

May 2016

Grant Thornton UK LLP

Audit Quality Inspection

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries, and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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

About the FRC's Audit Quality Review team

Our objective

The FRC's mission is to promote high quality corporate governance and reporting to foster investment. The Audit Quality Review team (AQR) contributes to this objective by monitoring and promoting improvements in the quality of auditing

What we do

AQR assesses the quality of the audits of listed and other major public interest UK entities and the policies and procedures supporting audit quality at the major audit firms in the UK. We also review audits of entities incorporated in Jersey, Guernsey or the Isle of Man whose securities are traded on a regulated market in the European Economic Area. We adopt a risk-based approach to our work and focus our reviews of individual audits on key areas specific to each review.

Our team

AQR consists of approximately 35 professional and support staff. Our inspection teams have extensive expertise with an average of 19 years post-qualification experience. Our audit quality review work is subject to rigorous internal quality control reviews. Independent non-executives oversee our work.

Working with Audit Committees (or equivalent bodies)

Audit Committees play an essential role in reviewing and monitoring the effectiveness of the audit process. We are committed to engaging with Audit Committees to improve the overall effectiveness of our reviews and to support our common objective of promoting audit quality. We speak with Audit Committee Chairs during the year as part of our work. We also send our reports on each individual audit reviewed to the Chair of the relevant Audit Committee (or equivalent body).

Priority sectors and areas of focus

Our priority sectors for inspection in 2015/16 were insurance; food, drink and consumer goods manufacturers and retailers; companies servicing the extractive industries; and business services. We reviewed a number of audits from these sectors at the firms, together with a number of first year audits which were identified as an area of focus given the extent of changes in auditors following increased audit tendering. We also paid particular attention to the audit of revenue recognition and complex supplier arrangements.

Thematic reviews

In addition to our annual programme of audit reviews, we undertake one or more thematic reviews each year. We review firms' policies and procedures in respect of a specific aspect of auditing, and their application in practice, enabling us to make comparisons between firms with a view to identifying both good practice and areas for improvement.

This year we have published reports on "Firms' audit quality monitoring" (January 2016) and "Engagement Quality Control Reviews" (February 2016). We expect all firms to take appropriate action to address the findings from our thematic reviews which apply to them.

Developments in Audit Quality 2015/16

In addition to reports on each of the major firms we have reviewed, the FRC intends to issue later in 2016 (and annually thereafter) a report on the quality of audit in the UK. This will include a report on the overall findings of our AQR activity.

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The AQR assesses the quality of audits and policies and procedures supporting audit quality at major firms

1 Overview

This report sets out the principal findings arising from the 2015/16 inspection of Grant Thornton UK LLP (“the firm”) carried out by the Audit Quality Review team of the Financial Reporting Council (“the FRC”). We conducted this inspection in the period from December 2014 to December 2015 (“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.

Section 2 sets out our key findings requiring action and the firm’s responses to these findings.

Section 3 sets out our overall assessment of the quality of the audits we reviewed in our 2015/16 inspection and how it compares with our assessments over the previous four years.

Appendix A sets out our objectives, scope and basis of reporting.

Appendix B explains how we assess audit quality.

We acknowledge the co-operation and assistance received from the partners and staff of the firm in the conduct of our 2015/16 inspection.

Scope of our 2015/16 inspection

Our inspection comprised a review of the firm’s policies and procedures supporting audit quality and reviews of selected aspects of individual audits.

The areas covered by our review of the firm’s policies and procedures included:

- Tone at the top;
- Independence and ethics;
- Audit methodology, training and guidance; and
- The firm’s own audit quality monitoring.

We reviewed selected aspects of seven¹ individual audits in 2015/16. In selecting which aspects of an audit to inspect, we took account of those areas identified to be of higher risk by the auditors and Audit Committees, our knowledge and experience of audits of similar entities and the significance of an area in the context of the audited financial statements.

