on a continual basis. They will scrutinise the roll-out of our root-cause analysis into shortcomings and good practice to ensure the lessons we learn are effectively shared and embedded across the whole audit practice.

We are conducting a **root and branch review of our AQR audit operations**, our engagement leads, people, and audit engagements. This includes rolling-out detailed and rigorous quality assessments for all our people. All engagement leads will be tested on a dedicated AQR module in a new reassessment of capabilities. Currently all RI's receive annual audit quality gradings and going forward, AQR managers will also receive annual quality gradings to ensure we are maintaining and building standards throughout the team. Quality will be the predominant driver of reward and progression. All AQR managers and their in-charges will be reviewed and assessed by the Audit Operational Board to ensure we continue to deliver improvement through the programme.

We have already increased the **control and support** by our central team on the higher risk audits of the firm through the use of a real time RAG rating assessment. The objective is to ensure that the right engagement team with the right amount of time are assigned to the audit with appropriate skills and experience. The central team has early (and continual) involvement in the audit to address issues arising and complete consistently good execution of audits at all stages of the audit by the engagement team.

#### Investing in our People

All **role specifications** and **performance assessment criteria** are being reviewed, covering materials from application through to interview to qualification and beyond. At more senior levels audit quality for our hires at partner and director level is being re-emphasised. All senior positions – whether for internal promotion or lateral hire, will be approved by the Head of Audit.

In Autumn 2018 the entire audit practice attended a mandatory **three-day training session** on the new audit methodology. There will be continual updates on the new methodology during 2019, along with tailored, specific training for our assistant managers and above, specifically focussed on the areas identified during this cycle's file reviews so that we share the best practice of how the new methodology is applied on all audits to achieve consistently good results as well as address areas identified by the FRC in our work.

We are setting up a dedicated **Audit Quality Academy** to ensure those joining the firm have the right skills. The Academy will host our audit training programme and from autumn this year, will run new programmes focused on building professional scepticism, technical excellence, project management and documentation skills, as well as leveraging the latest technological tools and platforms.

Following this and after annual quality assessments in September this year, we will create **individual improvement plans** for all audit engagement leads and managers who have achieved below the desired quality grading and restrict and even remove individuals from practice if they don't demonstrate required levels of improvement. We will also fast-track our highest quality managers through their development and consider them for transfer to our AQR Centres of Excellence.

---

## 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, where relevant, 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.

### **Urgently improve the extent and rigour of challenge of management in areas of judgement**

Effective audits require the appropriate use of professional judgement. This is particularly applicable for areas of heightened judgement, such as provisions, pensions, certain accounting treatments and impairment reviews. Auditors should apply rigorous challenge to the audit of key areas of judgement and obtain sufficient audit evidence to support their conclusions.

We identified instances of inadequate or insufficient challenge in the following areas on two audits:

- Inventory provision models used by management, including the related assumptions, underlying data inputs and model integrity.
- Cashflows and growth assumptions used in management's impairment assessments, including sensitivities and the integrity of the related business case models.
- The judgements, assumptions and methodologies used to value pension liabilities and assets.
- Classification and measurement in the financial statements of certain available-for-sale investments.
- Hedge effectiveness testing and management's assumptions.
- Management's assumptions used to calculate onerous lease provisions.
- The discount rate used in an impairment assessment with no involvement of valuation specialists.
- Potential impairment of loss-making cash generating units.
- Potential provision for losses due to delays on a loss-making contract.

## Firm's actions:

Our work on root cause analysis identified two key areas which impact the effectiveness of our challenge of management in areas of judgement.

### 1) Reflection and critical thinking

The principal challenge in achieving this is having the space and time to do so as key judgements requiring challenge are often resolved in the late stages of an audit when time is more pressured. We intend to create this space and time by focussing on:

- The review of our client base as noted in our overall response, which is a key part of our AIP, so that additional resource can be provided to our retained client base;
- The more focussed risk assessment under our new audit methodology to ensure our work effort is better focussed on the riskiest areas of an audit, which are often those areas that require more robust challenge.

### 2) Project management skills

The Audit Quality Academy which is part of the AIP, will focus on upskilling audit teams. As well as training on audit technical and financial reporting skillsets, project management skills are recognised as an area requiring significant improvement and will form part of the learning programme. This will include a refresh of our existing training module to ensure it is still relevant to current challenges and an evaluation of what further support in this area is required by the practice.

