



Financial Reporting Council

# Annual Enforcement Review 2021

July 2021

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# 1 Overview by Executive Counsel

The past year has been busy and successful against a challenging background.

We demonstrated our commitment to proactivity through increasing the matters identified for review through horizon scanning and through a steady increase in the turnover of cases at their early stages. On the timeliness front the year saw a significant increase in the number of cases resolved through Constructive Engagement as well as an improvement in the time taken to resolve such matters.

Our investigations portfolio has grown, with more investigations opened than in the past two years and an increase in the number of open investigations/enforcement actions at the year end. Case highlights included delivery of Initial Investigation Reports in both Carillion audit investigations and successful outcomes in Tribunal proceedings. In the Autonomy case, the Independent Tribunal imposed the highest financial sanction to date in any FRC matter; in the Silentnight case the Independent Tribunal made findings of Misconduct in respect of serious ethical issues.

Fewer investigations were resolved in the year, in part reflecting the stages of the matters in our portfolio and in part reflecting slower progress than we would like in the conclusion of cases through settlement where admissions are made. This year's Review therefore spotlights the benefit of regulatory cooperation, including where those subject to investigation proactively identify and remediate issues, and self-report or make full and frank early admissions.

Separately, we continue to address factors inhibiting our ability to progress matters more expeditiously, most particularly increasing the size of the Division by 44% during the year, with further growth planned for the year ahead. Whilst it will necessarily take time for all recruitment benefits to be delivered, we have a solid platform on which to build.

Last year to assist in driving audit quality we included Themes from past audit cases. This year, with a view to improving the quality of financial statements by demonstrating behaviours to be avoided, we have included Themes from past cases against those responsible for preparing financial statements. We also highlight challenges for accountants and auditors in addressing future uncertainties arising from EU Exit, climate change and the pandemic.

The impact of the pandemic on Society has been immense and has necessarily affected those whom we regulate as well as those at the FRC. Challenges have abounded but opportunities have also arisen, including more agile ways of working and harnessing of technology to enable investigations to progress, and public hearings to continue remotely whilst live streamed to a wider audience.

It is therefore fitting to end by thanking everyone who has engaged in the regulatory process this year, whether the subjects of investigations, audited entities, those with whom we work and - particularly - all members of the Division, for their efforts in ensuring that matters were able to progress in this most difficult of years.



**FRC Executive Counsel**  
Elizabeth Barrett

## 2 The year at a glance



**49**

current investigations



**16**

investigations opened into auditors, accountants and/or actuaries in the year



**15%**

increase in matters identified through horizon-scanning activities



preliminary enquiries opened



**48**

cases resolved through Constructive Engagement



**6**

cases resolved with settlement



**1**

case resolved through Tribunal



**3**

cases closed with no further action



Financial sanctions of

**£16.7 million**

(before settlement discount)



**44%**

growth in Enforcement Division



Recurring theme: Failure to exercise professional scepticism



Tribunal report on Autonomy highlighted failures to act with integrity, objectivity, scepticism and professional competence

## 3 Themes from past cases involving accountants working in business

### Introduction

Last year's themes section focused on the reasons behind common audit failings. This year we have chosen to highlight issues arising out of investigations into those responsible for preparing and approving companies' financial statements.

The primary responsibility for a company's financial statements lies with those who prepare the underlying financial information and with the company's directors, who are subject to statutory duties to satisfy themselves that the company's accounts give a true and fair view of the company's assets, liabilities and financial position.

The FRC does not currently have regulatory jurisdiction over members of management or directors of companies unless they are qualified accountants who are members of one of the six chartered accountancy bodies<sup>1</sup> and the case raises matters of important public interest.<sup>2,3</sup> In practice, this means our ability to investigate and take enforcement action is limited to some finance directors, certain CEOs and other, more junior, accountants working in business.

In cases where these accountants are found to have committed Misconduct, they are liable to be sanctioned. Misconduct is defined as:

*'an act or omission or series of acts or omissions, by a member ... in the course of his or its professional activities (including as a partner, member, director, consultant, agent, or employee in or of any organisation or as an individual) or otherwise, which falls significantly short of the standards reasonably to be expected of a member... or has brought, or is likely to bring, discredit to the member ... or to the accountancy profession.'*<sup>4</sup>

The Misconduct test sets a high hurdle. Minor breaches of standards or poor conduct by accountants will not be enough to amount to Misconduct.<sup>5</sup> Investigations that lead to sanctions are often at the higher end of seriousness.

### Relevant standards

The conduct standards for accountants include, among others, those set out in the Codes of Ethics published by each of the accountancy bodies.

While they differ slightly, all Codes require adherence to the fundamental principles expected of a professional accountant: integrity; objectivity; professional competence and due care; confidentiality and professional behaviour. These principles are framed in broad and general terms.

1 The professional accountancy bodies referred to in this report are the Institute of Chartered Accountants in England and Wales (ICAEW), the Institute of Chartered Accountants of Scotland (ICAS), Chartered Accountants Ireland (CAI), the Association of Chartered Certified Accountants (ACCA), the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Chartered Institute of Management Accountants (CIMA).

2 Financial statements that contain misstatements resulting in losses to significant numbers of UK investors are likely to be considered as public interest cases.

3 See [Accountancy Scheme](#) paragraph 5(1)(i)(a).

4 See [Accountancy Scheme](#) paragraph 2(1).

5 Prior to 2016, the Misconduct test was also applicable to all audit investigations. Since 2016, and the introduction of the Audit Enforcement Procedure (AEP), a lower test ('breach of a Relevant Requirement') is used in audit investigations.



The Misconduct test sets a high hurdle

- **Integrity** is an obligation on all professional accountants to be straightforward and honest in professional and business relationships. Integrity also implies fair dealing and truthfulness. By way of example, an accountant should not be associated with reports, returns, communications or other information where they believe that the information: (a) contains a materially false or misleading statement; (b) contains statements or information furnished recklessly; or (c) omits or obscures information required to be included where such omission or obscurity would be misleading.
- **Objectivity** is an obligation on all professional accountants not to compromise their professional or business judgement because of bias, conflict of interest or the undue influence of others.
- The obligation to exercise **professional competence and due care** requires accountants to attain and maintain the requisite knowledge necessary for a competent service to be provided based on current technical and professional standards and relevant legislation. Accountants are required to act diligently and in accordance with applicable technical and professional standards (applying sound judgement when exercising professional knowledge and skill, and acting carefully, thoroughly and on a timely basis).
- The principle of **confidentiality** means respecting, maintaining and preserving the confidentiality of information acquired as a result of professional and business relationships.
- The principle of **professional behaviour** obliges professional accountants to comply with relevant laws and regulations and avoid any action that may bring discredit to the profession. In relation to accountants who are company directors, such laws include statutory duties concerning corporate reporting and audit.

## Past cases

Over the past six years, we have investigated 26 accountants in relation to their conduct in preparing or approving financial statements and imposed sanctions on 18 individuals.<sup>6</sup> In many instances, we have also taken action against the auditors.

We set out below some of the themes arising from the concluded investigations.

### 1. Fraudulent use of company funds

The most serious cases involve accountants who commit fraud in order to make financial gains at the expense of the company itself or other stakeholders.<sup>7</sup> In one such case, the accountant director created fraudulent documents to give the impression that company funds were applied for the benefit of the company (in the form of leases) while in fact they were used for his own financial benefit.

<sup>6</sup> We also have ongoing investigations into a further 12 accountants. In some of those cases we have either already sanctioned the auditors, or in others, the audit investigations are ongoing. See further information about open investigations at page 31.

<sup>7</sup> These cases are usually investigated by criminal agencies in parallel with us. If accountants are convicted in the criminal courts, the conviction stands as evidence of Misconduct in itself. The criminal aspects of Fraud are outside of the FRC's remit.



Over the past  
six years,  
we have  
investigated

**26**  
accountants

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## 2. Misleading financial reporting

Many of our cases relating to financial reporting have involved accountants attempting to make a company appear more profitable than it is, either by overstating revenue earned within the reporting period or through understating the related costs incurred. Accountants have also overstated a company's underlying, or likely future, profitability by providing misleading information on the nature of a company's profit or financial position through mis-categorising certain items. Examples are set out below:

### a) Fabrication of revenue streams

Some accountants have fabricated revenue streams and provided false invoices to auditors, thereby allowing fictional amounts to appear in the financial statements or interim reporting, which bolstered the appearance of the company's results.

In one case, the accountants provided detailed monthly statements to the auditors including an additional revenue stream on a long-term contract, when in fact that revenue was non-existent and was not billed. The fabricated revenue streams were accepted by the auditors. This led to revenue being overstated by millions of pounds.

In another case, accountants within the company drew up false documents that purported to evidence contractual relations with another company, which allowed revenue to be recognised when in fact no revenue existed.

### b) Wrongly recognising revenue

An important principle of accounting is that revenue on contracts should not be recognised in the accounts until it is either received, or probable that it will be received in the future.

A number of our investigations into accountants have identified the recognition of revenue in the financial statements when the conditions for recognition under the accounting standards – and often the companies' own policies – do not allow it.

There are various examples of revenue being recognised before it has been received and when receipt is not guaranteed, or even probable. One case involved an international recruitment agency with a fee structure that provided for receipt of the finder's fee upon candidates starting their employment. The finance director dishonestly recognised the revenue for the fees in management accounts not only before the candidates started, but often before the job had even been secured, such that the probability threshold had not been reached.

In another case, a substantial seven-figure contract, with a material impact on the profitability of the company, was recognised in the company's accounts, while the contract was still the subject of discussion and negotiation.

Accountants in another case recognised revenue streams in relation to projects that were yet to start, and revenue in relation to claims where the essential preliminary stages (such as any acceptance of liability) had not been reached.

**Fabricated revenue streams and false invoices provided to auditors**

**Revenue recognised, before receipt is probable**

### c) Recognising revenue too early

Similarly, we have come across instances where revenue has been recognised prematurely. We have seen revenue recognised in one year when it should fall into the later year. This can be deliberate, in order to boost the revenue (and profits) of the earlier financial statements and thereby communicate a message that the company is more profitable than is in fact the case.

Possible indicators of such conduct, apparent from a number of our investigations, are material transactions entered into shortly before the company's accounting year end.

Our cases often concern contracts that span more than one accounting year. In such circumstances, there are specific accounting requirements governing how much of the total contract value can be recognised as revenue in any given year. Generally, the appropriate accounting approach has been to recognise the percentage of revenue proportionate to the total estimated costs to complete the contract to be recognised (often referred to as the 'stage of completion' method).<sup>8</sup> We have encountered accountants misrepresenting the degree to which the contract has been completed, to enable more revenue to be booked into the current year's accounts.

### d) Inappropriate capitalisation of costs

To a non-accountant, it may seem counter-intuitive that certain internal costs incurred by a company can be recorded as assets in the company's financial statements. The accounting standards, however, set out strict criteria for when such costs can be capitalised or recognised as intangible assets.

Costs can only be capitalised (and thereby not included in the company's profit and loss account) if it is probable that the expected future economic benefits attributable to the asset will flow to the entity, and that the cost can be measured reliably. Some of our investigations into accountants have identified instances of costs being inappropriately treated as intangible assets. An example includes capitalising regular human resources costs when there was no basis to do so, in a deliberate breach of the accounting standards.

We have seen examples of recognising intangible assets with no evidence that the necessary criteria have been met, e.g. a lack of any proper records or timesheets to provide a reliable measurement of costs for work carried out. By treating such costs wrongly as intangible assets, profits in the companies' accounts were overstated.

### e) Failure to account appropriately for bad debts

A common issue has been accountants seeking to obscure the nature of certain losses from users of the financial statements by categorising them inappropriately. In one case, a company had a number of bad debts from its customers but, rather than write these debts off and reflect this appropriately in the financial statements, the accountants included them in a generic liabilities general ledger account, which included amounts given as trade discounts and customer rebates. This account also included certain amounts relating to unpaid VAT (which netted off the bad debts) that were later the subject of a penalty for late payment. This accounting treatment obscured the nature of losses and liabilities from the readers of the accounts.

**Misrepresentation of the degree to which the contract is completed**

**Costs inappropriately treated as intangible assets**

**Obscuring the nature of losses and liabilities**

<sup>8</sup> This reflects the accounting standards in place at the time of the Misconduct. A more recent accounting standard, IFRS 15, allows for different approaches.

In another example, a number of debts that were overdue and unlikely to be paid were consolidated into a purported single transaction with a much later payment date. By this means, for which there was no legitimate accounting justification, the debts were inappropriately recorded as receivables due, instead of being written off. This again had the result of overstating both profit and assets.

#### **f) Inappropriate categorisation of liabilities so that financial statements were misleading as to the true level of a company's financing requirements**

We have seen various instances of accountants classifying liabilities as operational rather than financial, to hide the fact that they were loans or borrowings.

In one case, a short-term loan, which had been paid into the company a matter of days before the half-year end to bolster the interim reporting, was treated as an operational liability, masking the fact that it was a loan. This had a misleadingly positive impact on the 'cash conversion' figure, which was a key performance indicator used by analysts.

In another case, a complex arrangement to sell and lease back office and IT equipment was wrongly accounted for as an operating lease rather than a financing lease. This accounting treatment hid the fact that the arrangement was, in effect, a loan and resulted in a lower net debt figure, which is another metric of importance to analysts.

### **3. Goodwill in companies' assets**

Under accounting standards, goodwill can only be added to a company's balance sheet by acquiring other businesses. In essence, goodwill is the difference between the amount paid for the acquired business and the value of its assets and liabilities. Generally, it is assumed that this excess is the value of an additional intangible asset acquired.

Each year companies are required to determine the recoverable amount of the company's cash generating units (CGUs) with goodwill allocated to them. Many companies do this by estimating the future cash flows of those CGUs and then applying an appropriate discount rate to compute their present value. If the recoverable amount (e.g. value in use) is less than the recognised amount included in the financial statements, then an impairment has taken place. This impairment needs to reduce any goodwill attached to a CGU. Value in use calculations require management and the preparers of the accounts to prepare cashflow forecasts, relying on estimates. Although many of our audit investigations concern the audit of management's work on goodwill, the primary responsibility for conducting the goodwill assessment lies with management. We have seen examples of incorrect and sometimes reckless work in that respect.

In one case, substantial amounts of goodwill were included on the company's balance sheet when there was no justification for including any: the businesses that had been purchased in earlier years were all loss-making with net liabilities and, further, one of them had already gone into administration.

In other cases, the work conducted in relation to goodwill was flawed due to inaccurate estimates being used in models to assess future cash flows, as well as errors in the discount rates used.

**Classification of liabilities as operational rather than financial**



**Incorrect and in some cases reckless goodwill impairment calculation**

## 4. Misleading auditors

Some of our past cases reveal examples of management failing to provide relevant material to the Audit Committee and the auditors, for example, withholding key information relevant to whether the conditions for recognising revenue have been met, and in some cases overtly misleading auditors by providing false documents to evidence non-existent revenue streams.<sup>9</sup>

### Motives

Most of the accountants we have sanctioned have admitted acting with a lack of integrity (either deliberately or recklessly). As stated above, this includes not being straightforward and honest in business relationships and being associated with communications and reports that contain materially false or misleading statements.

While the motives for such lack of integrity are not always apparent, it is often clear that pressure for the company to meet financial targets and to achieve positive half-year or year end results is a big driver. Interestingly, while in some instances accountants may benefit from a bonus or share scheme that is linked to good financial results, this is not the position in all the cases; this suggests that seeing the company thrive, appear to do well, or merely stay afloat can be a motive in itself.

Another frequent observation is an excessive degree of optimism exhibited by management and directors: that the contracts will be signed; that revenue will increase; that the restructuring will be successful; or that the claims will be fruitful. This has led, in some circumstances, to accountants losing objectivity and yielding to pressure (or perceived pressure) applied by others associated with results or reports that, to their knowledge, are not justifiable or are not supported by the necessary evidence.

### Sanctions

All but one of the 18 accountants sanctioned by the FRC were excluded from membership of their accountancy body, and so unable to practise as chartered accountants. The length of exclusions ranged from three to 16 years.

In some cases, financial sanctions and costs were also imposed.



**Key information withheld or false documentation provided to the Audit Committee and auditors**

**Excessive degree of optimism and loss of objectivity**

<sup>9</sup> It is a criminal offence under section 501 of the Companies Act 2006 for a person to knowingly or recklessly make a misleading false or deceptive statement to an auditor. While the FRC does not have powers to take criminal action, referrals can be made to relevant prosecution agencies.

## 4 The team and processes

### Who are the FRC Enforcement Division?

We encompass the Case Examination and Enquiries (CEE) team and Investigations and Enforcement. During the year our team grew from 40 to 52\*.

#### The team comprises:

 <b>Executive Counsel:</b> Elizabeth Barrett	 21 Forensic accountants
 <b>Deputy Executive Counsel:</b> Claudia Mortimore, Jamie Symington	 6 Legal and accounting assistants
 20 Lawyers (qualified as either barristers or solicitors)	 1 Chief of Staff
	 1 Administrative Assistant

### Who can the FRC investigate?



Accountants and Actuaries under the Accountancy Scheme and Actuarial Scheme



Statutory Audit firms and Auditors under the Audit Enforcement Procedure (AEP)

#### Case Examination and Enquiries (CEE) - Intelligence-gathering, initial enquiries

##### SOURCES

- Horizon-scanning
- Referrals from other FRC teams, regulators, audit firms and professional bodies
- Complaints
- Whistleblowing disclosures

##### OUTCOMES

- Referral to Conduct Committee for decision on opening of investigation
- Constructive Engagement (AEP only)
- Referral to another FRC team
- Referral to a professional accountancy or actuarial body or regulator
- No further action

#### Investigations and Enforcement - Conduct of investigations referred by Conduct Committee

##### OUTCOMES

###### AEP:

- Initial Investigation Report (IIR)
- Decision Notice and proposed sanction
- Accepted or Tribunal convened

###### Scheme:

- Proposed Formal Complaint/ Formal Complaint
- Settlement or Tribunal convened

At any point, Executive Counsel can close a case should the threshold for taking enforcement action not be met

##### SANCTIONS

###### Financial:

- Unlimited fines
- Waiver of client fees

###### Non-financial sanctions e.g.

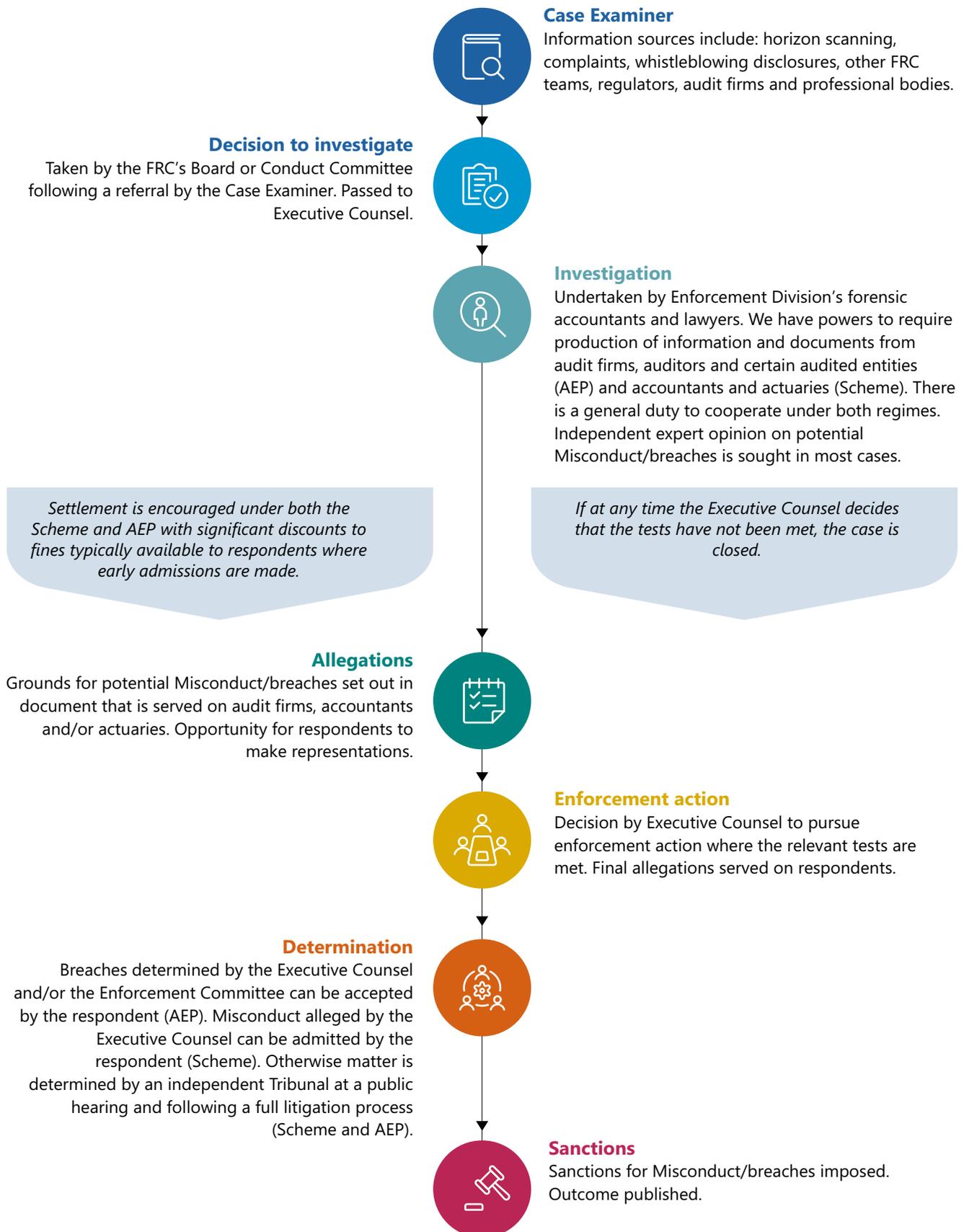
- Reprimand
- Exclusion as a member of a professional body
- Other remedial actions as appropriate

Sanctions are determined by reference to the [Sanctions Policy \(AEP\)](#), [Accountancy Sanctions Guidance \(Scheme\)](#) and [Actuarial Sanctions Guidance \(Scheme\)](#)

\* In October 2020, conduct of enquiries undertaken to support decisions on AEP matters was transferred from Enforcement to the recently formed Audit Firm Supervision team, this transfer included 4 CEE colleagues. On a like for like basis Enforcement and CEE has grown from 36 at March 2020, to 52 at March 2021, a growth of 44%. Enforcement March 2021 budgeted headcount was 72 as published in the [2021/22 Strategy, Plan and Budget](#).