¹ Independent of our inspection, the FRC launched an investigation under the Accountancy Scheme into the audit of the financial statements of one of the entities whose audit we were reviewing at the time. As a result, a final report on our review was not prepared and a final assessment of the audit was not completed. While relevant findings arising from this review have been included in this report, the quality assessment relates only to the other seven audits reviewed.

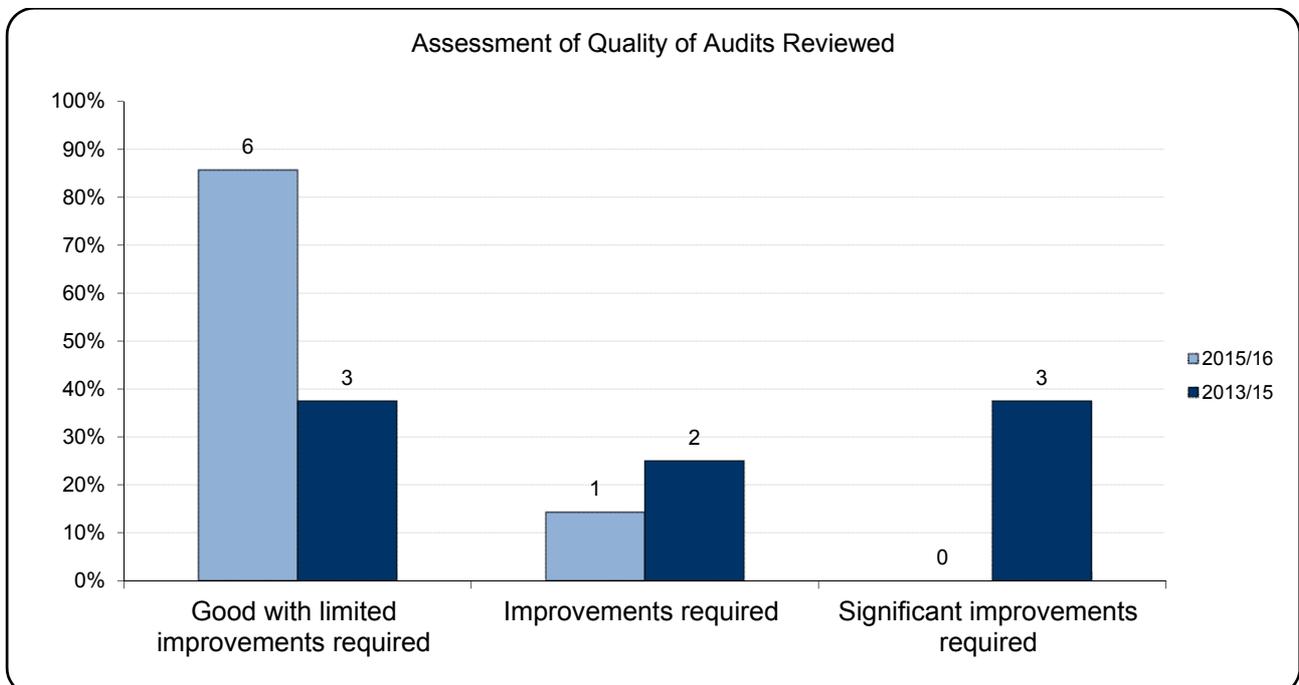
Key findings

In response to our last inspection report, the firm has strengthened its guidance and training regarding the application of professional scepticism. As part of a Grant Thornton International Limited (“GTIL”) initiative to develop a new global audit methodology and software platform, the firm has been providing enhanced audit technical training to its staff that is aligned to the specific requirements of International Auditing Standards.

Our key findings in the current year requiring action by the firm, which are elaborated further in section 2 together with the firm’s actions to address them, are that the firm should:

- Raise its audit quality benchmark for partners.
- Strengthen its audit quality monitoring arrangements.
- Improve awareness and monitoring of ethical and independence matters.
- Strengthen procedures related to the direction, supervision and review of group audits.
- Improve the accuracy or precision with which audit procedures are described in audit reports.
- Improve the quality of communications with Audit Committee.

The following chart shows our assessment of the quality of the firm’s audits which we reviewed in 2015/16 with comparative information for 2013/15. Further details are provided in section 3.