In addition to addressing the underlying cause, in order to achieve the urgent improvements required, we have taken the following actions:

- Summer 2018 was spent training the entire audit practice on the new audit methodology in preparation for December 2018 year-ends which are beginning to be reviewed in the current cycle. The case study used in training illustrated the importance of challenge of management and use of professional scepticism;
- The training also included topics such as considerations in relation to sources of evidence and their reliability, how we address changes to the audit plan when new facts and circumstances emerge;
- These factors together with building on a more detailed risk assessment on a line by line and assertion specific basis meant we were able to incorporate additional focus on items identified in previous reviews; and
- Challenge of management is also a key area of focus in our summer technical training 2019 for managers and engagement leads, which will be rolled out to the whole audit practice subsequently.

---

We will also be taking the following actions:

- We will also be introducing mandatory template working papers for this key audit area for use in the September 2019 audits onwards;
- Any files where there is a particular audit area where challenge of management is of higher than usual importance, we will have the appropriate workpapers reviewed by a further independent level of review to ensure procedures performed are of the highest standard in this regard.

We have identified broader considerations that impact this finding. We intend to focus on these to strengthen our work in this area:

- A successful audit requires the audit team to be confident in the integrity of data provided by management and to challenge management on the completeness and accuracy of the information they provide. We intend to strengthen the work we perform over information provided by the entity through:
  - Increased use of a software tool which links directly to the company's system;
  - Introduction of specific module on Information Provided by the Entity in training for associates;
  - Direct guidance on the importance of this will be provided to audit teams and communicated with quality control teams to ensure they consider as part of their reviews; and
  - Use of mandatory workpapers for information provided by the entity in each area where challenge of management is appropriate.
- Continuing to encourage the use of experts to ensure we have the expertise to challenge effectively:
  - our audit quarterly training Spring 2019 was focused on the use of experts and included considerations as to when they should be involved in the audit; and
  - this training was supported by the issuance of additional guidance on considerations for teams when determining whether an expert or specialist is required, such as where the audit team does not have the relevant expertise or requires input from a specialist in a particular field inter alia.

In order to ensure the impact of the agreed actions we will evaluate and monitor their effectiveness through the firm's technical team's hot review process and, the quality support teams' reviews and they will be reinforced through increased oversight and support provided for high risk audits by the firms technical specialists. We have introduced increased challenge when performing hot reviews by requesting documentation to support audit teams' responses on significant matters and will continue to do this as appropriate. A key element of the firm's AIP is further investment in our quality monitoring and support teams to facilitate more oversight and where

necessary, intervention. In the meantime, we have clarified the roles of senior members of the audit team including engagement quality control reviewers to ensure clarity of responsibility and have introduced a system of 'RAG' (red/amber/green) rating for in-progress high-risk engagements to identify audits on which our specialist teams need to intervene and provide additional support and/or challenge.

In addition, in June 2019 we updated our panel process, a formal risk management process available to engagement leaders when there are complex accounting or auditing issues. This involves experienced partners who will support the engagement leader. There are two differing types of Panels: the Internal Differences of Opinion Panel and the Audit Support Panel.

To assess the effectiveness of our actions we will then monitor the work performed in relation to challenge of management in areas of judgement as part of our 2019 internal quality monitoring.

## **Improve the consistency of audit teams' application of professional scepticism**

Professional scepticism is defined as "an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence."<sup>1</sup>

The application of professional scepticism is integral to an effective audit. We considered this area on every audit we inspected and identified instances where the level of professional scepticism employed and evidenced was insufficient. Our concerns included the following findings relating to one or more audits:

- Insufficient demonstration of scepticism by failing to corroborate explanations received from management regarding whether certain commercial arrangement transactions should have been disclosed.
- A lack of professional scepticism in relation to overseas bank balances where no third-party bank confirmations were received, including one case where there had been a continued failure to obtain confirmations, resulting in insufficient alternative procedures being performed.
- A lack of scepticism indicated by insufficient testing of manual revenue adjustments and high-risk journals made by management, to respond to identified fraud risks.
- Inadequate consideration of contradictory evidence in assessing the value of an unquoted investment.

<sup>1</sup> ISA 200, "Overall objectives of the independent auditor and the conduct of the audit in accordance with International Standards on Auditing (UK).

## Firm's actions:

Our work on root cause analysis identified the same two key areas impacting the consistency of the application of professional scepticism by audit teams as those impacting the effectiveness of our challenge of management. These are sufficient reflection and critical thinking and project management skills.

