

IN THE MATTER OF

THE EXECUTIVE COUNSEL TO THE FINANCIAL REPORTING COUNCIL

-and-

(1) MSR PARTNERS LLP
(formerly known as “Moore Stephens LLP”)

(2) STEPHEN CORRALL

EXECUTIVE COUNSEL’S FINAL DECISION NOTICE

Pursuant to Rule 18 of the Audit Enforcement Procedure

This Decision Notice is a document prepared by Executive Counsel following an investigation relating to, and admissions made by, the Respondents. It does not make findings against any persons other than the Respondents and it would not be fair to treat any part of this document as constituting or evidencing findings against any other persons or entities since they are not parties to the proceedings.

1. INTRODUCTION

- 1.1. The Financial Reporting Council (the “**FRC**”) is the competent authority for statutory audit in the UK, and operates the Audit Enforcement Procedure (the “**AEP**”), effective 17 June 2016. The AEP sets out the rules and procedure for the investigation, prosecution and sanctioning of breaches of *Relevant Requirements*.
- 1.2. The AEP contains a number of defined terms and, for convenience, those defined terms are also used within this document. Where defined terms are used, they appear in italics.
- 1.3. This *Decision Notice* also uses the following definitions:
- 1.3.1. “**FY2016**” means the financial year ended 30 June 2016, “**FY2016 financial statements**” means Laura Ashley plc’s (“**LA**”) consolidated financial statements for that period, and “**FY2016 Audit**” means the statutory audit of the FY2016 financial statements.

- 1.3.2. **“FY2017”** means the financial year ended 30 June 2017, **“FY2017 financial statements”** means LA’s consolidated financial statements for that period, and **“FY2017 Audit”** means the statutory audit of the FY2017 financial statements.
- 1.4. Pursuant to Rule 16(b) of the AEP, Executive Counsel has decided that the Respondents are liable for Enforcement Action, having made *Adverse Findings* against each of them. This *Decision Notice* is issued pursuant to Rule 18 of the AEP in respect of the conduct of:
 - 1.4.1. MSR Partners LLP (formerly Moore Stephens LLP, referred to herein as **“Moore Stephens”**) in relation to the FY2016 Audit. Moore Stephens was the *Statutory Audit Firm* for the FY2016 Audit. Effective 1 February 2019, the statutory audit practice of Moore Stephens was transferred to [REDACTED]. However, Moore Stephens remains registered as a *Statutory Audit Firm*.
 - 1.4.2. Mr Stephen Corrall, a partner of Moore Stephens (and now also partner of [REDACTED]) in relation to the FY2016 Audit. For FY2016, he was the *Statutory Auditor* of LA and signed off the FY2016 Audit report on behalf of Moore Stephens.
- 1.5. In this *Decision Notice*, Moore Stephens and Mr Corrall are referred to as the **“Respondents”**.
- 1.6. In accordance with Rule 17 and Rule 18 of the AEP this *Decision Notice*:
 - 1.6.1. outlines the *Adverse Findings* with reasons;
 - 1.6.2. proposes *Sanctions* with reasons;
 - 1.6.3. proposes an amount payable in respect of Executive Counsel’s costs of the matter; and
 - 1.6.4. is issued following the Respondents’ written agreement to the *Decision Notice*.
- 1.7. This *Decision Notice* is divided into the following sections:
 - 1.7.1. Section 2: Executive Summary of the *Adverse Findings*;
 - 1.7.2. Section 3: Background;
 - 1.7.3. Section 4: *Relevant Requirements* to which the *Adverse Findings* relate;
 - 1.7.4. Section 5: Detail of the *Adverse Findings*;
 - 1.7.5. Section 6 and 7: Proposed *Sanctions*;
 - 1.7.6. Section 8: Costs.

2. EXECUTIVE SUMMARY OF THE ADVERSE FINDINGS

- 2.1. LA is a well-known retailer with 160 high-street stores in the UK and international operations in 29 countries worldwide which employs almost 3000 people internationally (as of 21 September 2018). Its shares are listed on the main market of the London Stock Exchange.
- 2.2. As is set out in this *Decision Notice*, there were numerous and pervasive failures by the Respondents in the manner in which the FY2016 Audit was conducted. The audit failed in its principal objective: that of providing reasonable assurance that the FY2016 financial statements were free from material misstatement.
- 2.3. Whilst this *Decision Notice* explains the failings in the Respondents' audit work it does not question the truth or fairness of the FY2016 financial statements. In particular, whilst the audit work conducted to assess going concern was inadequate, it is not alleged that LA was not entitled to use the going concern assumption (see paragraph 3 below) in FY2016.
- 2.4. The *Adverse Findings* in this *Decision Notice* relate to three fundamental areas of audit work:
 - 2.4.1. Materiality;
 - 2.4.2. Revenue; and
 - 2.4.3. Going Concern.
- 2.5. Section 5 of this *Decision Notice* sets out the detailed *Adverse Findings*.
- 2.6. This *Decision Notice* proposes the following *Sanctions* in respect of the Respondents:
Moore Stephens
 - 2.6.1. A financial penalty of £825,000 adjusted for aggravating and mitigating factors (in particular reflecting an exceptional level of co-operation) by a reduction of 15%, and further discounted for admissions and early disposal by 35% so that the financial penalty payable is £455,813;
 - 2.6.2. a published statement in the form of a severe reprimand, requiring Moore Stephens to cease or abstain from repetition of the conduct giving rise to the breaches of *Relevant Requirements* detailed in this *Decision Notice*;
 - 2.6.3. a declaration that the FY2016 Audit report signed on behalf of Moore Stephens did not satisfy the *Relevant Requirements*, as set out in this *Decision Notice*;

- 2.6.4. In determining the *Sanctions* to be imposed on Moore Stephens, Executive Counsel has noted that in response to the identified failings in the FY2016 Audit, Moore Stephens took the remedial steps set out at paragraphs 2.6.5 to 2.6.12 below, and in those circumstances no further firm-wide non-financial sanctions will be required.

Remedial steps in relation to audit of Revenue

- 2.6.5. Engaging an IT audit and data analytics consultant to implement a range of new measures, including:
- 2.6.5.1. Workshops for Senior Statutory Auditors and staff from manager grade up on IT audit procedures;
 - 2.6.5.2. New IT audit methodology with an IT systems risk assessment checklist to be completed on every audit ensuring appropriate IT audit specialist involvement;
 - 2.6.5.3. One to one meetings between the IT audit consultant and all Auditor Directors and Managers to discuss their audit profile and to determine where an IT specialist will be required on an audit both in terms of IT general controls (“**ITGC**”) and data analytics;
 - 2.6.5.4. Training sessions for all Partners and Managers on the new IT audit methodology including the appropriate use of data analytics (using ‘Caseware IDEA’);
 - 2.6.5.5. Half day training given to audit team members below manager level with training material covering the following (training materials are also provided to managers):
 - (a) Understanding ISA 315 requirements;
 - (b) Understanding the IT environment and what IT applications will be in scope for a financial statements audit;
 - (c) Understanding the key IT risks for an audit including bespoke systems, new systems and interfaces;
 - (d) Understanding ITGC and how to complete an ITGC Design and implementation review for lower IT risk audits;

(e) Understanding how data analytics can assist in an audit.