The chart shows an overall improvement in our assessment of the quality of the specific audits we reviewed in 2015/16 compared with our assessment for those audits we reviewed in 2013/15. In particular, only one audit was assessed as requiring more than limited improvements in 2015/16 and no audits were assessed as requiring significant improvement.

Section 3 sets out examples of good practice which contributed to audits being assessed as requiring no more than limited improvements. It also sets out the principal issue resulting in one audit being assessed as requiring more than limited improvements.

We expect all the firms we inspect to make continuous improvements such that, by 2019, at least 90% of FTSE 350 audits reviewed will be assessed as requiring no more than limited improvements².

Root cause analysis

Thorough and robust root cause analysis is necessary to enable firms to develop effective action plans which are likely to result in improvements in audit quality being achieved. At our request, the firm has performed root cause analysis in respect of our key findings in this report.

Firm's overall response and actions:

We welcome the feedback from the AQRT, which provides us with helpful third party insights into practices so that we can ensure that our continuous process of quality improvement is targeted and moving at an appropriate pace. We are equally supportive of the AQRT's use of thematic reviews to shine a light on good practice.

The overall improvement in the AQRT's assessment of the quality of the specific audits selected for review is consistent with the recent findings of other external reviews of our engagements and of our own internal quality monitoring. We believe that this is a clear reflection of the effectiveness of the investment we have made in recent years to enhance our systems, training and guidance, in part in response to the findings of previous reviews by the AQRT.

We have carried out a root cause analysis of the findings that are set out in this report and are implementing an action plan to address each of the key findings. A number of actions have already been taken or have been built into our 2016 year-end procedures.

Our root cause analysis gave us comfort that our framework of firm-wide policies and procedures was fundamentally sound but in certain areas we had perhaps placed undue trust on individuals to "do the right thing" or had assumed that checks had been undertaken. We will therefore enhance our oversight and compliance monitoring in certain areas.

We are committed to continual improvement and delivery of quality service by all areas of the firm remains at the top of our agenda.

² FRC Plan and Budget 2016/17

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. The firm was asked to provide a response setting out the actions it has taken or will be taking in each of these areas.

Raise the firm's audit quality benchmark for partners

Audit quality needs to be given sufficient weight with the partners to emphasise its primary importance within the audit practice and drive improvements in audit performance.

We noted a number of areas where the firm could be viewed as placing insufficient importance on safeguarding and enhancing audit quality. For example:

- For objectives set in 2015, the firm allowed audit partners to set an audit quality objective to achieve at least a 2B assessment in an external regulatory audit review, being the second lowest of four categories (where improvements to the audit are required).
- It was not clear that some quality concerns raised as part of the partner recruitment processes had been adequately addressed.
- The firm has a number of quality metrics for partners that feed into the overall partner appraisal process. A number of discretionary overrides were made to these metrics during the moderation process (thereby increasing or decreasing the remuneration of those individuals) without sufficient evidence to justify this.
- The audit quality metrics of partners (contributing to their annual appraisal) were not affected by findings from internal or external quality reviews of audits for which they were the engagement quality control reviewer (EQCR).

Firm's actions:

RI audit quality goal/objective

The audit quality goal ("objective") for the firm's 2015/16 performance review was set centrally and cascaded to all RIs with supporting communications on quality. In view of previous results of quality reviews, the priority was to eradicate poor gradings whilst improving overall quality. The results of recent internal and external quality reviews demonstrate that this goal has achieved its desired outcome and did not drive behaviour that only aimed for a 2B assessment. For 2016/17 we will set a goal that further emphasises that the expected standard is at a higher level.

Quality interview process for recruitment and promotion to RI

We are currently conducting a review of the quality interview process that has been in place in its current form for 12 years for both external and internal candidates. If we conclude in the future that an external candidate meets the minimum standard but may require additional support, the Quality Interview panel will coordinate with the Partner and Director Selection Panel (PDSP) and the business in identifying and applying this.