## Enforcement process

A high-level overview of our enforcement process is set out in the flow chart below. Further details of the FRC's remit and powers can be found in Appendix A.



## 5 Review of the year

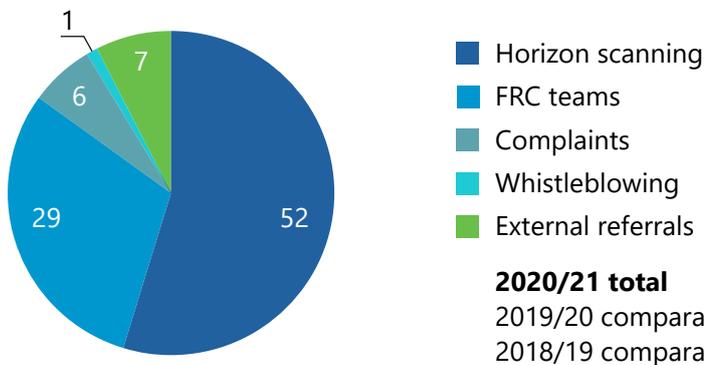
### Case Examination and Enquiries

2020/21 is the fourth full year since the AEP came into force and the CEE process was introduced. The AEP brought a significant shift in audit enforcement, with the expansion of the FRC's remit (to all public interest entities (PIEs), large AIM<sup>10</sup> companies and Lloyd's Syndicates) and a change to the threshold for examining potential Statutory Audit failures (to potential breaches of Relevant Requirements as opposed to potential Misconduct). The AEP also introduced Constructive Engagement, to deal with cases where the audit quality concerns can be appropriately and satisfactorily addressed, and the risk of repetition mitigated through engagement with the firm without the time and expense of full enforcement action. Further details of the FRC's powers, the AEP and Constructive Engagement process are set out in Appendix A.

The Case Examiner is responsible for decisions taken in respect of all cases presented to the Conduct Committee for potential investigation. However, since October 2020, enquiries undertaken to support these decisions in audit matters under the AEP are conducted with the assistance of the recently formed Audit Firm Supervision team. This is in order to leverage the detailed audit firm knowledge of the Audit Firm Supervisor, who is the primary contact for the firm and with whom the firm has regular liaison.

### Cases opened in the year<sup>11,12</sup>

#### Cases opened (by source)



**95**  
cases opened  
during the  
year

Ninety-five cases were opened in the year compared with 88 in the previous year, an increase of 8%. There were increases from our enhanced horizon-scanning activities and also referrals from other FRC teams, which in the current year comprised those arising from Audit Quality Review (AQR) inspections of individual audits, from reviews of financial statements by Corporate Reporting Review (CRR) and from existing Enforcement investigations.<sup>13</sup> The number of

<sup>10</sup> UK companies admitted for trading on AIM or NEX (other than the Main Board) with a market capitalisation of more than €200m, using the formula in MiFID II.

<sup>11</sup> The enquires and outcomes data comprises all cases passing through a case examination process, including all audit matters dealt with under the AEP, and all Scheme matters progressed to the Conduct Committee.

<sup>12</sup> The source category refers to the method by which a matter first came to our attention. It may be that matters we identify through horizon-scanning activities are subsequently the subject of complaints or referrals.

<sup>13</sup> Referrals from the Enforcement team relate to cases where potential breaches have been identified in additional audit years or where potential additional subjects have been identified in relation to an existing investigation under the AEP or the Schemes.

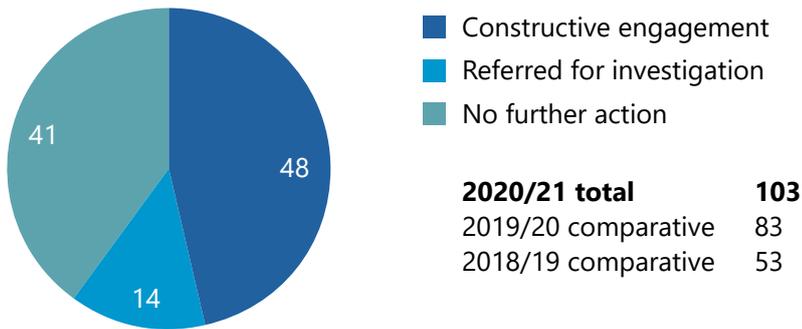
complaints and whistleblowing disclosures passed to CEE for initial assessment was fewer than half of those received in the previous year. This was due to complaints about matters not in the FRC's remit being dealt with directly by the Central Complaints Team, rather than being passed to CEE. A greater number of external referrals were received this year from professional bodies and other regulators, although these still accounted for less than 10% of the cases opened.

Similar to last year, the majority of cases opened were audit-related (93% compared with 90% last year). This reflects the lower threshold for examining auditors', as opposed to accountants', conduct. The independent review of the FRC by Sir John Kingman published in December 2018 (the FRC Review) recommended that the thresholds for investigating accountants' conduct should be lowered and aligned with that for auditors. More details of the progress made in implementing the FRC Review recommendations is set out in Section 8.

At 31 March 2021, 15 cases remained open, compared with 28 at 31 March 2020.

## Outcome of CEE cases<sup>14</sup>

### Cases closed by outcome



During the year, CEE closed 103 cases, an increase of 20, or 24%, on the previous year, revealing a steady increase in our turnover of cases. Of these:

- 14<sup>15</sup> cases (2019/20: 18) were referred by the Conduct Committee to Executive Counsel for investigation;
- 48 cases (2019/20: 33), almost half, were resolved through Constructive Engagement; and
- 41 (2019/20: 32) resulted in no further action by the Case Examiner, of which three were referred to other regulators and three were referred to the FRC's AQR team for consideration under the FRC's processes relating to entities incorporated in Crown Dependencies.

More details of the cases in each closure outcome are set out in the sub-sections below.

<sup>14</sup> Enquiries are regarded as closed at the point of referral for investigation by the Conduct Committee or when the decision is taken that no further enquiry work needs to be undertaken by the Case Examiner. Individual outcomes are not published, except where they lead to the opening of investigations and where, in accordance with the Publication Policies, it is considered appropriate to announce that investigation.

<sup>15</sup> Fourteen matters were referred from CEE and two matters were referred from Enforcement related to an ongoing investigation.



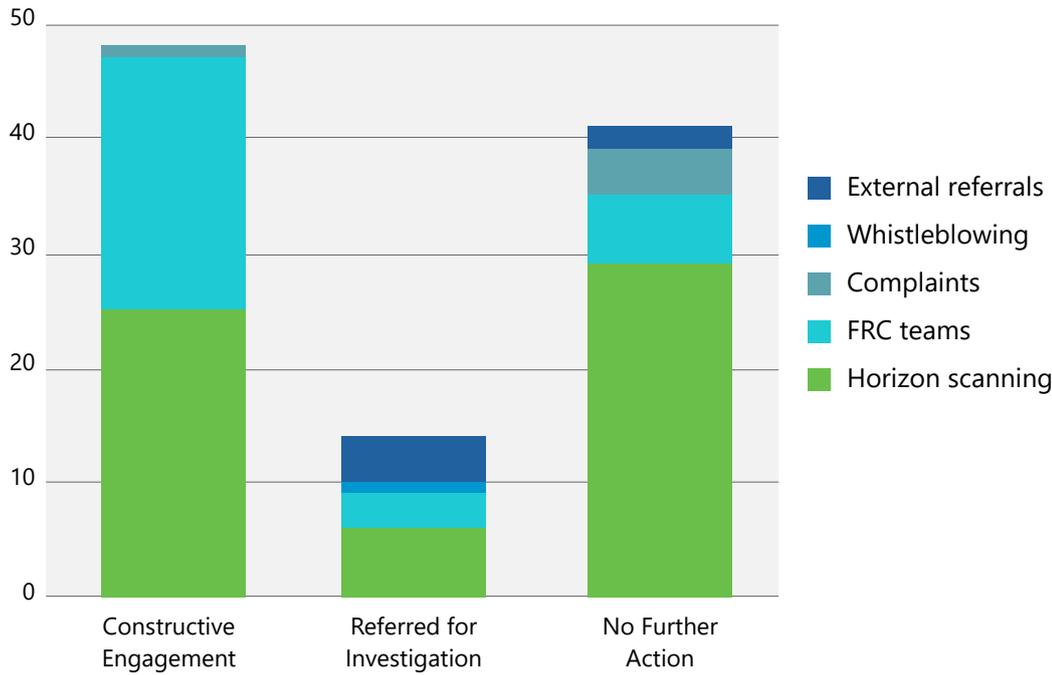
**93%**  
of cases  
opened in  
the year were  
audit-related



**48**  
cases were  
resolved  
through  
Constructive  
Engagement

The following chart illustrates how the case outcomes break down by the source of the enquiry:

### Outcome of cases with source details



Investigations can arise from a number of sources. Our horizon-scanning activities and referrals from other FRC teams are the source of the majority of our Constructive Engagement activity, each contributing in equal measure.

### Referrals to the Conduct Committee

The cases referred to the Conduct Committee, and the Conduct Committee’s decisions in the year comprised:

	Investigation under the AEP or Schemes	Referred back for Constructive Engagement or no further action	Total
Audit	12	3	15
Accountancy	2	0	2
Actuarial	0	1	1
<b>Total</b>	<b>14</b>	<b>4</b>	<b>18</b>

The 18 cases referred to the Conduct Committee came from a variety of sources. Seven were referrals from other FRC teams (including AQR and Enforcement), two were external referrals from a Recognised Supervisory Body (RSB)<sup>16</sup>; six came from our horizon-scanning activities; two as a result of self-referral by a professional firm; and one from a whistleblowing complaint.

<sup>16</sup> Recognised Supervisory Bodies (RSBs) are: the Institute of Chartered Accountants in England and Wales (ICAEW), the Institute of Chartered Accountants of Scotland (ICAS), Chartered Accountants Ireland (CAI) and the Association of Chartered Certified Accountants (ACCA).

Fourteen of these cases were referred for investigation (under the AEP or the Schemes). Further details of the new investigations opened (to the extent that details may be given) are shown under Investigations and Enforcement later in this section. Of the remaining four cases, three were passed back to the Case Examiner for resolution through Constructive Engagement and one resulted in no further action as the Conduct Committee decided it did not meet the threshold for consideration under the Actuarial Scheme.

The average time taken to refer a case to the Conduct Committee was under four months, which is in line with last year. Fifty per cent of cases were referred to the Committee within two months. Where cases took longer it was either because we were waiting for the outcome of other relevant reviews, for example company internal forensic reviews, or we initially sought to resolve them through Constructive Engagement, but ultimately concluded that they had not been satisfactorily resolved in this way.

## Constructive Engagement

We continued our focus during the year on further developing the Constructive Engagement process as an effective and efficient alternative to referring qualifying cases<sup>17</sup> for investigation.

Forty-eight cases, involving a wide range of issues, were dealt with through Constructive Engagement during the year, an increase of 45% on the previous year. The source of these cases was our horizon-scanning activities (25), cases referred by other FRC teams (22) and complaints received (1).

In resolving the 48 cases, we engaged with 11 separate Statutory Audit firms. Thirty-four (70%) of the 48 cases involved the Big Four accounting firms and 43 of the 48 cases (90%) involved the seven largest firms.

Half of the cases resolved through Constructive Engagement involved errors in financial statements, which led to subsequent restatements. The suitability of each case for Constructive Engagement is determined on its own merits taking into account a range of factors. In general, we determined cases were suitable for Constructive Engagement where the errors appeared unlikely to have had a real impact on decisions taken by users of an entity's financial statements. This may have been because the errors were only marginally material in a quantitative sense, were in highly technical areas of the financial statements or were in areas that were not of fundamental importance to the measurement of the underlying financial performance of the entity.

The other half included potential breaches of auditing standards that had been identified through AQR inspections, CRR reviews or by events in the public domain that warranted further enquiry as to how the auditors had approached the factors underlying those events. These cases were considered appropriate for resolution through Constructive Engagement as there was no apparent impact of the potential breaches on the financial reporting of the entities. In addition, timely intervention through Constructive Engagement could result in remedial actions being taken by the audit firm in time for the following year's audit (as well as on a firm-wide basis).

The average time taken to conclude the Constructive Engagement cases was just under five months; an improvement on 2019/20, where the average was just under seven months.



Number of cases dealt with through Constructive Engagement up **45%**



Average time taken to conclude cases through Constructive Engagement was under **five months**

<sup>17</sup> See paragraphs 13–15 of the Guidance for the Case Examiner, which can be found [here](#).

Across the 48 Constructive Engagement cases, the most common primary accounting areas encountered were as follows:

- **Revenue (9 cases):** in these cases, either no evidence was available to us that there had been a material error (but deficiencies in the audit work had been identified), or there was an error that we concluded was likely to have had a relatively low impact, for example, weaknesses in relation to audit procedures over the completeness of revenue or a failure adequately to distinguish separate revenue streams;
- **Cash flow statements (8 cases):** in common with the work of other FRC teams, we followed up on cases involving errors in cash flow statements, often the incorrect classification of cash flows where there was no obvious impact on users of financial statements;
- **Dividends or share buybacks (8 cases):** where interim financial statements had not been filed to justify the dividend distribution albeit sufficient distributable reserves existed at the relevant payment dates, or there were insufficient reserves to make a share buyback that was subsequently rectified by shareholder resolution;
- **Impairment (5 cases):** corporate costs inappropriately allocated during impairment reviews and insufficient specificity in testing to ensure compliance with the accounting standard, but not such as to have any apparent impact on the financial reporting of the entities;
- **Share premium accounting and merger reserves (4 cases):** overreliance on management's erroneous legal advice on the correct accounting treatment for transactions arising on acquisitions and the exercise of share options; and
- **Provisions/accruals (4 cases):** failure to accrue in a timely manner or lack of evidence of sufficient challenge to management's judgements albeit not resulting in any obvious error or likely to impact upon users of the financial statements.

In these 48 cases, the most common issues underlying the Allegations concerning the audit work were as follows:

- **Insufficient audit testing (24 cases),** often in an area not regarded as a significant risk or area of audit focus, for example accounting for reserves, or cash flow statements;
- **Lack of professional scepticism (21 cases),** failure to challenge or document the challenge to management's accounting treatment; overreliance on management or its advisers; or failure to consider the need for independent advice and insufficient quality review;
- **Lack of detail in audit procedures (8 cases),** for example where the wording of the audit test was insufficiently specific to match all aspects of the accounting standard;
- **Lack of professional judgement (7 cases),** for example including in a cash flow statement a payment that had been accrued but not yet paid, or applying one lending rate for hedge effectiveness testing to all portfolios when only one of the portfolios used that rate;
- **Lack of technical expertise (6 cases),** for example by failing to appreciate the significance of the maturity of money market deposits when considering cash and cash equivalents, or failing to use appropriate geographical and industry specialists.

In 39 of these 48 cases, bespoke remedial actions were agreed with the firms, usually on a firm-wide basis but in some cases specific to a particular audit. The latter occurred particularly in cases arising from AQR referrals, to ensure that the risk of repetition was adequately addressed. In the remaining nine cases, we were satisfied that steps already taken by the firm had adequately addressed the risk of repetition.

Bespoke remedial actions were agreed with firms in over **81%** of cases resolved by Constructive Engagement

The remedial actions undertaken as a result of our Constructive Engagement activity largely involved amendments to a firm's audit procedures and/or training and guidance to introduce the new audit procedures or to reinforce the existing audit methodology and guidance.

Examples of remedial actions include:

- Delivery of a mandatory e-learning course on distributions for all grades from Assistant Manager to Partner;
- A review of whether a blended audit approach utilising controls and substantive testing can be adopted if new controls are found to be designed and operating effectively;
- Enhanced review processes for financial statements of audited entities identified as at a higher risk of misstatement (e.g. listed companies, specialist audits etc.) with more in-house review and a review by an external firm;
- A fundamental change to a firm's audit methodology to change procedures where it no longer mandated the use of substantive analytical procedures, together with training for audit teams;
- Inclusion in a quarterly knowledge-sharing event of an explanation by the audit engagement leader of an audited entity's restatements and related accounting matters;
- Introduction of a policy that UK group audit teams will request bank confirmations for all cash and cash equivalent balances for all components within the scope for group reporting;
- Assigning work on the cash flow statement to more senior members of the audit team with enhanced supervision and review processes.

While each case is considered on its own merits, to illustrate the range of Constructive Engagement activity undertaken, three anonymised case examples are set out below.

## Case A



A listed company materially overstated its 2019 cash and cash equivalents balance in its balance sheet and cash flow statement, after failing to comply with certain provisions of IAS 7 Statement of Cash Flows.

The audit firm had not considered the accounting implications of a change in the maturity of certain short-term deposits and therefore did not obtain sufficient appropriate audit evidence that the company was complying with accounting standards relating to cash flow statements. The technical review team at the audit firm also failed to identify the issue. There was therefore information to suggest the audit firm had not complied with the auditing standards relating to audit evidence and/or quality control. This information constituted an Allegation about the 2019 audit.

The Allegation against the audit firm was suitable for Constructive Engagement because there was no apparent financial detriment or adverse investor, market or public comment on the audit resulting in a possible loss of confidence in the auditing profession. Although the restatement affected cash and cash equivalents, no loss of cash resulted.

As part of Constructive Engagement, the audit firm promoted a new firm-wide audit approach to the planning of the audit of the cash flow statement, ran firm-wide training on cash flow statements, conducted reviews of all cash flow statement errors, which had been identified by the FRC and internally, and produced a detailed technical update for all senior audit personnel on the specific issue relevant to this case.

The Case Examiner was satisfied that these steps appropriately addressed the risk of repetition in this case.



**The firm promoted a new firmwide audit approach to planning the audit of the cash-flow statement**

## Case B



We made enquiries of a firm involving their 2018 audit of a UK listed company. Our main concern related to the audit procedures performed in testing revenue.

The audit team adopted a controls-based audit approach to revenue testing. They failed to identify key differences in the characteristics of different revenue streams and wrongly concluded that reliance could be placed on a particular control. Further, the audit team considered the design effectiveness of the audited entity's controls but neglected to test the operating effectiveness.

This information constituted an Allegation about the 2018 audit. The Allegation was suitable for Constructive Engagement because, despite the weaknesses of the audit approach, no restatement or error crystallised. We also considered the outcome of the 2019 audit of revenue, which indicated that the issues had been rectified.

As part of Constructive Engagement, the firm undertook the following remedial actions:

- The introduction of a new mandatory revenue risk assessment template working paper which requires audit teams to identify and consider separate revenue streams;
- Delivery of a national quarterly training course on revenue risk assessment;
- Restructuring of the IT audit function with the new team integrating more with the respective audit teams;
- Additional detailed controls testing training for all audit teams, focusing on controls-based approaches and documentation regarding business processes and walk-through steps.

The Case Examiner was satisfied that these steps appropriately addressed the risk of repetition in this case.



**The Firm introduced a new mandatory revenue risk assessment template**

## Case C



A listed company restated its 2019 balance sheet to correct an undetected error relating to share buybacks. The audit team relied on discussions with management and did not request or review the relevant contractual documentation, and therefore did not identify the irrevocable nature of certain commitments (nor that management's representations were incorrect).

There was therefore information that raised a question as to whether the audit firm had complied with:

- Auditing standards relating to the overall objectives of an audit and the application of appropriate professional scepticism when considering the position taken by management; and
- Requirements to obtain sufficient, appropriate audit evidence to support the accounting treatment applied.

The issues had no impact on the fundamental trading performance of the entity or profit before tax (on which materiality was based). The case was therefore considered suitable for Constructive Engagement.

The Constructive Engagement process resulted in the audit firm developing a share buyback guide to alert audit teams to the importance of reviewing contractual arrangements. Other wider considerations such as the impact on distributable reserves were also included in the share buyback guide.

