

ACCOUNTANCY AND ACTUARIAL DISCIPLINE BOARD
IN THE MATTER OF ROLLO McCLURE FCA
and
McCLURE WATTERS CHARTERED ACCOUNTANTS
and
EMERGING BUSINESS TRUST LIMITED
and
EMERGING BUSINESS TRUST VENTURE FUND LIMITED

1. On the 17th December 2008 a Disciplinary Tribunal appointed under paragraph 8(1) of the Accountancy and Actuarial Discipline Board Scheme met to hear complaints made by Mr Cameron Scott, as Executive Counsel of the Accountancy and Actuarial Discipline Board ("AADB"), against Mr Rollo McClure FCA and McClure Watters Chartered Accountants who were, at all material times, respectively, a Member and Member Firm of the Institute of Chartered Accountants in Ireland ("ICAI")
2. The Tribunal was also asked to consider an agreement, under what is known as the "Carecraft procedure", between the Executive Counsel and Mr McClure on his own behalf and Mr David Watters, now the senior partner of McClure Watters, on behalf of McClure Watters.
3. The members of the Tribunal were Mr D Anthony Evans Q.C. (Chairman), Mr Richard Kennett FCA and Mrs Ann Wilks CBE. The Secretary to the Tribunal was Mr Jason Mansell, Barrister.

- 4 At the hearing Mr Philip Henry of Counsel appeared on behalf of the Executive
Counsel. Mr McClure and the firm were not legally represented at the hearing but
both Mr McClure and Mr Watters confirmed that they had had the opportunity to
take legal advice and had done so.
- 5 At the hearing we were helpfully provided with a Chronology setting out the
important and relevant dates starting with the "Commencement of the
investigation on the 13th July 2006" and concluding on 27th November 2008 when
the Complaints, Statement of Facts and the Agreement were ratified by McClure
Watters and Mr McClure (Annex A).
- 6 The ratified complaints made against both Mr McClure and the firm are set out in
Annex B hereto. Complaint 1 relates to the audits of Emerging Business Trust
Ltd ("EBT") for the year ended 30th September 1998 to the year ended 30th
September 2002. Mr McClure was the partner in McClure Watters responsible
for the audits and under the provisions of paragraph 3(3) of the AADB Scheme
his acts and omissions are taken to have been the acts and omissions of McClure
Watters. Complaint 2 relates to the audit of Emerging Business Trust Venture
Fund ("EBTVF") for the year ended 30th September 2001.
- 7 The gravamen of the complaint in relation to each audit of E.B.T. was that Mr
McClure failed to ensure that concerns raised over specific and significant
doubtful debts were resolved, failed to ensure that sufficient appropriate audit
evidence was obtained to support the conclusion that debtors were not materially
misstated and that appropriate allowance had been made for bad and doubtful

debts. He had placed great reliance on representations made by Mrs Theresa Townsley, a Director of EBT, a chartered accountant by profession, a partner in MTF Chartered Accountants ("MTF") and someone who has been Vice Chair and a Director of the Local Enterprise Development Unit ("LEDU"), and a Minister to the Strategy Review Steering Group. She had been appointed to the Shadow Board of Investment Northern Ireland and was Honorary Treasurer of Queen's University Belfast. She was someone of high repute in Northern Ireland and someone from whom one would expect to receive accurate and truthful information if asked for it. Mr McClure placed great reliance on the representations made by Mrs Townsley to support the appropriateness of the bad and doubtful debt provision but these were inadequate in that they were from an internal source, they were predominantly oral and Mrs Townsley had a vested interest in minimizing bad debts because of her position as a partner in MTF. They also frequently proved to be untrue. Furthermore he failed to investigate the circumstances where other audit evidence contradicted representations provided by Mrs Townsley as to the recoverability of doubtful debts and whether that affected the reliability of representations made by Mrs Townsley. He also failed to obtain additional reliable evidence to support the recoverability of identified doubtful debts. Mr McClure also failed to ensure that the audits of EBT's accounts for the years ended 30th September 1998, 1999, 2000, 2001 and 2002 complied with Auditing Standard SAS 420 in that he failed to ensure that sufficient reliable evidence was obtained to demonstrate that the provision for bad and doubtful debts was reasonable in the circumstances and consistent with other

audit evidence, failed to compare the provisions for bad and doubtful debts with actual results in later periods and failed to obtain confirmation of the status and progress of loan debtors being pursued by EBT's solicitors. He also failed to comply with Auditing Standard SAS 440 in that he failed to obtain signed management representation letters for the audit of EBT's accounts for the years ended 30th September 1998, 1999, 2000 and 2002. The final part of Complaint 1 covered Mr McClure's failure to ensure that the audits of EBT's accounts for the years ended 30th September 2001 and 30th September 2002 complied with Auditing Standard SAS 460 in that he failed to ensure that the accounts disclosed transactions with known related parties. He knew that Mr Michael Townsley, the husband of Mrs Theresa Townsley, was a director of and had a 10% shareholding in Arcom Multimedia Limited and he knew that EBT had made a loan to that company. Knowing the circumstances he failed to ensure that the related party transaction was disclosed in the financial statements.

- 8 The gravamen of the complaint in relation to the 2007 audit of EBTVF, the second complaint, is that Mr McClure failed to ensure that the audit complied with Auditing Standard SAS 460. He failed to ensure that the accounts disclosed transactions with known related parties, in that knowing that on about the 11th December 2000 EBTVF purchased 2565 ordinary shares for £50,000 and £20,000 in preference shares in Arcom Multimedia Limited, and knowing that Mr Michael Townsley, the husband of Mrs Theresa Townsley, was a director of and held a 10% share holding in Arcom Multimedia Limited, he failed to ensure that the related party transaction was disclosed in the financial statements of EBTVF. He

also knew that on about the 14th September 2001, EBTVF purchased 2500 ordinary shares and 22,500 preference shares in Fusion Antibodies Limited, and, knowing that Mr Michael Townsley was a director of and held a 50% shareholding in Fusion Antibodies Limited, failed to ensure that the related party transaction was disclosed in the financial statements of EBTVF.

- 9 The complaints were admitted by both Mr McClure and by Mr David Watters on behalf of McClure Watters.
- 10 Mr McClure and Mr Watters on behalf of McClure Watters admitted all the facts in the Statement of Facts (Annex C).
- 11 EBT was a publicly funded body. It was set up in 1996 to provide loan capital to small businesses in Northern Ireland as part of the reconstruction efforts in that province.
- 12 It originated in a loan fund operated by the International Fund for Ireland (IFI) whose objective was to provide finance for new business starts in disadvantaged areas and to individuals who had difficulty in obtaining access to finance. It was providing finance to bodies and individuals who would not otherwise be able to obtain it.
- 13 In 1996 IFI invited a number of organizations, one of which was MTF, to tender for the establishment of an independent and not-for-profit organization to take over the fund operated by IFI. EBT was the result of the process and MTF was appointed lead manager of that fund.

- 14 In 2002 Invest Northern Ireland (INI) and its successor body raised concerns as to the operation of the fund and in 2003 Pricewaterhouse Coopers (PWC) began an investigation into the establishment and operation of the EBT loan and the EBTVF.
- 15 EBT voluntarily ceased trading in 2005 and a liquidator was appointed by creditors to wind up the affairs of both funds.
- 16 PWC published its report on the 4th November 2005. They raised a number of issues including EBT's treatment of bad debts but they did not investigate the role of McClure Watters as auditors of EBT.
- 17 On the 10th May 2006 the House of Commons Public Accounts Committee produced a report on the matter and considered the issues raised so serious that a copy of the report was sent to the ICAI for that body's consideration. On the 26th June 2006 the case was referred to the AADB and an investigation by the AADB began on the 13th July 2006.
- 18 The investigation concentrated particularly on the audits of the bad debt provisions. The audit files were reviewed and Mr McClure, the audit partner, and staff were interviewed. In the course of the interviews Mr McClure accepted that aspects of his work during the audits of EBT in the years 1998 to 2000 and in respect of the audit of EBTVF in 2001 fell short of the standards reasonably to be expected of a member of the ICAI in the normal conduct of his profession.

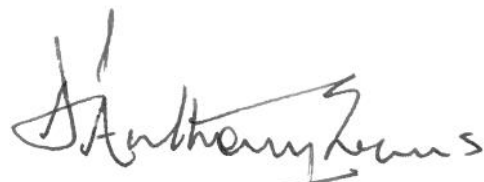
- 19 Mr McClure and the audit team had relied very heavily on what had been told to them by Mrs Townsley and were undoubtedly let down by someone whom they thought, and had reason to believe, they could trust.
- 20 A company such as EBT, providing financial assistance to smaller businesses, many of which were at an early stage of their business life-cycle, and many of which did not have recourse to traditional sources of funding is very clearly providing risk capital.
- 21 As such the directors had an important duty to ensure that the company's accounting policies were suitable for this business and complied with Financial Reporting Standards.
- 22 This duty could be seen to extend to other key stakeholders who were involved with the formation of EBT, such as IFI and LEDU, which provided the funding for EBT and which could and probably should have taken a proprietary interest in EBT as it was their funds being lent.
- 23 The list of directors of EBT demonstrates that collectively they had enough professional ability and experience to have been able to choose suitable accounting policies at the outset and they should have done so.
- 24 The auditors should have considered the accounting policies in their first year of office and discussed them with the directors. If the auditors felt the accounting policies were not appropriate they should have said so formally to the board as a whole. If the auditors felt that by using inappropriate accounting policies the

accounts did not present a "true and fair" view they should have qualified their Audit Opinion accordingly.

- 25 Whilst it is fair to say that the auditors failed it is abundantly clear that the directors also failed. Indeed their culpability is probably greater than that of the auditors. One must question the suitability of the directors, or at least some of them, to be directors of a company particularly one that is dependent on public funds. They will, no doubt, consider their position.
- 26 Furthermore the evidence suggests that when the auditors expressed some concerns on particular debts they were deceived and browbeaten by the administrators and managers of the EBT loan fund scheme, MTF Chartered Accountants. The dual responsibility of Mrs Townsley as a director of EBT and also as a partner in MTF, who were administering the loan portfolio, meant that she was both the lead contractor for a key service and a member of the board of directors responsible for reviewing the adequacy of that service. This was a conflict of interest and might have added to difficulties the auditors faced in relation to the treatment of bad or doubtful debts. It seems most surprising that Mrs Townsley should have held office as a director of EBT and EBTVF when her position as a partner of MTF, the manager of the funds, was such a clear and obvious conflict of interest and possibly unethical for a regulated professional such as a Chartered Accountant. The other stakeholders involved with EBT and EBTVF would also appear to have been remiss in allowing this.

- 27 Following the admission by Mr McClure draft statements of facts were sent to both McClure Watters and to Mr McClure. There was an immediate acceptance by Mr McClure of his culpability. Various revised draft statements of facts were sent over a period of time and on the 17th October 2008 the final complaints and the final statements of facts were sent to both McClure Watters and to Mr McClure.
- 28 The final complaints and statements of facts were signed by the Executive Counsel, by Mr Watters on behalf of Messrs McClure Watters and by Mr McClure on the 27th November 2008 (Annexes B and C).
- 29 A further Amendment to the Statement of Facts was agreed between the parties and provided to us at the hearing of the Tribunal on the 17th December 2008 (Annex D).
- 30 Because of the immediate acceptance by Mr McClure of his culpability there was an agreement in principle that the matter could be dealt with by way of the "Carecraft" procedure. (In re Carecraft Construction Co. Ltd (1994) 1 W.L.R. 172.)
- 31 A "Carecraft" Agreement was signed by the Executive Counsel on behalf of the AADB, by Mr Watters on behalf of McClure Watters and by Mrs McClure on the 27th November 2008. (Annex E).
- 32 As part of the agreement Mr McClure and McClure Watters admit the Complaints and all the facts in the Statement of Facts (Annex C).


- 33 There was no admission in the "Carecraft" Agreement as to the facts in the Amendment to the Statement of Facts (Annex D) produced at the hearing on the 17th December 2008. Those facts were, however, admitted orally at the hearing, the Amendments were to the benefit of McClure Watters and Mr McClure and we consider them to be part of the agreement.
- 34 Under the "Carecraft" agreement it was proposed, subject to the acceptance of the Disciplinary Tribunal that Mr Rollo McClure be fined a total of £6000 and be reprimanded, that McClure Watters be fined a total of £6000 and that the costs of £60,000 in total be paid to the AADB by Mr Rollo McClure and McClure Watters.
- 35 We are all quite satisfied that it is appropriate to use the "Carecraft" procedure in this matter and we are all satisfied that the terms of the agreement are appropriate and should be approved by us. We do approve them.



D. ANTHONY EVANS Q.C.
CHAIRMAN



RICHARD KENNETT FCA



ANN WILKS C.B.E.

Accountancy and Actuarial Discipline Board

In the matter of

Rollo McClure FCA

And

McClure Watters Chartered Accountants

Chronology

Date	Event
13 th July 2006	Commencement of investigation
2 nd July 2007	Interview of Rollo McClure and audit team
7 th January 2008	Draft statement of facts sent to McClure Watters and Rollo McClure
23 rd May 2008	Agreement in principle to deal with matter by way of Carcraft procedure
8 th July 2008	Draft Complaints, Statement of Facts and Agreement sent to McClure Watters
29 th August 2008	Revised draft Complaints, Statement of Facts and Agreement sent to McClure Watters and Rollo McClure
3 rd September 2008	Further revised draft Complaints, Statement of Facts and Agreement sent to McClure Watters and Rollo McClure
17 th October 2008	Final draft Complaints, Statement of Facts and Agreement sent to McClure Watters and Rollo McClure
24 th November 2008	Complaints, Statement of Facts and Agreement agreed and signed in escrow pending ratification by McClure Watters partners
27 th November 2008	Complaints, Statement of Facts and Agreement ratified by McClure Watters Partners

Annex B

Accountancy & Actuarial Discipline Board

**Annex A to the Agreement between Cameron Scott,
Mr. Rollo McClure FCA and McClure Watters Chartered Accountants
dated the 27th day of November 2008**

Complaints in respect of

Mr. Rollo McClure FCA

and

McClure Watters Chartered Accountants

COMPLAINTS against ROLLO McCLURE, and McCLURE WATTERS at all material times respectively a Member and Member Firm of the Institute of Chartered Accountants in Ireland ("ICAI").