Annual audit partner and RI quality gradings

The "metrics" are the result of a formulaic model that combines a significant number of quantitative and qualitative measures of audit quality. In our view there should always be scope for moderation, where necessary, to take account of unusual or one-off factors, both positive and negative, which in the judgement of the Head of Assurance are not captured or fully reflected by the other inputs to the model. To ensure that there is a complete audit trail, the Head of Assurance will produce a paper for the firm's Strategic Leadership Team that will set out the nature and reason for her interventions during the 2015/16 grading exercise.

Reflecting audit quality findings in the gradings of EQCRs

For 2015/16, the audit quality metrics as noted above, and the moderation process, will reflect the results of internal and external quality reviews of engagements where an individual served as EQCR.

Strengthen the firm's audit quality monitoring arrangements

A firm's Audit Quality Monitoring procedures ("AQM") evaluate the effectiveness of their quality control systems and the quality of completed audits, identifying where improvements can be made. Shortcomings in how a firm's internal AQM reviews are conducted and reported reduce their effectiveness and increase the likelihood of not identifying areas where action needs to be taken to achieve improvements.

The firm's 2014 AQM, which was completed in early 2015, was reviewed as part of our thematic inspection of this area. We noted certain shortcomings in the firm's arrangements as follows:

Quality control processes

Insufficient independent testing of the firm's quality control processes was undertaken, resulting in insufficient coverage over key central systems. No specific training or guidance was provided to reviewers on the level of testing required. Further, issues identified were not appropriately communicated within the firm to ensure that, where necessary, corrective action was taken.

Completed audits

The notification period provided to audit teams for individual reviews (up to a maximum of three months) often meant that the review did not cover the most recent audit completed. Further, in a number of cases, the overall outcome of the review did not appear to be consistent with the detailed finding(s).

Firm's actions:

Quality control process

For the 2016 quality review programme, a specialist central review team will perform the reviews of the effectiveness of the firm's quality control systems under the direction of the firm's Director, Assurance Quality Monitoring.

Completed audits

Reviews of completed files of the firm's highest risk audit engagements will be conducted throughout the year by the specialist central review team and will examine each selected file very soon after it has been completed. We will increase the time allocated to each review to more closely match the approach taken by the AQRT.

More training will be provided on the performance and completion of other reviews in order to improve their consistency and the recording and assessment of significant matters arising. We will also shorten the notification period to enable the review to cover the very latest completed engagement.

Improve awareness and monitoring of ethical and independence matters

Firms are required to have policies and procedures in place to maintain auditor objectivity and independence. Inadequate policies and procedures or insufficient monitoring of compliance with them could compromise the firm's objectivity and independence.

We identified a number of ethical and independence issues, including the following:

- The firm's monitoring procedures were insufficient to ensure that ethical breaches were identified and reported on a timely basis. Furthermore, the firm does not have mandatory independence training for their partners and staff.
- The firm did not identify that a new staff member was subsequently found guilty by their professional body of misconduct relating to a previous employment. The individual was also found to have inappropriately signed off the EQCR work steps for an AIM listed entity where an EQCR had not been involved. We have previously reported on weaknesses in the firm's audit software for changing and re-setting electronic passwords. Immediate action needs to be taken by the firm to strengthen procedures over access rights and signing authorities, either to prevent unauthorised access or to ensure that any future instances of unauthorised access are detected promptly.
- We identified concerns relating to the firm's approach to approving contingent fee arrangements for non-audit services. We noted instances where approval was given for non-audit services to be provided on a contingent fee basis on the basis that they would be completed before the commencement of the next year's audit. We also noted an instance of an existing contingent fee arrangement not being identified prior to accepting a new audit.
- The firm's policies and procedures relating to partners and staff holding prohibited investments in audited entities continue to require improvement to ensure the prompt identification and disposal of any such holdings.

Firm's actions:

We are currently reviewing the organisation and resourcing of the firm's ethics and independence function to respond to the new challenges of compliance with the revised FRC Ethical Standard and the impending retirement of the current Ethics Partner.