The Case Examiner was satisfied that the steps taken would mitigate the risk of repetition in this area.

Certain actions agreed through our Constructive Engagement activity are similar to the types of non-financial sanctions imposed at the conclusion of enforcement action, designed to improve audit quality. While Constructive Engagement outcomes do not amount to a sanction, and are not individually published, they can result in potentially onerous requirements for audit firms. The process requires full and open cooperation by audit firms and, during the year, we were generally satisfied with the level of cooperation and timeliness of responses we received.

The value of Constructive Engagement activity is also dependent on the new measures being appropriately followed by audit teams in practice. Responsibility for monitoring these improvements on an ongoing basis has been transferred to the dedicated Audit Firm Supervisor within the Audit Firm Supervision team. Where appropriate the Supervisors will work with the FRC's AQR team in conducting follow up work. The case examination process notes where similar matters are identified in audits conducted by the same audit firms, and recurring matters may be a catalyst for referring a matter to the Conduct Committee to consider opening an investigation.



**Constructive Engagement resulted in the firm developing a share buyback guide**

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## No further action

There were 41 cases closed in the year with no further action. The majority (29) arose from our horizon-scanning activities with the remainder coming from complaints, FRC teams and external referrals.

In 30 of these 41 cases, the information that came to our attention involved the Statutory Audit of at least one UK PIE or large AIM-listed organisation. We consider all such cases carefully and in detail to identify whether there may be underlying issues of relevance to the work conducted by the Statutory Auditors. However, on examination of the information available in these 30 cases, we found no basis to support further enquiry into the audit. The reasons for this included one or more of the following:

- There was no apparent material financial reporting error at the entity;
- There was no indication of a breach of a Relevant Requirement by a Statutory Auditor, for example, where the underlying issue was not within the scope of a Statutory Audit; and/or
- The complaints raised related to the conduct of an entity's directors or other personnel not within the FRC's remit, rather than its auditors.

In the remaining 11 cases, the reasons for no further action included:

- The cases involved non-UK auditors or UK audit matters which the FRC has delegated to the RSBs<sup>18</sup> (for example the audits of privately owned companies);
- The cases involved complaints against individual accountants which were either more appropriately dealt with by their professional body, or there was insufficient evidence of Misconduct;
- The matters did not involve the conduct of auditors, accountants or actuaries; or
- The case was more appropriately dealt with by another FRC team.

Where a case raises issues that are not in the FRC's remit, we can direct complainants to other bodies, which may address their complaints. This year, those bodies included the RSBs, the accountancy professional bodies, the Financial Conduct Authority, and the Insolvency Service.

## Oversight

All decisions by the Case Examiner to resolve cases through Constructive Engagement or to close them with no further action are subject to an internal review process. In addition, the details of all such cases are reported to the Conduct Committee on a quarterly basis.

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<sup>18</sup> RSBs are ICAEW, ICAS, CAI, and ACCA.

## Investigations and Enforcement

### Investigations opened

	2018/19	2019/20	2020/21
Investigations opened in year	15	14	16
Preliminary enquiries opened in year	1	3	0

The Conduct Committee opened 16<sup>19</sup> new investigations in the 12 months to 31 March 2021: 14 audit investigations under the AEP and two investigations into accountants under the Accountancy Scheme.

### The AEP investigations

The 14 investigations concern a wide range of audit issues including revenue recognition, related party transactions, group audits (including oversight of component auditors), goodwill impairment, inventory, recoverability of loans, going concern, provisions and liabilities, compliance with laws and regulations, presentation and disclosure, complete and adequate audit documentation, compliance with ethical requirements and lack of professional scepticism. Two of these investigations opened by the Conduct Committee followed referrals to the Case Examiner from the FRC's AQR team, following audit inspections.

In accordance with the FRC's Publication Policies,<sup>20</sup> not all investigations are announced at the outset, although if the case leads to enforcement action and the imposition of sanctions, the outcome will be published. The Conduct Committee makes the decision whether or not to announce a new investigation on a case-by-case basis. It will not normally decide to announce the opening of an investigation unless it considers that such publication is necessary in all the circumstances and any potential prejudice to the subject of an investigation is outweighed by the factors in favour of publication (see revised publication guidance box on the following pages).

The seven<sup>21</sup> new AEP investigations that have been announced are:

- Ernst & Young's audit of the financial statements of NMC Health plc for the year ended 31 December 2018;
- KPMG's audit of the financial statements of Eddie Stobart Logistics plc for the year ended 30 November 2017;
- PwC's audit of the financial statements of Eddie Stobart Logistics plc for the year ended 30 November 2018;
- Oliver Clive & Co's audit of the financial statements of London Capital & Finance plc for the year ended 30 April 2015;
- PwC's audit of the financial statements of London Capital & Finance plc for the year ended 30 April 2016;
- Ernst & Young's audit of the financial statements of London Capital & Finance plc for the year ended 30 April 2017;

<sup>19</sup> This comprised 14 matters referred from CEE and two matters referred from Enforcement related to an ongoing investigation.

<sup>20</sup> Links to the Publication Policies are here: [Accountancy and Actuarial Schemes](#); [AEP](#).

<sup>21</sup> As a comparison, two investigations were announced in 2019/20. A list of current FRC investigations which have been publicly announced under the AEP can be found [here](#), under the Accountancy Scheme can be found [here](#) and under the Actuarial Scheme can be found [here](#).

**14%**  
increase in  
investigations  
opened in the  
year

- Deloitte’s audits of the financial statements of Lookers plc for the years ended 31 December 2017 and 2018.

### Accountancy Scheme investigations

Two new investigations under the Accountancy Scheme were opened. In accordance with the FRC’s Publication Policy, neither of these was announced. Given the higher threshold for investigation, it is to be expected that fewer cases satisfy the criteria for opening an investigation under the Accountancy Scheme than under the AEP.

### Actuarial Scheme investigations

No new investigations were opened by the Conduct Committee under the Actuarial Scheme in 2020/2021.

### Preliminary enquiries

If the Conduct Committee considers that it does not have enough information to decide whether to open an investigation under the Schemes, it can direct Executive Counsel to conduct preliminary enquiries. No new preliminary enquiries were opened by the Conduct Committee under the Schemes in 2020/2021.

## Revised publication guidance

The FRC’s Publication Policies, which are determined by the Conduct Committee, were amended and reissued in January 2021.<sup>22</sup> The current Publication Policies<sup>23</sup> contain further guidance on when it may be appropriate to announce the opening of an investigation.

In order to determine that an announcement is necessary in all the circumstances, the Committee must consider that the announcement will:<sup>24</sup>

- Help to maintain public confidence in Statutory Auditors, the accountancy or actuarial professions;
- Help to maintain public confidence in the regulation of these professions;
- Protect users of financial statements;
- Protect investors;
- Help to prevent malpractice that is potentially widespread;
- Contribute to the effectiveness of the investigation itself, for example by bringing forward witnesses;

*Continued*

<sup>22</sup> The [Accountancy and Actuarial Scheme Publications Policy](#) was reissued again in March 2021.

<sup>23</sup> Links to the Publication Policies are here: [Schemes Publication Policy \(March 2021\)](#); [AEP Publication Policy \(January 2021\)](#).

<sup>24</sup> Paragraph 11 of the [AEP Publication Policy \(January 2021\)](#) and paragraph 15 of the [Schemes Publication Policy \(March 2021\)](#).

- Help to allay concern; or
- Help to contain speculation or rumour.

If an investigation leads to enforcement action and the imposition of sanctions, the sanctions applied, and type and nature of the contravention will be published. While this is a mandatory announcement under the AEP Publication Policy (and there is similarly a presumption in favour of publication under the Accountancy and Actuarial Schemes Publication Policy, which can only be rebutted if publication is not in the public interest), the FRC is prohibited from publishing the identity of a person sanctioned under the AEP where:<sup>25</sup>

- Such person is an individual and the FRC considers the publication of personal data would be disproportionate;
- Publication would jeopardise the stability of financial markets;
- Publication would jeopardise an ongoing criminal investigation; or
- Publication would cause disproportionate damage to any institution or individual involved.

Enforcement outcomes do not constitute findings against third parties, and the identity of third parties other than the audited entity will usually be anonymised in any announcements and/or related documents published under this Publication Policy, unless or to the extent that publication of that party's identity is considered fair and necessary in all the circumstances and is in compliance with any applicable data protection laws.<sup>26</sup>

The identity of the audited entity will usually be published in any announcements in relation to the outcome of investigations, unless and to the extent that identity of the audited entity is considered to be unfair and unnecessary in the circumstances.<sup>27</sup>

The FRC announced sanctions against Deloitte and one of its Statutory Auditors during November 2020 in respect of the Statutory Audit of the 2015 financial statements of a company<sup>28</sup> but the name of the Statutory Auditor was not announced as the prohibition above<sup>29</sup> was engaged. As a result, the name of the company was not announced since the identity of the Statutory Auditor is apparent from its published accounts.



**If an investigation leads to enforcement action and sanctions the outcome will be published**

<sup>25</sup> The Statutory Auditors and Third Country Auditors Regulations 2016 s 6(3) and Paragraph 18 of the AEP Publication Policy (January 2021).

<sup>26</sup> Paragraph 28 of the AEP Publication Policy (January 2021).

<sup>27</sup> Paragraph 29 of the AEP Publication Policy (January 2021) and paragraph 23 of the Schemes Publication Policy (March 2021).

<sup>28</sup> Press Notice: Sanctions against Deloitte.

<sup>29</sup> The Statutory Auditors and Third Country Auditors Regulations 2016 s 6(3) and Paragraph 18 of the AEP Publication Policy (January 2021).

## Concluded cases

### Outcome of investigations

	Closed with no further action	Closed with findings of Misconduct/ breaches and sanctions		Total
		Settlement	Tribunal	
2018/19	1	8	4	13
2019/20	4	8	1	13
2020/21	3	6	1	10

Ten cases were concluded in the 12 months to 31 March 2021. As with previous years this is lower than the number of cases opened in the same period, leading to an increase in the number of open cases. We continue to mitigate the risks this creates of capacity overload through increase in resources and improvements to efficiency.

Three preliminary enquiries were closed during the year without further action.<sup>30</sup>

### Cases concluded with sanctions

The FRC has published the outcomes of six investigations that have resulted in sanctions being imposed on audit firms and individuals.

Details of the seven cases are set out below. Additional case summaries are included in Appendix B.

#### BDO/Amtrust Europe Ltd/AEP<sup>31,32</sup>

In June 2020, a Final Decision Notice was issued making findings of breaches of Relevant Requirements by BDO and the Audit partner in relation to the statutory audits of the financial statements of Amtrust Europe Ltd (AEL) for the 2014 and 2015 financial years.

The breaches in each year concerned an area of audit work that was fundamental for the audits of this insurance company: the approach of AEL's management to setting its technical provision for outstanding claims. For the FY2014 audit, a single breach was determined, concerning a failure in documentation of the relevant audit work. In respect of the FY2015 audit, there were breaches in three areas of audit work: the use of independent actuaries as auditor's experts; the testing of management's accounting estimate and the data on which it was based; and the evaluation of the method of measurement used by management.

BDO received a financial sanction of £200,000 (discounted for admissions and early disposal to £160,000); a Reprimand and a non-financial sanction requiring BDO to conduct training and undertake quality performance reviews in respect of the audit of insurance undertakings. The sanction of a Reprimand has been imposed against the partner.

<sup>30</sup> In the 12 months to 31 March 20 preliminary enquiries into one accountant were closed. No preliminary enquiries were closed in the 12 months to 31 March 19.

<sup>31</sup> Press Notice: [Sanctions against BDO and a partner](#).

<sup>32</sup> Under the AEP, a new investigation must be commenced if additional matters are identified outside the scope of the initial investigation. In this instance, matters in the preceding audit year were identified leading to a second investigation under the AEP.



**7**  
investigations  
resulting in  
sanctions  
imposed  
on audit  
firms and  
individuals

## Deloitte/Autonomy Corporation plc/Accountancy Scheme<sup>33,34,35,36</sup>

In August 2020, the Tribunal imposed sanctions on Deloitte and two former partners following an investigation in relation to the published financial reporting of Autonomy Corporation plc (Autonomy) for periods between January 2009 and June 2011.

The Tribunal made numerous findings of Misconduct. One former partner, and thus Deloitte, were liable for failures to act with integrity and objectivity. Each of Deloitte and both partners failed to act with competence and due care.

The Misconduct arose from Deloitte's audit and review work during 2009 and 2010 relating to (1) the accounting and disclosure of Autonomy's sales of hardware, and (2) Autonomy's sales of software licences to value added resellers.

Deloitte and both partners failed to exercise adequate professional scepticism and failed to obtain sufficient appropriate audit evidence. Deloitte should not have issued unqualified audit opinions in those years based on the audit evidence obtained.

The Tribunal also made findings of Misconduct in relation to the consideration of Autonomy's communications with its regulator, the FRC's Financial Reporting Review Panel, in January 2010 (by one partner) and March 2011 (by the other partner). One partner acted recklessly and, in the circumstances, with a lack of integrity. The other partner failed to act with professional competence and due care.

Finally, one partner was culpable of further Misconduct for a loss of their objectivity on six separate occasions during audit and review work from October 2009 to July 2010.

The Tribunal imposed the following sanctions on Deloitte: a financial sanction of £15m, a Severe Reprimand, and a condition that it provide a root cause analysis of the reasons for the Misconduct, including why the firm's processes and controls did not prevent the Misconduct and whether the firm's current processes would lead to a different outcome.

The Tribunal imposed a financial sanction of £500,000 and an exclusion from membership of the Institute of Chartered Accountants in England and Wales (ICAEW) for five years on one partner and a financial sanction of £250,000 and a Severe Reprimand on the other partner. The Tribunal ordered that Deloitte pay all of the costs of the investigation claimed by the FRC's Executive Counsel, amounting to £5,635,014.53 (inclusive of VAT), together with the costs of the Tribunal.

33 Press notice: [Sanctions against Deloitte and two audit partners in relation to Autonomy Corporation plc](#).

34 [The FRC published the report of the Disciplinary Tribunal on 6 January 2021](#).

35 A link to the Tribunal's final report is available [here](#).

36 See further analysis of the findings at page 34.

### Deloitte/A company/AEP<sup>37</sup>

In September 2020, a Final Decision Notice was issued and sanctions imposed against Deloitte and a former partner in relation to the Statutory Audit of the financial statements of a company for the 52 weeks ended 2 January 2016 (2015 financial statements).

The breaches concerned the audit of (1) the company's defined benefit pension scheme and (2) the carrying value of the company's intangible assets. The respondents failed to ensure that the review work carried out by the Engagement Quality Control Reviewer (EQCR) was adequately documented, failed to obtain sufficient appropriate audit evidence to substantiate the cash holding of the defined benefit pension scheme and failed to obtain sufficient appropriate audit evidence in respect of its stress testing of the company's impairment model.

Deloitte received the following sanctions: a financial sanction of £500,000 (discounted to £362,500 for admissions and early disposal), a Reprimand and a non-financial sanction requiring Deloitte to prepare a progress report for the consideration of the FRC's AQR team setting out its current EQCR work programmes and how such work is documented during the course of the audit of PIEs. The partner received a Reprimand.

### Coats Group plc/Actuarial Scheme<sup>38</sup>

In May 2021 sanctions were imposed against an actuary in respect of Misconduct relating to the actuarial advisory services he provided to the Coats Group plc, formerly known as Guinness Peat Group (GPG), during the period September 2005 to March 2012.

During this seven-year period, the actuary provided ongoing actuarial advice to GPG, while also advising individual GPG executives in their capacity as trustees of three defined benefit pension schemes of subsidiary companies within GPG, despite the obvious conflicts of interest that arose. GPG's approach, regarded purely financially, favoured minimising contributions to the schemes in order to maximise the profits of the company.

Over the same period the actuary received information and documents that were confidential to the trustee bodies of the relevant pension schemes, despite the conflicts of interest noted above, and without ensuring that disclosure to him had been properly authorised.

The individual's conduct was contrary to the Impartiality and Compliance Principles of the Actuaries' Code (formerly the Professional Conduct Standards).

The actuary received the following sanctions: a financial sanction of £100,000 (discounted to £65,000 for mitigation, admissions and early disposal) and a Severe Reprimand.

<sup>37</sup> Press notice: [Sanctions against Deloitte and a partner.](#)

<sup>38</sup> Press notice: [FRC announces financial penalty and severe reprimand against an individual relating to actuarial advisory services.](#)

### haysmacintyre/Associated British Engineering/AEP<sup>39</sup>

In March 2021 a Final Decision Notice was issued and sanctions imposed against haysmacintyre and an audit partner in relation to the Statutory Audit of the financial statements of Associated British Engineering plc for the year ended 31 March 2018.

The breaches of standards were wide ranging and related to multiple audit areas including inventory, journal entry testing and documentation of work on going concern. The audit work involved in the testing of inventory was particularly deficient and involved failures to exercise both sufficient professional scepticism and reasonable judgement. Further, the auditors did not obtain sufficient appropriate audit evidence to provide a reasonable basis for the auditor's opinion.

haysmacintyre and the audit partner received the following sanctions: a financial sanction of £125,000 and £17,500 respectively (discounted to £70,000 and £10,000 respectively for mitigation, admissions and early disposal); Severe Reprimands and a declaration that the Statutory Audit Report did not satisfy the Relevant Requirements.

### UHY Hacker Young LLP/Inch Kenneth Kajang Rubber plc/AEP<sup>40</sup>

In March 2021, a Final Decision Notice was issued and sanctions imposed against UHY Hacker Young LLP (UHY) and a former partner in relation to the Statutory Audit of the financial statements of Inch Kenneth Kajang Rubber plc for the year ended 31 December 2016.

The breaches in this case related to a number of areas that were fundamental to the audit: the acceptance, planning and resourcing of the audit; assessing the capabilities of component auditors, instructing the component auditors and involvement in their assessment as to risk; the review of the work of a component auditor; the EQCR and the signing of the audit report. There were also breaches in relation to two specific areas of the audit: audit work on an industrial land transaction; and on the carrying value of an associate.

UHY received the following sanctions: a Severe Reprimand; a declaration that the Statutory Audit Report did not satisfy the Relevant Requirements; and a package of non-financial sanctions to prevent recurrence of the breaches including enhanced training, implementing a root cause analysis programme and reporting to the FRC on outcomes of root cause analysis and file reviews, and on the implementation of recommended actions following an independent review of UHY's audit practice. The former partner received a Severe Reprimand and a declaration, as well as a prohibition on acting as a Statutory Auditor of a PIE for two years, a requirement to undertake training and to report to the FRC on file reviews and inspections.

<sup>39</sup> Press notice: [Sanctions against haysmacintyre and a partner.](#)

<sup>40</sup> Press notice: [Sanctions against UHY Hacker Young LLP and a former partner.](#)

## Spotlight on Audit Documentation

Last year's themes section focused on two auditing standards – ISA (UK) 200 (Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing) and ISA (UK) 500 (Audit evidence) – and considered the underlying reasons for auditors' failure to apply sufficient scepticism and obtain sufficient, appropriate audit evidence.

While breaches of these standards remain a live issue, the cases that have concluded this year have also highlighted the prevalence of breaches of another auditing standard: ISA (UK) 230 (Audit Documentation). ISA (UK) 230 deals exclusively with the auditor's responsibility to prepare audit documentation for an audit of financial statements.

Auditors are required to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand (a) the nature, timing and extent of the audit procedures performed, (b) the results of the audit procedures performed, and the audit evidence obtained and (c) significant matters arising during the audit, the conclusions reached and significant professional judgements made in reaching those conclusions.

Proper audit documentation provides evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the audit and evidence that the audit was planned and performed in accordance with ISAs and applicable legal and regulatory requirements. Critically, by requiring a clear, precise, timely and sufficiently detailed record of the steps taken and decisions reached in the planning and performance of an audit, the standard enables the audit firm and the engagement team to be held accountable for their work.

Where audit procedures have been undertaken and judgements and decisions have been reached and concluded, auditors can be expected to identify the relevant contemporaneous documentary record. ISA (UK) 230 therefore has a pervasive effect on other areas of the audit, including reporting effectively to those charged with governance. Among other matters, it also enables effective and proper scrutiny to be exercised by regulators following the commencement of an investigation. Compliance with the documentation requirements in ISA (UK) 230 should consequently be at the forefront of the auditor's mind.

Regrettably, instances of non-compliance with ISA (UK) 230 have been a common feature in the investigations concluded this year.

In one case, the documents on the audit file were inconsistent as to whether a particular transaction was considered by the audit team to be with a related party. The audit firm failed to document the inconsistency between information identified during the audit and their final conclusion. It was not possible to understand what analysis had been undertaken by the audit team in this area, or whether significant discussions with management had occurred. It was also not apparent from documents on the audit file what understanding the group engagement team had of the work of the component auditors. Adverse findings such as these go to the heart of the standard in that the audit documentation did not record the nature, timing and extent of the audit procedures performed. Other examples of adverse findings relating to ISA (UK) 230 include insufficient documentation:

- Setting out what discussions the audit team had with the EQCR and the conclusions reached by the EQCR;



**Prevalent breaches of ISA (UK) 230 – the auditor's responsibility to prepare audit documentation**



**Compliance with the documentation requirements should be at the forefront of the auditor's mind**

- To explain the inclusion of a material uncertainty paragraph as to going concern in the audit report; and
- Of important exchanges between the audit team and the auditor's expert in an area of significant audit risk.