- 2.6.6. Introducing a requirement that the detailed computer audit methods (known as Computer Aided Audit Techniques, or “**CAATs**”) testing be set out in the audit working papers with summaries of work undertaken and results, in line with other audit tests.
- 2.6.7. For all data analytics work, introducing a new requirement to reconcile underlying data back to the trial balance and/or screenshots of the number of records/totals extracted from the client’s system and, where appropriate and possible, obtaining access to underlying databases which cannot be manipulated by the client, thereby improving audit quality.
- 2.6.8. Introducing a new requirement for all IDEA work to be carried out by a small number of IDEA users with a Peer/Quality Assurance review by the IT audit consultant.

Remedial steps in relation to audit of Going Concern

- 2.6.9. Revising documentation to emphasise the requirement to complete formal assessments of going concern on all statutory audits.
- 2.6.10. Reviewing procedures to assess the audited client’s viability statement.
- 2.6.11. Revising audit packs to require greater specific testing where management does not provide their formal assessment.

Remedial steps in relation to audit of Materiality

- 2.6.12. Amending its materiality documentation and providing extensive communications with audit teams on the correct approach to materiality.

Mr Corrall

- 2.6.13. A financial penalty of £110,000 adjusted for aggravating and mitigating factors (in particular reflecting an exceptional level of co-operation) by a reduction of 15%, and further discounted for admissions and early disposal by 35% so that the financial penalty payable is £60,775.
- 2.6.14. a declaration that the FY2016 Audit report signed by Mr Corrall did not satisfy the *Relevant Requirements*, as set out in this *Decision Notice*.

- 2.6.15. a condition that Mr Corrall shall not act as *Statutory Auditor* of a *Public Interest Entity* nor sign a *Statutory Audit Report* in respect of a *Public Interest Entity* until:
- (a) A period of 18 months has elapsed from the date of the *Decision Notice*;
 - (b) He has been re-approved to conduct such *Statutory Audits*, and to sign such *Statutory Audit Reports*, by his employer's *Audit Compliance Principal*; and
 - (c) He has completed training in relation to the application of ISAs 220, 320 and 570.
- 2.7. Executive Counsel highlights that the discounts given for co-operation and settlement reflect that: the Respondents self-reported the breaches of *Relevant Requirements*; they have shown insight into their failings; and prior to this *Decision Notice*, they imposed remedial actions to prevent recurrence of the breaches.

3. BACKGROUND

- 3.1. In 2018, Moore Stephens was ranked as the tenth largest audit firm in the UK, with revenues of £120m and 88 audit principals. FY2016 was Moore Stephens' first year as the *Statutory Audit Firm* for LA.
- 3.2. Mr Corrall is a partner [REDACTED] with 27 years auditing experience. He signed the FY2016 Audit report, on behalf of Moore Stephens, in respect of the FY2016 financial statements.
- 3.3. He had been the *Statutory Auditor* for LA since 2012.
- 3.4. The Respondents' statutory responsibility was to form an opinion as to whether the FY2016 financial statements showed a true and fair view and had been properly prepared in accordance with IFRS and the Companies Act 2006.
- 3.5. An audit involves obtaining sufficient appropriate "audit evidence" about the amounts and disclosures in the financial statements in order to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.
- 3.6. Audit evidence is defined in ISA 500 as "*information used by the auditor in arriving at the conclusions on which the auditor's opinion is based*". Audit evidence is primarily obtained from audit procedures performed during the course of the audit.

Audit work in relation to Revenue

- 3.7. The audit team for the FY2016 Audit planned to check LA's sales, using CAATs. Their plan was to trace sales from the till records in stores, and other primary records such as internet sales, through to the accounting system and the FY2016 financial statements.
- 3.8. However, the audit team did not follow their plan. Instead of tracing sales from the primary records, they checked two systems which were internal to LA - the inventory management system and the accounting system. This meant that they failed to adequately check that the sales recorded in the accounting system, and the FY2016 financial statements, were correct.
- 3.9. It is not alleged that LA's revenue was misstated, only that the audit team failed to audit it in an appropriate manner.

Materiality

- 3.10. Items or misstatements in financial statements are considered as material if they could influence the economic decisions of users.
- 3.11. ISAs require auditors to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement. The concept of materiality is therefore fundamental to the audit. It is applied by auditors at the planning stage (for example to determine the scope and coverage of audit work), and when performing the audit and evaluating the effect of identified and uncorrected misstatements.
- 3.12. Auditors usually choose their materiality threshold using a benchmark. Profit before tax (PBT) is a typical benchmark for a profit-orientated organisation, such as a retailer. Auditors of retail organisations often choose a percentage of PBT as their materiality threshold. For example, the percentage applied to PBT for a public-interest entity, such as Laura Ashley (LA), may be 5% as set out in ISA 320 para A7 (para A8 in the 2016 update). These are benchmarks and percentages very commonly used by the auditing profession for an entity such as LA.
- 3.13. For the FY2016 Audit, the audit team considered that the users of the FY2016 financial statements would be interested in both profit and revenue. It would be extremely unusual for an auditor to use revenue as a materiality benchmark for a retailer. However, instead of choosing between the two benchmarks, the audit team chose to use an average of the two.
- 3.14. In FY2016, PBT was £23.9m and revenue was £400.9m. Choosing an average of PBT and revenue meant that, in practice, the impact of the PBT benchmark was substantially reduced. The audit team calculated materiality of £4.3m. This was 18% of profit before

tax, more than three times the threshold of 5% of profit before tax which is very typical for a profit-orientated, public-interest entity.

- 3.15. This choice of materiality threshold determines the scope and coverage of the audit work. A lower materiality threshold would necessitate more audit work so that the auditor can fulfil his responsibility to provide reasonable assurance that the financial statements are free from material misstatement.
- 3.16. The FY2016 Audit report was also incorrect and misleading as to the materiality threshold set and how it was calculated. It is not suggested this error was intentional.

Audit work in relation to use of Going Concern Assumption

- 3.17. Executive Counsel does not suggest that LA was not a going concern in FY 2016. The *Adverse Finding* against the Respondents concerns solely their audit work in relation to the going concern assumption. LA continues to trade today, over two years after the FY2016 Audit report was published.
- 3.18. The going concern assumption is the assumption that a company will remain in business for the foreseeable future. In considering whether a company is a going concern, the key test is whether the company is able to pay its debts as they fall due. If the going concern assumption is not appropriate, an entity prepares its accounts on a break-up basis with assets valued on the basis of expected realisation from a forced sale. The going concern assumption is a fundamental principle in the preparation of financial statements.
- 3.19. The audit team did not gather enough appropriate audit evidence during the FY2016 Audit on which to base their conclusions. There were a number of aspects to the auditor's failings in regard to this work.
- 3.20. Whilst the audit team noted the importance of cash flow to trading companies, and that LA's cash levels would likely "*dip*" in the run up to the Christmas trading period (due to stock purchases) they did not:
- 3.20.1.1. assess how much cash the group would need to pay for Christmas stock and whether the group had access to enough cash to be able to pay for it.
 - 3.20.1.2. give any consideration to the group's cash needs throughout the year.
- 3.21. In FY2016, LA reported cash balances of £18.8m, and an overdraft of £14.9m. The overdraft limit had recently been increased from £10m to £15m during the year.
- 3.22. The audit team considered LA's budget for the forthcoming year. The budget assumed a 7% increase in sales, which the audit team acknowledged "...*may be slightly*

ambitious...” because sales had fallen 7% in FY2016. The audit team also calculated that the group would make a loss if sales fell by more than 5.5%. This should have led to further work to determine the appropriateness of the going concern assumption.