As part of that review we will take the following actions:

- **Monitoring:** New fields will be added to the firm's listed client database to enable central monitoring to more easily identify and address any instances of potential non-compliance in relation to rotation before they occur. We are also developing mandatory training on the subject.
- **Resetting of electronic passwords:** We will strengthen the central monitoring arrangements that are designed to identify any instances of invalid resetting of passwords. We will continue to treat any inappropriate uses of the reset facility as a serious disciplinary breach. We are undertaking a major revision of our audit software which will use current technology safeguards to protect access rights.
- **Contingent fees:** Our policy for the use of contingent fee arrangements for non-audit services has been in place for at least 6 years, is consistent with market practice and, in our view, it is compliant with the current Ethical Standards. However, it is being reviewed in the light of the changes being made by the revised FRC Ethical Standard.
- **Prohibited investments:** We will bring forward the point in time when proposed new audit appointments are reflected in the firm's financial interests tracking system in order to reduce the risk of financial holdings of partners and others remaining at the time when the firm's formal appointment occurs. We will also review the period that is allowed for individuals to dispose of financial interests once they have become "prohibited". We will increase the frequency of our reviews of the compliance with our policy.

Strengthen the firm's procedures related to the direction, supervision and review of group audits

Group audits present a number of challenges, in particular the need to work effectively with others. Early and thorough planning, comprehensive communication between group and component auditors and appropriate involvement in and review of the work of component auditors are vital. The engagement partner needs to assess the adequacy of work performed at both group and component level and the appropriateness of conclusions reached before signing the group audit opinion.

We noted certain shortcomings in the firm's procedures related to the direction, supervision and review of audit work in relation to overseas components. In particular:

- On one audit, where all of the audited entity's operations were overseas, there was insufficient evidence of review and challenge by the group audit team over intangible assets capitalised in the year, a significant risk area. Further, there was insufficient evidence of the Engagement Quality Control Reviewer ("EQCR") being involved in the final stages of the audit on a timely basis and insufficient evidence of their evaluation and challenge of judgments made in key audit areas.
- On another audit with significant overseas operations, the group audit team did not review the sales contracts of the audited entity's two main customers, both of which were due for

renewal in the foreseeable future, nor sufficiently challenge group management over the likelihood of renewal.

Firm's actions:

In response to the findings we have already:

- redrafted the guidance available to engagement teams to make the required procedures clearer, including the need for more explicit involvement in the work of a component auditor;
- directed the 'Quality Support Team', established during 2015 to work alongside the EQCR on higher risk assignments, to the audit of groups as part of their review procedures.

We are developing a new template for teams to use when reviewing a component auditor's work and will refresh the training modules relating to the audit of groups.

Improve the accuracy or precision with which audit procedures are described in audit reports

The extended audit report³, introduced in 2012, provides an insight into the principal risks to the quality of financial reporting identified by the auditor and how they have responded to them. It is important that the nature and extent of the audit work performed in response to identified risks is accurately set out in the audit report so that users are properly informed.

We reported issues last year concerning two of the firm's three extended audit reports reviewed and the firm responded by issuing new guidance to audit teams in March 2015. Of the audits reviewed this year, three required extended audit reports, all completed after the date of the new guidance.

The accuracy or precision of the description of the audit procedures performed in two of the three reports needed to be improved. In one case, the audit report incorrectly stated that the audit team had agreed underlying data sent to actuaries in connection with the measurement of a pension liability. In the other case, the report did not make it clear that certain controls testing described had covered only one of the group's components.

Firm's actions:

The quality of our enhanced audit reports is improving and this was recognised at the 2015 Investment Association Auditor Reporting Awards where we had two clients shortlisted for awards in three categories. We will reinforce with engagement teams that they use the standard document mapping the risks and our responses to the related audit testing in the audit file, so as to ensure that the audit procedures that we have performed are accurately described in the audit report.

³ The FRC published a report on the second year of extended auditor's reports in January 2016: "Extended auditor's reports: A further review of experience".