Unsurprisingly ISA (UK) 700 requires that the signing and dating of the auditor's report occurs only after completion of all the necessary audit procedures, including obtaining and considering all necessary available evidence on which to base the auditor's opinion. Audit procedures should only be performed after the date of the auditor's report in exceptional circumstances, for example where information becomes known to the auditor which, had it been known during the audit, might have caused the auditor's report to be modified. ISA (UK) 230 draws a clear distinction between audit procedures and the administrative process of assembling the final audit file. If in exceptional circumstances new or additional audit procedures are performed after the date of the auditor's report, the standard imposes additional documentation requirements. The auditor must record the exceptional circumstances as well as the audit procedures performed and audit evidence obtained, the conclusions reached and impact on the audit report, and when and by whom changes to audit documentation were made and reviewed.

Given the importance of this standard, we do not regard failures to comply with the requirements of ISA (UK) 230 as minor or as mere documentation breaches particularly where the lack of documentation, or failure to ensure that the audit procedures concluded at the point the auditor's report was signed are clearly identifiable from the audit file, thwart the objective of the standard or impede the efficient progression of an investigation. In such cases significant sanctions may result.

## **Closed cases**

Two investigations under the Accountancy Scheme and one investigation under the Actuarial Scheme were closed without enforcement action. In all three cases the evidence did not support a finding of Misconduct.

## Ongoing cases as at 31 March 2021

As at 31 March 2021, there were 49 open investigations:<sup>41</sup> 37 investigations into individuals and firms for audit work; two investigations into individuals and firms for non-audit work; and ten investigations into members who are either professional accountants working in business or actuaries. This represents a 14% increase in cases compared with 2019/20 (42 investigations). There were no ongoing preliminary enquiries as at 31 March 2021, compared with three open preliminary enquiries at 31 March 2020.

Of the 37 audit investigations, one is being investigated under the Accountancy Scheme and the remaining 36 under the AEP. The AEP investigations include four delegated by the Conduct Committee to the ICAEW to conduct the initial investigations. In three cases the ICAEW has remitted the matter to the Enforcement Division for Executive Counsel to finalise and deliver the Initial Investigation Report (IIR); one remains with the ICAEW.

Of the 37 audit investigations under the AEP and Accountancy Scheme, 19 have been announced:

- Grant Thornton's audit of the financial statements of Sports Direct International plc for the 52-week period ended 24 April 2016;
- KPMG Audit plc's audit of the financial statements of Rolls-Royce Group plc for the year ended 31 December 2010 and of Rolls-Royce Holdings plc for the years ended 31 December 2011, 2012 and 2013;
- PwC's audits of the consolidated financial statements of BT Group plc for the years ended 31 March 2015 to 31 March 2017;
- Deloitte's audits of the consolidated financial statements of Mitie Group plc for the years ended 31 March 2015 and 31 March 2016;
- KPMG's audits of the financial statements of Carillion plc for the years ended 31 December 2014, 2015 and 2016;
- KPMG's audit of certain matters relating to the financial statements of Carillion plc for the year ended 31 December 2013 and additional audit work carried out during 2017;
- Deloitte's audits of the consolidated financial statements of SIG plc for the years ended 31 December 2015 and 2016;
- KPMG's audits of Conviviality plc for the 52 weeks ended 30 April 2017;
- Grant Thornton's audits of Patisserie Holdings plc for the years ended 30 September 2015, 2016 and 2017;
- Grant Thornton's audits of the financial statements of Interserve plc for the years ended 31 December 2015, 2016 and 2017;
- Ernst & Young's audit of the financial statements of Thomas Cook Group plc for the year ended 30 September 2018;

<sup>41</sup> A case will comprise one of the below: (1) an audit investigation into an audit firm and audit partner(s) (under the Accountancy Scheme or the AEP); (2) an investigation into professional accountant(s) working in business (under the Accountancy Scheme); (3) a non-audit investigation into professional accountant(s) and accountancy firms (under the Accountancy Scheme); (4) an investigation into actuaries (under the Actuarial Scheme). Each case may include multiple subjects, and a case is not deemed to be closed until concluded against all subjects.



**49**

**open cases at  
the year end**

- Ernst & Young’s audit of the financial statements of Thomas Cook Group plc for the year ended 30 September 2017;
- Ernst & Young’s audit of the financial statements of NMC Health plc for the year ended 31 December 2018;
- KPMG’s audit of the consolidated financial statements of Eddie Stobart Logistics plc for the year ended 30 November 2017;
- PwC’s audit of the consolidated financial statements of Eddie Stobart Logistics plc for the year ended 30 November 2018;
- Oliver Clive & Co’s audit of the consolidated financial statements of London Capital & Finance plc for the period ended 30 April 2015;
- PwC’s audit of the consolidated financial statements of London Capital & Finance plc for the year ended 30 April 2016;
- Ernst & Young’s audit of the consolidated financial statements of London Capital & Finance plc for the year ended 30 April 2017;
- Deloitte’s audit of the financial statements of Lookers plc for the 52-week period ended 31 December 2017 and 2018.

The 37 audit investigations collectively concern a wide range of issues including:

 <b>Investigation issues</b>	
Goodwill	Lack of professional scepticism
Going concern	Compliance with ethical requirements
Pensions	Misleading the regulator
Inventory valuation and provisions	Related Party transactions
Presentation and disclosure	Compliance with laws and regulations
Costs & liabilities	Control environment
Cash	Use of experts
Other fixed asset impairments	Reverse factoring
Onerous contracts and leases	Investments and financial assets
Provisions	Reserves
Audit documentation	Setting of materiality levels
Objectivity and integrity	Recoverability of loans
Revenue recognition, including long-term contract accounting	Group audits including oversight of component auditors

All open investigations in relation to members who are professional accountants working in business are linked to audit investigations (some current; others concluded) and therefore concern many of the same issues. Of the ten investigations, eight have been announced, and relate to:

- The published financial reporting of Autonomy Corporation plc for the period between 1 January 2009 and 30 June 2011;
- The preparation and approval of the financial statements of Quindell plc for the period ended 31 December 2011 and to the year ended 31 December 2013 and the interim results for the half-year ended 30 June 2014;
- The preparation, approval and audit of the financial statements of Serco Geografix Ltd, Serco Ltd and Serco Group plc for the years ended 31 December 2011 and 31 December 2012;
- The preparation and approval of the financial statements of Sports Direct International plc for the 52-week period ended 24 April 2016;
- The preparation and review of financial information relating to Redcentric plc for the financial years ended 31 March 2015 and 2016;
- The preparation and approval of the financial statements of Carillion plc for the years ended 31 December 2014, 2015 and 2016, and the six months ended 30 June 2017, the preparation and reporting of other financial information during the period 2014–2017, and certain matters relating to the financial statements for the year ended 31 December 2013;
- The preparation and approval of Conviviality plc's financial statements and other financial information for the 52 weeks ended 30 April 2017; and
- The preparation and approval of Patisserie Holdings plc's financial statements and other financial information for the years ended 30 September 2015, 2016 and 2017.

Of the two investigations into individuals and firms for non-audit work, both have been announced:

- Matters relating to work carried out by KPMG LLP and one of its restructuring partners between 16 August 2010 and 5 April 2011 relating to companies trading under the name Silentnight; and
- Provision of materials to the FRC by KPMG in connection with the FRC's AQR including aspects of the audit of Carillion for the year end 2016.

## Carillion

Given the exceptional public interest arising from the collapse of Carillion we have provided progress updates on the investigation, including most recently in March 2021 when the FRC announced it had delivered its Initial Investigation Report<sup>42</sup> in connection with its investigation, opened in February 2019, into certain aspects of KPMG's audit of the financial statements of Carillion plc for the year ended 31 December 2013. This followed an announcement in September 2020 that the FRC had delivered its Initial Investigation Report<sup>43</sup> into KPMG's audit of the financial statements of Carillion plc for the years ended 31 December 2014, 2015 and 2016 and additional audit work carried out during 2017.

<sup>42</sup> Press notice: [FRC delivers initial investigation report into KPMG's 2013 audit of Carillion plc](#).

<sup>43</sup> Press notice: [FRC delivers initial investigation report into audit of Carillion plc](#).



**Investigation of substantial high-profile cases absorbs considerable resource**

## Tribunal hearings

### Autonomy Corporation plc

In July 2020, an independent Tribunal chaired by former Supreme Court Judge, Lord Dyson, was reconvened to determine appropriate sanctions in relation to the auditors Misconduct. The sanctions hearing followed the substantive hearing of the Executive Counsel's Formal Complaint during October and November 2019. A summary of the sanctions ordered by the Tribunal, which included a record financial sanction, can be found on pages 69-71.

### Silentnight

Over a four-week period in November and December 2020 the independent Tribunal heard the Formal Complaint against David Costley-Wood (a partner of KPMG) and KPMG, in relation to their restructuring work for the Silentnight group of companies. It was the first hearing of a Formal Complaint to be heard entirely remotely, using Zoom and the four-week hearing was streamed live to the public on YouTube. These arrangements were supported by fully electronic hearing bundles and an evidence operator who presented the evidence on screen in real time, as it was cited by counsel, in order to assist the efficiency of the proceedings. The proceedings were completed on time and without significant technical issues.

The Tribunal has since found that the respondents committed Misconduct in respect of two allegations in the Formal Complaint, specifically that: i) in the period 16 August 2010 to 31 March 2011 the respondents gave advice and assistance to both Silentnight and a private equity firm, in connection with latter's acquisition of Silentnight, despite the existence of a conflict of interest. In so acting, the respondents breached the fundamental principle of Objectivity; and ii) Mr Costley-Wood dishonestly assisted with the provision of untrue and misleading or materially incomplete statements to Silentnight, the trustees of the Silentnight Pension Scheme, the Pension Protection Fund and the Pensions Regulator as to the causes of Silentnight's difficulties, and that he did so in order to assist the private equity firm in its efforts to enable Silentnight to shed its liability under its pension scheme as cheaply as possible. By doing so, the respondents breached the fundamental principle of Integrity. The third Allegation was dismissed.

On 21 and 22 June 2021, the independent Tribunal re-convened to hear the parties' submissions on the appropriate sanctions to be imposed. The Tribunal's final determination, and publication of its full Report, is awaited.

## Spotlight on audit issues arising from Autonomy Tribunal Report

A summary of the facts and findings following the conclusion of the FRC's proceedings against Deloitte and audit engagement partners, Richard Knights and Nigel Mercer, is set out at Appendix B. Given the seriousness of the findings of Misconduct, further analysis of the audit issues is included in this section.

### Public interest duty

Auditors have an important public interest duty to uphold the reliability of corporate reporting through their audit reports and opinions. The Tribunal recognised the critical nature of this duty and that public confidence demands that auditors act with integrity, objectivity and professional competence and due care. The Tribunal concluded that the respondents failed to act in accordance with these fundamental principles and that Deloitte, Mr Knights and, to a lesser extent Mr Mercer, were culpable of serious and serial failures in discharge of their public interest duty.



**Auditors have an important public interest duty to uphold the reliability of corporate reporting through their audit reports and opinions**

## Loss of objectivity

The Tribunal found that on several occasions Mr Knights bowed to client pressure at exactly the point in time he should have resisted it. In one example, Mr Knights accepted Autonomy's accounting treatment for the sale and purchase of hardware despite not obtaining further audit evidence that he had previously asked Autonomy to provide. There was no objective basis for Mr Knights' change of position and the decision to approve the treatment bore all the hallmarks of being made in a hurry under client pressure. Other instances of Mr Knights' loss of objectivity included searching for ways for Autonomy to avoid being frank with users of the financial results and acting as an advocate for the wishes of the audited entity as opposed to acting as an independent auditor.

These findings of Misconduct are particularly serious. Users of financial statements and other stakeholders are entitled to expect the Statutory Audit process to operate without bias or undue influence. The Tribunal's findings show the consequences of not adhering to these key principles.

## Lack of integrity

The ethical failures in this case did not just extend to Mr Knights' loss of objectivity. The Tribunal concluded that he also acted recklessly and with a lack of integrity in failing to correct a statement made by Autonomy to its regulator that he must have known was materially misleading and that there was a real risk the regulator would be misled by it. The statement was made by Autonomy at a meeting with the regulator that Mr Knights attended. Mr Knights should not have stayed silent and instead should have taken steps to correct the misleading statement either at the meeting or shortly thereafter.

The ethical standards provide that a professional accountant should not be associated with communications where they believe that the information contains (a) a materially false or misleading statement or (b) statements of information furnished recklessly. It is imperative that an auditor abides by standards during the course of an audit engagement. The Autonomy Tribunal decision makes clear that when these standards are breached, significant sanctions will follow.

## Lack of professional scepticism

In addition to the ethical failures described above, a further theme from the Tribunal's decision was the wholesale nature of the failure of professional scepticism by the respondents. By way of example, this was evident in how Deloitte dealt with the issue of whether Autonomy's sales of hardware should have been disclosed to the market.

Autonomy's Annual Reports and Accounts presented the impression that it was a highly profitable software company. Deloitte knew Autonomy was selling software at high margins, that financial analysts valued it on its ability to grow revenue and that there was a risk that it might seek to overstate its revenue. So, when Autonomy started to sell material amounts of low margin hardware, these sales should have been viewed with heightened scepticism. Deloitte was aware such sales were of great interest to the market and that disclosure would likely have had a substantial adverse effect on Autonomy's share price. A sceptical auditor should have questioned how these sales were consistent with the business model that Autonomy portrayed to the market. Deloitte should have



**The Tribunal found that on several occasions Mr Knights bowed to client pressure at exactly the point in time he should have resisted it**



**A sceptical auditor should have questioned how these sales were consistent with the business model that Autonomy portrayed to the market**

insisted that the hardware sales were disclosed in Autonomy's financial statements, given that without such disclosure the financial statements did not give a true and fair view. This finding also underlines how important it is for an auditor both to understand an entity's business environment and to properly evaluate the matters that are material to the users of financial statements.

### Sanctions

As is apparent, the findings of Misconduct were very serious and wide ranging. The Misconduct included failures of professional scepticism, failures to obtain sufficient appropriate audit evidence, failures adequately to challenge materially misleading statements in Autonomy's Annual Reports and Accounts, failures to insist on disclosure in those accounts, two audit engagement partners permitting misleading statements to be made by Autonomy to its regulator on two separate occasions (on one occasion Mr Knights acting with reckless lack of integrity) and multiple losses of objectivity on the part of Mr Knights.

The Misconduct also enabled Autonomy, a FTSE 100 company, to present a misleading picture of its financial position. Moreover, the Tribunal was satisfied that the acts of Misconduct could seriously undermine confidence in the standards of conduct of members and member firms, and in the profession more generally.

These factors formed part of the Tribunal's decision to impose the package of sanctions against Deloitte, Mr Knights and Mr Mercer as outlined at page 69-71 of Appendix B. The financial sanction of £15m against Deloitte is the largest imposed to date in any FRC investigation.

The financial sanction of **£15m** against Deloitte is the largest imposed to date

## High Court litigation

### Sports Direct International plc

In February 2020, the Court of Appeal gave its ruling in *Sports Direct International plc v Financial Reporting Council*,<sup>44</sup> reversing in part the 2018 decision of the High Court. The issue concerned an application to the High Court for an order against an audited entity (Sports Direct) in respect of its failure to comply with a statutory notice requiring the production of documents, pursuant to the Statutory Auditors and Third Country Auditors Regulations 2016/649 (SATCAR) and the AEP.

The Court of Appeal decided that the recipient of a statutory notice to produce documents is not required to produce legally privileged documents. This decision applies whether the person entitled to the privilege is the auditor under investigation or the audited entity. This decision reversed the previous decision of the High Court, which found that the audited entity may be required to produce legally privileged information when it is not the subject of the investigation itself.

However, the Court of Appeal upheld the decision of the High Court that, where a request is made under SATCAR for emails and their attachments, the fact that the email may be privileged does not automatically mean that the attachment is privileged. If the attachment is not privileged, it should be provided to the regulator.



The recipient of a statutory notice is not required to produce legally privileged documents for use in the investigation of another person

<sup>44</sup> [2020] EWCA Civ 177.

The Supreme Court did not grant Sports Direct leave to appeal from the Court of Appeal's decision, and this litigation is now concluded.

Following this case, a further hearing was held as to the production of three specific reports which had been prepared by the auditors, where the High Court<sup>45</sup> decided that these documents should be provided to the FRC. This is because the reports had not been prepared for the sole or dominant purpose of litigation and were not, therefore, legally privileged.

The Court of Appeal did not grant Sports Direct leave to appeal from the High Court's decision, and this litigation is now concluded.

### **A v B and the Financial Reporting Council [2020] EWHC 1491**

In relation to an ongoing investigation, the FRC sought production of documents from B, the auditor of A, pursuant to a statutory notice for their production. However, A objected to the provision of certain documents on the basis that A asserted that the documents were subject to legal professional privilege and should therefore be withheld from production. B's position was that, as the recipient of the notice, it was required to form its own view on whether the documents requested were legally privileged and thus could be withheld from production. A issued proceedings against B and the FRC, seeking a declaration that B was required to withhold production of documents from the FRC on the grounds of A's assertion of its privilege. B issued a counterclaim against A (to which the FRC was not a party) seeking a declaration as to the privileged status of the disputed documents.

Giving judgement in June 2020, the High Court refused to make the declaration sought by A on the basis that granting the declaration would be inconsistent with the nature of the obligations imposed by the SATCAR regime. The Court held that it is for the auditor to determine whether a document is privileged. The duty to disclose the documents under the statutory notice is imposed upon the auditor, and disclosure could only be refused on the grounds that a document was, in fact, privileged. Mere assertion of privilege by the audited entity was insufficient.

In circumstances where an audited entity disagrees with the auditor's determination of privilege, then the entity can bring proceedings against the auditor, including seeking an injunction, based on the terms of the underlying relationship between the auditor and the entity. The status of the documents would then be determined in those proceedings, to which the FRC could be joined if necessary. Equally, the FRC is able to challenge a decision to withhold documents on the basis of privilege by an application to Court.

In respect of B's counterclaim, the High Court found that none of the six disputed documents was privileged.

A sought permission to appeal the decision in respect of the declaration and in respect of one of the disputed documents. In October 2020 the Court of Appeal refused A's application for permission to appeal on both grounds and the litigation is now concluded.



**The Court held that it is for the auditor to determine whether a document is privileged**

<sup>45</sup> The Financial Reporting Council Ltd v Frasers Group plc (formerly Sports Direct International plc) [2020] EWCH 2607 (Ch).

## 6 Sanctions

### Introduction

During 2020/2021, the FRC imposed sanctions in six cases in relation to audit matters and one case in relation to an actuarial matter.

### Sanctions

The total sanctions imposed during a year depend on the number and nature of cases that have arisen for sanctioning purposes. This year, as last year, a range of financial and non-financial sanctions have been imposed on audit firms and individuals; in all but the actuarial case these sanctions were imposed with a key objective of driving audit quality. Sanctions are imposed in accordance with our published Sanctions Policy and Guidance.<sup>46</sup>

The number of financial sanctions imposed in the year to 31 March 2021 decreased compared with the previous two years, reflecting the smaller number of cases that closed with adverse findings and sanctions in the year. Compared with 2019/20, the total amount of these financial sanctions before discount remained consistent while the amount after discount saw an increase, dominated by the impact of the record level of sanctions imposed by the independent Tribunal in the Autonomy case. The level of total discounts and reductions offered, in accordance with the Sanctions Policy and Guidance, ranged from 20% to 44%, reflecting the level of cooperation and timing of admissions and settlement with firms.