4. RELEVANT REQUIREMENTS TO WHICH THE ADVERSE FINDINGS RELATE

- 4.1. Rule 1 of the AEP states that *Relevant Requirements* has the meaning set out in regulation 5(11) of the Statutory Auditors and Third Country Auditors Regulations 2016 (“**SATCAR**”). The *Relevant Requirements* include, but are not limited to, the International Standards on Auditing (UK and Ireland) (“**ISAs**”) issued by the International Auditing and Assurance Standards Board.
- 4.2. The ISAs relevant to Executive Counsel’s *Decision Notice* are those effective for audits of financial statements for periods ending on or after 15 December 2010.
- 4.3. The *Relevant Requirements* referred to in this *Decision Notice* are the following:
 - 4.3.1. ISA 200 (Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing);
 - 4.3.2. ISA 220 (Quality Control for an Audit of Financial Statements);
 - 4.3.3. ISA 230 (Audit Documentation);
 - 4.3.4. ISA 265 (Communicating Deficiencies in Internal Control to Those Charged with Governance and Management);
 - 4.3.5. ISA 300 (Planning an Audit of Financial Statements);
 - 4.3.6. ISA 320 (Materiality in Planning and Performing an Audit);
 - 4.3.7. ISA 500 (Audit Evidence);
 - 4.3.8. ISA 570 (Going Concern); and
 - 4.3.9. ISA 700 (Forming an Opinion and Reporting on Financial Statements).
- 4.4. Paragraph 14 of ISA 200 requires that a *Statutory Auditor* shall comply with relevant ethical standards. In the case of Mr Corral, this included Section 130 of the ACCA Rulebook (the “**ACCA Code**”) (Professional Competence and Due Care).

Extracts from the ISAs and the ACCA Code setting out those parts which are of particular relevance to the *Adverse Findings* are set out in Appendix 1 hereto.

5. ADVERSE FINDINGS

Adverse Finding 1 – Determination of materiality threshold

- 5.1. The materiality threshold for the FY2016 Audit was set at more than three times that which was appropriate. As a result, insufficient audit testing was undertaken.
- 5.2. The setting of materiality has a pervasive impact on the audit process including the auditor's assessment of risks of material misstatement and the response to those risks.
- 5.3. The approach to determining the materiality threshold for the FY2016 Audit did not comply with paragraph 10 of ISA 320, in that insufficient consideration was given to the guidance at paragraphs A1 and A3-A7 of ISA 320.
- 5.4. Paragraph 10 of ISA 320 requires the auditor, when establishing the overall audit strategy, to determine materiality for the financial statements as a whole. Paragraphs A1 and A3-A7 of ISA 320 provide relevant guidance on determining materiality. In particular, materiality should be determined with a view to obtaining reasonable assurance that the financial statements as a whole are free from material misstatement.
- 5.5. Section 130.1(b) of the ACCA Code required Mr Corral to act diligently in accordance with applicable technical and professional standards when providing professional services.
- 5.6. As LA is a profit-orientated public-interest entity in the retail sector, it would have been appropriate, in accordance with the *Relevant Requirements*, for the materiality threshold to have been set at 5% of estimated profit before tax for the FY2016 Audit. That would have given a threshold of £1.3m. However, group materiality for the FY2016 Audit was instead initially calculated by taking an average of 5% of estimated profit before tax and 1.5% of revenue giving a figure of £3.5 million (13.2% of estimated profit before tax).
- 5.7. Using revenue as a benchmark for calculating materiality was inappropriate for a profit-orientated entity, particularly in the case of a high-volume, low-margin retail business such as LA.
- 5.8. The group materiality figure of £3.5 million also fell outside the range of 5-10% of profit before tax initially identified by the audit team.¹ However, despite this, the audit team later increased group materiality for the FY2016 Audit to £4.3 million (16.2% of estimated profit before tax) by taking an average of 5% of estimated profit before tax and 2% of revenue.

¹ "EMAT Materiality – Group".

- 5.9. In light of the foregoing, Moore Stephens and Mr Corrall breached ISA 320 and Mr Corrall breached Section 130.1 of the ACCA Code.

Adverse Finding 2 – Reporting on materiality threshold

- 5.10. The auditor's report, published in the FY2016 financial statements, was inaccurate, misleading and incomplete in its reporting of the materiality threshold applied.
- 5.11. Paragraph 19A of ISA 700 requires the auditor to explain in the auditor's report how the concept of materiality has been applied in the planning and performance of the audit and requires that the report must specify the materiality threshold used by the auditor.
- 5.12. Paragraph A13B of ISA 700 requires that this explanation should be tailored to the particular circumstances and complexity of the audit and that it might include significant revisions to the materiality thresholds that were made as the audit progressed.
- 5.13. The auditor's report for FY2016:
- 5.13.1. incorrectly stated that materiality audit was £3.5 million (it was in fact £4.3 million);
 - 5.13.2. did not record that materiality was significantly increased as the audit progressed from £3.5 million to £4.3 million, contrary to paragraph A13B of ISA 700; and
 - 5.13.3. incorrectly stated that materiality was "*based on a percentage of revenue*" (it was in fact based on an average of a percentage of profit before tax and a percentage of revenue).
- 5.14. Moore Stephens' and Mr Corrall's conduct thereby breached paragraph 19A of ISA 700.

Adverse Finding 3 – Materiality: quality control

- 5.15. Mr Corrall failed to document his review of the final calculation of materiality.
- 5.16. Paragraph 17 of ISA 220 requires the engagement partner, through a review of the audit documentation and discussion with the engagement team, to be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached. Paragraph 8(a) of ISA 230 requires the auditor to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing and extent of the audit procedures performed to comply with the ISAs and applicable legal and regulatory requirements.

5.17. In this regard:

5.17.1. The appropriateness of the benchmarks and percentages used to calculate materiality was fundamental to, and a highly significant judgment in the context of, the FY2016 Audit.

5.17.2. Mr Corrall did not document his review of the final calculation of materiality applied by the audit team in the conduct of the FY2016 Audit, as he was required to do in his capacity as engagement partner.

5.18. Moore Stephens' and Mr Corrall's conduct thereby breached paragraph 8 of ISA 230.

Adverse Finding 4 – Audit procedures in relation to revenue

5.19. Whilst it is not suggested that LA incorrectly reported their revenue, the audit testing carried out was insufficient for the auditors to obtain sufficient appropriate audit evidence as to verify whether LA had accurately reported or not.

5.20. The audit of sales revenue was of central importance to the FY2016 Audit.

5.21. Paragraph 6 of ISA 500 requires the auditor to design and perform audit procedures that are appropriate for the purpose of obtaining sufficient appropriate audit evidence.

5.22. Mr Corrall and Moore Stephens failed to do this in the following circumstances.

5.23. The substantive testing of revenue by the audit team was carried out using CAATs.

5.24. The objective of the CAATs testing was to reconcile a high volume of sales transactions from records of store and online sales to the general ledger. The audit planning working paper² described CAATs testing for revenue which would have been appropriate.