The principal challenge in increasing the amount of reflection and critical thinking is having the space and time to do so – to step away from the process and consider the whole and how the different aspects of the audit, estimates and judgements fit together. We intend to create this space and time by focussing on the key areas noted in the previous section.

The second relates to project management. For example, where there are changes to the audit plan it is important to understand why these changes have taken place and be sceptical as to the reasons. If we are confident in our project management this facilitates sceptical thinking in relation to the reasons for changes as opposed to attributing changes to logistical considerations. As noted in our overall response, the Audit Quality Academy will focus on upskilling audit teams in this area.

In addition to addressing the underlying causes, we have taken or are taking the following immediate actions in order to improve the consistency of audit teams' application of professional scepticism in the shorter term.

- The case study for the Summer 2018 technical training referred to previously illustrated the importance of the use of professional scepticism;
- This is also a key area of focus in our Summer technical training 2019 referred to previously. An example includes specifically addressing the assessment of conflicting information on a file and documenting appropriately the resolution of this conflict;
- The actions in relation to work of experts referred to in the previous section also apply here as audit teams leverage on that knowledge in order to be sceptical;
- The work on Information Provided by the Entity is equally relevant as we should be sceptical about the sources of information we receive;
- The application of professional scepticism and resolution of conflicting information will also be built into the refreshed core training modules. Training interventions will not only cover how to exercise professional scepticism but also how to document this effectively; and
- The mandated use of the professional scepticism standard workpaper.

---

Our wider work on root cause analysis identified that effective on-the-job coaching was a key factor in achieving a quality audit. As a result, we believe that increased effective on-the-job coaching will provide the framework to instil the requirement to apply professional scepticism effectively on all audits and embed the lessons learned from other findings in this report. This will be achieved by creating space through the methods detailed earlier in this report.

To help embed this, coaching sessions will also take place for both new and existing engagement leads, which will be led by engagement leads who have demonstrated good practice in this area. The benefits to audit quality of increased engagement lead presence on site, challenge meetings and discussions with teams as well as ad hoc meetings with the company, will be part of that messaging.

In order to ensure the effectiveness of the actions we will re-enforce this message through the technical team's hot reviews, the quality support teams' reviews and through the increased oversight and support provided for high risk audits as described in more detail in the previous section.

There is also a new Audit Support Panel, which can be raised at the request of audit teams or by the EQCR, Quality Standards team or National Technical Team. If the panel cannot reach a consensus on a matter then it has the authority to prevent the team from signing the audit report.

To assess the effectiveness of our actions we will then monitor the work performed in relation to scepticism as part of our 2019 internal quality monitoring.

## **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. Accounting for revenue recognition may be susceptible to manipulation and auditors should therefore evaluate and address the related fraud risks.

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

- Insufficient testing was performed to conclude on the occurrence of website revenue (20% of group revenue). In particular, no audit procedures were undertaken to test the completeness and accuracy of the transfer of sales data between operational and accounting systems and also to assess the reliability of bank-related entries.
- Insufficient evidence obtained over cash handling controls where the testing had been limited to the last two weeks of the year, with no justification of how this approach provided sufficient audit evidence that controls over revenue completeness had operated effectively throughout the year.
- Inadequate procedures to assess the reliability of source data used to test revenue occurrence, where records for testing were selected from a population that excluded approximately 80% of customers.

## Firm's actions:

Our work in root cause analysis identified the key cause for the findings identified was insufficient reflection and critical thinking. Secondary causes related to technical skills specific to the audit of revenue.

Reflection and critical thinking could be demonstrated more effectively in our audits. The principal challenge in achieving consistent reflection and critical thinking is having the space and time to do so. This will be achieved through a review of the companies that we audit and improved project management skills, as described in more detail above. The more focussed risk assessment under our new audit methodology is designed to help provide that space by ensuring our work effort, including time to stand back and reflect, is focussed on the riskiest areas of revenue, be that by assertion or revenue stream.

In relation to technical skills, the effective audit of revenue has been a key focus for the firm over the last year, with specific attention in the roll out of the new audit methodology to the practice between July and October 2018. The case study built on previous training that had taken place earlier in the year of understanding business processes and controls and IT general controls. These factors together with a specific focus on revenue and building on a more detailed risk assessment on a line by line and assertion specific basis, such as disaggregating revenue streams, meant we were able to incorporate additional focus on items identified in previous reviews.