Improve the quality of communications with Audit Committees

Audit Committees have a key role to play in overseeing the effectiveness of the audit. High quality communications with Audit Committees are therefore essential to safeguard audit quality.

The quality of the firm's communications with Audit Committees continues to require improvement. Issues arising included deficiencies in the reporting of misstatements and disclosure omissions; the nature and extent of interaction with the Audit Committee; the reporting on a significant risk area; and the accuracy of the reported audit approach.

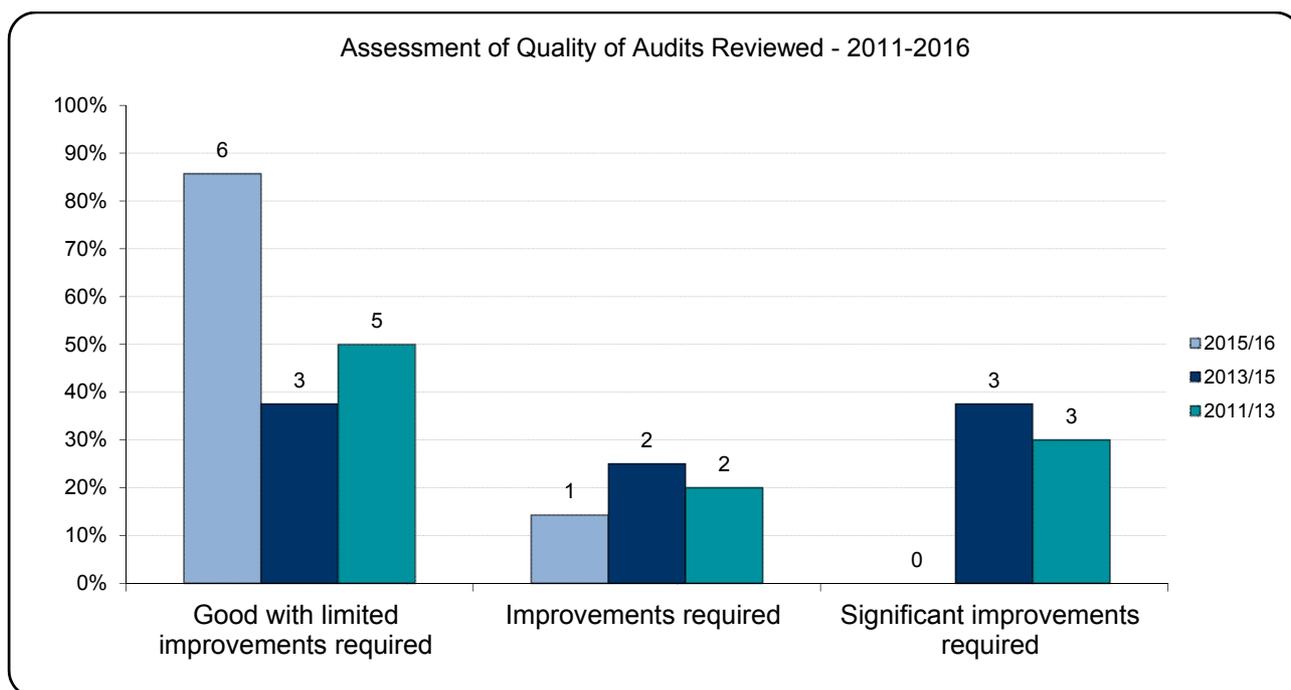
Firm's actions:

We have revised our policy and monitoring with regard to the templates to use when communicating with Audit Committees and incorporated an explicit requirement for documentation of management's explanation for uncorrected misstatements and disclosure omissions identified during the course of the audit. Through training we have reinforced with engagement teams the need for consistency between the work captured on the audit file and the reporting to those charged with governance.

3 Assessment of the quality of audits reviewed

We reviewed selected aspects of seven individual audits in 2015/16. Of these, two were first year engagements.

The bar chart below shows the results of our assessment of the quality of the audits we reviewed in 2015/16, with comparatives for the previous four years⁴. The number of audits within each category in each year is shown at the top of each bar.