5.25. However, the CAATs testing that was actually carried out by the audit team only reconciled the general ledger with an internal stock system and not to records of sales transactions. This was insufficient for the purposes of testing revenue.

5.26. As a result, the CAATs sales testing was not designed and/or performed in a way that was appropriate for the purpose of obtaining sufficient appropriate audit evidence in relation to revenue.

5.27. Moore Stephens' and Mr Corrall's conduct thereby breached paragraph 6 of ISA 500.

² Working Paper E1000, "Updated planned procedures".

Adverse Finding 5 – Revenue: quality control in relation to engagement team experience

- 5.28. Mr Corrall and Moore Stephens failed to ensure that the audit team had the required experience.
- 5.29. Paragraph 14 of ISA 220 requires the engagement partner to be satisfied that the engagement team have the appropriate competence and capabilities to perform the audit engagement in accordance with professional standards.
- 5.30. Paragraph 15 of ISA 220 requires the engagement partner to take responsibility for the direction, supervision and performance of the audit engagement.
- 5.31. It was Mr Corrall's responsibility as engagement partner to ensure that the IT specialist auditor who carried out the CAATs testing for sales revenue had appropriate experience and had the capabilities and competence to fulfil the role that had been assigned to him. However, the IT specialist auditor did not in fact have appropriate experience of applying CAATs testing to the audit of a multi-outlet retail business, such as LA, and he failed to appreciate that the CAATs testing of revenue, which he carried out, was inappropriate.
- 5.32. Further, after the initial planning stage, the audit team did not maintain sufficient contact with the IT specialist auditor while the CAATs testing was carried out, so as to ensure that the CAATs testing was appropriately directed, supervised and performed.
- 5.33. Moore Stephens' and Mr Corrall's conduct thereby breached paragraphs 14 and 15 of ISA 220.

Adverse Finding 6 – Revenue: quality control in relation audit strategy

- 5.34. Mr Corrall and the audit team failed to identify that the CAATs testing for revenue undertaken was inappropriate and inadequate and did not reflect the test described in the audit planning working papers.
- 5.35. The audit strategy document purported to describe the CAATs testing that the audit team intended to carry out in respect of revenue. However, the document contained two descriptions of the CAATs testing, being:
- 5.35.1. First, tracing external takings/sales through to the general ledger; and

- 5.35.2. Second, reconciling sales and purchases from the internal stock system to the general ledger *“to ensure that [the latter] has accurately recorded movements in stock”*³ (i.e. merely comparing the records kept on two internal systems).
- 5.36. The audit team in fact undertook the testing as described in paragraph 5.35.2 above; namely a reconciliation between two internal systems.
- 5.37. The fact that the CAATs testing for revenue undertaken did not reflect the test described in the audit planning working papers, and did not meet the stated objective, was apparent from numerous working papers on the audit file for FY2016,⁴ some of which are marked as reviewed by Mr Corral⁵.
- 5.38. Mr Corral and the audit team failed to note or correct:
- 5.38.1. The obvious contradictions between the working papers recording the CAATs testing that was actually carried out and the CAATs testing that had been planned; and
- 5.38.2. The inappropriateness and inadequacy of the CAATs testing that was carried out.
- 5.39. Paragraph 9 of ISA 300 requires the auditor to develop an audit plan that shall include a description of the nature, timing and extent of planned further audit procedures at the assertion level.
- 5.40. The description of the CAATs testing in the audit strategy document (setting out the audit plan) incorrectly summarised the proposed work. Accordingly, Mr Corral and Moore Stephens breached paragraph 9 of ISA 300.
- 5.41. Paragraph 8 of ISA 220 requires the engagement partner to take responsibility for the overall quality on each audit engagement to which that partner is assigned.
- 5.42. Paragraph 14 of ISA 220 requires the engagement partner to be satisfied that the engagement team have the appropriate competence and capabilities to perform the audit engagement in accordance with professional standards.
- 5.43. The failures set out above indicate that review procedures were inadequate (paragraph 8 of ISA 220) and/or that reviews were carried out by a team member with insufficient

³ EAUDSTRA Audit strategy and plan.

⁴ Working Paper M000, “Revenue overview”; Working Paper M101, “IT audit substantive testing Index”; Working Paper M102, “Sales substantive testing Phase 1”; Working Paper M103, “Sales substantive testing Phase 2 SA”; Working Paper M104, “Sales substantive testing Phase 2 SO”; Working Paper M105, “Sales substantive testing Phase 3 SA”; Working Paper M105, “Sales substantive testing Phase 3 SO”; Working Paper M1065, “Sales substantive testing – Summary”.

⁵ E.g. Working Paper M1065, “Sales substantive testing – Summary”; Working Paper M102, “Sales substantive testing Phase 1”.

experience (paragraph 14 of ISA 220) because they did not result in the scope of audit work being questioned or corrected.

- 5.44. Paragraph 17 of ISA 220 requires the engagement partner, through a review of the audit documentation and discussion with the engagement team, to be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached.
- 5.45. In light of the foregoing, Moore Stephens and Mr Corral breached paragraphs 8, 14 and 17 of ISA 220.

Adverse Finding 7 – Assessment of going concern

- 5.46. Statutory auditors are required to obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern assumption in the preparation of the financial statements. The going concern assumption is the assumption that a company will remain in business for the foreseeable future.
- 5.47. Moore Stephens and Mr Corral failed to obtain sufficient appropriate audit evidence when assessing LA's continued use of the going concern assumption.
- 5.48. Paragraph 12 of ISA 570 requires that *"the auditor shall evaluate management's assessment of the entity's ability to continue as a going concern"*.
- 5.49. Paragraph 16 of ISA 570 required (so far as material) that:
- "If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include:*
- (a) Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.*
- ...
- (c) Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future action:*
- (i) Evaluating the reliability of the underlying data generated to prepare the forecast; and*
- (ii) Determining whether there is adequate support for the assumptions underlying the forecast. ..."*
- 5.50. Paragraph A15 of ISA 570 provided that relevant audit procedures under paragraph 16 of ISA 570 may include *"analysing and discussing cash flow ... with management"* and/or *"confirming the existence, terms and adequacy of borrowing facilities"*.

5.51. Mr Corrall and the audit team should have concluded that paragraph 16 of ISA 570 required them to obtain sufficient appropriate audit evidence to determine whether or not a “*material uncertainty*” existed, in particular in the light of the following facts and matters:

5.51.1. As at 30 June 2016:

5.51.1.1. LA had utilised £14.9 million of its £15 million overdraft facility, which was repayable on demand.

5.51.1.2. LA held cash balances with a total value of £18.8 million;

5.51.2. A right of set-off existed between the overdraft facility and the cash balances held by LA at its bank (there being insufficient evidence on the audit file that any consideration was given to this, even though the right of set-off was set out on the face of the overdraft facility letter, which was on the audit file); and

5.51.3. It is typical for retail businesses, such as LA, to increase inventory prior to Christmas and, as a result, they have high seasonal demands for cash in autumn to pay suppliers. The audit file for FY2016 acknowledged this seasonality of LA’s trading cash flows.⁶

5.52. However, the audit file for the FY2016 Audit does not include any assessment by management of LA’s ability to continue as a going concern, nor is there any evidence on the audit file that the audit team asked management to produce any going concern assessment or cash flow forecasts or evaluated any such assessment or forecasts (as required by paragraphs 12, 16(a) and (c) of ISA 570).