There has also been renewed focus on revenue in audit methodology training sessions spring 2019. These have included sessions on completeness, general risk assessment and responses to those risks, incorporating controls and substantive testing. Our central guidance has also been refreshed to support the messages being communicated.

Specific areas we are focussing on to strengthen our work in this area also include:

- Increased emphasis on controls testing which the new audit methodology has given us the opportunity to refresh our understanding and confidence in application;
- Interim review of controls testing applied for the first time under the new LEAP methodology for the 2018 year ends to ensure appropriate application and subsequent sharing of best practice or additional training as required;
- Use of mandatory standard work papers in certain areas where appropriate; and
- Revised approach to IT general controls with a change in the structure for auditing these, using internal experts to focus on complex systems and upskilling audit teams to perform this work on low complexity systems. We will build on this by increasing the audit expertise of our internal experts as well as recruitment of additional IT auditors.

---

In addition, Grant Thornton International has a working group focusing on the methodology and approach to IT general controls. The intention is that these will be refreshed and a new suite of working papers and supporting guidance will be released in time for 31 December 2019 year-ends. These areas of training will be re-enforced by the Audit Quality Academy.

An emphasis on increased effective on-the-job coaching as described in detail in the previous section, will provide the framework to remind teams to reflect and think critically and embed the technical learning in relation to revenue.

In order to ensure the effectiveness of the actions proposed here we will re-enforce this message through the technical team's hot reviews, the quality support teams' reviews and through the increased oversight and support provided for high risk audits as referred to previously.

To assess the effectiveness of our actions we will monitor the work performed in relation to revenue as part of our 2019 internal quality monitoring.

## Improve the audit of going concern

The assessment of the appropriateness of the going concern assumption and related disclosures is fundamental in determining whether the financial statements are fairly presented. Auditors should therefore assess, and report whether the financial statements provide clear, unambiguous information to users about relevant events and conditions and any material uncertainties arising.

Management's cash flow forecast models generally form an important element of the basis for adopting the going concern assumption in the preparation of the financial statements. Auditors should scrutinise these models to assess their robustness and consistency with management's assumptions in their going concern assessment.

We reviewed the audit of going concern on two audits inspected and identified the following issues:

- On one audit, the audit team performed insufficient procedures over the models supporting management's going concern assessment. The audit team did not explain how they concluded on the integrity and accuracy of the inputs to the cash flow model or perform an arithmetical check of the model's mechanics.
- On the same audit there was also insufficient consideration of the need to include a 'Material Uncertainty Related to Going Concern' paragraph in the auditor's report in respect of events and conditions that might cast doubt on the group's ability to continue as a going concern.
- On the other audit, the audit team did not sufficiently evidence their consideration of a potential condition that might cast doubt over going concern and the viability assessment.

## Firm's actions:

Our work on root cause analysis identified two key areas which impact the effectiveness of our audit work on going concern.

The first is project management, as going concern is often one of the last pieces of work to complete on a file so we need to ensure teams have sufficient capacity at that stage to audit this effectively. Our new audit methodology recognises this and focusses work on going concern at the execution stage rather than the concluding stage. As well as training on audit technical and financial reporting skillsets, project management skills are recognised as an area requiring significant improvement and will form part of the learning programme. This will improve the work on going concern as by bringing the work forward we will allow more time for robust challenge of management's models and assumptions.

The second is technical skills in relation to the audit of going concern. Going Concern is a specific area of focus in the summer 2019 audit technical training and subsequent roll out, as discussed in a previous section. The case study on which the training centres includes various factors which would indicate a risk in relation to going concern and exercises challenge teams on how to address those risks. This is being facilitated jointly between our central technical team and practice. The summer training is mandated for all managers and engagement leads and the subsequent roll out is mandatory for all grades. This learning will be further re-enforced by the Audit Quality Academy.

We noted the findings in this report focussed on the scrutiny of management's forecast cash flow models to assess their robustness and consistency with management's assumptions in their going concern assessment. We recognise that a successful audit requires the audit team to be confident in the integrity of data provided by management and to challenge management on the completeness and accuracy of the information they provide. The actions we are taking in relation to this are detailed above.

Part of the broader framework to improve the audit of going concern lies in obtaining a robust initial assessment from management. This is emphasised in the summer training. The project management training noted above will include the skills required to facilitate this, such as clear expectations in relation to timing and quality and effective communication of those expectations, clarity of respective roles and responsibilities of auditor and client in relation to provision of information. The implications where this assessment is not received will also be addressed in terms of how we can educate clients within ethical guidelines and potential impact on agreed signing dates if the delay means we are not able to fulfil our statutory duties in this respect.