	2018/19	2019/20	2020/21
Total financial sanctions imposed:			
Pre-discount	£42.9m	£16.5m	£16.7m
Post-discount	£32.0m	£11.3m	£16.4m
Number of financial sanctions imposed	27	11	8
Number of non-financial sanctions imposed	38	27	28
<i>Of which:</i>			
Exclusions	6	-	1
Requirements and undertakings	9	10	11

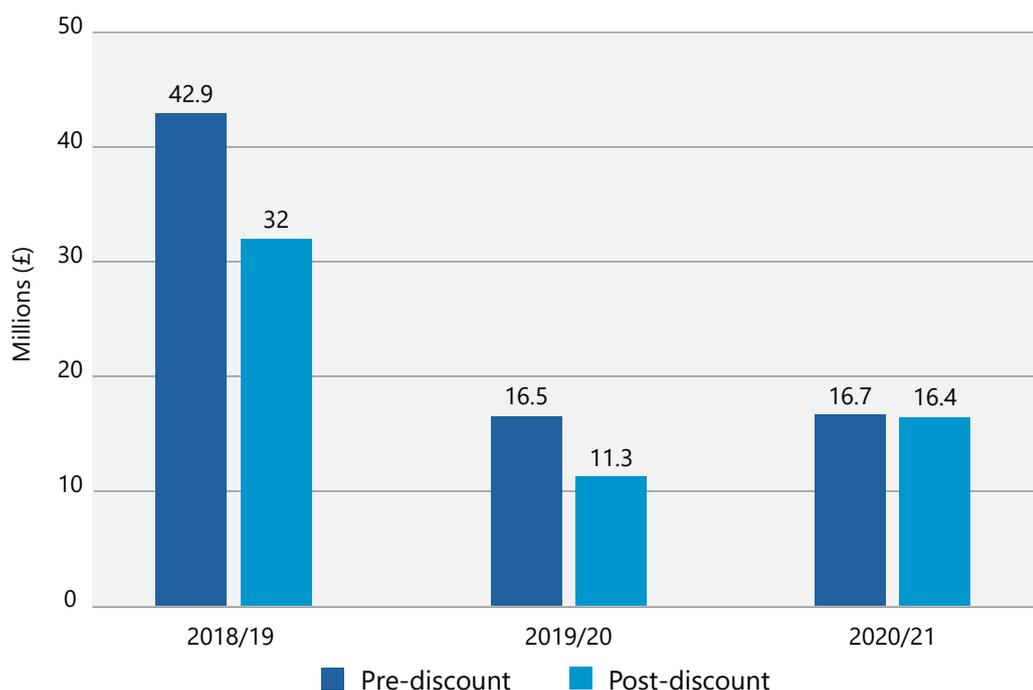


We imposed sanctions in 6 cases in relation to audit matters, with a mix of 8 financial and 28 non-financial sanctions in order to improve audit quality

The total sum of financial sanctions imposed was **£16.7m** (£16.4 after settlement discounts)

<sup>46</sup> Links to the sanctions policies are here: [Sanctions Policy \(Audit Enforcement Procedure\) \(effective from 1 June 2018\)](#); [Accountancy Scheme Sanctions Guidance \(March 2021\)](#); [Actuarial Scheme Sanctions Guidance \(March 2021\)](#).

## Total financial sanctions



**Proportionality is a key consideration in setting sanctions**

## Financial sanctions against audit firms

The FRC has imposed four financial sanctions on audit firms during the year in respect of five investigations.<sup>47</sup> The total amount of financial sanctions on audit firms alone (pre-discount for settlement) was £15.8m.

Three of the four financial sanctions imposed on audit firms in the year were under the AEP, with one under the Accountancy Scheme.

The independent Tribunal imposed a financial sanction of £15m on Deloitte in relation to the adverse findings of Misconduct in the Autonomy case. In assessing the nature and seriousness of the Misconduct, it found that it was 'very serious and wide-reaching' and that Deloitte was culpable of 'serious and serial failings to discharge their critical public interest duty to uphold the reliability of the reporting of Autonomy'. The Tribunal commented that '[i]t is in the wider public interest that a severe fine be imposed in a case as bad as this'.<sup>48</sup>

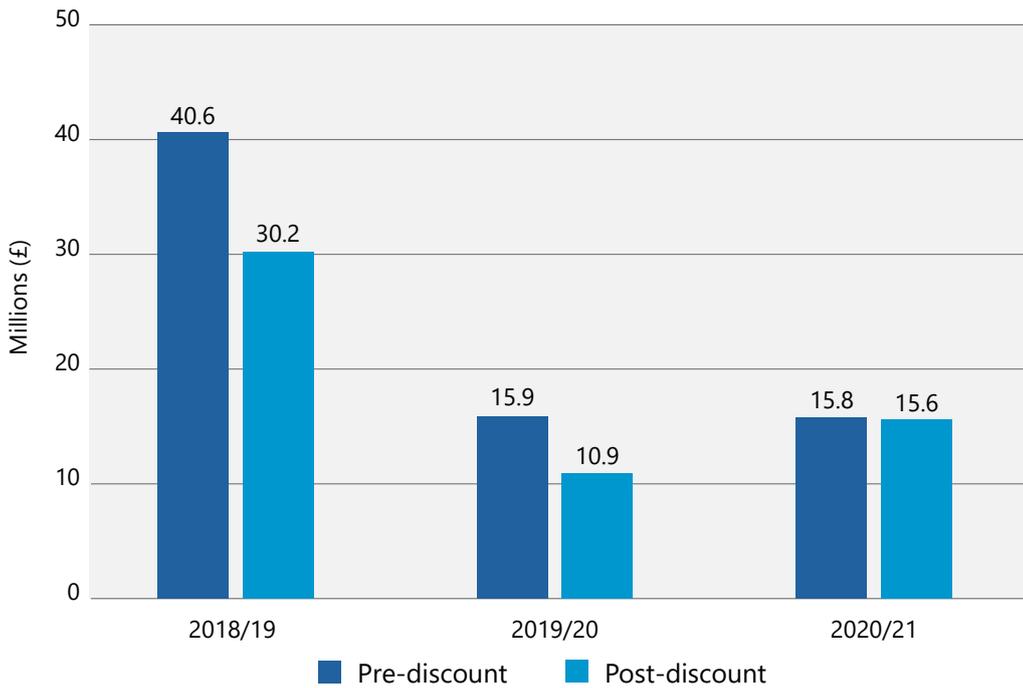
Proportionality is a key consideration in setting sanctions. In assessing proportionality, Executive Counsel and / or the Tribunal consider a wide range of factors to determine a sanction commensurate with all the circumstances of the case. These factors, examples of which are set out in the FRC's published Sanctions Guidance, include the seriousness of the breaches or Misconduct and the circumstances and financial strength of the firm.

In rare cases, consideration of the circumstances surrounding the breaches, the remediation taken by the firm and / or the financial strength of the firm may lead to the imposition of non-financial sanctions only.

<sup>47</sup> Extensions to existing cases in the AEP are counted as new cases as the AEP does not make provision for amendments to scope. In 2020/21, one set of sanctions was imposed against two AEP cases, where the two cases were in respect of the Statutory Audit of the financial statements to different financial years of the same entity.

<sup>48</sup> The Tribunal's final report is available [here](#).

### Financial sanctions - Audit Firms

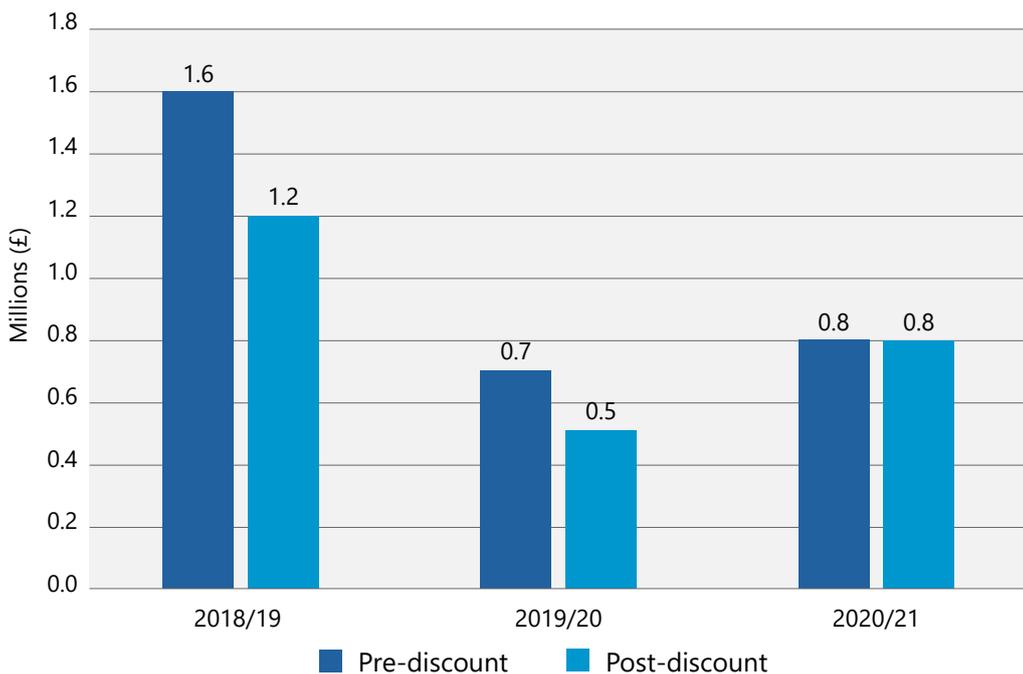


	2018/19	2019/20	2020/21
Number of financial sanctions against audit firms	9	5	4

### Financial sanctions against audit partners

The total amount of financial sanctions on audit partners was £0.8m.

#### Financial sanctions against audit partners



**£15.8m**  
financial sanctions imposed on audit firms

The financial sanctions take into account the seriousness of the breaches (or Misconduct, if under the Accountancy Scheme) as well as the financial resources of the partner.

	2018/19	2019/20	2020/21
Number of financial sanctions against audit partners	13	6	3

In two matters during the year, in which financial sanctions were imposed on the audit firm, no financial sanctions were imposed on the audit partners, who each received a Reprimand. In both cases, the Executive Counsel took account of the breaches and the personal circumstances of the audit partner and considered that it would not be proportionate to impose any further financial sanction.

### Sanctions against accountants and actuaries

A financial sanction of £100,000 (discounted to £65,000 for mitigation, admissions and early disposal) was imposed on one member who is an actuary in the year to 31 March 2021.

No financial sanctions were imposed on members who are professional accountants working in business in the year to 31 March 2021.

### Non-financial sanctions

Non-financial sanctions remain a key tool for us in seeking to improve the quality of financial reporting and audits. As well as the imposition of reprimands and severe reprimands, non-financial sanctions published in the year include:

- A condition that Deloitte provides a root cause analysis of the reasons for the Misconduct, why the firm's processes and controls did not prevent the Misconduct and whether the firm's current processes would lead to a different outcome;
- Exclusion of a former Deloitte audit partner from membership of the ICAEW for five years;
- A requirement that Deloitte prepares a progress report for the consideration of the FRC's AQR, setting out its current EQCR work programmes and how such work is documented during the course of the audit of PIEs;
- A requirement that BDO implements, in respect of the audit of insurance undertakings, an appropriate training programme designed to improve quality and consistency in the firm's processes for obtaining and evaluating independent actuarial audit evidence and in the documentation of those processes and of auditors' key judgements; and
- A requirement that for a period of two years from the date of the Decision Notice, BDO undertakes a quality performance review of the work relating to the obtaining and evaluating of actuarial audit evidence for all Statutory Audits of insurance undertakings that used independent actuaries as auditor's experts and reports the results annually to the FRC;
- A declaration by Executive Counsel that, as a result of the adverse findings set out in the Final Decision Notice, the Statutory Audit Report signed by the audit partner on behalf of haysmacintyre did not satisfy the Relevant Requirements;



**Non-financial sanctions remain a key tool to improve the quality of financial reporting and audits**

- A requirement that UHY implements and monitors enhanced mandatory training for all audit partners, to be reported annually to the FRC for three years;
- A requirement that UHY implements a root cause analysis programme, such that all root cause analysis on PIE audits is undertaken by an external provider;
- Following an independent review of UHY's audit practice, a requirement to report to the FRC on the implementation of recommended actions within 12 months;
- A requirement that UHY reports to the FRC annually the outcomes of root cause analysis on PIE audits and a summary of the outcomes of hot and cold file reviews on PIE audits, and any remedial action, for a period of three years;
- A requirement that an audit partner shall not act as Statutory Auditor of a PIE nor sign a Statutory Audit Report in respect of a PIE for a period of two years;
- A requirement that an audit partner is required to have regular external hot and cold reviews on a selection of non-PIE audits for which they are the engagement partner, to be agreed with the FRC's Executive Counsel. The outcomes of these reviews are to be reported to Executive Counsel annually for a period of three years;
- A requirement that an audit partner is required to provide the FRC's Executive Counsel with Association of Chartered Certified Accountants (ACCA) inspection outcomes in relation to any inspections of non-PIE audits for which they are the engagement partner for a period of three years;
- A requirement that an audit partner is required to agree a training programme with the FRC's Executive Counsel, including periodic reporting. The audit partner is required to confirm completion of their training and to provide any certificates of completion (where applicable). The training programme should be completed within 18 months of the date of the Final Decision Notice. The audit partner is required to complete training in relation to the following areas: audit quality control; audit documentation; audit evidence; and professional scepticism.

In every case, care is taken to ensure that the bespoke non-financial sanctions will address underlying causes of the breaches or Misconduct and that a programme of monitoring or reporting on these sanctions is put in place to ensure effectiveness and demonstrate the impact on improving audit quality.

Executive Counsel encourages and takes into account timely, proactive and effective remedial work by firms or individuals designed to prevent failures recurring. If sufficient remedial work has been carried out, this may result in no additional non-financial sanctions being required in the relevant respect(s). Remedial action already undertaken by a firm in response to the breaches identified may also be a mitigating factor taken into account in determining sanction. Examples of such remedial action highlighted this year include introducing new audit guidance, processes, and templates, including new root cause analysis and quality control policies, introducing additional mandatory audit testing and training, enhanced recruitment, additional internal quality control reviews and instructing a comprehensive independent review of the audit practice.

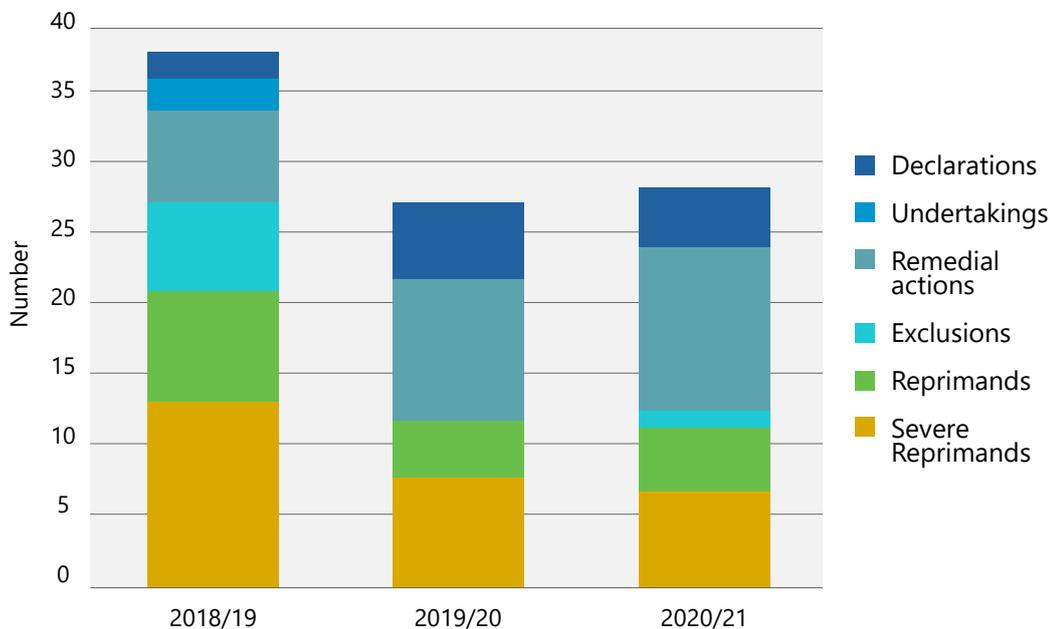


**Bespoke non-financial sanctions address underlying causes of the breaches or Misconduct**

## Number of non-financial sanctions

	2018/19	2019/20	2020/21
Severe reprimands	13	8	7
Reprimands	8	4	4
Exclusions	6	-	1
Remedial actions	7	10	12
Undertakings	2	-	-
Declarations	2	5	4
<b>Total</b>	<b>38</b>	<b>27</b>	<b>28</b>

### Non-financial sanctions



Although fewer cases concluded with sanctions in 2020/21 compared with 2019/20, the number of non-financial sanctions has slightly increased. We have imposed non-financial sanctions in all audit cases that have concluded with adverse findings during the year.

## Monitoring of non-financial sanctions

A key aspect of imposing meaningful and effective non-financial sanctions is ensuring that there is a mechanism in place to monitor the effectiveness of the non-financial sanctions and demonstrate the impact on improving audit quality. During the year, we have received a number of reports from audit firms in compliance with the terms of non-financial sanctions imposed in previously concluded cases. We consider these reports carefully in conjunction with the dedicated Audit Firm Supervisor (a member of the Audit Firm Supervision team).

In many cases, the monitoring of non-financial sanctions will take place over a number of years. This ensures that issues are reported on a timely basis and progress on implementing further enhancements can be measured. The reports we have received thus far demonstrate



**In many cases, monitoring of non-financial sanctions will take place over a number of years**

that issues are being identified by the firms through the required amplified reviews and action is being taken to address these issues with a view to improving audit quality. In some instances, we have required further detail in addition to the report provided or in subsequent reports, to provide more detail on the impact and outcomes of the firm's actions.

## Settlement

We look for opportunities to enter into settlements in our cases at an appropriate stage where we have sufficient understanding of the matter to secure the right regulatory outcome in the public interest. We continue to encourage firms and individuals to make full and frank early admissions and, although overall progress in this area has been slower than we would have wished, we are seeing signs of improvement in ongoing investigations. Early admissions demonstrate cultural change and an understanding and acceptance by firms and individuals of areas where they have fallen short of the standards. This is a critical first step in improving audit quality as well as a means of delivering earlier published outcomes and driving wider behavioural change. The published Sanctions Guidance and Policy provides for discounts of up to 35% for early admissions and settlement. Five cases resulting in sanctions in 2020/21 were as a result of settlements between the respondents and Executive Counsel. Where financial sanctions were imposed, reductions of between 20% and 35% were allowed for admissions and early disposal of the matter. The level of discount last year was between 30% and 35%, reflecting the extent, significance and timing of admissions. In *Autonomy*, as the case was fully contested before the independent Tribunal, there was no reduction to the financial sanction for admissions or early disposal.

In addition to discount for settlement, financial sanctions may be adjusted for aggravating and mitigating factors, in particular to reflect an exceptional level of cooperation (see the 'Spotlight on cooperation' panel below). Exceptional cooperation is over and above the level of cooperation that is required and is therefore to be expected. There is no amount specified in the published Sanctions Guidance and Policy for exceptional cooperation; however, the independent review of FRC sanctions in 2017 conducted by Sir Christopher Clarke suggested that there may be cases where a discount of up to 50% is appropriate (for settlement and exceptional cooperation). In one case during the year, there was a 15% adjustment to the financial sanction for exceptional cooperation, before a further discount for admissions and early disposal.



**Early admissions demonstrate cultural change**

**Reductions between 20% and 35% were allowed for admissions and early disposal of the matter**

## Spotlight on cooperation

This section explores the concept of cooperation and its importance in the context of investigations, enforcement action and sanction.

A respondent's level of cooperation can have a positive impact on the timeliness and efficiency of an investigation, allowing it to conclude earlier than might otherwise be possible. As well as being a requirement under SATCAR and the Accountancy and Actuarial Schemes, cooperation, whether exceptional or whether insufficient, is also relevant at the point of determining sanction (see further below).

The Sanctions Policy and Guidance each address the concept of 'exceptional' cooperation, and list 'an exceptional level of cooperation' as an example of behaviour that may mitigate the Misconduct/breach of the Relevant Requirements, and so should be taken into account when deciding the sanction or combination of sanctions to be imposed.

Conversely, a respondent having 'failed to cooperate with, or hindered, the investigation' is listed as an example of behaviour that may aggravate the Misconduct/breach of the Relevant Requirements, and so should be taken into account when deciding the sanction or combination of sanctions to be imposed.

Because cooperation is required, unless 'exceptional', the provision of cooperation by a respondent is not a factor that constitutes mitigation at the point of determining appropriate sanction.

### Three decisions that refer to 'exceptional' cooperation

#### ***Executive Counsel v. (1) Deloitte LLP; (2) Richard Knights; and (3) Nigel Mercer (Re Autonomy Corporation plc) 6 January 2021***<sup>49,50</sup>

In Executive Counsel's enforcement proceedings under the Accountancy Scheme relating to the audit of Autonomy, the respondents contended that they had provided an exceptional level of cooperation to the FRC over the seven-year period of investigation and proceedings, referring in particular to a detailed presentation provided to the FRC. While accepting that the respondents cooperated in the investigation, the independent Tribunal was not persuaded that, viewed overall, the cooperation of the respondents was 'exceptional'. Almost all of the examples cited by the respondents as evidencing cooperation were commonplace and required by the Accountancy Scheme. **The respondents' cooperation therefore did not amount to a mitigating factor when considering the level of sanction.**

#### ***Executive Counsel v. MSR Partners LLP & Anor (Re Laura Ashley plc) 29 March 2019***<sup>51</sup>

Executive Counsel's Final Decision Notice following an investigation under the AEP relating to the audit of Laura Ashley by MSR Partners LLP (March 2019) records MSR's fine of £825,000 being reduced to £455,813. This reduction included a 15% adjustment to reflect mitigating factors, in particular an exceptional level of cooperation. A further discount of 35% was provided to reflect admissions and early disposal of the matter. As set out in the Decision Notice:



**A respondent's level of cooperation can have a positive impact on the timeliness and efficacy of an investigation**

49 Press notice: [Sanctions against Deloitte and two audit partners in relation to Autonomy Corporation plc](#).

50 A link to the Tribunal's final report is available [here](#).

51 Press notice: [Sanctions against MSR Partners LLP and a partner](#).

*'[The Subjects] conducted a **full and frank root cause analysis** as to how the breaches of Relevant Requirements had occurred and **self-reported** the breaches of Relevant Requirements by sharing that document on a voluntary basis (without restriction) with Executive Counsel.'*

*'[The Subjects] dealt **timeously, properly and fully** with all requests for information made on behalf of Executive Counsel.'*

### **Executive Counsel v haysmacintyre LLP & Anor (Re Associated British Engineering plc) 30 March 2021<sup>52</sup>**

The Final Decision Notice relating to the audit of Associated British Engineering by haysmacintyre acknowledges the exceptional cooperation during the course of the investigation, and the financial sanctions in relation to the audit firm and the audit partner were each reduced by 15%, before a further discount of 35% for admissions and settlement. As set out in the Decision Notice:

*'[The respondents] provided an **exceptional level of cooperation** during Executive Counsel's investigation of the breaches, in that the firm conducted a **full and frank root cause analysis** as to how breaches of Relevant Requirements had occurred and **self-reported the breaches** by sharing that document on a voluntary basis (without restriction) with Executive Counsel.'*

#### **Exceptional cooperation – what does it look like?**

The Tribunal in the Autonomy proceedings stated: *'What is exceptional is a question of fact and degree and to some extent a matter of judgement.'* The Sanctions Policy and Guidance cite non-exhaustive examples of 'exceptional' cooperation as: (1) self-reporting to the FRC and/or bringing to the attention of the FRC any facts and/or matters that may constitute an Allegation of Misconduct/of a breach of a Relevant Requirement; and (2) volunteering information or documentation not specifically requested but that may assist the investigation.