5.53. In their assessment of going concern, the audit team relied on monthly profit and loss forecasts prepared by management to which they applied certain sensitivities.⁷ These forecasts showed that LA would make a loss if sales fell by more than 5.5%.

5.54. Further, the audit file for FY2016 records⁸ that:

5.54.1. LA’s pro rata sales had fallen 7% in FY2016 as compared with the financial year ended 30 June 2015 (“**FY2015**”);

5.54.2. The budget for FY2016 was stated by the auditor to have been “*very ambitious*”;

⁶ Working Paper H100, “Going concern review” (tab “Cash”): “*Cash is likely to dip towards Oct/Nov due to extra stock bought for the Christmas period and then increase back to a higher level*”.

⁷ Working Paper H100, “Going concern review” (tab “Budget”).

⁸ Working Paper H100, “Going concern review” (tab “Budget”).

- 5.54.3. The auditor considered that it was “*not surprising*” that the targets for FY2016 had not been met; and
- 5.54.4. The forecasts for FY2017 were based on a 7% increase in sales which the auditor stated “*may be slightly ambitious*”.⁹
- 5.55. The audit file for FY2016 does not evidence any analysis of future monthly cash flows.
- 5.56. There is no evidence on the audit file for FY2016 that any consideration was given to LA’s maximum cash requirement for the forthcoming financial year.
- 5.57. The audit file for FY2016 records that cash had been depleted in FY2016 by capital expenditure of £36 million, but states that “*no large capital expenditure [was] planned*” for FY2017.¹⁰ However, it is not sufficiently evidenced on the audit file where the audit team obtained this information from or how it was verified by them. Regardless of what information was obtained or what verification was actually performed, there is a need to document this fully on the audit file.
- 5.58. The audit file for FY2016 also states in relation to the overdraft facility: “*Although they were very close to the limit at period end, they have a good relationship with [REDACTED] and there is no reason to believe this cannot be extended if needed.*”¹¹ However, the auditor did not properly evaluate the potential consequences such as through an analysis of future monthly cash flows.
- 5.59. The audit file for FY2016 also concludes:¹²
- “As can be seen from the above the group has sufficient cash resources to cushion from any unexpected fall in sales/profits.*
- There is enough cash in the group to cover the overdraft facility if it is recalled (although unlikely).*
- If debtors and creditors remain in line with prior years then cash flow will not pose an issue.”*¹³
- 5.60. However, the audit file for FY2016 does not record how or on what basis the audit team reached these conclusions.
- 5.61. In light of the above, Moore Stephens and Mr Corrall failed to obtain sufficient appropriate audit evidence that no material uncertainty existed as to LA’s ability to

⁹ See also Working Paper H100, “Going concern review” (tab “Sales”), which stated that the budgeted increased in sales was “*a little ambitious*”.

¹⁰ Working Paper H100, “Going concern review” (tab “Cash”).

¹¹ Working Paper H100, “Going concern review” (tab “Cash”).

¹² Working Paper H100, “Going concern review” (tab “Cash”).

¹³ See also Working Paper H100, “Going concern review” (tab “Sales), which stated that “*with regard to sales, going concern is not considered to be a major issue*”.

continue as a going concern and their conduct thereby breached paragraphs 12 and 16 of ISA 570.

Adverse Finding 8 – Period of going concern evaluation

- 5.62. LA's annual report for FY2016 contained a viability assessment prepared by management which stated that: *"The principal risks are regularly assessed as to the likely impact on the business over a 3 year period."* However, the audit team's work on going concern only covered a period of 1 year (not 3 years) from the end of FY2016.
- 5.63. Paragraph 13 of ISA 570 requires that: *"In evaluating management's assessment of the entity's ability to continue as a going concern, the auditor shall cover the same period as that used by management to make its assessment."*
- 5.64. Moore Stephens' and Mr Corrall's conduct thereby breached paragraph 13 of ISA 570.

Adverse Finding 9 – Going concern: communication regarding internal controls

- 5.65. Paragraph 9 of ISA 265 requires the auditor to *"communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis"*.
- 5.66. The absence of any going concern assessment by management should have been identified as such by Moore Stephens and Mr Corrall and communicated in writing to LA's audit committee. Moore Stephens and Mr Corrall failed to do this and thereby breached paragraph 9 of ISA 265.

Adverse Finding 10 – Auditor's report to the Audit Committee regarding going concern

- 5.67. The auditor's report to the Audit Committee contained incorrect statements concerning which documents were reviewed by the auditors in their assessment of going concern.
- 5.68. Paragraph 8 of ISA 230 requires the auditor to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing and extent of the audit procedures performed. The auditor's report to the audit committee forms part of the "audit documentation".
- 5.69. The auditor's report to LA's audit committee for FY2016 states: *"As part of our audit work on the Group's ability to trade as a going concern we reviewed budgets, cash*

flows, business plans and the use of provisioning.” However, there is no evidence on the audit file for FY2016 that the audit team reviewed cash flows, business plans or the use of provisioning in their assessment of going concern. The statements to the contrary in the auditor’s report to the audit committee were therefore incorrect.

5.70. Moore Stephens’ and Mr Corrall’s conduct thereby breached paragraph 8 of ISA 230.

Adverse Finding 11 – Quality control in relation to assessment of going concern

5.71. Paragraph 15 of ISA 220 requires that the engagement partner shall take responsibility for the direction, supervision and performance of the audit engagement.

5.72. There is no evidence on the FY2016 Audit file that the working papers relating to going concern were reviewed by Mr Corrall as engagement partner.

5.73. Moore Stephens’ and Mr Corrall’s conduct thereby breached paragraph 15 of ISA 220.

6. PROPOSED SANCTIONS – MOORE STEPHENS

6.1. Paragraph 10 of the FRC’s Sanctions Policy (Audit Enforcement Procedure) (the “**Policy**”) provides that *Sanctions* are intended to be effective, proportionate and dissuasive. The reasons for imposing *Sanctions* are identified in paragraph 11 of the Policy as the following:

6.1.1. to declare and uphold proper standards of conduct amongst Statutory Auditors and Statutory Audit Firms and to maintain and enhance the quality and reliability of future audits;

6.1.2. to maintain and promote public and market confidence in *Statutory Auditors* and *Statutory Audit Firms* and the quality of their audits and in the regulation or the accountancy profession;

6.1.3. to protect the public from *Statutory Auditors* and *Statutory Audit Firms* whose conduct has fallen short of the *Relevant Requirements*; and

6.1.4. to deter *Statutory Auditors* and *Statutory Audit Firms* from breaching the *Relevant Requirements* relating to *Statutory Audit*.

6.2. Paragraph 12 of the Policy provides that the primary purpose of imposing Sanctions for breaches of the *Relevant Requirements* is not to punish, but to protect the public and the wider public interest.