COMPLAINT 1

- A. In performing the audits of Emerging Business Trust Ltd ("EBT") for the years ended 30 September 1998 to 30 September 2002 inclusive, the work performed by Rollo McClure fell short of the standards reasonably to be expected of a Member in the normal conduct of his profession in the following respects:
- B. Under the provisions of paragraph 3(3) of the AADB Scheme, the acts and omissions of Rollo McClure are taken to have been the acts and omissions of McClure Watters . Therefore, in performing the audits of EBT for the years ended 30 September 1998 to 30 September 2002 inclusive, the work performed by McClure Watters fell short of the standards reasonably to be expected of a Member Firm in the normal conduct of its profession in the following respects:

PARTICULARS OF COMPLAINT

By failing to carry out the 1998, 1999, 2000, 2001 and 2002 audits of EBT with due skill, care, diligence and expedition and with proper regard for the technical and professional standards expected of them as a Member and as a Member Firm, Rollo McClure and McClure Watters breached Fundamental Principle 4 of the Institute of Chartered Accountants in Ireland's (ICAI) Guide to Professional Ethics which requires Members and Member Firms to carry out their professional work with due skill, care, diligence and expedition and with proper regard for the technical and professional standards expected of them.

In particular, Rollo McClure:

1. failed to ensure that the audits of EBT's accounts for the years ended 30 September 1998, 1999, 2000, 2001 and 2002 complied with Auditing Standard SAS 240 'Quality Control', in that he failed to ensure that concerns raised over specific and significant doubtful debts were appropriately resolved.
2. failed to ensure that the audits of EBT's accounts for the year ended 30 September 1998, 1999, 2000, 2001 and 2002 complied with Auditing Standard SAS 400 'Audit Evidence', in that he failed to ensure that sufficient appropriate audit evidence was obtained to support the conclusion that debtors were not materially misstated and that appropriate allowance had been made for bad and doubtful debts. The reliance placed on the representations of Mrs Townsley as reliable evidence to support the appropriateness of the bad and doubtful debt provision was inadequate in that:
 - i. It was from an internal source,
 - ii. The evidence was predominately oral, and
 - iii. Mrs Townsley had a vested interest in minimising bad debts given her position as a partner in MTF.

Additionally, he failed to investigate the circumstances where other audit evidence contradicted representations provided by Mrs Townsley as to the recoverability of doubtful debts and to consider whether that cast doubt on the reliability of other representations by the said Mrs Townsley. Furthermore, he failed to obtain additional, reliable evidence to support the recoverability of identified doubtful debts.

3. failed to ensure that the audits of EBT's accounts for the year ended 30 September 1998, 1999, 2000, 2001 and 2002 complied with Auditing Standard SAS 420 'Audit of Accounting Estimates', in that he:
 - i. Failed to ensure that sufficient reliable evidence was obtained that the provision for bad and doubtful debts was reasonable in the circumstances and consistent with other audit evidence,
 - ii. Failed to compare the provisions for bad and doubtful debts with actual results in later periods,
 - iii. Failed to obtain confirmation of the status and progress of the loan debtors being pursued through EBT's solicitors.
4. failed to comply with Auditing Standard SAS 440 'Management Representations', in that he failed to obtain signed management representation letters for the audit of EBT's accounts for the years ended 30 September 1998, 1999, 2000 and 2002 in accordance with the recommendations of the SAS.
5. failed to ensure that the audits of EBT's accounts for the year ended 30 September 2001 and 30 September 2002 complied with Auditing Standard SAS 460 'Related Parties', in that he failed to ensure that the accounts disclosed transactions with known related parties, in accordance with the requirements of SAS 460. In particular, knowing that Mr Townsley, Mrs Townsley's husband, was a director and held a 10 per cent shareholding in Arcom Multimedia Limited and knowing that EBT had made a loan to Arcom, he failed to ensure that the related party transaction was disclosed in the financial statements.

COMPLAINT 2

- A. In performing the audit of Emerging Business Trust Venture Fund Ltd ("EBTVF") for the year ended 30 September 2001, the work performed by Rollo McClure fell short of the standards reasonably to be expected of a Member in the normal conduct of his profession in the following respects:
- B. Under the provisions of paragraph 3(3) of the AADB Scheme, the acts and omissions of Rollo McClure are taken to have been the acts and omissions of McClure Watters. Therefore, in performing the audits of EBTVF for the year ended 30 September 2001, the work performed by McClure Watters fell short of the standards reasonably to be expected of a Member Firm in the normal conduct of its profession in the following respects:

PARTICULARS OF COMPLAINT

By failing to carry out the 2001 audit of EBTVF with due skill, care, diligence and expedition and with proper regard for the technical and professional standards expected of them as a Member and as a Member Firm Rollo McClure and McClure Watters breached Fundamental Principle 4 of the Institute of Chartered Accountants in Ireland's (ICAI) Guide to Professional Ethics which requires Members and Member firms to carry out their professional work with due skill, care, diligence and expedition and with proper regard for the technical and professional standards expected of them:

In particular, Rollo McClure:

1. failed to ensure that the audit of EBTVF's accounts for the year ended 30 September 2001 complied with Auditing Standard SAS 460 'Related Parties', in that he failed to ensure that the accounts disclosed transactions with known related parties, in accordance with the requirements of SAS 460. In particular, he:

- i. knowing that on or around the 11th December 2000, EBTVF purchased 2,565 ordinary shares for £50,000 and £20,000 in preference shares in Arcom Multimedia Limited, and knowing that Mr Townsley, Mrs Townsley's husband was a director of and held a 10% shareholding in Arcom Multimedia Limited, failed to ensure that the related party transaction was disclosed in the financial statements of EBTVF.
- ii. knowing that on or around 14 September 2001, EBTVF purchased 2,500 ordinary shares and 22,500 preference shares in Fusion Antibodies Limited, and knowing that Mr Townsley, Mrs Townsley's husband, was a director of and held a 50% shareholding in Fusion Antibodies Limited, failed to ensure that the related party transaction was disclosed in the financial statements of EBTVF.



Cameron Scott

27/11/08

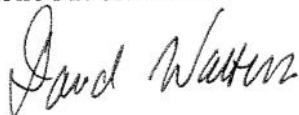
Date



Rollo McClure FCA

27/11/08

Date



David Watters for and on behalf of McClure Watters

27/11/08

Date

Annex C

Accountancy & Actuarial Discipline Board

**Annex B to the Agreement between Cameron Scott,
Mr. Rollo McClure FCA and McClure Watters Chartered Accountants
dated the 27th day of November 2008**

Statement of Facts in respect of

Mr. Rollo McClure FCA

and

McClure Watters Chartered Accountants

STATEMENT OF FACTS

1. BACKGROUND

MR ROLLO McCLURE / McCLURE WATTERS

- 1.1. Mr Rollo McClure ("Mr McClure") began working as a trainee accountant in 1964 with the firm Hugh Smiley and Sons in Belfast. Mr McClure qualified as a Chartered Accountant with the ICAI in 1970. Mr McClure then joined Cooper Brothers (and later Coopers and Lybrand) whom he worked for in London, Belfast and South Africa. In 1976 Mr McClure returned to Belfast and joined the firm Jackson Andrews in 1976 and became a partner in that firm in 1977. Mr McClure left Jackson Andrews in 1989 to establish the firm McClure Watters along with Mr David Watters in October 1989.
- 1.2. Mr McClure was the audit partner on the McClure Watters audits of the Emerging Business Trust ("EBT") and the Emerging Business Trust Venture Fund ("EBTVF") over the period 1997 to 2004.
- 1.3. Mr McClure retired as a partner in McClure Watters in March 2006¹. Mr McClure is now a part time consultant at McClure Watters.

EBT

The formation of EBT

- 1.4. EBT was established as a company limited by guarantee on 26 September 1996. The purpose of the company was to take over responsibility for the management of a Small Firms Loans Scheme that had originally been operated by the International Fund for Ireland ("IFI") since 1993.
- 1.5. EBT received approximately £3.75 million in grants which was made up of a grant of £3 million from IFI; £1.6m of its existing loan portfolio (the "Pilot Loan Fund") and the remainder by way of cash grants; and a grant of £750,000 from the Local Enterprise Development Unit ("LEDU")², which had previously been responsible for administering one of the IFI loan funds.
- 1.6. McClure Watters' letter of engagement was signed by Mrs Townsley on behalf of the EBT Board on 9 January 1998³. McClure Watters were engaged to provide services for EBT commencing with its first period of account, being the year to 30 September 1997. The engagement letter shows that these services included 'accounting and business services', 'audit of statutory accounts', 'corporate taxation services' and 'investment business advice'. McClure Watters were appointed auditors of the EBTVF in 2001.

The directors of EBT

- 1.7. The Chairman of the EBT Board of Directors was John Simpson. The Directors of EBT were as follows:

John Simpson	An economist who was a Senior Lecturer in Economics at Queen's University, Belfast. Has worked as an Economic Advisor to several
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¹ FALLP notes of 8 November 2006 meeting between FALLP and McClure Watters

² NIAO Report table 3.1

³ McClure Watters Letter of Engagement dated 7 January 1998.

	Government Departments. Has served as elected Vice-President of the European Economic and Social Committee, of the European Union.
Teresa Townsley (FCA)	A partner in MTF. She has been Vice Chair and a Director of LEDU and a Minister to the Strategy Review Steering Group. She has also been appointed to the Shadow Board of Investment Northern Ireland and appointed Honorary Treasurer of Queens University Belfast.
Brian Slowey (FCA)	A Fellow of the institute of Chartered Accountants and a Fellow of the Irish Management Institute. Has been Director of IFI and was Group Managing Director of Cantrell and Cochrane before moving to Guinness and becoming Chairman of Guinness Ireland.
Robert Downes	He has been involved in industrial development in both the public and private sectors, including with Scottish Enterprise National. Has been a Director with the Scottish Development Agency and a member of the Council for Urban Economic Development in Washington DC.
Patrick McShane	He has acted as a consultant to IFI and has been member of the Rural Development Council and Chairman of the Rural Housing Association. Has been Chief Executive of Workspace (Draperstown) Limited.
Kenneth O'Neill	Was Director of NISBI - The Small Business Institute at the University of Ulster. Has served on the Boards of a variety of private companies and economic development organizations, including The Enterprise Board for West Belfast and International Council of Small Business (ICSB)
Michael Mills	He was founder Chairman of the Craigavon Region of Business in the community and has been Chairman of the Carpet Foundation. Has also worked for ESSO and Ulster Carpets.
Julian Crozier	Formerly an Under Secretary in the Department of Economic Development where he had responsibility for the Department's Labour Market Group.
Victor Haslett	Was on the Board of IFI, LEDU and Ulster Community Investment Trust, as well as EBT, and has been Vice President of Northern Ireland Chamber of Commerce. Has been Deputy Chief Executive of Willis and Chairman of Property News.com.
Dr Alan Neville	Joined LEDU in 1980 having worked in an electronics-related industry. He has represented LEDU in a variety of venture capital, small business lending initiatives and business development programmes.

1.8. Mrs Townsley, together with her husband Michael Townsley ("Mr Townsley"), was a partner in MTF Chartered Accountants ("MTF"). MTF were appointed to act as administrators and managers of the EBT's loan fund scheme.

1.9. MTF's role was to administer the existing loan funds that EBT had inherited, to assess applications for new loans, to issue the loans to successful applicants, and to administer those loans⁴. The administration of the loans involved ensuring the timely repayment of those loans, following up on any late payments and assessing the position of those late paying companies. MTF were required to report to the EBT Board on all of these matters, ensuring that the Board were up to date with EBT's business.

EBT's Business

1.10. EBT's results, per their financial statements, for the years ended 30 September, between 1997 to 2002⁵, inclusive are summarised in the table below:

⁴ Management Agreement

⁵ The results for the periods ended 30 September 2003 and 31 March 2004 were not finalised.

Years ended 30 September	1997 £'000	1998 £'000	1999 £'000	2000 £'000	2001 £'000	2002 £'000	Draft, unaudited Mar 2004	
							2003 £'000	2004 £'000
P&L								
Turnover	128	164	151	113	87	94	87	122
Operating (loss)	(89)	(104)	(128)	(217)	(144)	(181)	(262)	(404)
(Loss) on ordinary activities after tax	(34)	(9)	(45)	(130)	(61)	(129)	(224)	(349)
Balance sheet								
Fixed Assets and investments	-	-	-	-	-	-	204	874
Loan debtors due after > 1 year	1,572	1,621	1,349	1,145	729	907	835	689
Loan debtors due < 1 year	428	467	443	409	456	453	311	344
Other debtors	443	250	125	342	225*	782	818	120
Cash	1,453	1,389	1,653	1,601	1,497	1,228	980	991
Creditors due within 1 year	(1,229)	(155)	(116)	(272)	(15)	(17)	(32)	(30)
Creditors due after more than 1 year	(290)	(290)	(290)	(290)	(290)	(290)	(290)	(290)
Net assets/(liabilities)	2,377	3,282	3,163	2,935	2,602	3,063	2,826	2,698
Members' grant reserves	2,411	3,324	3,250	3,152	2,881**	3,470	3,457	3,454
Profit and Loss Account	(34)	(42)	(87)	(218)	(279)	(407)	(631)	(756)
Capital and reserves	2,377	3,282	3,163	2,935	2,602	3,063	2,826	2,698

* restated as £725 in 2002 accounts

** restated as £3,381 in 2002 accounts

1.11. EBT's turnover represents the interest receivable on loans, administration fees charged on the issue of loans and bank interest earned on cash. As it is directly related to loans made, the size of turnover fluctuates in line with loan debtors. The main categories of cost incurred by EBT were fund administration fees, consultancy fees for loan appraisals and bad debts.

1.12. The table below details the main categories of expenses/deductions incurred by EBT for each financial period. It also shows, where applicable, the percentage of those expenses/deductions that were disclosed in the EBT financial statements as relating to Mrs Townsley's firm MTF.

Period ended:	Sep-97	Sep-98	Sep-99	Sep-00	Sep-01	Sep-02	Sep-03	Mar-04
	£	£	£	£	£	£	£	£
Expenses/deductions include:								
Loan management charges	108,394	134,900	132,500	124,450	97,450	86,340	75,850	109,700
% TT/MTF related	100%	100%	100%	100%	100%	100%	94%	62%
Consultancy fees - loan appraisal	52,500	56,581	48,096	51,095	31,499	35,823	19,095	29,778
% TT/MTF related	57%	56%	51%	50%	53%	79%	71%	62%
Bookkeeping and accountancy	5,500	6,000	6,000	6,000	6,000	6,000	6,600	9,960
% TT/MTF related	100%	100%	100%	100%	100%	100%	100%	100%
Audit fees	4,000	4,500	4,000	4,000	4,250	5,750	4,255	13,200
Bad and doubtful debts	5,000	24,872	38,589	111,018	59,605	47,113	137,283	89,635

1.13. It can be seen from the above table, by far the most significant category of expense charged to the Profit and Loss Account was for loan management charges, which were solely attributable to MTF.