We will also be introducing a mandatory workpaper in respect of going concern for the 2019 audit cycle together with additional risk identification procedures to highlight clients where going concern factors may be more complex at the planning stage of the audit such that additional review procedures by an independent engagement lead can be performed.

In order to provide a framework to embed these actions we will reinforce the importance of on the job coaching as described previously. Further, to ensure the effectiveness of the actions proposed here we will re-enforce this message through the technical team's hot reviews, the quality support teams' reviews and through the increased oversight and support provided for high risk audits.

To assess the effectiveness of our actions we will monitor the work performed in relation to going concern as part of our 2019 internal quality monitoring.

## **Improve the audit of the completeness and evaluation of prior year adjustments**

Accounting Standards require material errors relating to prior periods to be adjusted retrospectively. Omissions and misstatements are material if they could individually or collectively influence the economic decisions of users of the financial statements. Auditors should perform sufficient work over the completeness and evaluation of prior period misstatements.

We identified issues relating to the assessment of potentially material prior year adjustments on two audits:

- Insufficient audit evidence over the completeness of correcting adjustments arising from accounting misstatements, including the assessment of whether the cumulative errors were material.
- Insufficient testing of a known prior period adjustment and inaccurate reporting to the Audit Committee of the required adjustment.

### **Firm's actions:**

Our work on root cause analysis identified areas which impact the effectiveness of our audit work on the completeness and evaluation of prior year adjustments.

The first is technical skills in relation to prior period adjustments, including evaluation of misstatements and consideration of materiality in different periods. These will be the subject of training interventions which will be further re-enforced by the Audit Quality Academy. We will also continue to strongly mandate consultation with our central technical team for all prior period misstatements and re-enforce that message with the practice.

The second is project management, including how audit teams interact with companies for the timely provision of quality information, as prior period misstatements are often addressed in the late stages of the audit process, so we need to ensure teams have sufficient capacity to complete the work effectively. The Audit Quality Academy, as noted above will focus on this.

---

Finally, the ability to reflect and think critically also impacts our work in this area. As stated above, we intend to create the space and time to think by the review of the companies we audit and the more focussed risk assessment under our new audit methodology.

We are also putting practical procedures in place in respect of evaluation of prior year adjustments through a mandatory workpaper on this area and updates to our audit deliverables documents template to ensure teams appropriately consider and communicate our findings to those charged with governance.

An emphasis on increased effective on-the-job coaching will provide the framework to improve the audit of the completeness and evaluation of prior year adjustments both in terms of project management and technical skills and by challenging thinking within audit teams. This will be achieved by creating space in the ways noted above.

In order to ensure the effectiveness of the actions proposed here we will re-enforce these messages through the technical team's hot reviews, the quality support teams' reviews and through the increased oversight and support provided for high risk audits as described in more detail above.

To assess the effectiveness of our actions we will monitor the work performed in relation to evaluation of prior period adjustments as part of our 2019 internal quality monitoring.

---

### 3 Developments in the year

The firm has enhanced its policies and procedures during the year in the following key areas:

- The firm have taken steps to further improve their procedures and processes relating to independence and ethics, but we note that a number of agreed actions are ongoing and their completion should remain a key focus for the firm. Specifically, the 2018 partner and staff prohibited investments testing results show that progress has been made but the firm should continue to drive understanding and improve the levels of compliance.
- The firm has launched Grant Thornton International's LEAP audit methodology and software platform, which are part of the drive to improve audit quality. The firm has trained partners and staff in the new methodology and audit teams are now implementing the new approach. The firm's intention was that most audits of 31 December 2018 year-ends would use the LEAP methodology and platform. The new platform has experienced implementation issues and the firm has therefore reverted to the previous platform while using the new methodology.

We note the co-operation and assistance received from the partners and staff of the firm in the conduct of our 2018/19 inspection.

#### **Audit Quality Review**

FRC Audit and Actuarial Regulation Division

July 2019

---

This report has been prepared for general information only. The FRC does not accept any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using this document or arising from any omission from it.

© The Financial Reporting Council Limited 2019  
The Financial Reporting Council Limited is a company limited by guarantee.  
Registered in England number 2486368.  
Registered Office: 8th Floor, 125 London Wall, London EC2Y 5AS

**FINANCIAL REPORTING COUNCIL  
8TH FLOOR  
125 LONDON WALL  
LONDON EC2Y 5AS**

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

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