- 6.3. Executive Counsel proposes the following *Sanctions* against Moore Stephens:
- 6.3.1. a financial penalty of £825,000 adjusted for aggravating and mitigating factors (in particular reflecting an exceptional level of co-operation) by a reduction of 15%, and further discounted for admissions and early disposal by 35% so that the financial penalty payable is £455,813. The financial penalty shall be paid no later than 28 days after the date of this *Decision Notice*;
 - 6.3.2. a published statement in the form of a severe reprimand, requiring Moore Stephens to cease or abstain from repetition of the conduct giving rise to the breaches of *Relevant Requirements* detailed in this *Decision Notice*;
 - 6.3.3. a declaration that the FY2016 Audit report signed on behalf of Moore Stephens did not satisfy the *Relevant Requirements*, as set out in this *Decision Notice*;
 - 6.3.4. In determining the *Sanctions* to be imposed on Moore Stephens, Executive Counsel has noted that in response to the identified failings in the FY2016 Audit, Moore Stephens took the remedial steps set out at paragraphs 2.6.5 to 2.6.12 above, and in those circumstances no further firm-wide non-financial sanctions will be required.
- 6.4. In reaching this decision, Executive Counsel has, in summary, considered the following matters in accordance with the Policy.

Nature, seriousness, gravity and duration of the breaches

- 6.5. As a result of the breaches of *Relevant Requirements*, the FY2016 Audit failed in its principal objective, namely to obtain reasonable assurance about whether the FY2016 financial statements as a whole were free from material misstatement.
- 6.6. The audit areas relevant to the breaches (revenue, materiality and going concern) are fundamental to statutory audits and it is of the utmost importance that they are audited in accordance with *Relevant Requirements*.
- 6.7. The breaches of *Relevant Requirements*:
- 6.7.1. were serious, and numerous.
 - 6.7.2. were pervasive throughout the audit; for example the setting of materiality at three times the appropriate level.
 - 6.7.3. relate only to one audit year.
- 6.8. Whilst it is not alleged that the FY2016 financial statements were in fact misstated, in aggregate the breaches:

- 6.8.1. adversely affected, or potentially adversely affected, a significant number of people in the United Kingdom (such as the public, investors or other market users), and could have harmed investor, market and public confidence in the truth and fairness of the financial statements published by *Statutory Auditors* or *Statutory Audit Firms*. LA's shares are listed on the main market of the London Stock Exchange.
- 6.8.2. undermine confidence in the standards of conduct in general of *Statutory Auditors* and *Statutory Audit Firms*, and/or in *Statutory Audit*.
- 6.9. Executive Counsel considers it likely that the same type of breach will occur, absent remedial action.
- 6.10. Moore Stephens is not a large audit firm. Its UK fee income as of December 2018 was £120 million and its audit fee income was £24 million. It has 88 partners.
- 6.11. The breaches were neither intentional, dishonest, deliberate nor reckless.
- 6.12. The *Adverse Findings* indicate that the internal review and quality procedures applied at Moore Stephens were ineffective.
- 6.13. Once Moore Stephens' management became aware of the possibility of breaches of *Relevant Requirements*, a Root Cause Analysis was conducted, which was subsequently provided to Executive Counsel on a voluntary basis.

Identification of *Sanction*

- 6.14. Having assessed the nature, seriousness, gravity and duration of the breaches, Executive Counsel has identified the following combination of *Sanctions* as appropriate:
- 6.14.1. a financial penalty of £825,000;
- 6.14.2. a published statement in the form of a severe reprimand, requiring Moore Stephens to cease or abstain from repetition of the conduct giving rise to the breaches of *Relevant Requirements* detailed in this *Decision Notice*;
- 6.14.3. a declaration that the FY2016 Audit report signed on behalf of Moore Stephens did not satisfy the *Relevant Requirements*, as set out in this *Decision Notice*; and
- 6.14.4. In determining the *Sanctions* to be imposed on Moore Stephens, Executive Counsel has noted that in response to the identified failings in the FY2016 Audit, Moore Stephens took the remedial steps set out at paragraphs 2.6.5 to

2.6.12 above, and in those circumstances no further firm-wide non-financial sanctions will be required.

6.15. Executive Counsel has then taken into account any aggravating and mitigating factors that exist (to the extent that they have not already been taken into account in relation to the nature, seriousness, gravity and duration of the breaches).

Aggravating factors

6.16. There are no aggravating factors that have not already been considered in the context of the seriousness of the breaches.

Mitigating factors

6.17. Moore Stephens provided an exceptional level of co-operation during the investigation of the breaches by Executive Counsel in that they:

6.17.1. conducted a full and frank Root Cause Analysis as to how the breaches of *Relevant Requirements* had occurred and self-reported the breaches of *Relevant Requirements* by sharing that document on a voluntary basis (without restriction) with Executive Counsel. As paragraph 69 of the Policy explains:

“In order for cooperation to be considered as a mitigating factor at the point of determining appropriate sanction it will therefore be necessary for the Statutory Auditors and Statutory Audit Firms to have provided an exceptional level of cooperation. Non-exhaustive examples of conduct which may constitute such cooperation include: a) self-reporting to the FRC and/or bringing to the attention of the FRC any facts and/or matters which may constitute an allegation of a breach of the Relevant Requirements...”

6.17.2. dealt timeously, properly and fully with all requests for information made on behalf of Executive Counsel.

6.18. Moore Stephens did not stand to gain any profit or benefit, beyond the fee chargeable for the FY2016 Audit, from the breach of the *Relevant Requirements*.

6.19. In light of the mitigating factors, Executive Counsel considers that a discount to the financial penalty of 15% is appropriate.

Deterrence

6.20. Having considered the matters set out at paragraphs 72 and 73 of the Policy, Executive Counsel considers that no adjustment for deterrence is required in this case.

Discount for Admissions and Settlement

6.21. Having taken into account the full admissions by Moore Stephens and the stage at which those admissions were made (at an early point within Stage 1 of the case in accordance with paragraph 84 of the Policy), Executive Counsel determined that a reduction of 35% as to the financial penalty is appropriate, such that a financial penalty of £455,813 is payable.

Other considerations

6.22. In accordance with paragraph 47(c) of the Policy, Executive Counsel has taken into account the size / financial resources and financial strength of Moore Stephens and the effect of a financial penalty on its business. and whether any financial penalty would be covered by insurance.

7. PROPOSED SANCTIONS – MR CORRALL

7.1. Executive Counsel proposes the following *Sanctions* against Mr Corrall:

- 7.1.1. A financial penalty of £110,000 adjusted for aggravating and mitigating factors (in particular reflecting an exceptional level of co-operation) by a reduction of 15%, and further discounted for admissions and early disposal by 35% so that the financial penalty payable is £60,775. The financial penalty shall be paid no later than 28 days after the date of this *Decision Notice*;
- 7.1.2. a declaration that the FY2016 Audit report signed by Mr Corrall did not satisfy the Relevant Requirements, as set out in this *Decision Notice*;
- 7.1.3. a condition that Mr Corrall shall not act as *Statutory Auditor of a Public Interest Entity* nor sign a *Statutory Audit Report* in respect of a *Public Interest Entity* until:
 - (a) A period of 18 months has elapsed from the date of the *Decision Notice*;
 - (b) He has been re-approved to conduct such *Statutory Audits*, and to sign such *Statutory Audit Reports*, by his employer's Audit Compliance Principal; and
 - (c) He has completed training in relation to the application of ISAs 220, 320 and 570.

7.2. In reaching this decision, Executive Counsel has, in summary, considered the following stages and taken account of the following factors in accordance with the Policy.