1.14. The next largest expense/deduction was for bad and doubtful debts. The deductions identified in the table above, as disclosed in the Profit and Loss Account of EBT, represent EBT's write off/provision against those loans which EBT itself issued. Additional deductions were recorded by EBT against its Reserves representing write offs/provisions against those loans, which had originally been issued by IFI, as part of its Pilot Loan Scheme.

- 1.15. The table below details the total write offs/provisions made by EBT against both the loans issued by EBT itself (i.e. post September 1996) and the loans originally issued by IFI as part of the Pilot Loan Scheme (i.e. pre September 1996).

	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02
	£'000	£'000	£'000	£'000	£'000	£'000
EBT Loan Fund	5	25	39	111	60	47
Pilot Loan Fund	89	87	74	98	271	11
Large Loan Scheme	29	-	-	-	-	-
Total Bad Debts	123	112	113	209	331	58
Operating (loss) before Pilot Loan Fund and Large Loan Scheme bad debts	(89)	(104)	(128)	(217)	(144)	(181)
Operating (loss) after Pilot Loan Fund and Large Loan Scheme bad debts	(207)	(191)	(202)	(315)	(415)	(192)

Investigation of events at EBT

- 1.16. In early 2002, INI (formerly LEDU) instigated a review of EBT's files. Following this review, and discussions with the Department of Enterprise, Trade and Investment, PricewaterhouseCoopers ("PwC") were appointed by, INI's solicitors, to investigate events surrounding the establishment and operation of EBT and EBTVF, and their interaction with INI. PwC's fieldwork, conducted during a period of 12 months from January 2003, raised a number of issues/criticisms, including EBT's treatment of bad debts (see paragraph 40). However, PwC were not asked to investigate the role of McClure Watters as auditors of EBT and did not comment on McClure Watters' involvement in the criticised areas. PwC issued the findings of their investigation in November 2005.
- 1.17. In April 2005, EBT voluntarily ceased to carry on business and BDO Stoy Hayward was appointed liquidator to oversee the winding up of its affairs, along with those of EBTVF.
- 1.18. In February 2006, the Comptroller and Auditor General of the Northern Ireland Audit Office reported on the matter. This report did not focus on the role of the McClure Watters as auditors of EBT.
- 1.19. The matter was subsequently discussed by the House of Commons Committee of Public Accounts ("PAC") and reported upon in their 46th Report of Session 2005 - 2006, published on 10 May 2006.

WHY DEBTS AND THE RECOGNITION OF BAD DEBTS ARE IMPORTANT (SPECIFIC RISKS TO EBT)

- 1.20. EBT provided financial assistance to businesses, which were often at an early stage of the business life-cycle, many of which did not have recourse to traditional methods of funding. It is common that such businesses would be more likely than other businesses to default on their loan repayments or otherwise cease to trade.
- 1.21. In recognition of this it was important for EBT to carefully monitor its loan debtors and take appropriate action when there was a default on the repayments. In the event of default, EBT should have assessed the likely recovery of the debt, either in full or in part. In accordance with recognised accounting standards, EBT should have made provision for those debts that were considered to be doubtful and write off those debts that were deemed to be irrecoverable.
- 1.22. Given that debtors were largely businesses at an early stage of development it was likely that security, even if technically available over debts outstanding, was likely to realise a fraction of its face value. Further, costs of recovery could reduce the amount recoverable. The fact that EBT held security over a debt, which was in default would not mean it was likely to be recovered in full.
- 1.23. The term “provision” means “a liability of uncertain timing or amount.”⁶ Where it is considered that recovery of a debt is unlikely or doubtful a provision will be set up. This reduces the value of the debt receivable in the balance sheet and the profit for the period by the amount of debt that is considered doubtful. In assessing the worth of trade debtors, it is not uncommon to provide only partially against the risk of non-recoverability, in order to reflect the degree of uncertainty involved.
- 1.24. Where a debt is known to be irrecoverable, the debt should be “written off”, rather than provided for. This means that the value of the debt written off is included as a cost in the profit and loss account of the business and the debt itself is removed as an asset of the business from the balance sheet, rather than an equivalent amount being off-set against the debt as occurs when a provision for the debt is made.
- 1.25. Provisions against debts may be ‘Specific’ or ‘General’. Specific provisions are made where individual debts can be identified as being doubtful. Each individual doubtful debt is provided against. General provisions are made where individual doubtful debts cannot be identified but where it is expected that a certain proportion of a portfolio of debtors will not be collectable. Such a provision is generally based on management’s past experience or industry experience of levels of debtor recoverability. The rate of default and bad debts is considered a key indicator for the performance of funds such as EBT. Consequently, minimising the expense from bad and doubtful debts to a minimum was important to EBT, and to MTF, as administrators/managers of the fund.

⁶ Financial Reporting Standard 12 (FRS 12) ‘Provisions, contingent liabilities and assets’ and Financial Reporting Standard for Smaller Entities (FRSSE)

- 1.26. In May 1996 MTF produced a document entitled "Business Plan for FINAL Discussion Purposes"⁷. The Business Plan emphasises the involvement of MTF as loan fund managers in respect of IFI's Pilot Loan Scheme. In particular it states:

"The level of activity and low bad debt has been attributed to the quality of the current management and the quality of the appraisal process, including the recognition of key practical prior conditions and security."

- 1.27. A document entitled 'Performance of EBT based on grant offer expectations'⁸ noted that *"the Ledu letter of offer suggested an acceptable bad debt rate of 25% per year which when compared with the result of 2% per year suggests we have performed well."*
- 1.28. In October 2002, MTF prepare a briefing document for the EBT directors setting out points for a meeting with the IFI Chairman⁹. The document notes that in the six years up to 30 September 2002 EBT's "provision in cumulative total on the loan portfolio are approximately 11% of funds issued. This [being] an average of 2% per annum for bad debts".
- 1.29. It is also noted in the October 2002 briefing document that in their review of EBT the Department of Trade & Industry ("DTI") concluded that *"EBT was an example of one of, if not the most successful small fund they had seen in Europe."* It is further stated that *"Given the expected deficit and provisions against other similar funds at transfer this outturn is better than expected. DTI small Firms Loan Scheme reports an annual 30% write off in many UK areas."*
- 1.30. The above examples illustrate the significance of bad and doubtful debts in respect of a business such as EBT, and the managers / administrators connected with the fund. It is not alleged that Rollo McClure or McClure Watters were involved in the preparation or even had sight of the documents mentioned at paragraphs 1.27, 1.28 and 1.29.

EBT's approach to bad and doubtful debts

- 1.31. The approach adopted by a business, especially one whose sole purpose is to provide debt financing, to recognising and recording bad debt provisions and write-offs can have a significant impact on the reporting of profits and performance indicators. It is clear that a material misstatement in respect of the recoverability of debtors would affect the truth and fairness of EBT's financial statements. The audit of the debtors balance would therefore be a fundamental part of the EBT audit.
- 1.32. EBT did not adopt the approach of making a general provision against its total debtor population. EBT's approach was rather to make provisions, or partial provisions, against specific loan debtor balances whose recoverability was identified as being doubtful.
- 1.33. This is an unusual approach for a business involved in providing debt financing which will typically suffer a constant, and significant level of bad debts.

⁷ EBT Business Plan

⁸ Performance of EBT document

⁹ October 2002 Briefing document

- 1.34. MTF state that “there was an approved policy and procedures for dealing with bad debts”¹⁰. According to MTF’s response to extracts from the PwC report, provisions are made when deemed necessary by the board, at their discretion¹¹
- 1.35. In a report produced by Mrs Townsley on behalf of EBT, reference is made to EBT’s bad debt procedures as follows¹²:

“Bad Debt Procedures

“While detailed procedures exist to address non payment of loan each defaulting portfolio client is treated on an individual basis. Once this reaches a certain stage an external firm of Solicitors is involved. Other professionals can also be involved. A careful monitoring of the debt outstanding, the costs of recovery and the likelihood of recovery dictates when the final write off decision is taken.”

- 1.36. The EBT Board Minutes indicate that the issue of bad debts was sometimes raised in meetings and discussed by the members of the Board.
- 1.37. It appears that EBT’s policy with regard to bad debts changed subsequent to the commencement of INI’s and PwC’s investigations. In EBT’s unsigned financial statements for the year ended 30 September 2003 and 31 March 2004, the bad debt policy includes the following “With effect from 1 October 2002, in addition to those debts which have been specifically provided for by Board approval, the company has made provisions for all debts on which no repayment has been made for a period of two years or more.”¹³

Criticisms of EBT’s approach to providing for bad and doubtful debts

- 1.38. In view of the inherent risk associated with the businesses to which EBT was granting funds, it has been criticised for lacking clarity on the basis on which provisions were made¹⁴. Also, concern has been raised as to the timeliness of the provisions and write offs that were made for debts identified to have been bad or doubtful¹⁵.

¹⁰MTF response to NIAO

¹¹MTF response to extracts of the PwC report

¹²Report sent by Mrs Townsley to IFI, on behalf of EBT, under cover letter dated 26 June 2003

¹³draft financial statements for the year ended 30 September 2003 and period ended 31 March 2004

¹⁴Paragraph 119 of The PwC Report

¹⁵Paragraph 113 of The PwC Report

1.39. There is evidence to suggest that the level of provisions/write offs may have been understated. The table below summarises the total balances of loans identified within the audit files of McClure Watters, which by their categorisation, would give rise to concerns over recoverability, and for which full provisions were not made¹⁶:

	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
	£	£	£	£	£	£
Pilot Loan Fund companies known to have ceased trading. [Amounts not fully provided for.] ¹⁷	108,212.33	56,495.81				
EBT Loan Fund balances in respect of companies known to be in liquidation [and not fully provided for] ¹⁸	40,645.00	27,978.12				
Notable defaulters identified by auditors as part of their sample testing ¹⁹	86,913.63	50,619.00	60,012.00	60,762.00	132,995.00	68,711.00
Possible doubtful debts identified by Mr McClure ²⁰	5,493.00			36,911.22		
Possible doubtful debts identified by John Hansen of McClure Watters ²¹	14,975.88	40,000.00				
Debtors identified as being pursued by Edwards & Co ²²			204,288.10			
Slow moving debtors identified by McClure Watters [where no provision was made] ²³					175,249.00	41,439.00
Total	256,239.84	175,092.93	264,300.10	97,673.22	308,244.00	110,150.00

1.40. For the years 1997/98 and 1998/99, EBT did not fully write off a number of loans in the Pilot Loan portfolio, even though the companies were known to have ceased trading. Mrs Townsley provided assurances to the McClure Watters audit team that these loans were recoverable, either through repayment or recoverable on security, although no independent evidence was provided to support this. See the first category in the table at paragraph 1.39.

1.41. In addition, EBT did not fully provide for non-recovery of a number of loans in the EBT loan fund to companies, which were known to be in liquidation. Mrs Townsley also provided assurances to McClure Watters that these debts were expected to be fully recovered although no independent evidence was provided to support this. See the second category in the table at paragraph 1.39.

¹⁶ See Annex 1 – Table of doubtful debts and workings supporting the figures in the table

¹⁷ Page 2 of Annex 1 – Pilot loan fund debtors known to have ceased trading and not fully provided for

¹⁸ Page 3 of Annex 1 – EBT loan fund debtors known to be in liquidation and not fully provided for

¹⁹ Page 4 of Annex 1 – Notable defaulters identified by McClure Watters as part of sample testing

²⁰ Page 5 of Annex 1 – Possible bad debts identified by Rollo McClure

²¹ Page 5 of Annex 1 – Possible bad debts identified by John Hansen

²² Page 6 of Annex 1 – Potential bad debts identified from Edwards & Co schedule

²³ Pages 7 and 8 of Annex 1 – Slow moving debtors identified by McClure Watters in 2001 and 2002

- 1.42. A substantial proportion of these outstanding debts was not recovered and was subsequently written off. In relation to the EBT loan fund, of the £40,645 balance of debt that was owed from companies known to be in liquidation and that was believed to be recoverable as at 30 September 1998, £22,678 (56%) was subsequently written off in the following year (year ended 30 September 1999), and a further £7,313.43 written off in the year after that (year ended 30 September 2000)²⁴.
- 1.43. In relation to the Pilot Loan Fund, of the balance of £108,212 that was believed to be recoverable from companies that were known to have ceased trading for the year ending 30 September 1998, £53,505 (49%) was subsequently written off over the following year (year ended 30 September 1999), and a further £35,413 in the two years thereafter²⁵.
- 1.44. In addition, there were further loans, which were identified by McClure Watters as being possible doubtful debts which were not provided for or written off by EBT. This includes defaulting loans that were identified through sample testing, loans sent to solicitors Edwards & Co. for further action, slow moving debtors identified through debtor analysis and possible doubtful debts identified by Mr McClure and John Hansen (also formerly of McClure Watters) following his review of the audit file.
- 1.45. In light of this knowledge a competent auditor could be expected to identify that bad debt provisioning was a high risk area and thus they would ensure that they obtain reasonable, detailed assurances regarding the recoverability of doubtful debts and the adequacy of bad debt provisions in subsequent periods.

RELATED PARTY TRANSACTIONS

Relevant accounting standards

- 1.46. There is a presumption that transactions recorded in financial statements are carried out on an 'Arm's Length Basis'. This means that all parties are dealing from equal bargaining positions and neither party is subject to the other's control or dominant influence, and the transaction is treated with fairness, integrity and legality. The purpose of related party disclosures is to ensure that users of the accounts are aware of transactions where parties are subject to, or apparently subject to, the other's control or dominant influence.
- 1.47. Related party disclosure makes users of accounts aware of the existence of related parties, and the effect of material transactions with them on the reported financial position and results.
- 1.48. Paragraph 15.1 of the FRSSE states "*Where the reporting entity:*
(a) purchases, sells or transfers goods and other assets or liabilities; or ...
(c) provides or receives finance or financial support;
(irrespective of whether a price is charged) to, from or on behalf of a related party then such material transactions should be disclosed..."