#### **Assessment of cooperation**

The Enforcement Division tracks and aims to give feedback on a respondent's cooperation throughout the course of an investigation. Cooperation is generally assessed against four categories (although relevant matters that do not fall within one of those categories may also be taken into account):

- Timeliness, e.g. full and helpful timely responses, apparent that sufficient resource has been allocated to the investigation;
- Engagement, e.g. fully prepared for interview, helpful and constructive approach;
- Transparency, e.g. self-reporting, voluntary waiver of privilege;
- General approach, e.g. positive desire to learn from previous audits and improve audit quality, proactive identification and implementation of effective remediation.

<sup>52</sup> Press Notice: [Sanctions against haysmacintyre and a partner](#).

## 7 Timeliness

We continue to focus on improving the timeliness of our investigations and enforcement action. During the year, despite the challenges presented by the pandemic, we grew the Division by 44% to provide increased resource to help address this challenge. In this section, as in previous years, we report on our performance in this respect by reference to both our established KPI – a period of two years between commencement of an investigation and service of either the Proposed Formal Complaint (PFC) or IIR (or closure or settlement if sooner) – and other relevant case length data.

### Time to service of PFC, IIR or settlement or closure (if earlier)

As explained in previous years, the KPI relates to the investigation stage of our process as in later phases the timetable will largely be set by others (e.g. Tribunal Chair) and is therefore not within the control of Executive Counsel.<sup>53</sup>

In the year to 31 March 2021, 15 enforcement cases fell to be measured against the KPI<sup>54</sup> and the table below sets out our performance against this measure.

	Number of cases
PFC/IIR served (or case concluded without PFC/IIR) within two years	6
PFC/IIR not served/case not otherwise concluded within two years due to:	
Finalisation of settlement process	3
Case delegated to ICAEW	3
Covid disruption	2
Parallel SFO proceedings	1
<b>Total</b>	<b>15</b>

The target has therefore been met in 40% of cases compared with 44% last year.

Where we did not meet the KPI, the reasons were as follows:

- The pandemic had a significant disruptive impact on everyone and the FRC was no exception. There were two particular cases where the effect of Covid-19 was felt most obviously, having an impact on both the availability of members of case teams with childcare responsibilities and independent experts managing significant business disruption in their commercial practices. However, it had a wider impact on all our work and this section of the report, as others, should be read with the backdrop of the pandemic firmly in mind.
- Three matters that missed the KPI this year were delegated by the Conduct Committee to the ICAEW. In such cases, while it is the ICAEW that undertakes the investigation, it is the Executive Counsel that is responsible for finalisation and service of the IIR. While we have agreed a timeframe in which the ICAEW will seek to provide us with the draft IIR in such matters, this year the ICAEW was not in a position to do so and in two of these cases this was as a result of the pandemic. It was not therefore possible for us to finalise and serve the IIRs within the two-year period.

<sup>53</sup> It should be noted that guidance has been issued to Tribunals that matters should progress as expeditiously as possible.

<sup>54</sup> i.e. those that either met the KPI, or exceeded 24 months without meeting the KPI, within the year.

**40%**  
of investigations were completed within our target of two years



The pandemic had a significant disruptive impact on everyone and the FRC was no exception

- As noted in previous years, where we are in settlement discussions at the date of the KPI we assess whether the public interest appears more likely to be served by continuing those discussions or by serving an IIR or PFC or, sometimes, both. Settlement discussions in three cases this year were given priority over service of an IIR/PFC.
- In one case we were required to pause our process pending resolution of parallel SFO proceedings relating to the same individual in respect of the same underlying factual matters.

### Average time to service of PFC, IIR or settlement (if earlier)

The average length of time to service of PFC/IIR (or settlement, if earlier) in cases reaching this milestone during the year is set out below.

	2018/19	2019/20	2020/21
Number of cases where PFC/IIR issued (or settled/closed if earlier)	6	16	13
Average length of time to issuance of PFC/IIR (or settlement/closure if earlier) (in months)	24	23	26

### Time to complete a case

The table below sets out average case lengths of those matters that concluded this year and in the previous two years.

	2018/19	2019/20	2020/21
Average length of cases referred to Tribunal (months)	82	48	91
(No of cases)	(4)	(1)	(1)
Average length of cases concluded as a result of settlement or service of undisputed Decision Notice (months)	42	23	31
(No of cases)	(8)	(8)	(6)
Average length of cases closed with no further action (months)	31	20	31
(No of cases)	(1)	(4)	(3)

The relatively small number of cases from which the figures are derived means it is necessary to be cautious when attempting to identify meaningful patterns or trends. The single case referred to the Tribunal that concluded this year was *Autonomy*. The cases concluded as the result of settlement included an older legacy case, without which the average length of cases resolved through settlement would have been 26 months. The cases closed with no further action included one case paused for a lengthy period as a result of parallel SFO proceedings.



**Settlement discussions in three cases this year were given priority over service of an IIR/PFC**

## Average age of cases open at year end

The table below sets out the average age and volume of cases that remain open at the year end, over the last three years.

	2018/19	2019/20	2020/21
No of cases open at year end	41	42 <sup>55</sup>	49
No of cases opened in year	15	14	16
Average age of cases open at year end (in months)	20.9	25.4	25.4

The average age of cases open at year end has remained broadly stable despite the increase in the number of cases open at the year end, suggesting an overall improvement in timeliness. The small increase in the average age of cases over the last two years remains largely attributable to the need to pause investigations pending parallel criminal or other proceedings. The table below sets out data relating to the age profile of our cases at year end compared with year end last year.

We closed three legacy cases during the year, with the year of opening ranging from 2013 to 2017. Six legacy cases remain open; in all six we were required to pause our process pending resolution of parallel criminal or other proceedings.

Year investigation opened (to 31 March)	2013	2014	2015	2016	2017	2018	2019	2020	2021	Total
Cases open at 1 April 2020	2	-	-	2	5	9	12	12	-	42
AEP connected case							1			1
Cases closed in year	1				2	4		3	-	10
Cases open at 31 March 2021	1	-	-	2	3	5	13	9	16	49



We closed three legacy cases during the year

<sup>55</sup> Two connected AEP cases are counted as a single investigation in 2018/19 and 2019/20 and as two investigations in 2020/21.

Extensions to existing cases in the AEP are counted as new cases, as the AEP does not make provision for amendments to scope. From 2020/21 we are consistently counting these extensions to existing cases in the AEP as separate cases. If 2018/19 and 2019/20 were restated on a like-for-like basis, the number of cases open at year end would be 42 and 43, respectively, and the average age of cases open at year end would be 20.4 in 2018/19 and 24.6 in 2019/20.

## 8 Looking to the Future

### Introduction

Last year, we considered the likely impacts of Covid-19 and Brexit, each of which continue to bring significant changes to companies and to audit firms some of which will be permanent. With respect to Covid-19, the FRC, together with the Financial Conduct Authority and the Prudential Regulation Authority, announced a series of actions in March 2020 to ensure that information continues to flow to investors and to support the continued functioning of the UK's capital markets. Since then, the FRC has issued a number of updates to this guidance.<sup>56</sup>

Companies continue to face increased risks and uncertainty. The ongoing impact of Covid-19 and Brexit has yet to be determined, as has the effect of climate change.<sup>57</sup> In both financial reporting and audit, new and previously untested procedures have replaced those that could not be performed due to Covid-19. The effectiveness of these new procedures has yet to be assessed. Against this background, preparation of financial statements will be more challenging, with additional disclosure required in complex and sensitive areas. In some cases, companies may be concerned about how these disclosures should be made.

### Ongoing uncertainty: Covid-19, Brexit and climate change

Against a background of ongoing uncertainty, a number of issues that have already featured in many of our cases will require particular care and scrutiny.

### Risk assessment

In general terms, companies should be assessing and providing additional disclosures on the longer-term impacts of Covid-19, Brexit and climate change on their business model and strategy. Auditors will, in turn, need to consider these assessments and make their own assessments of the risk of material misstatement to the financial statements and respond appropriately. Auditors will therefore need to gain an understanding of how each of these factors has and will affect the entities they audit.

More specifically, processes within entities have been adapted at short notice, with an increased risk of financial controls being weakened. Auditors will need to respond to this increased risk and adapt audit procedures accordingly.

**Companies continue to face increased risk and uncertainty under the ongoing impact of Covid-19, Brexit and climate change**

**Processes within entities have adapted at short notice, with an increased risk of financial controls being weakened**

<sup>56</sup> <https://www.frc.org.uk/covid-19-guidance-and-advice>.

In June the FRC released: Amendments to FRS 102 and FRS 105 – COVID-19-related rent concessions beyond 30 June 2021.

<sup>57</sup> <https://www.frc.org.uk/getattachment/22ee8a43-e8ca-47be-944b-c394ecb3c5dd/Climate-Change-v9.pdf> and <https://www.frc.org.uk/getattachment/ab63c220-6e2b-47e6-924e-8f369512e0a6/Summary-FINAL.pdf>.

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## Going concern

The assessment of going concern and related disclosures, which is already a common feature in Enforcement investigations, will continue to be a key area of consideration for companies and auditors.

In their financial reporting, companies need to provide detail on risks and uncertainties relating to going concern and viability. The ability of the company to continue as a going concern, and whether the going concern basis of accounting is appropriate, needs to be assessed. Where this assessment identifies events or conditions that may cast significant doubt on the company's ability to remain a going concern, then these uncertainties must be disclosed.

Disclosures in relation to going concern and viability should typically include the key factors affecting the company's prospects, how these factors are being managed, judgements and assumptions being made, together with a range of possible outcomes. Information provided in relation to going concern might include, for example, the use of Government support measures, access to bank and other financing, the risk of operational disruption due to climate change and significant changes to commodity pricing. Disclosures relating to viability need to consider a company's longer-term prospects and resilience and might consider, for example, longer-term changes in consumer behaviour and structural changes to the business.

In turn, auditors will need additional procedures to respond to increased uncertainties and the probable need to consider increased disclosure. Prior to Covid-19, the FRC issued a revised auditing standard on going concern that required more rigorous audit procedures and additional information in audit reports. Auditors need to plan their work such that they can identify events or conditions that might cause significant doubt on going concern. If such events or conditions exist, then further audit procedures should be performed and an assessment of whether additional disclosures relating to going concern is required.

In some cases, companies may be concerned about how disclosures relating to going concern and viability should be made, particularly where the financial statements need to disclose material uncertainties relating to going concern. To assess whether these disclosures are appropriate, auditors will need to ensure that an appropriate level of challenge is exercised over companies' going concern assessments, conclusions and related disclosures. It is likely that, in the current circumstances, audit work on going concern will need to be more extensive and will require more evidence from companies, in order to meet the required standards.

## Judgements and accounting estimates

Another area that regularly features in Enforcement investigations is the making and audit of judgements and estimates, and related disclosures. The requirement to make judgements and estimates is likely to increase in relation to a number of areas including going concern, inventory provisioning, impairment of assets and onerous leases. Judgements and estimates are always required, but in times of uncertainty they are of heightened significance and require greater transparency to meet investor expectations.

Companies are required to provide details relating to estimates that have a significant risk of causing a material adjustment to assets and liabilities within the next financial year. This should typically include the basis of the judgement, sensitivity analysis to changes in assumptions and ranges of possible outcomes.

These requirements relate to the most difficult, subjective and complex judgements. Current levels of uncertainty mean that significant additional disclosure is likely to be required. Again, there may be some cases where companies are concerned about how these disclosures should be made.

**The requirement to make judgements and accounting estimates is likely to increase**

Auditors need to assess whether these judgements and related disclosures are reasonable. In doing this, they will need to employ heightened professional scepticism, carefully considering the sufficiency, appropriateness and reliability of evidence obtained, and whether this evidence incorporates any inconsistencies or indicators of management bias. In some cases, additional audit procedures will be required to meet the required standards.

Ineffective challenge of management has been identified as a recurring issue over the last few years in inspections conducted by the FRC's AQR team and in Enforcement investigations. Challenge may be more difficult in an environment of change and uncertainty, but it will be more important than ever.

## Fraud

The primary responsibility for the prevention and detection of fraud rests with the directors as those responsible for the governance and management of the entity. However, an auditor must obtain reasonable assurance that the financial statements taken as a whole are free from material misstatement caused by fraud. These responsibilities are undergoing change and clarification against a background calling for heightened vigilance.

The Department for Business, Energy and Industrial Strategy (BEIS) is currently consulting on proposals to restore trust in audit and corporate governance, including statutory requirements for directors to report on the steps they have taken to prevent and detect material fraud and for auditors to report in relation to such a director's statement. In May 2021 the FRC issued a revision of the UK auditing standard on the responsibilities of auditors relating to fraud<sup>58</sup> designed to provide increased clarity as to the auditor's obligations. The revisions come into force for the audits of periods commencing on or after 15 December 2021, with early adoption permitted.

The current environment calls for increased care. Over the last year, accounting and financial reporting processes have been adapted at short notice with financial controls potentially being weakened, creating an increased risk of fraud. In some cases, there will also be an increased risk of fraud arising from economic pressure on management or employees to misrepresent earnings.

Auditors must respond to these risks and adapt audit procedures. Importantly, they must maintain professional scepticism throughout all aspects of the audit looking for both contradictory as well as confirmatory evidence. Indications that evidence may not be authentic, is inconsistent with other evidence, or otherwise implausible should be investigated further.

## Actuarial work – pensions and insurance

Actuaries should continue to be aware of the risks of underfunding of company pension schemes, the ability to continue to rely on sponsor covenants and the impact on pension asset valuations.

In the coming few years, it is likely that many companies will need to increase disclosures in their financial reporting and that these will often require complex judgements. This will mean significant challenges for accountants, actuaries and auditors, requiring expertise and in some cases additional work, particularly in the areas set out above. The FRC as a whole will continue to provide guidance on how to meet these challenges and fulfil professional responsibilities.<sup>59</sup>

**Increased risk of fraud, arising from economic pressure on management and employees**

<sup>58</sup> [https://www.frc.org.uk/getattachment/e48499f2-b69b-4f45-8bef-762583eab1cd/ISA-\(UK\)-240-Final.pdf](https://www.frc.org.uk/getattachment/e48499f2-b69b-4f45-8bef-762583eab1cd/ISA-(UK)-240-Final.pdf).

<sup>59</sup> <https://www.frc.org.uk/covid-19-guidance-and-advice>.

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## Enforcement approach

Transparency in financial reporting in general, and truth and fairness in financial statements specifically, are as important as ever and the standards against which Enforcement will hold accountants, auditors and actuaries to account will continue to be applied. As always, however, Enforcement will consider in each case the context in which work is performed and ensure a proportionate response.

## Regulatory reform

The FRC continues its strategy for taking the organisation through a period of significant change to create ARGA. On 18 March 2021 the Government published its white paper, *Restoring trust in audit and corporate governance*,<sup>60</sup> paving the way for legislation to be introduced that will implement the reforms recommended in the three independent reviews published in 2019: the FRC Review, the Brydon Review and CMA's market study (together 'the Reviews'). The white paper includes far-reaching proposals affecting the FRC's purpose and objectives, and the roles and responsibilities of those we regulate. The new legislative proposals being consulted on have the potential to significantly alter and enhance the FRC's enforcement powers.

Covid-19 and the UK's exit from the EU have heavily affected the available Parliamentary time, and we are awaiting the Government's update on the timetable for tabling legislation.

## Government white paper: *Restoring Trust in Audit and Corporate Governance*

The Government's white paper sets out its proposals for a new directors' enforcement regime that would provide ARGA with powers to investigate and sanction directors of PIEs in relation to corporate reporting and audit-related responsibilities. It proposes that the directors' duties within the scope of the new regime would include the existing statutory duties and new duties proposed elsewhere in the white paper. The white paper also recognises that directors' duties under existing legislation are not designed for enforcement by a regulator and therefore proposes to give ARGA the power to impose more detailed requirements as to how certain statutory duties relating to corporate reporting and audit are to be met by directors.

The white paper also proposes to introduce legislation giving ARGA statutory powers to take enforcement action in relation to accountants. The Government envisages that those powers will be similar to the investigatory and sanctioning powers that are exercisable in relation to Statutory Auditors. The Government also proposes to give ARGA the power to establish a standardised code of ethics with which members of the chartered bodies (either individuals or firms) would be required to comply and that would be enforceable under new powers.

Similarly, the white paper proposes to introduce a strengthened, statutory basis for the regulation of the actuarial profession with clear and defined roles and responsibilities. It proposes ARGA should have responsibility for the investigation and discipline of members of the actuarial profession for matters that raise, or appear to raise, important issues affecting the public interest. It also is considering what remit ARGA should have for entities that undertake actuarial work.

**Proposals for a new directors' enforcement regime would provide ARGA with powers to investigate and sanction directors of PIEs in relation to corporate reporting and audit-related responsibilities**

<sup>60</sup> Consultation paper: [Restoring trust in audit and corporate governance](#).

We are giving careful consideration to what the implications would be for Enforcement in giving effect to the legislative proposals arising from the white paper and continue to work with Government during the consultation and implementation process.

## Continuous improvement

The Enforcement Division is also proceeding with a programme of transformation steps to implement change that is not dependent on legislation. In 2018 Sir John Kingman recognised evidence of a positive shift in the FRC's enforcement approach. Enforcement's drive for improvement in timeliness and efficiency continues. This year saw a major recruitment initiative resulting in expansion of the headcount in Enforcement by 44% from 36<sup>61</sup> at March 2020 to 52 at March 2021. Further headcount growth to 72 by March 2022 is planned.

We have ensured that over the last year our own work of holding professional accountants, auditors and actuaries to account, as far as possible, has remained broadly on track. We have continued to investigate, bring enforcement action, and conduct litigation, adapting as necessary to remote working and other Covid-19 restrictions while ensuring fairness to all parties. While availability of individuals both within the FRC and among those we work with and those we regulate has necessarily been impacted, in other respects we have adapted with speed and agility to minimise disruption to our activities. Formal interviews have proceeded, virtual court hearings have taken place and we conducted a four-week trial remotely before the independent Tribunal in November 2020 involving factual and expert evidence. We have also successfully recruited and onboarded a significant number of new staff.

## Governance changes

During 2020 the FRC consulted on changes to its governance structure designed to streamline the number of councils and committees and support greater Executive-led decision-making. The governance changes approved by the Board took effect from 1 January 2021 and include a change to the role of the Conduct Committee, which now focuses predominantly on Enforcement matters.

While the FRC Board retains the decision to open an investigation under the AEP and Schemes, delegation to the Conduct Committee remains in place. In practice therefore in the majority of cases the Conduct Committee is expected to continue to make decisions to open and announce investigations and determine other enforcement publication matters.

The FRC's sub-committee structure has been removed, which has resulted in the removal of the Case Management Committee, which previously advised the Enforcement Division on the conduct of investigations. Instead, Enforcement and the Conduct Committee can call upon a broad Advisory Panel of experienced practitioners and experts for specialist advice and input on a targeted basis. The Advisory Panel includes auditors, accountants, actuaries, and professionals with other relevant experience including institutional investment, senior financial management and audit committee expertise.

**Formal interviews have proceeded, virtual court hearings have taken place and a four week Tribunal hearing was conducted remotely**

**Whilst the FRC Board retains the decision to open an investigation, under the AEP and Schemes, delegation to the Conduct Committee remains in place**

<sup>61</sup> During the year to 31 March 21 the Enforcement and Case Examination and Enquiries (CEE) team grew from 40 to 52. In October 2020, enquiries undertaken to support decisions on AEP matters were transferred from Enforcement to the recently formed Audit Firm Supervision team. This transfer included four CEE colleagues. On a like-for-like basis, Enforcement and CEE has grown from 36 at March 2020, to 52 at March 2021, an increase of 44%.