Nature, seriousness, gravity and duration of the breaches

7.3. As a result of the breaches of *Relevant Requirements*, the FY2016 Audit failed in its principal objective, namely to obtain reasonable assurance about whether the financial statements as a whole were free from material misstatement.

7.4. The audit areas relevant to the breaches (revenue, materiality and going concern) are fundamental to the FY2016 Audit and it is of the utmost importance that they are audited in accordance with *Relevant Requirements*.

7.5. The breaches of *Relevant Requirements*:

7.5.1. were serious, and numerous.

7.5.2. were pervasive throughout the audit; for example the setting of materiality at three times the appropriate level.

7.5.3. relate only to one audit year.

7.6. Whilst it is not alleged that the FY2016 financial statements were misstated, in aggregate the breaches:

7.6.1. adversely affected, or potentially adversely affected, a significant number of people in the United Kingdom (such as the public, investors or other market users), and could have harmed investor, market and public confidence in the truth and fairness of the financial statements the financial statements published by *Statutory Auditors* or *Statutory Audit Firms*. LA's shares are listed on the main market of the London Stock Exchange.

7.6.2. undermine confidence in the standards of conduct in general of *Statutory Auditors* and *Statutory Audit Firms*, and/or in *Statutory Audit*.

7.7. Executive Counsel considers it likely that the same type of breach will occur, absent remedial action.

7.8. The breaches were neither intentional, dishonest, deliberate nor reckless.

Identification of *Sanction*

7.9. Having assessed the nature, seriousness, gravity and duration of the breaches, Executive Counsel has identified the following combination of *Sanctions* as appropriate:

7.9.1. a financial penalty of £110,000;

- 7.9.2. a declaration that the FY2016 Audit report signed by Mr Corrall did not satisfy the *Relevant Requirements*, as set out in this *Decision Notice*;
- 7.9.3. a condition that Mr Corrall shall not act as Senior Statutory Auditor of a *Public Interest Entity* nor sign a statutory audit report in respect of a *Public Interest Entity* until:
- (a) A period of 18 months has elapsed from the date of the Decision Notice;
 - (b) He has been re-approved to conduct such *Statutory Audits*, and to sign such Statutory Audit Reports by his employer's Audit Compliance Principal; and
 - (c) He has completed training in relation to the application of ISAs 220, 320 and 570.

7.10. Executive Counsel has then taken into account any aggravating and mitigating factors that exist (to the extent that they have not already been taken into account in relation to the seriousness of the breaches), and the fact that Mr Corrall has already received a monetary penalty imposed by Moore Stephens.

Aggravating factors

7.11. There are no aggravating factors that have not already been considered in the context of the seriousness of the breaches.

Mitigating factors

7.12. Mr Corrall did not stand to gain any profit or benefit from the breaches of the *Relevant Requirements* (save to the extent that he had an interest in Moore Stephens being paid engagement fees for the FY2016 Audit).

7.13. Mr Corrall has no previous adverse compliance or disciplinary record.

7.14. Mr Corrall (through Moore Stephens) provided an exceptional level of co-operation during the investigation of the breaches by Executive Counsel in that:

- 7.14.1. a full and frank Root Cause Analysis was conducted (with which Mr Corrall complied) as to how the breaches of *Relevant Requirements* had occurred and the breaches of *Relevant Requirements* were self-reported by sharing that document on a voluntary basis (without restriction) with Executive Counsel. As paragraph 69 of the Policy explains:

"In order for cooperation to be considered as a mitigating factor at the point of determining appropriate sanction it will therefore be necessary for the Statutory Auditors and Statutory Audit Firms to have provided an

exceptional level of cooperation. Non-exhaustive examples of conduct which may constitute such cooperation include: a) self-reporting to the FRC and/or bringing to the attention of the FRC any facts and/or matters which may constitute an allegation of a breach of the Relevant Requirements...

7.14.2. all requests for information made on behalf of Executive Counsel were dealt with timeously, properly and fully.

7.15. In light of the mitigating factors, Executive Counsel considers that a discount to the financial penalty of 15% is appropriate.

Deterrence

7.16. Having considered the matters set out at paragraphs 72 and 73 of the Policy, Executive Counsel considers that no adjustment for deterrence is required in this case.

Discount for Admissions and Settlement

7.17. Having taken into account the full admissions by Mr Corral and the stage at which those admissions were made (at an early point within Stage 1 of the case in accordance with paragraph 84 of the Policy), Executive Counsel determined that a reduction of 35% as to the financial penalty is appropriate, such that a financial penalty of £60,775 is payable.

Other considerations

7.18. In accordance with paragraph 47(d) of the Policy, Executive Counsel has taken into account the financial resources and annual income of Mr Corral, the effect of a financial penalty on Mr Corral and his future employment, and whether he is insured as to any financial penalty.

8. COSTS

8.1. Executive Counsel proposes that the Respondents pay her costs in full in this matter, being £86,500. Such costs shall be paid no later than 28 days after the date of this *Decision Notice*.

Signed:



**CLAUDIA MORTIMORE
DEPUTY EXECUTIVE COUNSEL**

Date: 29 March 2019

APPENDIX 1 – EXTRACTS OF RELEVANT REQUIREMENTS

Extracts from ISAs

1. ISA 200: Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing

1.1. Paragraph 14 states as follows:

“The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements.”

2. ISA 220: Quality Control for an Audit of Financial Statements

2.1. Paragraph 8 states as follows:

“The engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned.”

2.2. Paragraph 14 states as follows:

“The engagement partner shall be satisfied that the engagement team, and any auditor’s experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to:

(a) Perform the audit engagement in accordance with professional standards and applicable legal and regulatory requirements; and

(b) Enable an auditor’s report that is appropriate in the circumstances to be issued.”

2.3. Paragraph 15 states as follows:

“The engagement partner shall take responsibility for:

(a) The direction, supervision and performance of the audit engagement in compliance with professional standards and applicable legal and regulatory requirements; and

(b) The auditor’s report being appropriate in the circumstances.”

2.4. Paragraph 17 states as follows:

“On or before the date of the auditor’s report, the engagement partner shall, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has

been obtained to support the conclusions reached and for the auditor's report to be issued."

3. ISA 230: Audit Documentation

3.1. Paragraph 8 states as follows:

"The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

(a) The nature, timing and extent of the audit procedures performed to comply with the ISAs (UK and Ireland) and applicable legal and regulatory requirements;

(b) The results of the audit procedures performed, and the audit evidence obtained; and

(c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions."

4. ISA 265: Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

4.1. Paragraph 9 states as follows:

"The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis."

5. ISA 300: Planning an Audit of Financial Statements

5.1. Paragraph 9 states as follows:

"The auditor shall develop an audit plan that shall include a description of:

(a) The nature, timing and extent of planned risk assessment procedures, as determined under ISA (UK and Ireland) 315.

(b) The nature, timing and extent of planned further audit procedures at the assertion level, as determined under ISA (UK and Ireland) 330.

(c) Other planned audit procedures that are required to be carried out so that the engagement complies with ISAs (UK and Ireland).

6. ISA 320: Materiality in Planning and Performing an Audit

6.1. Paragraph 10 states as follows:

“When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.”