²⁴Page 1 of Annex 1

²⁵Page 2 of Annex 1

Related parties definitions

1.49. The term 'related parties' is defined in the FRSSE as follows:

"Two or more parties are related parties when at any time during the financial period:

- (a) one party has direct or indirect control of the other party; or*
- (b) the parties are subject to common control from the same source; ..."*

1.50. This means that any two organisations that are operated or owned by the same people are related parties. Similarly, a person is a related party if they run, operate or own the reporting entity. Transactions between any of these parties should be disclosed clearly in the financial statements. Consequently, transactions between EBT and EBTVF or EBT and its directors should have been disclosed as related party transactions, as should transactions with any organisations the directors exert control over.

1.51. The FRSSE continues with its definition:

"related parties of the reporting entity include the following: ...

- (iii) investors with significant influence and their close families; and*
- (iv) directors of the reporting entity and of its parent undertakings and their close families."*

1.52. Mr Townsley is a related party of EBT and EBTVF as he is Mrs Townsley's husband. In addition, any organisations in which Mr Townsley has a controlling interest are also related parties. Therefore, transactions between EBT / EBTVF and organisations over which Mr Townsley could exert direct or indirect control should be disclosed as related party transactions.

Related parties

Arcom

1.53. In October 1999 EBT received an application for a loan of £20,000 from Arcom Multimedia Limited ("Arcom"). EBT's accounting records show Arcom to be a loan debtor as at 30 September 2000, indicating that a loan had been issued during that year²⁶.

1.54. In November 2000, Mr Townsley formally became a director²⁷ of and purchased a ten percent share in Arcom at only £1.08 per share. The directorship and share ownership imparted some control over Arcom to Mr Townsley. This should have been disclosed as a related party transaction in EBT's financial statements because EBT had a pre-existing loan to Arcom and Mr Townsley is close family of Mrs Townsley (a director of EBT).

²⁶September 2000 EBT aged debtors analysis for IFI loans

²⁷Mr Townsley's letter to John Simpson dated 6 November 2003

- 1.55. In December 2000, having been previously notified of Mr Townsley's interest in the company, EBTVF agreed to invest in 2,565 ordinary shares for £50,000 or £19.49 per share and a further £20,000 in preference shares²⁸. This should have been disclosed as a related party transaction in EBTVF's financial statements.

Fusion

- 1.56. In March 2001 EBT received a loan application from Fusion Antibodies Limited ("Fusion")²⁹, a company which Mr Townsley co-founded in November 2000 and held 50% of the shares³⁰. The application was approved for an equity investment at the case committee of 12 April 2001³¹.
- 1.57. On 14 September 2001, EBTVF purchased 2,500 ordinary shares and 22,500 preference shares in Fusion. The investment agreement was signed by Mrs Townsley on behalf of EBTVF and Jim Johnston and Mr Townsley on behalf of Fusion.³²
- 1.58. The equity investment was made by EBTVF. There was no transaction occurring between EBT and Fusion and as such no related party disclosure would have been required in EBT's financial statements. Disclosure would however have been required in the financial statements of EBTVF.

Appropriateness of treatment adopted

- 1.59. At no point was disclosure made in EBT's or EBTVF's financial statements of any related party transactions relating to Mr Townsley's involvement with Arcom and Fusion.
- 1.60. Related party transaction should, potentially, have been disclosed in EBT's financial statements for each year that Mr Townsley was a director of and owned shares in Arcom and a loan from EBT was in existence (a related party disclosure should have first been made in the financial statements for the year ended 30 September 2001).
- 1.61. In respect of EBTVF, related party disclosures should have first been made in the year EBTVF made its equity investments in the two companies (that being, the year ended 30 September 2001).
- 1.62. In interview, Mr McClure said that he knew of the connection between Mr Townsley, Arcom and Fusion and accepted that the related party disclosures in the financial statements were deficient in failing to mention the involvement of Mr Townsley although he asserted that the Board were fully aware of all these transactions.

²⁸EBT DBM Board minutes 11 December 2000

²⁹Fusion Antibodies' loan application form dated 23 March 2001

³⁰Mr Townsley's letter to the AADB dated 5 September 2006

³¹EBT DBM Minutes dated 12 April 2001

³²Investment Agreement dated 14 September 2001

AUDIT REQUIREMENTS

Planning the audit

- 1.63. It was not for McClure Watters to dictate the bad/doubtful debt policy to EBT; the responsibility for setting the accounting policy with regards the treatment of bad/doubtful debts lay with the EBT Board.
- 1.64. As the auditors of EBT, however, McClure Watters were required to assess whether or not the accounting treatments adopted by EBT were appropriate and compliant with GAAP, and that the financial statements of the company reflected a true and fair view of the business.
- 1.65. The Auditing Standard that covers planning the audit is SAS 200. Its first requirement is "Auditors should plan the audit work so as to perform the audit in an effective manner"³³ and it goes on to require that "Auditors should develop and document an overall audit plan describing the expected scope and conduct of the audit."³⁴
- 1.66. An assessment of risk and materiality is an important element of the planning stage of the audit. The auditor should consider the risk of material misstatement both with reference to the entity as a whole and to specific areas of the accounts. The level of risk assessed will be reflected in the quantity of work performed and, to a lesser extent, the nature of the work.

Audit evidence

- 1.67. The most relevant Auditing Standard in respect of audit testing is SAS 400, 'Audit Evidence'. Other relevant standards are SAS 410 'Analytical Procedures', SAS 420 'Audit of Accounting Estimates', SAS 430 'Audit Sampling', and SAS 440 'Management Representations'.
- 1.68. SAS 400 says "Auditors should obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion"³⁵ and goes on to say that the auditors' judgement as to what is sufficient appropriate evidence may be influenced by such factors as:

"the assessment of the nature and degree of risk of misstatement at both the financial statement level and the account balance or class of transactions level;

the nature of the accounting and internal control systems, including the control environment;

the materiality of the item being examined;

the experience gained during previous audits and the auditors' knowledge of the business and industry;

the findings from audit procedures, and from any audit work carried out in the course of preparing the financial statements, including indications of fraud or error; and

*the source and reliability of information available"*³⁶

³³Paragraph 2 of SAS 200

³⁴Paragraph 10 of SAS 200

³⁵Paragraph 2 of SAS 400

³⁶Paragraph 6 of SAS 400

- 1.69. Furthermore SAS 400 states that the “*reliability of audit evidence is influenced by its source*”, and in general terms:

“audit evidence from external sources (for example confirmation received from a third party) is more reliable than that obtained from the entity’s own records; ...

evidence obtained directly by auditors is more reliable than that obtained by or from the entity; ...

evidence in the form of documents and written representations is more reliable than oral representations; ... ”

- 1.70. SAS 410, ‘Analytical Procedures’ requires the auditors to “*apply analytical procedures at the planning and overall review stages of the audit.*” Such procedures include the comparison of the entity’s financial information with “*similar industry information*”. When the auditors identify “*significant fluctuations or unexpected relationships ... inconsistent with other relevant information or that deviate from predicted patterns*” they are required to “*investigate and obtain adequate explanations and appropriate corroborative evidence*”

- 1.71. SAS 420, ‘Audit of Accounting Estimates’ requires, in language similar to the other Standards referred to above, that “*Auditors should obtain sufficient appropriate audit evidence as to whether an accounting estimate is reasonable in the circumstances and, when required, is appropriately disclosed.*”³⁷

- 1.72. However the Standard goes on to give some more specific instruction as follows³⁸:

“11. Auditors should adopt one or a combination of the following approaches in the audit of an accounting estimate:

review and test the process used by management or the directors to develop the estimate;

use an independent estimate for comparison with that prepared by management or the directors;

or review subsequent events.”

- 1.73. In reviewing and testing the process used for making the accounting estimate, the auditors are required to evaluate the data and consider the assumptions on which the estimate is made. They are also, where possible to compare “*estimate made for prior periods with actual results for those periods*”.

- 1.74. SAS 420 also states “*Auditors should make a final assessment of the reasonableness of the accounting estimate based on their knowledge of the business and whether the estimate is consistent with other audit evidence obtained during the audit.*”

- 1.75. In respect of ‘Audit Sampling’ SAS 430 requires the selection of a sample in such a way that the sample can be expected to be representative of the population being tested. Having performed their audit procedures on the sample the auditors are required to “*(a) analyse any errors detected in the sample; and (b) draw inferences for the population as a whole.*”

³⁷Paragraph 8 of SAS 420

³⁸Paragraph 11 of SAS 420

- 1.76. SAS 440, 'Management Representations' states *"Auditors should obtain written confirmation of representations from management on matters material to the financial statements when those representations are critical to obtaining sufficient appropriate audit evidence"*.
- 1.77. Furthermore, where representations relate to matters material to the financial statements, SAS 440 requires the auditors to:
- (a) *"seek corroborative audit evidence;*
 - (b) *evaluate whether the representations made by management appear reasonable and are consistent with other audit evidence obtained, including other representations; and*
 - (c) *consider whether the individuals making the representations can be expected to be well-informed on the particular matters."*
- 1.78. Also, SAS 440 states, where *"a representation appears to be contradicted by other audit evidence, the auditors should investigate the circumstances to resolve the matter and consider whether it casts doubt on the reliability of other representations."*

Summary

- 1.79. In most areas, McClure Watters' audit of EBT was adequate to enable them to form an independent, informed opinion on the truth and fairness of the accounts. The audit files were properly maintained and the auditors identified the key risk areas as part of their planning for the audits. The auditors performed their substantive testing in accordance with their planning documentation and the audit senior/managers identified relevant points for the partner's attention.
- 1.80. I set out below, in respect of each accounting period, what the auditors did and the deficiencies in their work. I then go on to summarise what, in my opinion the auditors did wrong and what should have been done in order to ensure an audit of an adequate standard was performed.

2. AUDIT WORK FOR THE YEAR ENDED 30 SEPTEMBER 1998

Planning

- 2.1. McClure Watter's audit planning documentation identifies 'Recoverability of loans' as being a 'Critical Area' of the EBT audit. Mr McClure records the following in the planning section of the audit file:
- " ... Emphasis on debtors / procedures / security ...*
- Review of bad debts with T. Townsley ..."*
- 2.2. Materiality was set at £20,000 for the audit of EBT's year ended 30 September 1998.³⁹
- 2.3. The audit programme set a tolerable error margin at 75% of materiality. Therefore errors or omissions, individual or cumulative, up to £15,000 would be accepted before further audit work would be done.

³⁹EBT 1998 Audit File p71 of 368

- 2.4. The audit team were required to select a sample of debtors from the 30 September 1998 debtors' listings (comprising 'IFI Pilot Loans, IFI/LEDU loans, and EBT loans') on which they were to perform their substantive audit testing.

Substantive testing

- 2.5. A debtors' circularisation was undertaken and the sample of 20 debtors were asked to confirm the amount owed to EBT at the Balance Sheet date. The auditors received responses from only 9 debtors of the 20 debtors in the sample (45% of the sample).
- 2.6. During the course of their substantive testing the auditors identify loan debtors where they record that they are unable to state whether or not security is adequate to cover the outstanding loan, or they record that no security is in place. In their working papers the auditors record the fact that there is a problem with security on the old IFI loans in so much as there are some loans where the security documentation has not been signed. Furthermore that some IFI and EBT loans are secured on fixed assets that may be grossly overvalued.
- 2.7. The auditors identify 8 of 20 debtors (40% of the sample population) as having defaulted on their loan repayments. The value of these loans against which defaults occurred was £92k. Of the 8 debtors in default the auditors note that half of them were on reduced payments and another debtor was being pursued by EBT's solicitors.
- 2.8. In respect of the debtors in default the auditors note as follows:

"Defaults occur quite often but are monitored carefully. Only persistent defaulters are considered a problem, when the matter is dealt with by EBT's solicitors. Often a customer will request reduced payments for a few months to ease cashflow. Since most loans are now repaid by DD rather than SO, EBT can control repayments more effectively"

- 2.9. The auditors conclude in respect of their substantive testing as follows:

"The nature of the businesses to which EBT makes loans are inherently risky and it is to be expected that most borrowers will default at some stage. However EBT has improved its monitoring procedures and is having reasonable success on recovering security"

- 2.10. As part of his audit file review Mr McClure questions whether further provision should be made in respect of the defaulters identified during the substantive testing. The audit manager responds, *"Most of these have resumed paying ...the defaults resulted from temporary liquidity problems rather than any serious long term problem"*
- 2.11. Mr McClure appears to have discussed the matter with Mrs Townsley, as he notes on the audit file *"TT [Mrs Townsley] insists all ok"*.

Review of Doubtful Debts

- 2.12. As at 30 September 1998 there are amounts totalling £108,212, against which a provision has not been made, in respect of IFI loan debtors as 'Businesses known to have ceased trading'. The auditors note *"Teresa Townsley believes that these outstanding balances will still be recoverable on security"*.

- 2.13. In response to a query raised by the audit manager during the course of his audit file review, the auditors note that they have not checked the security for the debtors on the schedule, save where such debtors may have formed part of the sample of 20 debtors in the substantive testing.
- 2.14. Mr McClure raises further queries in respect of the IFI loan debtors categorised as 'Businesses known to have ceased trading' and which have not been fully provided for. In response it is noted *"Spoke to TT on 11/3/99 – no further provision necessary. The company is starting to recover some money they had previously considered doubtful."*
- 2.15. In addition to the those debtors identified as being "Businesses known to have ceased trading", the schedule identifies an IFI loan debtor with a loan of £10,292 as being a 'Persistent Defaulter'. There is no explanation as to why a provision was not made for this balance.
- 2.16. As at 30 September 1998 there are loan balances totalling £40,645 against which no provision has been made, for EBT loan debtors identified as being 'Companies in Liquidation'.
- 2.17. In his review of the audit papers Mr McClure asks on what basis it has been assumed that the amount of £40,645 will be recoverable in full. In response the auditors note that it is the *"Opinion of the directors that security is adequate to recover these amounts"*.
- 2.18. As part of his audit file review Mr McClure enquires as to what tests the auditors have done "to ensure [EBT's] potential bad debts have all been provided for". The response to which was "My review of their systems confirmed that all potential bad debts are looked at by the board. It is the directors judgement as to which ones are provided. This was in accordance with the audit plan."
- 2.19. The auditors identify two further potential bad debts totalling £20,468.88. It is noted "Teresa Townsley believes that the provision for bad debts ... is adequate and that legal action and recovery of security will cover any potential bad debtors."

Letter of Representation

- 2.20. The McClure Watters' audit file for the year ended 30 September 1998 included an unsigned Letter of Representation⁴⁰. The letter states:

"Recoverability of Loans

We are satisfied that sufficient provision has been made for bad debts and that the balance of loans not provided for will be recoverable."