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## **AEP review**

The AEP came into force on 17 June 2016. On the same day, the FRC published a feedback statement that stated that the new procedure would be subject to a post-implementation review. On 22 July 2021, the FRC launched a public consultation on the proposed amendments.

## 9 Glossary

Term	Meaning
<b>ACCA</b>	The Association of Chartered Certified Accountants.
<b>Accountancy Scheme</b>	A contractual arrangement between the FRC and the accountancy professional bodies that provides for the FRC to investigate (and take enforcement action against) their members in cases that raise important issues affecting the public interest in the UK.
<b>Actuarial Scheme</b>	A contractual arrangement between the FRC and the actuarial professional bodies that provide for the FRC to investigate (and take enforcement action against) actuaries in cases that raise important issues affecting the public interest in the UK.
<b>AEP</b>	Audit Enforcement Procedure, which is the process under which the FRC can investigate Statutory Auditors and audit firms in relation to audits of PIEs, large AIM-listed companies and Lloyd's Syndicates for breach of a Relevant Requirement.
<b>AER</b>	The FRC's Annual Enforcement Review.
<b>AIM</b>	Alternative Investment Market.
<b>Allegation</b>	Information about a Statutory Auditor or Statutory Audit Firm that raises a question as to whether they have breached a Relevant Requirement.
<b>AQR</b>	The FRC's Audit Quality Review team. This team is responsible for monitoring the quality of the audit work of Statutory Auditors and audit firms in the UK that audit public interest entities (PIEs) and certain other entities within the scope retained by the FRC.
<b>ARGA</b>	Audit, Reporting and Governance Authority.
<b>Audit firm</b>	The sole practitioner, partnership, limited liability partnership or other corporate entity engaged in the provision of audit services.
<b>Audited entity</b>	Entity whose financial statements are subject to audit by the audit firm.
<b>Auditor</b>	Auditor refers to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm.
<b>BEIS</b>	Department for Business, Energy and Industrial Strategy.
<b>Big Four</b>	The four largest accounting firms – Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers.
<b>Big Six</b>	The Big Four accounting firms, plus Grant Thornton and BDO.
<b>Brydon Review</b>	The independent review led by Sir Donald Brydon into how the audit process and product could be developed to better serve the needs of users and the wider public interest.
<b>CAI</b>	Chartered Accountants Ireland.
<b>CASS</b>	Client Assets Sourcebook.
<b>CASS audit</b>	Engagements to provide assurance on client assets for the Financial Conduct Authority.
<b>Client Asset Reports</b>	Annual reports on client assets required by the FCA.
<b>CEE</b>	The FRC's Case Examination and Enquiries team. This team is responsible for gathering intelligence and conducting initial enquiries on cases arising under the AEP, the Accountancy Scheme or the Actuarial Scheme.

<b>CIMA</b>	The Chartered Institute of Management Accountants.
<b>CMA</b>	Competition and Markets Authority.
<b>CMA Review</b>	The Statutory audit services market study published by the CMA in April 2019.
<b>Conduct Committee</b>	The Conduct Committee is a sub-committee of the FRC that decides whether to open investigations under the enforcement schemes and performs an oversight role in relation to the FRC's enforcement work. It is also the body responsible for making decisions about publication of certain case-related matters and issuing guidance.
<b>Constructive Engagement</b>	A process introduced by the AEP for resolving cases with an audit firm where the audit quality concerns do not necessarily warrant a full enforcement investigation.
<b>CRR</b>	The FRC's Corporate Reporting Review team reviews directors' reports and accounts of public and large private companies for compliance with the law. It also keeps under review interim reports of all listed issuers and annual reports of certain other non-corporate listed entities.
<b>Decision Notice</b>	A document issued at the end of an AEP investigation that sets out the Allegations against the respondent, as well as a recommended sanction.
<b>Engagement partner</b>	The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.
<b>Engagement quality control review partner or EQCR</b>	A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgements the engagement team made and the conclusions it reached in formulating the report.
<b>Formal Complaint</b>	A document issued at the end of an Accountancy Scheme investigation that sets out the alleged Misconduct.
<b>FRC</b>	Financial Reporting Council.
<b>FRRP</b>	The Financial Reporting Review Panel (FRRP) was in existence until 31 December 2020. It comprised a body of individuals drawn from commerce and the professions who, from time to time, were called on as peers, to join a five-person Review Group to consider issues raised in respect of the Conduct Committee's reviews of company reports and accounts.
<b>IAASB</b>	The International Auditing and Assurance Standards Board.
<b>IASB</b>	The International Accounting Standards Board.
<b>ICAEW</b>	The Institute of Chartered Accountants in England and Wales.
<b>ICAS</b>	The Institute of Chartered Accountants of Scotland.
<b>IFoA</b>	The Institute and Faculty of Actuaries.
<b>IFRS</b>	The International Financial Reporting Standards issued by the International Accounting Standards Board.
<b>IIR</b>	Initial Investigation Report. Under the AEP, this report is served on the respondent at the end of an investigation and sets out the Allegations against the respondent, the Relevant Requirements that appear to have been breached, and summarises the evidence and documents obtained over the course of the investigation.

<b>ISAs</b>	International Standards on Auditing (UK and Ireland), which are based on standards issued by the International Auditing and Assurance Standards Board. These form part of the Relevant Requirements that apply to Statutory Audit work.
<b>FRC Review</b>	The independent review of the FRC led by Sir John Kingman which was published in December 2018.
<b>KPI</b>	Key performance indicator.
<b>Member Firm</b>	A firm that is subject to the systems of discipline, professional conduct, and regulation of any of the bodies that participates in the contractual arrangement of the Accountancy or Actuarial Schemes.
<b>Member</b>	A member of any of the bodies that participate in the contractual arrangement of the Accountancy or Actuarial Schemes, or a person who is subject to the systems of discipline, professional conduct and regulation of any such body.
<b>Misconduct</b>	An act or omission or series of acts or omissions, by a member or Member Firm in the course of their or its professional activities (including as a partner, member, director, consultant, agent, or employee in or of any organisation, or as an individual) or otherwise, which falls significantly short of the standards reasonably to be expected of a member or Member Firm or has brought, or is likely to bring, discredit to the member or the Member Firm or to the accountancy profession.
<b>Misstatement</b>	A difference between the reported amount, classification, presentation, or disclosure of a financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework.
<b>Non-audit work</b>	Any engagement in which an audit firm provides professional services to an audited entity, its affiliates or another entity where the subject matter of the engagement includes the audited entity and/or its significant affiliates other than the audit of financial statements of the audited entity.
<b>Objectivity</b>	Acting and making decisions and judgements impartially, fairly and on merit (having regard to all considerations relevant to the task in hand but no other), without discrimination, bias, or compromise because of commercial or personal self-interest, conflicts of interest or the undue influence of others, and having given due consideration to the best available evidence.
<b>Participants in the Accountancy Scheme</b>	Participants in the Accountancy Scheme that are not also RSBs are: the Chartered Institute of Management Accountants (CIMA) and the Chartered Institute of Public Finance & Accountancy (CIPFA).
<b>Partner</b>	Any individual with authority to bind the firm with respect to the performance of a professional services engagement.
<b>PFC</b>	A Proposed Formal Complaint, which is a draft of a Formal Complaint setting out the alleged Misconduct following an Accountancy Scheme investigation. Under the Accountancy Scheme, a respondent has eight weeks to make representations in response to the PFC. After considering these representations, the FRC may finalise the Formal Complaint.

<b>PIEs</b>	<p>Public Interest Entities. These are:</p> <p>(a) an issuer whose transferable securities are admitted to trading on a regulated market; or</p> <p>(b) a credit institution within the meaning of Article 4(1)(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council, other than those listed in Article 2 of Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and investment firms; or</p> <p>(c) an insurance undertaking within the meaning given by Article 2(1) of Council Directive 1991/674/EEC of the European Parliament and of the Council on the annual accounts and consolidated accounts of insurance undertaking.</p> <p>No other entities have been specifically designated in law in the UK as PIEs.</p>
<b>Professional accountant</b>	For the purpose of the ISAs (UK) and the FRC's Ethical Standard, professional accountants are those persons who are members of a professional accountancy body, whether in public practice (including a sole practitioner, partnership or corporate body), industry, commerce, the public sector or education.
<b>Professional scepticism</b>	An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to error or fraud, and a critical assessment of evidence.
<b>Relevant ethical standards</b>	In the UK the firm and its personnel are subject to ethical requirements from two sources: the FRC's Ethical Standard concerning the integrity, objectivity and independence of the firm and its personnel, and the ethical standards established by the auditor or assurance practitioner's relevant professional body.
<b>Relevant Requirement</b>	<p>A requirement with which a Statutory Auditor must comply. The Relevant Requirements include those set out in:</p> <p>(a) SATCAR;</p> <p>(b) the Audit Regulation (537/2014/EU);</p> <p>(c) the ISAs; and</p> <p>(d) the FRC's Ethical Standard.</p>
<b>RNS</b>	Regulatory News Service: a regulatory and financial communications channel managed by the London Stock Exchange for companies to communicate with the professional investor.
<b>RSB</b>	Recognised Supervisory Bodies (RSBs) are: the Institute of Chartered Accountants in England and Wales (ICAEW), the Institute of Chartered Accountants of Scotland (ICAS), Chartered Accountants Ireland (CAI) and the Association of Chartered Certified Accountants (ACCA).
<b>SATCAR</b>	The Statutory Auditors and Third Country Auditors Regulations 2016/649.
<b>Schemes</b>	The Accountancy Scheme and Actuarial Scheme.

<b>Statutory Audit</b>	An audit performed pursuant to the EU Audit Directive and Regulation or otherwise designated by national law as a Statutory Audit, which in the UK is an audit of financial statements or consolidated financial statements required by the Companies Act 2006 (as amended).
<b>Statutory Auditor</b>	A person appointed as an auditor under the Companies Act 2006 who is approved by or on behalf of the FRC to carry out Statutory Audits.
<b>Sufficiency (of audit evidence)</b>	The measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.
<b>Tribunal</b>	The panel appointed in order to conduct hearings where Executive Counsel has decided to take enforcement action against the subject of an investigation. Tribunals are formed of former auditors, lawyers and lay persons.

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## Appendix A – Summary of Remit and Powers

### Who can the FRC investigate and act against?

The FRC's overarching mission is to serve the public interest by setting high standards of corporate governance, reporting and audit and by holding to account those responsible for delivering them.

As the Competent Authority for Statutory Audit and the independent disciplinary body for accountants and actuaries in public interest cases, the FRC is committed to delivering robust, fair and transparent regulatory outcomes on a timely basis.

Those within the FRC's jurisdiction include Statutory Auditors and audit firms, accountants, firms of accountants, and actuaries.

### Auditors

The FRC has responsibility for enforcement action in relation to Statutory Audit firms and individual Statutory Auditors.

### Accountants

The FRC can also take enforcement action in respect of suspected Misconduct by individual accountants and firms of accountants, who are members of the professional accountancy bodies<sup>62</sup> in relation to non-audit work in public interest cases. These individuals are often working within businesses preparing financial statements and other financial information.<sup>63</sup>

### Actuaries

The FRC can take enforcement action in respect of suspected Misconduct by individual actuaries who are members of the Institute and Faculty of Actuaries (IFoA) in public interest cases. The FRC has no jurisdiction over firms employing actuaries.

The FRC currently has no powers to investigate, take enforcement action or impose sanctions on individuals, including directors, who are not members of the professional accountancy bodies or the IFoA (members). The scope of our enforcement powers is to the subject of consultation for legislative change as discussed above in Chapter 8.

<sup>62</sup> The professional accountancy bodies referred to in this report are ICAEW, ICAS, CAI, ACCA, CIPFA and CIMA.

<sup>63</sup> Members who undertake audit work but are not a Statutory Auditor also fall within the jurisdiction of the Accountancy Scheme

## The Enforcement regimes

The FRC operates three Enforcement regimes.

- The **Audit Enforcement Procedure**<sup>64</sup> in respect of Statutory Auditors and Statutory Audit firms<sup>65</sup> in relation to audits of PIEs,<sup>66</sup> large AIM-listed companies<sup>67</sup> and Lloyd's Syndicates,<sup>68</sup>
- The **Accountancy Scheme**<sup>69</sup> in respect of accountants and firms of accountants who are members of the Participants in that scheme, in relation to non-audit work in public interest cases.<sup>70</sup> These individuals are often working within businesses preparing financial statements and other financial information;<sup>71</sup> and
- The **Actuarial Scheme**<sup>72</sup> in respect of individual actuaries who are members of the IFoA.

### The Audit Enforcement Procedure

The AEP confers powers on the FRC Board to open investigations. In the majority of cases the decision to open investigations is delegated to the Conduct Committee. An investigation is opened by the Board or Conduct Committee where there is information that *'raises a question as to whether there has been a breach of a Relevant Requirement'* and it considers that there is a good reason to investigate. Enforcement action can be taken if the Executive Counsel or the Enforcement Committee conclude that the investigation establishes that there has been a breach of a Relevant Requirement under auditing or ethical standards.

As noted earlier, the AEP is currently subject to a post-implementation review and a public consultation on proposed amendments will take place in autumn 2021.

### The Accountancy Scheme and Actuarial Scheme (the Schemes)

The Schemes are contractual arrangements between the FRC and the accountancy/actuarial professional bodies and provide for the FRC to investigate and take enforcement action against members in cases that raise important issues affecting the public interest in the UK.<sup>73</sup>

The Schemes confer power on the FRC Board to open investigations. In the majority of cases the decision to open investigations is delegated to the Conduct Committee. Investigations are opened by the Conduct Committee principally where it determines that a matter raises or appears to raise important issues affecting the public interest in the UK and that there are *'reasonable grounds to suspect that there may have been Misconduct'*.<sup>74</sup> Misconduct is defined as conduct that falls significantly short of the standards reasonably to be expected of such an accountant, accountancy firm or actuary, or which has brought, or is likely to bring discredit to the accountant/actuary or to their profession.

<sup>64</sup> [The Audit Enforcement Procedure](#).

<sup>65</sup> Before June 2016, all audit and accountant investigations were conducted under the Accountancy Scheme. Following implementation of EU legislation, the FRC became the UK Competent Authority for audit and the AEP replaced the Accountancy Scheme for audit matters. The Accountancy Scheme remains in place for audit investigations that began before June 2016 and all non-audit matters.

<sup>66</sup> As defined in Regulation 2, SATCAR.

<sup>67</sup> With a market capitalisation of more than €200m.

<sup>68</sup> Other audit-related matters are delegated by law to the professional accountancy bodies, although the FRC can investigate such matters where it considers it is in the public interest to do so.

<sup>69</sup> [The Accountancy Scheme](#).

<sup>70</sup> The Accountancy Scheme does not apply to insolvency work, accountants' statutory obligations in relation to money laundering and terrorist financing, or 'reserved legal activities' under the Legal Services Act 2007.

<sup>71</sup> Members who undertake audit work, but are not a Statutory Auditor, also fall within the jurisdiction of the Scheme.

<sup>72</sup> [The Actuarial Scheme](#).

<sup>73</sup> Matters not affecting the public interest are dealt with by the professional bodies.

<sup>74</sup> It is also possible for Executive Counsel to commence an investigation into a firm or individual for an apparent failure to comply with the obligations under paragraphs 14(1) or 14(2) of the Schemes.



**The Audit Enforcement procedure is currently under review**

Enforcement action can be taken where Executive Counsel determines that there is a realistic prospect that a Tribunal will find that individual professional accountants/actuaries or accountancy firms have engaged in Misconduct.

## Information gathering powers

Both the AEP and the Schemes contain provisions allowing the FRC to request information and documentation from a number of individuals and entities. In the case of the AEP, failure to comply with such requests is a criminal offence.

The following table sets out which Enforcement regime applies in respect of the individuals and entities within the FRC's jurisdiction pre- and post-implementation of the relevant EU legislation in June 2016.

Subjects of inquiry and investigation	Auditors (firms and individuals)	Accountants	Actuaries
<b>Powers pre-2016</b>	Accountancy Scheme <sup>75</sup>	Accountancy Scheme	Actuarial Scheme <sup>76</sup>
<b>Powers post-2016</b>	Audit Enforcement Procedure <sup>77</sup>	Accountancy Scheme	Actuarial Scheme

The FRC has a number of live investigations under each of its Enforcement regimes. Further details are set out below.

### Current status of audit investigations

As of 1 April 2020, one out of 27 of our investigations into **audit** were under the Accountancy Scheme. One investigation closed during the year and one audit investigation under the scheme opened so that at 31 March 2020, one **audit** investigation is being conducted under the Accountancy Scheme and 37 under the AEP.

### Current status of non-audit investigations

As at 31 March 2021, there were 12 open non-audit investigations into accountants, accountancy firms or actuaries under the Schemes.

## Sanctions

The AEP and the Schemes each prescribe a range of sanctions that can be imposed following a finding of Misconduct or a breach of Relevant Requirements. The sanctions may be of a financial nature (such as an unlimited fine or waiver of client fees) or non-financial (such as a Reprimand or exclusion as a member of a professional body). These include:

- Unlimited fines;
- Reprimands or Severe Reprimands;<sup>78</sup>

<sup>75</sup> [The Accountancy Scheme](#).

<sup>76</sup> [The Actuarial Scheme](#).

<sup>77</sup> [The Audit Enforcement Procedure](#).

<sup>78</sup> The decision as to whether a Reprimand or a Severe Reprimand is appropriate will depend on the facts of individual cases and the seriousness of the Misconduct/breaches.

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- Orders designed to prevent recurrence, such as placing restrictions on the nature of work undertaken or clients represented, and education and training programmes;
  - Waiver or repayment of client fees;
  - Prohibition from conducting Statutory Audits, withdrawal of registration or practising certificate; and
  - Exclusions as a member of a professional body.

Additional sanctions under the AEP include:

- Notice to cease or abstain from conduct giving rise to the breach of a Relevant Requirement (and publication of this);
- A declaration that the Statutory Audit Report does not satisfy the Relevant Requirements; and
- Temporary prohibition from being a member of the management body of an audit firm or a director of a PIE.

Details of the sanctions that may be imposed are set out in the relevant published procedural documentation and related guidance.<sup>79</sup>

## Case Examinations and Enquiries

Case Examination and Enquiry in Enforcement is responsible for the initial assessment, and the Enforcement Case Examiner is responsible for decisions taken in respect of all cases reviewed for potential investigation. However, since October 2020, enquiries undertaken to support these decisions on AEP matters are conducted with the assistance of the recently formed Audit Firm Supervision team, in order to leverage the detailed audit firm knowledge of the Supervisors in that division.

### Sources of enquiries

Most enquiries are generated from horizon-scanning activities, which include searches of listed company Regulatory News Service (RNS) updates and reviews of reports in the financial press. Other sources of enquiries are complaints, whistleblowing disclosures and referrals from other FRC teams, regulators and professional bodies.

Consideration is given to the nature of the issue before deciding to make further enquiries in order to ensure that our actions are proportionate and risk-based.

### Horizon scanning

When performing horizon-scanning activities, the types of issues of interest include:

- Material misstatements in a company's financial statements that may not have been detected through the Statutory Audit process (including errors in the audited financial statements themselves and in other parts of the annual report that an auditor has a duty to review);

<sup>79</sup> [Sanctions Policy \(Audit Enforcement Procedure\) \(effective from 1 June 2018\)](#); [Accountancy Scheme Sanctions Guidance \(March 2021\)](#); [Actuarial Scheme Sanctions Guidance \(March 2021\)](#).

- 
- Indications of fraud that may not have been detected by the Statutory Audit process; and
  - Indications of Misconduct by professional accountants or actuaries where it may be in the public interest for the FRC to make enquiries, primarily in relation to the preparation and approval of financial statements which may contain material errors.

In relation to errors in a set of financial statements, we focus on those that appear to be material and could reasonably be expected to influence the decisions of users of the financial statements.

## Complaints and whistleblowing disclosures

Complaints and whistleblowing disclosures are managed centrally by the FRC and are referred for further assessment and enquiry if they appear to relate to audit, accounting or actuarial matters within the FRC's Enforcement remit.

## Referrals

Other FRC teams may refer matters for further enquiry if they become aware of matters indicative of auditing, accounting or actuarial irregularities. A primary source of such referrals is from audit inspections conducted by the FRC's Audit Quality Review team (AQR).

In addition, the FRC's Corporate Reporting Review team (CRR) may identify a material error in a company's financial statements in terms of an incorrect accounting treatment or a disclosure failure, which may also raise a question as to whether there has been a failure in the audit process.

CEE liaises closely with other relevant regulators and prosecuting authorities to identify cases of public interest and determine which body may be best placed to act. CEE both receives and makes referrals, and information is received from and shared with other agencies as permitted through formal legal gateways.

## Outcomes of an enquiry

An enquiry will end in one or more of the following outcomes:

- Referral to the Conduct Committee for a decision on whether an investigation should be opened;
- In AEP cases only, resolution through Constructive Engagement (more information on the Constructive Engagement process is set out below);
- Referral to another FRC team, such as CRR or AQR;
- Referral to a professional accountancy body<sup>80</sup> where that body is better placed to investigate and/or if the matter does not fall within the FRC's remit; or
- No further action by the FRC where the initial enquiry identified no evidence of acts or omissions likely to amount to potential breaches or Misconduct.