6.2. Paragraph A1 states as follows:

“In conducting an audit of financial statements, the overall objectives of the auditor are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and to report on the financial statements, and communicate as required by the ISAs (UK and Ireland), in accordance with the auditor’s findings. The auditor obtains reasonable assurance by obtaining sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk. Materiality and audit risk are considered throughout the audit, in particular, when:

- (a) Identifying and assessing the risks of material misstatement;*
- (b) Determining the nature, timing and extent of further audit procedures; and*
- (c) Evaluating the effect of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor’s report.”*

6.3. Paragraph A3 states as follows:

“Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

- *The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);*
- *Whether there are items on which the attention of the users of the particular entity’s financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);*
- *The nature of the entity, where the entity is in its life cycle, and the industry and economic environment in which the entity operates;*
- *The entity’s ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity’s earnings); and*
- *The relative volatility of the benchmark.”*

6.4. Paragraph A4 states as follows:

“Examples of benchmarks that may be appropriate, depending on the circumstances of the entity, include categories of reported income such as profit before tax, total revenue, gross profit and total expenses, total equity or net asset value. Profit before tax from continuing operations is often used for profit-oriented entities. When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues.”

6.5. Paragraph A5 states as follows:

“In relation to the chosen benchmark, relevant financial data ordinarily includes prior periods’ financial results and financial positions, the period-to-date financial results and financial position, and budgets or forecasts for the current period, adjusted for significant changes in the circumstances of the entity (for example, a significant business acquisition) and relevant changes of conditions

in the industry or economic environment in which the entity operates. For example, when, as a starting point, materiality for the financial statements as a whole is determined for a particular entity based on a percentage of profit before tax from continuing operations, circumstances that give rise to an exceptional decrease or increase in such profit may lead the auditor to conclude that materiality for the financial statements as a whole is more appropriately determined using a normalized profit before tax from continuing operations figure based on past results.”

6.6. Paragraph A6 states as follows:

“Materiality relates to the financial statements on which the auditor is reporting. Where the financial statements are prepared for a financial reporting period of more or less than twelve months, such as may be the case for a new entity or a change in the financial reporting period, materiality relates to the financial statements prepared for that financial reporting period.”

6.7. Paragraph A8 states as follows:

“Determining a percentage to be applied to a chosen benchmark involves the exercise of professional judgment. There is a relationship between the percentage and the chosen benchmark, such that a percentage applied to profit before tax from continuing operations will normally be higher than a percentage applied to total revenue. For example, the auditor may consider five percent of profit before tax from continuing operations to be ISA (UK and Ireland) 320 appropriate for a profit-oriented entity in a manufacturing industry, while the auditor may consider one percent of total revenue or total expenses to be appropriate for a not-for profit entity. Higher or lower percentages, however, may be deemed appropriate in the circumstances.”

7. ISA 500: Audit Evidence

7.1. Paragraph 5(c) states as follows:

“Audit evidence – Information used by the auditor in arriving at the conclusions on which the auditor’s opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and information obtained from other sources.”

7.2. Paragraph 6 states as follows:

“The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.”

8. ISA 570: Going Concern

8.1. Paragraph 12 states as follows:

“The auditor shall evaluate management’s assessment of the entity’s ability to continue as a going concern.”

8.2. Paragraph 13 states as follows:

“In evaluating management’s assessment of the entity’s ability to continue as a going concern, the auditor shall cover the same period as that used by management to make its assessment as required by the applicable financial reporting framework, or by law or regulation if it specifies a longer period. If management’s assessment of the entity’s ability to continue as a going concern covers less than twelve months from the date of the financial statements as defined in ISA 560, the auditor shall request management to extend its assessment period to at least twelve months from that date.”

8.3. Paragraph 16 states as follows:

“If events or conditions have been identified that may cast significant doubt on the entity’s ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include:

(a) Where management has not yet performed an assessment of the entity’s ability to continue as a going concern, requesting management to make its assessment.

(b) Evaluating management’s plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management’s plans are feasible in the circumstances.

(c) Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future action:

(i) Evaluating the reliability of the underlying data generated to prepare the forecast; and

(ii) Determining whether there is adequate support for the assumptions underlying the forecast.

(d) Considering whether any additional facts or information have become available since the date on which management made its assessment.

(e) Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future action and the feasibility of these plans.”

8.4. Paragraph A15 states as follows:

“Audit procedures that are relevant to the requirement in paragraph 16 may include the following:

- Analyzing and discussing cash flow, profit and other relevant forecasts with management.*
- Analyzing and discussing the entity's latest available interim financial statements.*
- Reading the terms of debentures and loan agreements and determining whether any have been breached.*
- Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties.*
- Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications.*
- Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds.*
- Evaluating the entity's plans to deal with unfilled customer orders.*

- *Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern.*
- *Confirming the existence, terms and adequacy of borrowing facilities.*
- *Obtaining and reviewing reports of regulatory actions.*
- *Determining the adequacy of support for any planned disposals of assets."*

9. ISA 700: Forming an Opinion and Reporting on Financial Statements

9.1. Paragraph 19A states as follows:

"In the case of entities that are required, and those that choose voluntarily, to report on how they have applied the UK Corporate Governance Code, or to explain why they have not, the auditor's report shall:

(a) Describe those assessed risks of material misstatement that were identified by the auditor and which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team;

(b) Provide an explanation of how the auditor applied the concept of materiality in planning and performing the audit. Such explanation shall specify the threshold used by the auditor as being materiality for the financial statements as a whole; and

(c) Provide an overview of the scope of the audit, including an explanation of how such scope addressed the assessed risks of material misstatement disclosed in accordance with (a) and was influenced by the auditor's application of materiality disclosed in accordance with (b)."

9.2. Paragraph A13B states as follows:

"The explanation, of how the auditor applied the concept of materiality in planning and performing the audit, is tailored to the particular circumstances and complexity of the audit and, in addition to specifying the threshold used by the auditor as being materiality for the financial statements as a whole, might include, for example:

- *Materiality level or levels for those classes of transactions, account balances or disclosures where such materiality levels are lower than materiality for the financial statements as a whole (as described in paragraph 10 of ISA (UK and Ireland) 320).*
- *Performance materiality (as described in paragraph 11 of ISA (UK and Ireland) 320).*
- *Any significant revisions of materiality thresholds that were made as the audit progressed.*
- *The threshold used for reporting unadjusted differences to the audit committee.*
- *Significant qualitative considerations relating to the auditor's evaluation of materiality."*

Extracts from the ACCA Rulebook (2016)

10. Section 130 of the ACCA Rulebook states as follows:

"130.1 The principle of professional competence and due care imposes the following obligations on all professional accountants:

(a) To maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service; and

(b) To act diligently in accordance with applicable technical and professional standards when providing professional services.

130.2 Competent professional service requires the exercise of sound judgment in applying professional knowledge and skill in the performance of such service. Professional competence may be divided into two separate phases:

(a) Attainment of professional competence; and

(b) Maintenance of professional competence.

130.3 The maintenance of professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments. Continuing professional development enables a professional accountant to develop and maintain the capabilities to perform competently within the professional environment.

130.4 Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis.

130.5 A professional accountant shall take reasonable steps to ensure that those working under the professional accountant's authority in a professional capacity have appropriate training and supervision.

130.6 Where appropriate, a professional accountant shall make clients, employers or other users of the accountant's professional services aware of the limitations inherent in the services."