⁴⁰EBT 1998 Audit File p59 of 368

DEFICIENCIES IN THE AUDIT

- 2.21. The purpose of a debtors' circularisation is to obtain third party confirmation of the existence and value of an asset. A failure to respond to such a circularisation may be for a number of reasons. The auditors failed to consider the significance of a debtor failing to respond in relation to the recoverability of the debt and the inferences that may be drawn in respect of the population as a whole.
- 2.22. The auditors did not analyse the results of their substantive testing to assess the nature and extent of the errors detected and whether or not any inferences should be drawn to the population as a whole.
- 2.23. Having identified that security on IFI loans may not have the appropriate documentation and also having identified that assets on which loans are secured may be grossly overvalued, the auditors did not obtain any audit evidence to corroborate Mrs Townsley's representation that amounts for 'Businesses known to have ceased trading' will be recovered on security.
- 2.24. If a business has ceased trading, it is highly unusual to recover the full amount of the outstanding debt, although much would be dependent on the level of security held over the debt. The audit team did not go on to obtain evidence to satisfy them that these debts were recoverable, even though the cumulative values were significantly greater than the materiality and computed precision level determined at the planning stage of the audit.
- 2.25. Of the £40,465 debt for *Companies in liquidation*, there is no indication on the audit file that the auditors considered the adequacy of the security in question in order to corroborate the directors' opinion that amounts would be recoverable on security.
- 2.26. In the face of evidence that the bad debt provisions may have been significantly undervalued, the auditors work on amounts material to the Financial Statements was predominantly limited to questioning Mrs Townsley, who as a partner in MTF, the administrators of the fund, had an interest in keeping bad debt expenses to a minimum.
- 2.27. Where other bad debts had been classified as resumed paying, the audit file does not provide any evidence that the auditors checked the EBT records to confirm that the debtors had resumed paying or whether such payments were significantly reduced from the original repayments.
- 2.28. Although reference is made to debtors being referred to a solicitor and matters being pursued legally, there is no evidence on the audit file to show that the auditors sought confirmation from EBT's solicitors of the debts being pursued and the costs being incurred in such legal action.
- 2.29. There is no record on the audit file to show the systems test, which evidences "*that all potential bad debts are looked at by the board*".
- 2.30. The auditors did not perform an analytical review to compare EBT's level of provisions / bad debt write offs with similar industry data.
- 2.31. The auditors did not obtain written confirmation of representations on matters material to the financial statements.
- 2.32. The auditors signed off their audit opinion that the accounts showed a true and fair view .

3. AUDIT WORK FOR THE YEAR ENDED 30 SEPTEMBER 1999

Planning

3.1. The Partner Planning Directive⁴¹ completed by Mr McClure states:

"The majority of the work will be on debtors and recoverability. Our emphasis is on whether EBT's systems & procedures monitor the loans and identify potential bad debts, rather than make assessments on debt recoverability ourselves..."

Circularise a sample of 20 loans and carry out the tests per the audit programmes."

3.2. Mr McClure's planning comments also include the instructions to "Follow through this year on debts which were provided last year – in particular Technical Typesetting £14,976 – was this converted to equity? (+ why?)"

3.3. 'Recoverability of loans' was identified as one of the 'Critical Areas' on the EBT audit planning documentation⁴².

3.4. As with the previous year, materiality was set by McClure Watters at £20,000.⁴³ The Computed Precision figure was calculated at 75% of materiality.

3.5. It was also noted in the audit planning section of the file that "John Hansen may be able to identify some bad debts"⁴⁴.

3.6. The audit team were required to select a sample of debtors from the 30 September 1999 debtors' listings (comprising 'IFI Pilot Loans, IFI/LEDU loans, and EBT loans') on which they were to perform their substantive audit testing.

Substantive testing

3.7. A debtors' circularisation was undertaken and 19 of the sample of 20 debtors were asked to confirm the amount owed to EBT at the Balance Sheet date. The auditors received responses from 16 of the selected 19 debtors (80% of the total sample). The value of the three debtors from whom a response was not received totalled £35,548.

3.8. A debtors' circularisation letter was not sent to one of the debtors on the basis that legal action was being pursued against the debtor and it was believed that the debtor "would almost certainly not respond".

3.9. The auditors record the fact that security for IFI Pilot Fund loans was weak⁴⁵. To illustrate the point the auditors provide an example where £10,000 was realised on EBT loan security valued at £13,000, and yet only £1,500 was realised on an old IFI loan security valued at £12,290.

⁴¹EBT 1999 Audit file p51 of 310

⁴²EBT 1999 Audit file p54 of 310

⁴³EBT 1999 Audit file p57 of 310

⁴⁴EBT 1999 Audit File p63 of 310

⁴⁵ EBT 1999 Audit File p144 of 310

- 3.10. From their sample of 20 debtors, the auditors identify 5 debtors as having notable defaults. The auditors note that of the 5 defaulters identified, *"one loan is to be w/off [written off], three are on reduced payments and one other missed a few payments but now poses no problems"*⁴⁶.
- 3.11. In total for the year ended 30 September 2000, the unprovided loan debtor balance in relation to defaulting loans identified by the auditors was £50,619 (see table at paragraph 1.39).
- 3.12. In respect of one of the debtors identified as being on reduced payments the audit working papers note that repayments have not continued after the year end. They also state that they are not in a position to comment on the solvency of the business, and furthermore they note that the assets on which the loan is secured had a lower value at cost than the balance of the loan outstanding.
- 3.13. Following their audit of the sample of 20 debtors the auditors concluded that *"Procedures for identifying + following up defaulters appears adequate."*⁴⁷ They also note:

"TT advises that this year EBT have taken a tougher stance regarding problem debtors and they are much more willing to pursue the matter through the courts"

Review of doubtful debts

- 3.14. As at 30 September 1999 there are amounts totalling £56,495, against which a provision has not been made, in respect of IFI loan debtors as 'Businesses known to have ceased trading'. The explanations noted by the auditors against the loan debtor balances, tend to relate to a reference to the amount being recoverable on security, rather than loan repayments continuing to be met.
- 3.15. As at 30 September 1999 unprovided amounts totalling £27,978.12 are included in the category of EBT loans where the Companies have been identified as having gone into liquidation of loan balances, for which no provision was made in 1998 are classed as *"should be recovered on security"* as EBT were *"going for enforcement"*⁴⁸. One of the debtor's had appeared on the 'Companies in Liq' schedule in the previous year. The auditors recorded:

"Discussed bad debts with TT. She is happy that her provision is adequate and that there is no need for further provision."

- 3.16. Material provisions/write offs were made in the year to 30 September 1999, in respect of IFI Pilot Loan and EBT loans bad debt balances that the auditors had raised in the previous year's audit, and which they were told that *"security was adequate to recover the amounts"*⁴⁹, or Mrs Townsley had maintained that the amounts were recoverable.
- 3.17. It is noted that the £40,000 of additional potential bad/doubtful debt balances identified by Mr Hansen *"have not been provided for by TT, although she regularly reviews bad debts and is satisfied with her provision."* Mr McClure notes on the same paper *"Discussed with TT. While she is aware of these she is happy not to provide at this stage."*

⁴⁶ EBT 1999 Audit File p145 of 310

⁴⁷ EBT 1999 Audit File p145 of 310

⁴⁸ EBT 1999 Audit file p212 of 310

⁴⁹ EBT 1998 Audit file p114 of 368

- 3.18. As part of the audit file review the question is asked "Is the cost of recovery of bad debts considered when we look at the likelihood of recovery per N400...". The response recorded on the file was "Per TT no! It would be too difficult as costs vary widely. However, legal costs should now be back down to 4-5 per year - so any affect is considered immaterial OK"⁵⁰

Letter of Representation

- 3.19. The McClure Watters' audit file for the year ended 30 September 1999 included an unsigned Letter of Representation. The letter states⁵¹:

"Recoverability of Loans

We are satisfied that sufficient provision has been made for bad debts and that the balance of loans not provided for will be recoverable"

DEFICIENCIES IN THE AUDIT

- 3.20. The auditors did not document any queries made as to why debts they had previously been told were recoverable on security should subsequently be provided for and written off. There is no evidence on the audit file to show that the auditors compared the estimate made for the prior period with the actual results, and the implication this would have on the explanations being supplied in respect of the current year's audit.
- 3.21. The purpose of a debtors' circularisation is to obtain third party confirmation of the existence and value of an asset. The auditors recognised that a debtor in dispute with EBT was unlikely to respond to a circularisation letter and so for this reason the circularisation letter was sent to only 19 of the sample of 20 loan debtors. The auditors did not consider the significance of a debtor failing to respond in relation to the recoverability of the debt and the inferences that may be drawn of the population as a whole.
- 3.22. Having identified 25% of their debtor sample as being notable defaults, the auditors did not analyse their results to assess the nature and extent of the errors detected and whether or not any inferences should be drawn to the population as a whole.
- 3.23. Having identified that the assets on which old IFI loans are secured may be grossly overvalued, the auditors did not obtain any evidence to corroborate Mrs Townsley's representation that amounts for 'Businesses known to have ceased trading' will be recovered on security.
- 3.24. If a business has ceased trading, it is highly unusual to recover the full amount of the outstanding debt, although much would be dependent on the level of security held over the debt. The audit team did not go on to obtain evidence to satisfy them that these debts were recoverable, even though the cumulative values were significantly greater than the materiality and computed precision level determined at the planning stage of the audit.
- 3.25. Of the £27,978.12 debt for 'Companies in liquidation', there is no indication on the audit file that the auditors considered the adequacy of the security in question in order to corroborate the directors' opinion that amounts would be recoverable on security.

⁵⁰ EBT 1999 Audit File p23 of 310

⁵¹ EBT 1999 Audit file p24-25 of 310

- 3.26. The auditors fail to consider the impact of costs on the recoverability of loans. Having identified it as an issue, the auditors appear to have accepted Mrs Townsley's instruction that it is not appropriate for them to consider it.
- 3.27. Although reference is made to EBT being more willing to pursue matters legally, there is no evidence on the audit file to show that the auditors sought confirmation from EBT's solicitors of the debts being pursued and the costs being incurred in such legal action.
- 3.28. In the face of evidence that the bad debt provisions may have been significantly undervalued, the auditors' work on amounts material to the Financial Statements was predominantly limited to questioning Mrs Townsley, who as a partner in MTF, the administrators of the fund, had an interest in keeping bad debt expenses to a minimum.
- 3.29. The auditors did not perform an analytical review to compare EBT's level of provisions / bad debt write offs with similar industry data.
- 3.30. The auditors did not obtain written confirmation of representations on matters material to the financial statements.
- 3.31. The auditors signed off their audit opinion that the accounts showed a true and fair view.

4. AUDIT WORK FOR THE YEAR ENDED 30 SEPTEMBER 2000

Planning

- 4.1. The Overall Audit Plan states:

"The main audit emphasis should be on the balance sheet, in particular, debtors. We should concentrate on reviewing the systems and procedures in place to monitor loans and identify bad debts, rather than assessing the recoverability of debtors ourselves."

- 4.2. The audit plan also includes the comment "When assessing bad debt provision, look at problem debts last year and review whether they were recovered in line with client position."
- 4.3. Materiality was set by McClure Watters at £20,000 for the audit of EBT's year ended 30 September 2000⁵². The audit programme refers to a 'Tolerable Error' figure, which is calculated as being 50% of materiality i.e £10,000.
- 4.4. The audit team were required to select a sample of 20 debtors from the 30 September 2000 debtors' listings (comprising 'IFI Pilot Loans, IFI/LEDU loans, and EBT loans') and obtain third party confirmation of the amount owed to EBT by performing a debtors' circularisation⁵³.

⁵² EBT 2000 Audit file p54 of 289

⁵³ EBT 2000 Audit File p75 of 289

Substantive testing

- 4.5. A debtors' circularisation was undertaken and 16 of the sample of 20 debtors were asked to confirm the amount owed to EBT at the Balance Sheet date. The auditors received responses from 9 of the selected 16 debtors (45% of the total sample).
- 4.6. Debtors' circularisation letters were not sent to four of the debtors in the sample on the basis that they were being dealt with by EBT's solicitors and it was felt that the debtors would almost certainly not respond to the circularisation. The cumulative balance of the 11 debtors for whom McClure Watters did not obtain third party confirmation of existence and value was £154,026.
- 4.7. The auditors note that security on the old IFI/Pilot Fund loans is poor. However, the audit team consider that the procedures are much improved for all new EBT loans⁵⁴.
- 4.8. From their sample of 20 debtors, the auditors identify as notable defaults 5 debtors with outstanding amounts totalling £60,012. The debts are not provided for as being doubtful, on the basis that Mrs Townsley considered the debts recoverable "*either by repayment or security realisation*".
- 4.9. In respect of their review of 4 of the 5 notable defaults the auditors had recorded in response to their tailored audit programme that they were unable to say if any of the businesses were solvent and in respect of security, the auditors' comments included:
- "charge over plant + machinery value @ 14-10-96 £15,107.90 (computers)"* was adequate to cover the borrowing "*at the time of the loan*"
- "charge over plant + machinery value £15,000"* with no indication as to when the valuation was made
- "Don't know"* if the "*assignment of debtors*" was adequate security to cover the borrowing
- "charge over Plant + Equipment"*, which was adequate to cover borrowing without any reference to the nature of the plant and equipment or its current value.
- 4.10. In response to the comment on the tailored audit programme "*Loan appears recoverable*", for those debtors identified as being notable defaults, the auditors record "*With solicitor*"

⁵⁴ EBT 2000 Audit File p30 of 289

Review of doubtful debts

4.11. In reviewing the debts written off during the year the auditors note that loans that had previously been identified as being recoverable on security were being written off in the current year. As part of the audit file review the audit manager notes, *"Many of the names on this list [list of debts being written off] were ones which we were told would be recoverable. Does this indicate that they have been over optimistic about bad debts."* In response to this it is noted *"They have had a complete clear out of bad debts this year to bring debtors to a more realistic level"* and that *"TT [Mrs Townsley] has gone through each debtor and believes that the provision is more than accurate."*

4.12. The following points in respect of bad and doubtful debts, and the responses to them, are recorded in the file review as follows⁵⁵:

"7. See LY file N300/A. I think you should do some checking on realisation of security as LY."	"Not done. TT says provision is adequate. Do this test next year though!"
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4.13. Upon reviewing the audit file, Mr McClure also raises a number of points in respect of bad and doubtful debts. The points raised and the responses given are recorded as follows⁵⁶:

"9 H6/2 DRJ Public £13,095 is definitely a bad debt – why has this not been provided? (The proprietor has skipped the country!)."	"I pushed the issue of BD [Bad Debt] provision as far as I could."
"10 There are a number of other debtors where there appear to have been no payments made in the last year. Have these been considered for w/off?"	"All debtors have been closely looked at. TT is not prepared to change the provision again"

4.14. There is a letter on the audit file from Edwards & Co, EBT's solicitors, detailing the loan debtors they are pursuing on EBT's behalf. A schedule lists 31 debts, totalling £326,962.20 identified by EBT's solicitors as items of *"potential loss"*. Debts totalling £250,784 had not been provided for or written off.