We identified the following examples of good practice on certain audits in 2015/16 assessed as requiring no more than limited improvements:

- Effective audit strategies and procedures for the audit of investments.
- An appropriate level of resource was devoted to the first year audits we reviewed.

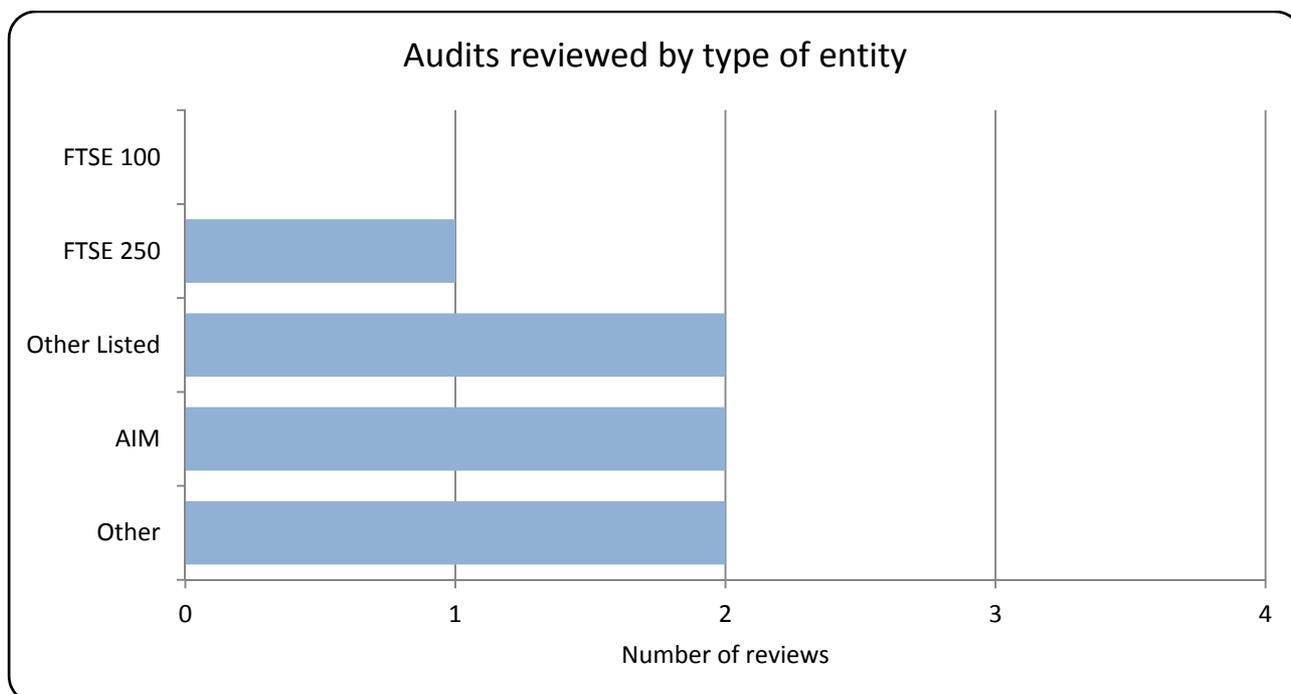
The principal issue resulting in one audit being assessed as requiring more than limited improvements in 2015/16 was insufficient audit evidence in relation to revenue. The audit team should have considered an alternative audit approach such as testing the operating effectiveness of key internal controls and/or performing additional substantive analytical procedures.

⁴ 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.

Audits inspected in 2015/16

We estimate that the firm audited 218 UK entities within the scope of independent inspection as at 31 December 2014. Of these entities, our records show that 58 had securities listed on the main market of the London Stock Exchange, including one FTSE 100 and three FTSE 250 companies.

The following chart provides a breakdown of the audits inspected in 2015/16 by type of entity⁵:



Audit Quality Indicators

The firm's transparency report for the year ended 30 June 2015 includes certain Audit Quality Indicators (AQIs) which the six largest audit firms are using. We believe that such AQIs provide useful additional information to those wishing to understand firms' approaches to monitoring and improving audit quality.