4.15. Mrs Townsley prepared a summary for 28 of the 31 loan debtors identified by EBT's solicitors, providing information on the progress in pursuing the debtors. The narrative provided however does not provide comfort as to the recoverability of the loans.

4.16. One of the notable defaults identified by the auditors as part of their substantive testing does not appear on the schedule, even though the auditors had recorded in response to the comment on the tailored audit programme *"Loan appears recoverable"*, that the loan debtor was *"With solicitor"*

⁵⁵ EBT 2000 Audit File p31 of 289

⁵⁶ EBT 2000 Audit File p26 of 289

Letter of Representation

- 4.17. The McClure Watters' audit file for the year ended 30 September 2000 included an unsigned Letter of Representation⁵⁷. The letter states:

"Recoverability of Loans

We are satisfied that sufficient provision has been made for bad debts and that the balance of loans not provided for will be recoverable."

DEFICIENCIES IN THE AUDIT

- 4.18. The auditors, having been told that Mrs Townsley had changed her approach to bring debtors to a 'realistic level' do not consider whether they need to alter their audit plan to take into account that Mrs Townsley's previous representations may have been unreasonable. Furthermore the auditors do not query what prompted the change in policy to make the figures more 'realistic'.
- 4.19. The purpose of a debtors' circularisation is to obtain third party confirmation of the existence and value of an asset. The auditors recognised that a debtor in dispute with EBT was unlikely to respond to a circularisation letter and so for this reason the circularisation letter was sent to only 16 of the sample of 20 loan debtors. The auditors did not consider the significance of a debtor failing to respond in relation to the recoverability of the debt, and the inferences that may be drawn to the population as a whole.
- 4.20. Having again identified 25% of their debtor sample as being notable defaults, the auditors did not analyse the results of their substantive testing to assess the nature and extent of the errors detected and whether or not any inferences should be drawn to the population as a whole.
- 4.21. In some instances the auditors document that they do not think that security is adequate to cover borrowings, and yet they accept Mrs Townsley's representation that the debts were recoverable "*either by repayment or security realisation*". The auditors do not investigate the circumstances to resolve the fact that Mrs Townsley's representation is contradicted by other evidence obtained by the auditors. The auditors do not consider whether their evidence casts doubt on the reliability of the representations by Mrs Townsley.
- 4.22. Although the auditors noted a debtor as being '*With Edwards + Co*' in their substantive testing, the loan debtor does not appear on the schedule supplied by Edwards & Co. There is no evidence on the file to indicate that the auditors sought an explanation for this omission.
- 4.23. One of the debts on the list provided by EBT's solicitors, which has not been provided for is described by Mr McClure as being "*definitely a bad debt*" on the basis that "*the proprietor has skipped the country*"⁵⁸. There is nothing further recorded on the audit files to indicate why the auditors considered this debt recoverable despite Mr McClure's concerns. The auditors do not investigate the circumstances to resolve the fact that Mrs Townsley's representation is contradicted by other evidence obtained by the auditors.

⁵⁷ EBT 2000 Audit file p42-43 of 289

⁵⁸ EBT 2000 Audit File p26 of 289

- 4.24. Furthermore, there is no explanation contained in the audit files to indicate that the auditors fully considered the letter from Edwards & Co, and the narrative given in Mrs Townsley's progress schedule. Had they done so, they would have identified that the schedule was incomplete and that little comfort could be drawn from the narrative in respect of the progress of the legal action. The auditors did not evaluate the data and assumptions on which estimates as to recoverability were made.
- 4.25. In the face of evidence that the bad debt provisions may have been significantly undervalued, the auditors' work on amounts material to the Financial Statements was predominantly limited to questioning Mrs Townsley, who as a partner in MTF, the administrators of the fund, had an interest in keeping bad debt expenses to a minimum. The auditors did not obtain any evidence to corroborate the representations made.
- 4.26. The auditors did not perform an analytical review to compare EBT's level of provisions / bad debt write offs with similar industry data.
- 4.27. The auditors did not obtain written confirmation of representations on matters material to the financial statements.
- 4.28. The auditors signed off their audit opinion that the accounts showed a true and fair view.

5. AUDIT WORK FOR THE YEAR ENDED 30 SEPTEMBER 2001

Planning

- 5.1. The Overall Audit Plan⁵⁹ states:

"The main audit emphasis should be on the balance sheet, in particular, debtors. We should concentrate on reviewing the systems and procedures in place to monitor loans and identify bad debts, rather than assessing the recoverability of debtors ourselves.

A sample of 20 debtors should be circularised and tests performed as per the audit programmes."

- 5.2. The audit plan also includes the comment "When assessing bad debt provision, look at problem debts last year and review whether they were recovered in line with client position."
- 5.3. Materiality was set by McClure Watters at £25,000 for the audit of EBT's year ended 30 September 2001⁶⁰. The audit programme used by McClure Watters also refers to a 'Tolerable Error' figure, which is calculated as being 50% of materiality i.e. £12,500.

⁵⁹ EBT 2001 Audit file p54 of 283

⁶⁰ EBT 2001 Audit file p53 of 283

Substantive testing

- 5.4. The audit team were required to “circulate a sample of loan balances and agree replies to the company's records [and] follow up debtors from whom no replies have been received.”⁶¹.
- 5.5. As with previous years, McClure Watters selected a sample of 20 loan debtor balances to test and perform their tests in accordance with their tailored audit programmes.
- 5.6. The audit file indicates that 3 of the 20 loan debtors did not respond to the debtors' circularisation letter⁶². A further four of the 20 loan debtors were noted to be ‘*with solicitor*’. In respect of these, the auditors stated “*legal action currently in progress. No point in sending debtors circularisation as reply extremely unlikely.*” The cumulative value of loan balances for which responses to debtor circularisations were not obtained was £79,515.
- 5.7. It is noted that, of the sample of 20 loan debtors, 5 “*notable defaulters*” were identified with balances totalling £60,762. The auditors record that these loans are identified as being “*with solicitor*” and are “*considered recoverable by client*”. The auditors themselves conclude that the debtors are not recoverable. However a provision is only made against one of the balances totalling £16,772.
- 5.8. The auditors note that security held over debts is much improved⁶³, however they noted that there were several security realisations during the year in respect of security equipment, and these realised less than 35% of their recorded security value.

Review of doubtful debts

- 5.9. The auditors identified all loan debtors with little or no movement from the previous year by comparing the previous year's debtors with current year's debtors. The list, which showed a total slow moving debtor balance of £254,966, was given to the client who “*identified the debtors to make a provision against*”. This provision came to only £110,669⁶⁴ (39% of the total identified by the auditors).
- 5.10. Included in the debts provided for / written off in the year ended 30 September 2001 are debtors who had been identified as having ceased trading in the audit working papers for the year ended 30 September 1999. At the time of McClure Watters' audit of EBT's year ended 30 September 1999 the auditors were advised that either that the balances would be recoverable on security or that the debtor “*pays sporadically*”.
- 5.11. In his Partner Review Points Mr McClure notes “There are further bad debts to be discussed with [Mrs Townsley] ... What about [three debts listed totalling £43,000]”. It is also noted by Mr McClure that “There seems to be a lot of large EBT amounts with no movement on them – have we reviewed these with [Mrs Townsley]?” Alongside this it is noted “Discussed [Mr McClure / Mrs Townsley] No further adjustment made.” Reference is also made to the fact that there a lot of personal guarantees on loans outstanding.

⁶¹ EBT 2001 Audit file p84 of 283

⁶² EBT 2001 Audit file p95 of 283

⁶³ EBT 2001 Audit file p93 of 283

⁶⁴ This provision was in addition to the £220,103 provision already made during the year

- 5.12. The audit file shows that the auditors obtained a letter from Thomas Armstrong solicitors who stated "I am not aware of any litigation involving the Company. However, I understand that Messrs Edwards & Co. of Hill Street, Belfast may act from time to time in respect of the collection of outstanding accounts. You may wish to raise this query with that firm."⁶⁵
- 5.13. In 2000, Edwards & Co provided letters regarding EBT's 'potential loss'. The auditors note that a letter was sent to Edwards & Co during the 2001 audit but there is no evidence of a response on the audit file. Although the auditors make a note to chase up the letter from Edwards & Co⁶⁶. There is no indication that this was done.

Related Party Transactions

- 5.14. The Audit Objectives set out on the audit file in respect of related party transactions required the auditors to "*Be alert for any other transactions noted during the course of the audit*". The response recorded against this requirement was "*None noted*".
- 5.15. The other Audit Objective in respect of related party transactions was to "*Obtain written representations from directors concerning related parties*".

Letter of Representation

- 5.16. The McClure Watters' audit file for the year ended 30 September 2001 included a Letter of Representation signed by John Simpson⁶⁷. The letter states:

"Recoverability of Loans

We are satisfied that sufficient provision has been made for bad debts and that the balance of loans not provided for will be recoverable" and

"Transactions with Directors and other Related Parties

We confirm that we have disclosed to you all material related party transactions. In addition, the company has had at no time during the year any arrangement, transaction or agreement to provide credit facilities (including loans, quasi loans or credit transactions) for directors or connected persons nor to guarantee or provide security for such matters.

We are satisfied that the disclosure in the financial statements of related party transactions is appropriate and contains all the elements necessary for an understanding of the financial statements."

DEFICIENCIES IN THE AUDIT

- 5.17. The purpose of a debtors' circularisation is to obtain third party confirmation of the existence and value of an asset. The auditors recognised that a debtor in dispute with EBT was unlikely to respond to a circularisation letter and so for this reason the circularisation letter was sent to only 16 of the sample of 20 loan debtors. The auditors did not consider the significance of a debtor failing to respond in relation to the recoverability of the debt and the inferences that may be drawn in respect of the population as a whole.

⁶⁵ EBT 2001 Audit file p198 of 283

⁶⁶ EBT 2001 Audit file p26 of 283

⁶⁷ EBT 2001 Audit file p42-43 of 283

- 5.18. Having again identified 25% of their debtor sample as being notable defaults, the auditors did not analyse the results of their substantive testing to assess the nature and extent of the errors detected and whether or not any inferences should be drawn to the population as a whole.
- 5.19. The auditors gain assurance as to the recoverability of the loan debtors through discussion with Mrs Townsley or by virtue of the fact that the debts are identified as being 'with solicitor'. One debtor was identified as a notable defaulter and there was no security recorded for the debtor. In spite of this, no provision was made for the debtor. The auditors did not make an assessment as to whether or not the estimate in respect of providing for bad and doubtful debts was consistent with other audit evidence.
- 5.20. The auditors did not obtain confirmation from Edwards & Co as to the debts being pursued on EBT's behalf or the costs of taking such action. Therefore in the face of evidence that the bad debt provisions may have been significantly undervalued, the auditors' work on amounts material to the Financial Statements was predominantly limited to questioning Mrs Townsley, who as a partner in MTF, the administrators of the fund, had an interest in keeping bad debt expenses to a minimum. The auditors did not obtain any evidence to corroborate the representations made.
- 5.21. The auditors identified material amounts of slow moving debts, for which no provisions were made. They also recorded provisions / write offs being made against loan debtors which were identified as doubtful debts for the year ended 30 September 1999 audit. The auditors failed to evaluate the data and consider the assumptions on which the estimate for providing for bad and doubtful debts is made, and they failed to assess whether the estimate was consistent with other audit evidence.
- 5.22. The auditors did not perform an analytical review to compare EBT's level of provisions / bad debt write offs with similar industry data.
- 5.23. . (See 5.17 above)
- 5.24. The auditors signed off their audit opinion that the accounts showed a true and fair view.
- 5.25. There is no consideration of any related party transactions other than: Mrs Townsley's links with MTF and LEDU; Mr Slowey's link with IFI; the directors' salaries and intercompany balances with EBTVF. EBT had made the loan to Arcom in 1999 and Mrs Townsley disclosed Mr Townsley's involvement in Arcom in October 2000. For this year and for the year ended 30 September 2002, this deficiency is also applicable to McClure Watters' audit of the EBTVF financial statements, as they failed to consider EBTVF's equity investments in both Arcom and Fusion as related party transactions.

6. AUDIT WORK FOR THE YEAR ENDED 30 SEPTEMBER 2002

Planning

- 6.1. The Overall Audit Plan⁶⁸ states:

"Our main audit emphasis is on the balance sheet. Debtors are the critical area and we should concentrate on reviewing and testing the systems/controls in place with regard to issuing and recovering loans."

⁶⁸ EBT 2002 Audit file p69 of 313

A sample of 20 debtors should be circularised and tested according to the tailored audit programmes. ...

The bad debt provision should be studied carefully and we should see how last years provision panned out when assessing the adequacy of the current years provision."

- 6.2. In the audit Planning Checklist⁶⁹, debtors are noted as "*Possible problem/important areas*" to be discussed with the client at the planning stage of the audit.
- 6.3. The auditors state in the 'Going Concern Preliminary Assessment' that "Large debt w/off's are a problem ...No significant GC problems anticipated as any loss this year can be covered by the large cash reserves."⁷⁰
- 6.4. Materiality was set by McClure Watters at £25,000 for the audit of EBT's year ended 30 September 2002⁷¹. The audit programme used by McClure Watters also refers to a 'Tolerable Error' figure, which is calculated as being 50% of materiality i.e. £12,500.
- 6.5. The audit team were required to "circulate a sample of loan balances and agree replies to the company's records [and] follow up debtors from whom no replies have been received."⁷²

Substantive testing

- 6.6. As with previous years, McClure Watters selected a sample of 20 loan debtor balances on which to perform tests in accordance with their tailored audit programmes.
- 6.7. Debtors' circularisation letters were sent to 18 of the sample of 20 debtors. It was noted in respect of 2 of the loan debtors that that legal action was taking place against 2 of the debtors and so indicates that there was "*legal action taking place. No point in sending out a circ as no reply would be likely.*"
- 6.8. Of the 18 debtors selected for circularisation, 4 loan debtors did not respond. A response was received therefore from 14 debtors (70% of sample). The McClure Watters Audit Summary Memorandum stated "*Some debtor replies o/s. Reminder sent 5 Dec.*" There is no evidence on file indicating that any further debtor circularisations were obtained before the audit was signed off. The cumulative value of loan balances for the outstanding circularisations was £98,944.
- 6.9. In respect of EBT's monitoring of the loan debtors through the receipt of their financial statements, the auditors note⁷³:

"Of the sample of 20 debtors investigated, 7 provided accounts for review. It should however be borne in mind that the majority of these were new loan issues and therefore the provision of accounts was essential prior to the loan agreement.

This has been discussed with the client in the past and who feels that not much more can be done to improve the situation."

⁶⁹ EBT 2002 Audit file p60 of 313

⁷⁰ EBT 2002 Audit file p67 of 313

⁷¹ EBT 2002 Audit file p68 of 313

⁷² EBT 2002 Audit file p94 of 313

⁷³ EBT 2002 Audit File p108 of 313

6.10. Of the sample of 20 loan debtors, 7 were considered by the auditors to be defaulting loan debtors with a total outstanding balance of £143,530 (see table at paragraph 1.39⁷⁴). In respect of their substantive testing on these 7 loans the auditors noted that there were concerns over the adequacy of security for these loans and the auditors either concluded that the loans were not recoverable or they failed to say one way or the other. The auditors note however “No provision against [these] debtors considered necessary by TT”⁷⁵.

Review of doubtful debts

6.11. The auditors identified all loan debtors with little or no movement from the previous year by comparing the previous year’s debtors with current year’s debtors⁷⁶. The list contains 27 loan debtors, 13 of which are “with solicitor”, 10 of which were provided for in prior year and 4 of which are repaying under special arrangements. The auditors note the list was “discussed with [Teresa Townsley]. She does not consider that any further provision is required against the above debtors.” The total outstanding loan balance on the slow-moving loans identified by the auditors is £175,249 (see table at paragraph 1.39⁷⁷).

6.12. In respect of security over the debts, it is noted that security on the older loans, particularly IFI loans, is poor. This is demonstrated by the following table which shows amounts realised during the year on securities held by debtors⁷⁸:

Debtor	Original value of security	Realised amount
Boxer Co	£15,040	£720
Sam Manufacturing	£12,945	£178
Enviro. Concept Eng.	£3,500	£513
North Star Products	£19,500	£1,500
Safari Ireland	£15,000	£950

6.13. The Audit Summary Memorandum⁷⁹ stated that “Edwards & co reply o/s. Reminder sent 10 Dec....DM sent another reminder 11/5/03”. Consequently, there is no evidence on audit file from EBT’s solicitors regarding recoverability of loan debtors.

6.14. Although there is no direct response from Edwards & Co regarding the debtors being pursued by legal means, the audit file includes a summary of loan debtors entitled “Edwards and Company update on loan clients - November 2002”. This appears to be a document created by EBT because it refers to Edwards & Co in the third person (e.g. “We have advised Edwards that...”) and is sent from an MTF fax machine. The summary classifies the debtors as follows:

- 2 where the proprietor/guarantor/director was being pursued;
- 9 at the stage where Edwards & Co have been notified to take action;

⁷⁴ Page 4 of Annex 1 – Notable defaulters identified by auditors as part of their sample testing

⁷⁵ EBT 2002 Audit file p177 of 313

⁷⁶ EBT 2002 Audit file p178 of 313

⁷⁷ Page 7 of Annex 1 – Potential bad debtors identified from slow moving debtors schedule

⁷⁸ EBT 2002 Audit file p107 of 313

⁷⁹ EBT 2002 Audit File p31 of 313

- 8 where legal action has commenced but no evidence of further development;
 - 2 where some money has been collected but further action on-going;
 - 1 where witnesses summonsed to give evidence;
 - 3 where money may be collected on sale of security (these have been provided for already); and
 - 2 with issues regarding ownership/sale of securities.
- 6.15. The two debtors where the proprietor/guarantor/director is being pursued have both already been provided for (Armagh Guttering and Grasp Displays). This is appropriate as there is no indication that either person is likely to be found soon.
- 6.16. Of the 9 debtors where Edwards & Co have been notified to take action, 2 have already been provided for. Of the other debtors, the working papers give no support to the recoverability of the debt. They merely refer to correspondence being sent to Edwards & Co and EBT are awaiting a reply.
- 6.17. Of the 8 debtors where legal action has commenced, 2 have already been provided for. Of the other debtors, the working papers give little or assurance as to the recoverability of the debt.
- 6.18. The auditors note "The standard procedure [for chasing up defaulting debtors] is to send 3 reminder letters then a letter threatening legal action. After 5 or 6 months of defaults...interest is not charged to the account. At the y/e some £302k of loan balances had zero interest applied to them (2001 - £272k)"⁸⁰. The matter of loans identified with zero interest is recorded on the Audit Summary Memorandum, and it is noted "Discussed potential bad debts with TT however she did not think it necessary for any further provision."⁸¹
- 6.19. In McClure Watters' unsigned management recommendations letter dated 22 May 2003⁸², under the heading 'Bad Debts' they state:

"Our review of the company's systems has satisfied us that all potential bad debts are identified by the directors. However, there appear to be significant doubtful debts for which no provision has been made. The company appears to be placing a lot of reliance on the adequacy of the security on the loans, which, particularly in the case of the older debtors, may not always be adequate."

⁸⁰ EBT 2002 Audit File p108 of 313

⁸¹ EBT 2002 Audit file p30 of 313

⁸² EBT 2002 Audit File p54 of 313

Related party transactions

6.20. McClure Watters' audit objectives for related party transactions are to⁸³:

Requirement	Response
"7. Be alert for any other transactions noted during the course of the audit"	"1. IFI and Invest NI (LEDU) – Teresa and V Haslett are directors 2. MTF Chartered Accountants – Teresa is partner 3. EBT Venture Fund. No other RPs noted."
"8. Obtain written representations from directors concerning related parties"	Obtained Letter of Representation (see paragraph 6.22)
"9. Prepare a schedule of payments to directors"	This was obtained and contains no significant comment.

6.21. There is no consideration of any related party transactions other than: Mrs Townsley's links with MTF and LEDU; Mr Slowey's link with IFI; the directors' salaries and intercompany balances with EBTVF⁸⁴. The auditors do not document here any work done to ensure that all related party disclosure is provided correctly.

Letter of Representation and management letter

6.22. The McClure Watters' audit file for the year ended 30 September 2002 included an unsigned Letter of Representation⁸⁵. The letter states:

"Recoverability of Loans

*We are satisfied that sufficient provision has been made for bad debts and that the balance of loans not provided for will be recoverable. We further confirm that we are satisfied with the levels of security obtained against new loan issues."*and

"Transactions with Directors and other Related Parties

We confirm that we have disclosed to you all material related party transactions. In addition, the company has had at no time during the year any arrangement, transaction or agreement to provide credit facilities (including loans, quasi loans or credit transactions) for directors or connected persons nor to guarantee or provide security for such matters.

We are satisfied that the disclosure in the financial statements of related party transactions is appropriate and contains all the elements necessary for an understanding of the financial statements."

⁸³ EBT 2002 Audit File p87 of 313

⁸⁴ EBT 2002 Audit file p88-89 of 313

⁸⁵ EBT 2002 Audit File p49-50 of 313

DEFICIENCIES IN THE AUDIT

- 6.23. Given that, of the 20 debtors selected for testing, 2 were being pursued by solicitors for payments and 4 did not respond to the circularisation⁸⁶. The purpose of a debtors' circularisation is to obtain third party confirmation of the existence and value of an asset. The auditors recognised that a debtor in dispute with EBT was unlikely to respond to a circularisation letter and so for this reason the circularisation letter was sent to only 18 of the sample of 20 loan debtors. The auditors did not consider the significance of a debtor failing to respond in relation to the recoverability of the debt and the inferences that may be drawn in respect of the population as a whole.
- 6.24. McClure Watters audit work revealed that EBT had realised only small parts of the value of loans made to several debtors that had held strong security over their loans such as plant and machinery. The auditors have previously identified that many loans had highly depreciable items such as computers and specialist sailing equipment as security.
- 6.25. The auditors appear to accept that a provision is not needed if a debtor is "*with solicitor*" despite the fact that, under EBT's policy, there must have been significant defaults to reach that stage. McClure Watters did not obtain a letter from solicitors which would have provided further background on these debtors' situations and whether a provision was necessary. The auditors fail to obtain third party evidence that would enable them to evaluate the data and consider the assumptions on which the estimate is made that debts with solicitors are recoverable.
- 6.26. Debtor balances previously identified as doubtful, but for which the directors and Mrs Townsley had provided assurances over recoverability, had to be written off in the current year. There is no record that the auditors considered the implication of this in respect of assessing the estimate of the provision for bad and doubtful debts in the current year.
- 6.27. Notable losses were made on realisation of securities held against some bad debts where the securities had previously been considered to be sufficient to cover the debt (see paragraph 6.12). In spite of recording such evidence the auditors did not obtain any evidence to corroborate the representations from Mrs Townsley that debts are recoverable on security.
- 6.28. In their detailed audit work, the auditors conclude that several loans reviewed are not recoverable and yet these loans are not provided for or written off, this included six of seven main defaulters identified. The auditors evidence is contradicted by Mrs Townsley's representations and yet they do not investigate the circumstances to resolve the matter. The auditors do not consider whether the representations are reasonable in light of the inconsistent evidence.
- 6.29. The auditors did not perform an analytical review to compare EBT's level of provisions / bad debt write offs with similar industry data.
- 6.30. The auditors did not obtain written confirmation of representations on matters material to the financial statements.
- 6.31. The auditors signed off their audit opinion that the accounts showed a true and fair view.

⁸⁶ EBT 2002 Audit file p109 of 313

- 6.32. There is no consideration of any related party transactions other than: Mrs Townsley's links with MTF and LEDU; Mr Slowey's link with IFI; the directors' salaries and intercompany balances with EBTVF. EBT had made the loan to Arcom in 1999 and Mrs Townsley disclosed Mr Townsley's involvement in Arcom in October 2000. For this year and for the prior year ended 30 September 2001, this deficiency is also applicable to McClure Watters' audit of the EBTVF financial statements, as they failed to consider EBTVF's equity investments in Arcom and Fusion as related party transactions.

7. WHAT THE AUDITORS SHOULD HAVE DONE

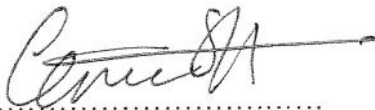
- 7.1. The auditors should have ensured that EBT's audited accounts for the years ended 30 September 1998 to 2002 complied with the requirements of the Financial Reporting Standard for Smaller Entities ('FRSSE') in respect of the accounting treatment of bad and doubtful debts and the disclosure of related party transactions.
- 7.2. The auditors should have ensured that EBTVF's audited accounts for the years ended 30 September 2001 to 2002 complied with the requirements of the Financial Reporting Standard for Smaller Entities ('FRSSE') in respect of the disclosure of related party transactions.
- 7.3. The auditors should have ensured that the audits of EBT's accounts for the years ended 30 September 1998 to 2002 complied with Auditing Standards in particular SAS 240 'Quality Control', SAS 400 'Audit Evidence', SAS 420 'Audit of Accounting Estimates', SAS 430 'Audit Sampling', SAS 440 'Management Representations', SAS 460 'Related Parties' and SAS 470 'Overall review of financial statements'.
- 7.4. McClure Watters and Mr McClure should have ensured compliance with SAS 240 'Quality Control', by ensuring that concerns raised over specific and significant doubtful debts were appropriately resolved (i.e. other than being discussed with Mrs Townsley).
- 7.5. The auditors should have ensured that sufficient appropriate audit evidence was obtained to support the conclusion that debtors were not materially misstated and that appropriate allowance had been made for doubtful debts for the audits of EBT's accounts for the years ended 30 September 1998 to 2002, in accordance with SAS 400 'Audit Evidence'.
- 7.6. The auditors should not have relied on representations from Mrs Townsley as reliable evidence to support the appropriateness of the bad debt provision, on the basis that:
- (i) the evidence was from an internal source;
 - (ii) the evidence was predominantly oral; and
 - (iii) Mrs Townsley had a vested interest in minimising bad debts given her position as a partner in MTF.
- 7.7. Furthermore, the auditors should have investigated the circumstances where other audit evidence contradicted representations provided by Mrs Townsley as to the recoverability of doubtful debts and to consider whether this cast doubt on the reliability of those representations.

- 7.8. The auditors should have sought and obtained additional, more reliable, evidence to support the recoverability of identified doubtful debts, despite clear indications that the level of provision was understated.
- 7.9. The auditors should have ensured that sufficient appropriate audit evidence was obtained regarding accounting estimates for the audits of EBT's accounts for the years ended 30 September 1998 to 2002, in accordance with SAS 420 'Audit of Accounting Estimates'. In particular the auditors should have:
- (i) ensured that sufficient reliable evidence was obtained that the provisions made for bad and doubtful debts was reasonable in the circumstances and consistent with other audit evidence;
 - (ii) compared the provision for bad and doubtful debts with actual results in later periods;
 - (iii) obtained confirmation of the status and progress of the loan debtors being pursued through EBT's solicitors; and
 - (iv) compared the provision for bad and doubtful debts to an independent estimate for specific debts which were identified as doubtful.
- 7.10. The auditors should have ensured that errors [or omissions] in the sample testing performed were properly analysed and to draw inferences from these errors [or omissions] to the population as a whole, for the audits of EBT's accounts for the years ended 30 September 1998 to 2002, in accordance with SAS 430 'Audit Sampling'. In particular, the auditors should have:
- (i) Ensured satisfactory alternative procedures were performed where no response was received from debtors which were circularised; and
 - (ii) Drawn inferences from the poor response rate of circularised debtors to the population as a whole or, alternatively, to record why a lack of response to the debtors circularisation was not considered an error.
- 7.11. The auditors should have obtained signed management representation letters for the audit of EBT's accounts for the years ended 30 September 1998 to 2000 and 30 September 2002, in accordance with the recommendations of SAS 440 'Management Representations'.
- 7.12. The auditors should have ensured that the EBT and EBTVF financial statements for the years ended 30 September 2001 to 2002 disclosed known related party transactions, in accordance with the requirements of SAS 460 'Related Parties'. In particular the auditors should have:
- (i) Ensured that in planning the audit, the risk that material undisclosed related party transactions may exist; and
 - (ii) Been alert for evidence of material related party transactions, such as Mr Townsley's interest in Arcom, that were not included in the information provided by the directors.