We are pleased that firms have made a good start in identifying and monitoring AQIs. We would, however, encourage them to gather the relevant data on a more consistent basis and follow-up the results more effectively.

Audit Quality Review

FRC Audit Division

May 2016

⁵ The listed entities whose audits we reviewed include one investment trust.

Appendix A – Objectives, scope and basis of reporting

Matter	Explanation
Objectives of our inspection	The overall objective of our work is to monitor and promote improvements in the quality of auditing. As part of our work, we monitor compliance with the regulatory framework for auditing, including the Auditing Standards, Ethical Standards and Quality Control Standards for auditors issued by the FRC and other requirements under the Audit Regulations issued by the relevant professional bodies. 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.
Audits in the scope of our inspection	<p>In addition to the UK audits in scope, as stated in section 3 of our report, the UK firm audits a number of entities incorporated in Jersey, Guernsey or the Isle of Man whose securities are traded on a regulated market in the European Economic Area. These audits are inspected by us under separate arrangements agreed with the relevant regulatory bodies in those jurisdictions. The firm and relevant bodies have informed us that the firm was not registered to conduct audit work in any of these jurisdictions.</p> <p>Grant Thornton UK LLP also supplies audit services to local authorities and the NHS (Local Public Audits - LPAs). Whilst we review LPAs undertaken by firms, this is done under separate arrangements agreed with the Public Sector Audit Appointments Limited (PSAA), previously the Audit Commission. The results of these reviews are not included in this report because the LPA inspections fulfil a different purpose to those considered in this report. These reviews of LPAs form part of the PSAA's assessment of the quality of contracted-out audits. The PSAA publishes its assessment both in overall terms and individually by firm. The most recent reports can be found on its website.</p>
Impact of our risk-based inspection approach	Our inspection was not designed 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 for review and cannot be relied upon for this purpose.
Key audit areas inspected	In selecting which aspects of an audit to inspect, we take account of those areas considered to be higher risk by the auditors and Audit Committees, our knowledge and experience of audits of similar entities and the significance of an area in the context of the audited financial statements. The rationale for including each area of audit work (or excluding any area of focus listed in the auditors' report) is documented as part of the planning process for each audit inspected.
Our reports on individual audits	We issue a report on each individual audit reviewed during an inspection to the relevant audit engagement partner or director and the chair of the relevant entity's Audit Committee (or equivalent body).
Our emphasis on improvements to audit quality	We seek to identify areas where improvements are, in our view, needed in order to safeguard audit quality and/or comply with regulatory requirements and to agree an action plan with the firm designed to achieve these improvements. Accordingly, our reports

Matter	Explanation
	place greater emphasis on weaknesses identified which require action by the firm than areas of strength and are not intended to be a balanced scorecard or rating tool.
Basis of our public reporting	While our 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. 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 which, in turn, reflects the firm's client base. An issue reported in relation to a particular firm may therefore apply equally to other firms without having arisen in the course of our 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.
Purpose of this report	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 and its 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.
Inspection findings included in our public report	We exercise judgment in determining those findings to include in our public report on each inspection, taking into account their relative significance in relation to audit quality, in the context of both the individual inspection and any areas of particular focus in our overall inspection programme for the year. Where appropriate, we have commented on themes arising or issues of a similar nature identified across more than one audit.
Inspection of audits outside our scope	<p>The professional accountancy bodies in the UK register firms to conduct audit work. Their monitoring units are responsible for monitoring the quality of audit engagements falling outside the scope of our work but within the scope of audit regulation in the UK. Their work, which is overseen by the FRC, 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 and are not otherwise defined as being within the scope of our work.</p> <p>All matters raised in this report are based solely on the work which we carried out for the purposes of our inspection.</p>

Appendix B – How we assess audit quality

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

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

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

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

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

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

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

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

Equally, where we have assessed an audit as requiring significant improvements, this does not necessarily imply potential misconduct on the part of an individual or audit firm which may warrant investigation and/or enforcement action by the FRC.



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