7.13 The auditors should have carried out an adequate review of the audited financial statements for the years ended 30 September 1998 to 2002, in accordance with the requirements of SAS 470 'Overall Review of Financial Statements'. In particular they should have considered :

a. whether the financial statements adequately reflected the information and explanations previously obtained and conclusions previously reached during the course of the audits, specifically with regard to writing off and providing for bad debts and the disclosure of related parties; and

b. whether the presentation adopted in the financial statements may have been unduly influenced by Mrs Townsley's vested interest in minimising bad debts given her position as a partner in MTF.



Cameron Scott

27/11/08

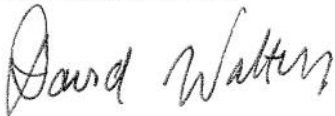
Date



Rollo McClure FCA

27/11/08

Date



David Watters for and on behalf of McClure Watters

27/11/08

Date

Annex D

Accountancy & Actuarial Discipline Board

**Annex B to the Agreement between Cameron Scott,
Mr. Rollo McClure FCA and McClure Watters Chartered Accountants
dated the day of November 2008**

Amendment to the Statement of Facts in respect of

**Mr. Rollo McClure FCA
and
McClure Watters Chartered Accountants**

- 1.1. The purpose of the table at paragraph 1.39 of the Statement of Facts is to summarise the total balances of loans identified within the audit files of McClure Watters, which by their categorisation, would give rise to concerns over recoverability, and for which full provisions were not made. In preparing this table it was necessary to identify those debtors that had been identified more than once in the audit file for any particular year to avoid duplication and thus doublecounting of the loan balances.
- 1.2. The workings to support the table at paragraph 1.39 of the Statement of Facts are included in the Tables at Annex 1. Due to an oversight, two debtor balances were not identified as being duplicates and they have been doublecounted in the table at paragraph 1.39. As a consequence the total values stated for 1998 and 2002 in the Statement of Facts have been overstated.
- 1.3. For convenience, the table at paragraph 1.39 of the Statement of Facts is set out below:

	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
	£	£	£	£	£	£
Pilot Loan Fund companies known to have ceased trading. [Amounts not fully provided for.]	108,212.33	56,495.81				
EBT Loan Fund balances in respect of companies known to be in liquidation [and not fully provided for]	40,645.00	27,978.12				
Notable defaulters identified by auditors as part of their sample testing	86,913.63	50,619.00	60,012.00	60,762.00	132,995.00	68,711.00
Possible doubtful debts identified by Mr McClure	5,493.00			36,911.22		
Possible doubtful debts identified by John Hansen of McClure Watters	14,975.88	40,000.00				
Debtors identified as being pursued by Edwards & Co			204,288.10			
Slow moving debtors identified by McClure Watters [where no provision was made]					175,249.00	41,439.00
Total	• 256,239.84	175,092.93	264,300.10	97,673.22	308,244.00	110,150.00

- 1.4. Included within the 1997/1998 figure of £86,913.63 ('Notable defaulters identified by auditors as part of their sample testing') is a loan balance for Countess Quilting of £5,633.54. A loan balance for Countess Quilting has also been included in the 1997/1998 figure of £108,212.33 ('Pilot Fund companies known to have ceased trading. Amounts not fully provided for'). To rectify the duplication of this loan debtor an adjustment has been made to remove the loan debtor from the 'Notable defaulters identified by auditors as part of their sample testing' and thus reduce the total balance for this category to £81,280.09. The overall effect, as shown in the revised table at paragraph 1.6 below is to reduce the overall total for 1997/1998 to £250,606.30.

1.5. Included within the 2001/2002 figure of £132,995 ('Notable defaulters identified by auditors as part of their sample testing') is a loan balance for Deaftech of £16,158.00. A loan balance for Deaftech has also been included in the 2001/2002 figure of £175,249.00 ('Slow moving debtors identified by McClure Watters where no provision was made'). To rectify the duplication of this loan debtor an adjustment has been made to remove the loan debtor from the 'Notable defaulters identified by auditors as part of their sample testing' and thus reduce the total balance for this category to £116,837. The overall effect, as shown in the revised table at paragraph 1.6 below is to reduce the overall total for 2001/2002 to £292,086.00.

1.6. Following these adjustments the revised table summarising the total balances of loans identified within the audit files of McClure Watters, which by their categorisation, would give rise to concerns over recoverability, and for which full provisions were not made, is as set out below:

	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
	£	£	£	£	£	£
Pilot Loan Fund companies known to have ceased trading. [Amounts not fully provided for.]	108,212.33	56,495.81				
EBI Loan Fund balances in respect of companies known to be in liquidation [and not fully provided for]	40,645.00	27,978.12				
Notable defaulters identified by auditors as part of their sample testing	81,820.09	50,619.00	60,012.00	60,762.00	116,837.00	68,711.00
Possible doubtful debts identified by Mr McClure	5,493.00			36,911.22		
Possible doubtful debts identified by John Hansen of McClure Watters	14,975.88	40,000.00				
Debtors identified as being pursued by Edwards & Co			204,288.10			
Slow moving debtors identified by McClure Watters [where no provision was made]					175,249.00	41,439.00
Total	250,606.30	175,092.93	264,300.10	97,673.22	292,086.00	110,150.00

1.7. The adjustments necessary in respect of both 1997/1998 and 2001/2002 were made in relation to 'Notable defaulters identified by auditors as part of their sample testing', which appears as Table 3 in Annex 1. Attached to this document is the revised version of Table 3, incorporating the adjustments referred to above.

ANNEX 1 TO THE STATEMENT OF FACTS IN RESPECT OF MR. ROLLO McCLURE FCA AND McCLURE WATTERS CHARTERED ACCOUNTANTS

Table from Statement of Facts (para 1.39)

	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	
Pilot Loan Fund companies known to have ceased trading. Amounts not fully provided for.	108,212.33	56,495.81					TABLE 1
EBT Loan Fund balances in respect of companies known to be in liquidation and not fully provided	40,645.00	27,978.12					TABLE 2
Notable defaulters identified by auditors as part of their sample testing	81,280.09	50,619.00	60,012.00	60,762.00	116,837.00	68,711.00	TABLE 3
Possible doubtful debts identified by Rollo McClure	5,493.00			36,911.22			TABLE 4
Possible doubtful debts identified by John Hansen	14,975.88	40,000.00					TABLE 4
Debtors identified as being pursued by Edwards & Co			204,288.10				TABLE 5
Slow moving debtors identified by McClure Watters where no provision was made					175,249.00	41,439.00	TABLES 6 & 7
	250,606.30	175,092.93	264,300.10	97,673.22	292,086.00	110,150.00	

ANNEX 1 TO THE STATEMENT OF FACTS IN RESPECT OF MR. ROLLO McCLURE FCA AND McCLURE WATTERS CHARTERED ACCOUNTANTS

TABLE 3: Notable defaulters identified by auditors as part of their sample testing

1998	Balance	Adjustment	Adjusted Total	Notes
J&B Enterprises	10,452.95	0.00	10,452.95	Provision made in 2000
Aldine Print	13,726.99	0.00	13,726.99	Provision made in 2001
Countess Quilting	11,633.54	(11,633.54)	-	Balance included at Table 1 of Annex.
Catalyst Clothing	12,799.29	0.00	12,799.29	Provision made in 2001
Geophysical Services	11,707.79	0.00	11,707.79	Provision made in 2000
M&M Computer Systems	8,266.89	0.00	8,266.89	Provision made in 2001
NME Fabric	11,514.29	0.00	11,514.29	
Scenic Maps	12,811.89	0.00	12,811.89	Provision made in 1999
	92,913.63	(11,633.54)	81,280.09	
1999				
Anrol Environmental Ltd	19,152.00	0.00	19,152.00	
BBS Friction Limited	6,654.00	0.00	6,654.00	
Do-Re-Me	11,868.00	0.00	11,868.00	Provision made in 2001
Pine For You	12,303.00	(5,000.00)	7,303.00	Provision only partly considered (£5k provided as known to have ceased trading). Rest provided in 2001.
Cornerstone	5,633.00	0.00	5,633.00	
	55,610.00	(5,000.00)	50,610.00	
2000				
Silver Hand Ceramics	4,954.00	0.00	4,954.00	
M&M Computer Systems	8,561.00	0.00	8,561.00	Provision made in 2001
Personal Image Wear	16,084.00	0.00	16,084.00	Provision made in 2001
Wardrobes	13,640.00	0.00	13,640.00	
DMA Broadcast	16,773.00	0.00	16,773.00	
	60,012.00	0.00	60,012.00	
2001				
Boxer Co	4,283.00	0.00	4,283.00	Provision made in 2002
GPS	8,910.00	0.00	8,910.00	Provision made in 2002
Hannpac	12,804.00	0.00	12,804.00	
Sam Manufacturing	17,992.00	0.00	17,992.00	Provision made in 2002
DMA Broadcast	16,773.00	0.00	16,773.00	
	60,762.00	0.00	60,762.00	
2002				
Deaftech	16,158.00	(16,158.00)	-	Appears on 2003 list of those currently not paying and on 2003 list of defaulters and on 2003 ledger print. Appears not to have been written off on 2002 or before. Included in Table 6
M Robinson	12,720.00	0.00	12,720.00	Appears on 2003 ledger print. So appears not to have been written off in 2002 or before.
Need of Meats	10,535.00	(10,535.00)	-	Provision already considered
Advance Precision Tooling	46,752.00	0.00	46,752.00	
Fresh Alternatives	26,793.00	0.00	26,793.00	
Glenanne Jacquards	10,801.00	0.00	10,801.00	
Sailcoach	19,771.00	0.00	19,771.00	
	143,530.00	(26,693.00)	116,837.00	
2003				
Deaftech	16,158.00	(16,158.00)	-	5 May 2004 Board Minutes show decision to provide.
Hannpac	12,804.00	(12,804.00)	-	Included in 'List 2' - those debtors not paid within 2 years (and so under new policy should have been provided for in 2003)
Anrol Environmental Ltd	22,030.00	0.00	22,030.00	Audit notes: "provisions should be made" but there is no indication that provision was actually made.
Business Media Group Ltd	25,480.00	0.00	25,480.00	Audit notes: "provisions should be made" but there is no indication that provision was actually made.
Fresh Alternatives Ltd	27,907.00	(27,907.00)	-	Included in 'List 2' - those debtors not paid within 2 years (and so under new policy should have been provided for in 2003)
Sailcoach Assoc	21,201.00	0.00	21,201.00	Audit notes: "provisions should be made" but there is no indication that provision was actually made.
	125,560.00	(56,869.00)	68,711.00	

Accountancy & Actuarial Discipline Board

Agreement between

**Cameron Scott,
Mr. Rollo McClure FCA
and**

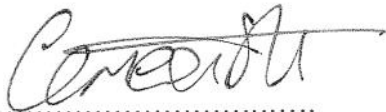
McClure Watters Chartered Accountants

1. This Agreement is made on the 27th day of November 2008 between Mr Cameron Scott as Executive Counsel of the Accountancy and Actuarial Discipline Board ("AADB"), of Aldwych House, 71-91 Aldwych, London WC2B 4HN ("Mr Scott") of the first part, and Mr Rollo McClure (Rollo McClure), of

and McClure Watters Chartered Accountants (McClure Watters), of 1 Lanyon Quay, Belfast BT1 3LG of the second part. Mr Scott, Rollo McClure and McClure Watters together are described as "the Parties".
2. The Agreement is evidenced by the signatures of Mr Scott on his own behalf; by Rollo McClure on his own behalf and by David Watters on behalf of McClure Watters.
3. Mr Scott has laid Complaints against Rollo McClure and McClure Watters pursuant to a referral by the Institute of Chartered Accountants in Ireland in accordance with paragraph 6(2) of the Scheme adopted by the AADB of certain facts and matters relating to Emerging Business Trust Ltd ("EBT") and Emerging Business Trust Venture Fund Ltd ("EBTVF") which, in the opinion of the AADB, raised important issues affecting the public interest in the United Kingdom.

4. The Parties desire to dispose of the annexed Complaints in a summary manner by analogy with that procedure in the Chancery Division of the High Court in proceedings under the Company Directors Disqualification Act 1986 known as the "Carecraft procedure". Although this is the first such agreement under The Scheme adopted by the AADB, this procedure has previously been approved for disciplinary proceedings by disciplinary tribunals in a number of cases.
5. The Parties recognise that the orders to be made in this case are a matter for the Disciplinary Tribunal, but, by analogy with the Carecraft procedure, wish to recommend to the Disciplinary Tribunal what these should be.
6. In further pursuance of this aim, Rollo McClure and McClure Watters will admit the annexed Complaints. [Annex A]
7. Rollo McClure and McClure Watters will also admit all the facts in the annexed Statement of Facts. [Annex B]
8. McClure Watters acknowledges its responsibility for the acts and omissions of Rollo McClure in relation to the audits of EBT and EBTVF as set out in the statement of facts.
9. The Parties will request that the annexed Complaints and Statement of Facts be the Complaints annexed to the Disciplinary Tribunal Report in accordance with Regulation 35(a) of the AADB Regulations.
10. The Parties will recommend to the Disciplinary Tribunal that the following orders be made:
 - (a) Rollo McClure be fined £ 6000 in respect of the audits of EBT for the years 1998 to 2002 and in respect of the audits of EBTVF for the years 2001 and 2002 inclusive, and be reprimanded;
 - (b) McClure Watters be fined £6,000 in respect of the audits of EBT for the years 1998 to 2002 and in respect of the audits of EBTVF for the years 2001 and 2002 inclusive
 - (c) that costs of £60,000 in total be paid to the AADB by Rollo McClure and McClure Watters in respect of the complaints in relation to EBT and EBTVF.

11. The fines and costs set out at paragraphs 9 and 10 will be payable within 14 days of the approval of this agreement by the Disciplinary Tribunal at an oral hearing.
12. In order to fulfil the terms of this Agreement, the Parties agree to attend before a Tribunal on such date or dates as the Tribunal may order, so as to make the admissions, and put forward the recommendations contained in this Agreement.
13. The Parties recognise that if, in its discretion, the Tribunal declines to accept the recommendations made, then by analogy with the Carecraft procedure the Agreement will be terminated and the Parties will not be bound by it. The case will then proceed as normal. The recommendations as to penalties and costs will be of no effect.



Cameron Scott

27/11/08

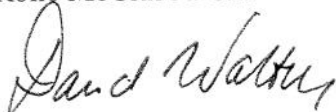
Date



Rollo McClure FCA

27/11/08

Date



David Watters for and on behalf of McClure Watters

27/11/08

Date