CEE may also make a referral to another regulator or agency, regardless of whether the matter is also progressed within the FRC.

<sup>80</sup> Professional accountancy bodies include the Recognised Supervisory Bodies (RSBs), the Participants in the Accountancy Scheme and other accountancy bodies. A list of the RSBs and the Participants is included in the Glossary.

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## **Constructive Engagement**

### **What is Constructive Engagement?**

Constructive Engagement is a process introduced by the AEP for resolving cases where the audit quality concerns can be appropriately and satisfactorily addressed without full investigation and enforcement action.

As set out in paragraphs 13 and 14 of the Guidance for Case Examiner, the use of Constructive Engagement is entirely at the discretion of the Case Examiner. Examples given of cases for which it will or may be suitable include:

- Cases where there has been a minor technical breach, usually at the very lowest end of the spectrum of Allegations; and
- Cases where there is no real concern about harm to investor, market or public confidence in Statutory Audit process and where there is no evidence of financial detriment to anyone.

### **Who conducts Constructive Engagement?**

Constructive Engagement decisions are made by the Case Examiner. Detailed enquiries, and identification of remedial actions where appropriate, are conducted by the Audit Firm Supervision team.

### **How does Constructive Engagement work?**

We seek information from the audit firm about the audit work conducted and the issues underlying the potential audit breach, including reviewing relevant audit working papers and obtaining explanations from the audit team. Sometimes, an audit firm will be asked to appoint an independent team to perform an in-depth review of the audit work, to an agreed scope. The Case Examiner will then agree appropriate remedial actions with the firm, for example modifications to firm-wide audit procedures and/or staff training.

Constructive Engagement will only succeed with the full cooperation of an audit firm. If an enquiry is not or cannot be resolved to the Case Examiner's satisfaction, it may be referred to the Conduct Committee for a decision on opening an investigation. As part of its oversight role, the Conduct Committee is provided with information about all cases resolved via Constructive Engagement.

### **How do we share learnings from Constructive Engagement activities?**

Although the FRC does not publish individual outcomes of Constructive Engagement, we communicate themes and learnings to audit firms, and share insights with accountancy bodies (for circulation to their members), other regulators and other teams within the FRC, who feed the results into their work. More information on the cases dealt with via Constructive Engagement is set out on pages 16 to 20.

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## The Board

The Board is responsible for and oversees the maintenance and operation of Enforcement procedures with the assistance of the Conduct Committee. The Board delegates Enforcement decisions, for example to open and close investigations and take enforcement action, as set out in the FRC's published Enforcement procedures.

## Conduct Committee

The Conduct Committee is a committee of the FRC Board, to which its Chair reports on Enforcement matters. It comprises FRC Board members and others with a range of skills, experience and relevant technical expertise. Membership of the Committee excludes current practising auditors as well as employees or officers of the professional bodies regulated by the FRC. The Conduct Committee decides whether to open investigations under the AEP and Schemes and performs an oversight role in relation to the FRC's Enforcement work, including the work of the Case Examiner. If it considers that an AEP case is suitable for Constructive Engagement, it can refer the matter back to the Case Examiner. If it considers that it does not have sufficient information to open an investigation under the Schemes, it can direct Executive Counsel to conduct preliminary enquiries.<sup>81</sup> The Conduct Committee is also responsible for making decisions about publication of certain case-related matters and for issuing guidance.<sup>82</sup>

<sup>81</sup> Preliminary enquiries will usually be conducted by lawyers and forensic accountants within the Enforcement Division, but assistance from external specialists can also be sought (see paragraphs 6(10) and 7(7) of the Schemes).

<sup>82</sup> All guidance issued by the Conduct Committee is published on the FRC website.

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## Appendix B – Summary of Cases Concluded and Published with Sanctions in 2020/21

### BDO/Amtrust Europe Ltd / AEP

In June 2020, a Final Decision Notice was issued following admissions of breaches of Relevant Requirements by BDO and a partner in relation to the Statutory Audit of the financial statements of Amtrust Europe Ltd (AEL) for the 2014 and 2015 financial years.

#### Points to note

- The breaches of Relevant Requirements related to an area of audit work that was fundamental for the audits: the approach of AEL's management to setting its technical provision for outstanding claims.
- The sanctions reflect the fact that BDO had already adopted a number of appropriate measures designed to address the shortcomings evident in the relevant audit work.
- The breaches of Relevant Requirements were not intentional, dishonest, deliberate or reckless.
- The findings do not question the truth or fairness of the FY2014 or the FY2015 financial statements.

#### The facts

AEL is an insurance company with multiple lines of business across Europe, Asia-Pacific and Canada. BDO had first been appointed as the Statutory Audit Firm for AEL for the financial year ended 31 December 2007 and remained as such for all subsequent years until the FY2015 audit. Mr Roberts is a partner of BDO, with 30 years' auditing experience. He signed the FY2014 audit report and the FY2015 audit report, on behalf of BDO.

In both 2014 and 2015, AEL's most significant individual line of business by gross written premiums was the Italian hospitals medical-malpractice indemnity line of business (MedMal). After entering the MedMal market in 2009, AEL had by 2015 become its leading provider, with about half of the market share.

#### The issues

The breaches of Relevant Requirements concerned the auditor's response to the approach of AEL's management to setting its technical provision for outstanding claims for MedMal. The provision was determined, for both of the audits, to be a matter of considerable judgement by management and therefore an area of significant risk of material misstatement.

For the FY2014 audit, a single breach related to documentation of the auditors' consideration of compliance by AEL with the ABI SORP in respect of the provisions.

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For the FY2015 audit, the breaches concerned failures:

- To test adequately how AEL had estimated the provisions, and the data on which the estimate was based;
- To evaluate the adequacy of the auditor's expert's work, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence, and
- To prepare adequate audit documentation relating to these matters.

## **The outcome**

The following sanctions were imposed:

### **On BDO**

- A financial penalty of £200,000, discounted to £160,000 for admissions and early disposal;
- A published statement in the form of a Reprimand;
- A requirement that BDO implement in respect of the audit of insurance undertakings an appropriate training programme designed to improve quality and consistency in the firm's processes for obtaining and evaluating independent actuarial audit evidence and in the documentation of those processes and of auditors' key judgements; and
- A requirement that for a period of two years from the date hereof BDO undertake a quality performance review of the work relating to the obtaining and evaluating of actuarial audit evidence for all Statutory Audits of insurance undertakings that used independent actuaries as auditor's experts and report the results annually to the FRC.

### **On Mr Roberts**

- a published statement in the form of a Reprimand.

## **Deloitte/Autonomy Corporation plc/Accountancy Scheme**

In August 2020, the Tribunal imposed sanctions on Deloitte and Richard Knights and Nigel Mercer (former partners of Deloitte) following an investigation in relation to the published financial reporting of Autonomy Corporation (Autonomy) for periods between January 2009 and June 2011. No findings were made by the Tribunal against any third party, including Autonomy or any other individual.

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## Points to note

The Tribunal made numerous findings of Misconduct, including a failure to act in accordance with the Fundamental Principle of Professional Competence and Due Care (against all the respondents), through a lack of integrity (against Mr Knights) and through a loss of objectivity (against Mr Knights). The Misconduct related to the following areas:

- Deloitte's failure to adequately challenge Autonomy's accounting and disclosure of purchases and sales of hardware;
- Deloitte's failure to adequately challenge Autonomy's accounting for transactions with VARs;
- Failures by Mr Knights and Mr Mercer to correct misleading statements made by Autonomy to its regulator, the FRC's Financial Reporting Review Panel (FRRP), during January 2010 and March 2011 respectively; and
- Mr Knights' loss of objectivity.

The FRC's investigation was carried out at the same time as various other parallel criminal and civil proceedings involving members of the former Autonomy management.

## The facts

Autonomy was a FTSE 100 company. It was a highly profitable technology company engaged in the business of selling software. Its total revenue in the period 2009, 2010 and the first half of 2011 was approximately \$2.1bn with operating profits of \$756m. The vast bulk of its profit was derived from sales of software licences. It presented itself to the market as a rapidly growing software company, whose revenue growth resulted from rising, high-margin software sales.

In October 2011, the entire issued share capital of Autonomy was acquired by a subsidiary of Hewlett-Packard (HP) for approximately \$11bn. Later, during November 2012, HP wrote down \$8.8bn of the value of Autonomy, alleging '*serious accounting improprieties*'. The FRC opened its investigation into the published financial reporting of Autonomy for periods between 1 January and 30 June 2011, during February 2013.

Deloitte conducted the audits of Autonomy's financial statements from the financial years ended 31 December 2003 to 31 December 2010 inclusive. The audits were carried out from Deloitte's office in Cambridge, where Autonomy had its headquarters. Mr Knights was the audit engagement partner for the year ending 31 December 2009 and was the joint audit engagement partner for first quarter review in 2010. Mr Knights was also involved in the second quarter review in 2010. Mr Mercer was the audit engagement partner for the year ending 31 December 2010.

## The issues

For each of 2009 and 2010, the Tribunal decided that Autonomy's financial statements did not give a true and fair view given the absence of disclosure of material amounts of hardware sales. It further found that Deloitte, Mr Knights and Mr Mercer failed to address materially misleading statements in Autonomy's Annual Report and accounts. Given these circumstances, Deloitte should have refused to sign unqualified audit opinions until the hardware sales were fairly disclosed and the misleading statements corrected.

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The Tribunal decided that Deloitte, Mr Knights and Mr Mercer failed to demonstrate adequate professional scepticism (for each of 2009 and 2010) and obtain sufficient appropriate audit evidence (for 2009) in relation to Autonomy's accounting treatment for the costs of purchasing hardware. In one quarter this accounting treatment enabled Autonomy to improve its gross margin by 15%. There were also further failures to exercise adequate professional scepticism and to obtain sufficient appropriate audit evidence in relation to whether it was appropriate for Autonomy to recognise revenue on certain sales of software to value added resellers (VARs). Deloitte should not have issued an unmodified audit opinion in 2009 without obtaining further evidence.

The Tribunal also made findings of Misconduct against Deloitte, Mr Knights and Mr Mercer for failing to correct misleading statements made by Autonomy to the FRRP. In one of these instances the Tribunal found that Mr Knights acted recklessly and with a lack of integrity in failing to correct a statement made by Autonomy that he must have known was materially misleading and that there was a real risk that the FRRP would be misled by it.

Mr Knights was culpable of further Misconduct for the loss of his objectivity on six separate occasions during audit and review work from October 2009 to July 2010.

The Tribunal commented that it was *'the wholesale nature of the failure of professional scepticism in relation to the accounting for the hardware sales and the VAR transactions as well as our findings of Misconduct and of breaches of Fundamental Principles that make this case so serious'*. A number of the other breaches of standards related to:

- ISA (UK) 300 (Planning);
- ISA (UK) 315 (Understanding the Entity and its Environment);
- ISA (UK) 330 (The Auditor's responses to assessed risks);
- ISA (UK) 500 (Audit Evidence);
- ISA (UK) 700 (The Auditor's report on financial statements);
- ISA (UK) 720A (The Auditor's responsibilities relating to other information in documents containing audited financial statements); and
- ISA (UK) 720B (The Auditor's statutory reporting responsibility in relation to directors' reports).

## **The outcome**

Deloitte received a fine of £15m, a Severe Reprimand and agreed to provide a root cause analysis of the reasons for the Misconduct, why the firm's processes and controls did not prevent the Misconduct and whether the firm's current processes would lead to a different outcome.

Mr Knights received a fine of £500,000 and was excluded from membership of the ICAEW for five years. Mr Mercer received a fine of £250,000 and a Severe Reprimand.

The Tribunal commented: *'The findings of loss of objectivity and lack of integrity against Mr Knights and Deloitte are particularly serious and unusual. So too are the findings that all the respondents failed to correct misleading statements made to the FRRP'*

The Tribunal also made orders awarding costs against Deloitte in respect of Executive Counsel's costs and the Tribunal's costs.

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## Deloitte/A Public Listed Company/AEP

In September 2020 a Final Decision Notice was issued in relation to the Statutory Audit of the financial statements of a company for the 52 weeks ended 2 January 2016 (2015 financial statements).

### Points to note

Executive Counsel served the respondents with an IIR 18 months after commencing the investigation. Following consideration of the respondents' representations and completion of the investigation, the Final Decision Notice was issued just under three years after the commencement of the investigation.

The sanctions determined by Executive Counsel reflect, among other things, the fact that Deloitte had already undertaken a number of remedial measures designed to address the shortcomings in the audit work in question following a report by the FRC's AQR team on the audit of the 2015 financial statements.

### The facts

Deloitte was appointed as auditor to the company in 2002 and retained that appointment throughout the intervening period.

The breaches of Relevant Requirements were not pervasive as regards the wider audit work. However, the breaches did relate to the efficacy of the EQCR process and failures to obtain sufficient appropriate audit evidence in relation to a material balance and in an area of significant audit risk.

### The issues

The breaches of Relevant Requirements related to the audit of (1) the company's defined benefit pension scheme (DB Scheme) and (2) the carrying value of the company's intangible assets. The respondents failed to ensure that the review work carried out by the EQCR was adequately documented, failed to obtain sufficient appropriate audit evidence to substantiate the cash holding of the DB Scheme and failed to obtain sufficient appropriate audit evidence in respect of its stress testing of the Company's impairment model.

The breaches related to:

- ISA (UK) 230 (Audit Documentation);
- ISA (UK) 500 (Audit Evidence); and
- ISA (UK) 560 (Subsequent Events).

The breaches of Relevant Requirements were not intentional, dishonest, deliberate or reckless.

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## The outcome

The following sanctions were imposed on Deloitte:

- A financial penalty of £500,000 (discounted to £362,500 for admissions and early disposal);
- A Reprimand; and
- A non-financial sanction requiring Deloitte to prepare a progress report for the consideration of the FRC's AQR team setting out its current EQCR work programmes and how such work is documented during the course of the audit of PIEs.

The partner received a Reprimand.

Deloitte also paid Executive Counsel's costs of the investigation.

## Coats Group plc/Actuarial Scheme

In October 2020 a settlement agreement was concluded between the Executive Counsel and Mr Richard Jones, a Fellow of the IFoA. Under the settlement agreement Mr Jones admitted Misconduct in connection with his work in relation to three defined benefit pensions schemes linked to subsidiaries of Guinness Peat Group (GPG), now Coats plc.

### Points to note

The FRC's investigation followed a referral from the IFoA, and concerned various matters identified in the course of the Pensions Regulator's investigation into the pension schemes. The Pensions Regulator reported the outcome of its investigation in June 2017.

The Misconduct arose from Mr Jones providing advice to GPG and its subsidiaries while also advising individual GPG executives acting as trustee directors of the relevant pension schemes, despite the obvious conflicts of interest.

### The facts

GPG was an investment company that acquired the trading businesses that had originally established the pension schemes. GPG's strategy ultimately involved selling the main assets of the trading businesses and paying out the proceeds to its shareholders. However, the pension schemes (and hence the obligation to fund them) were retained within GPG.

By 2012 each of the schemes was in deficit on a 'buy out' basis, in aggregate in excess of £1bn. The approach of the scheme trustees to the funding of the schemes and the appropriate investment strategies for scheme assets was capable of having a very significant impact on the level of contributions that might be sought from the relevant GPG subsidiaries.

The trustees included individuals nominated by GPG. Two senior GPG executives were appointed as directors of the trustee companies. Mr Jones was a longstanding adviser of GPG on pensions matters. He also provided advice and assistance to the two individuals in their capacity as trustees.

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## The issues

The potential conflict of interest between GPG and the scheme members was evident to Mr Jones and others from an early stage. As a result, separate advisory teams were formed and Chinese walls were put in place between corporate and trustee files. In practice, however, Mr Jones advised and assisted the GPG-nominated trustees over a period of seven years. That assistance often involved Mr Jones being provided with information and reports prepared by the schemes' advisers, and drafting responses challenging the reports, that were sent by the GPG-nominated trustees in their own names. There was an obvious risk that the approach of the trustees would be influenced in such a way that the interests of GPG were favoured over those of the members of the schemes. Additionally, the reports received by Mr Jones were generally confidential to the trustee bodies and that confidentiality had been breached by them being provided to him.

## The outcome

Mr Jones accepted that his conduct involved breaches of both the Impartiality Principle and the Confidentiality Principle as set out in the Professional Conduct Standards as applicable during the relevant period, and that that amounted to Misconduct under the Actuarial Scheme.

The following sanctions were imposed:

- a Severe Reprimand, and
- a financial penalty of £100,000, reduced to £65,000 for mitigation and settlement.

## haysmacintyre/Associated British Engineering/AEP

In March 2021 a Final Decision Notice was issued in relation to the Statutory Audit of the financial statements of Associated British Engineering plc (ABE) for the year ended 31 March 2018 (FY2018 financial statements).

## Points to note

The Final Decision Notice was issued 18 months after the commencement of the investigation.

The breaches of Relevant Requirements were pervasive, extensive and, in relation to the audit of inventory, serious. However, they were not intentional, dishonest, deliberate or reckless.

The audit failed in its principal objective: that of providing reasonable assurance that the FY2018 financial statements were free from material misstatement.

The respondents provided an exceptional level of cooperation during the investigation, such that it was considered a mitigating factor by Executive Counsel and reduced the level of financial penalties that would otherwise have been payable. This included undertaking a detailed investigation into the failures that led to the breaches and sharing those findings with Executive Counsel.

The Final Decision Notice does not make a finding that the FY2018 financial statements were misstated.

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## The facts

ABE was an engineering company based in the UK. Its core operating activity was manufacturing and supplying diesel engines and spare parts for diesel engines and providing associated repair services.

David Cox is a partner of haysmacintyre, with more than 15 years' auditing experience. He signed the audit report on 30 July 2018 in respect of the FY2018 financial statements. Mr Cox had been the Statutory Auditor for ABE since 2016. Mr Cox and haysmacintyre were under a duty to form an opinion as to whether the FY2018 financial statements showed a true and fair view and had been properly prepared in accordance with IFRS and the Companies Act 2006.

## The issues

There were multiple failures by the respondents in the manner in which they conducted the audit. The breaches of Relevant Requirements related to the following audit areas: (1) inventory; (2) journal entry testing; (3) revenue recognition and debt recovery; (4) defined benefit pension scheme; (5) documentation of audit work on going concern; and (6) review and supervision of the audit.

In their audit work on inventory, the respondents failed to exercise both sufficient professional scepticism and reasonable professional judgement; they did not obtain sufficient appropriate audit evidence to provide a reasonable basis for the auditor's opinion. In two other areas (journal entry testing and defined benefit pension scheme), the respondents failed to conduct the audit so as to obtain sufficient appropriate audit evidence.

The breaches of standards related to:

- ISA (UK) 200 (Overall objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing);
- ISA (UK) 220 (Quality Control for an Audit of Financial Statements);
- ISA (UK) 230 (Audit Documentation);
- ISA (UK) 240 (The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements);
- ISA (UK) 330 (The Auditor's Responses to Assessed Risks);
- ISA (UK) 402 (Audit Considerations Relating to an Entity Using a Service Organisation);
- ISA (UK) 500 (Audit Evidence);
- ISA (UK) 530 (Audit Sampling); and
- ISA (UK) 701 (Communicating Key Audit Matters in the Independent Auditor's Report).

The breaches of Relevant Requirements were not intentional, dishonest, deliberate or reckless.

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## The outcome

The following sanctions were imposed on haysmacintyre:

- A declaration that, as a result of the adverse findings set out in the Final Decision Notice, the Statutory Audit Report signed on behalf of haysmacintyre did not satisfy the Relevant Requirements;
- A Severe Reprimand; and
- A financial penalty of £125,000 (discounted to £70,000 for mitigating factors, admissions and early disposal).

Mr Cox also received a declaration in the above terms and a Severe Reprimand. He was subject to a financial penalty of £17,500 (discounted to £10,000 for mitigating factors, admissions and early disposal).

The sanctions determined by Executive Counsel reflect, among other things, the fact that haysmacintyre has already undertaken an extensive programme of remedial measures designed to address the shortcomings evident in the audit work in question following a report by the FRC's AQR team on the audit of the 2018 financial statements.

haysmacintyre also paid Executive Counsel's costs of the investigation.

## UHY Hacker Young LLP/Inch Kenneth Kajang Rubber plc/AEP

In March 2021, a Final Decision Notice was issued and sanctions imposed against UHY Hacker Young LLP (UHY) and a former partner in relation to the Statutory Audit of the financial statements of Inch Kenneth Kajang Rubber (IKKR) for the year ended 31 December 2016.

### Points to note

At the time of the audit, IKKR was a PIE as it was listed on the main market of the London Stock Exchange, although it is no longer listed in the UK. It was a small Group with a market capitalisation under £50m and reported revenue of less than £2m in 2016.

At all times relevant to the audit, its operations were entirely based in South East Asia, primarily Malaysia. While its registered office was in Scotland, the activities of the parent company were minimal and the operational and financial management of the group was also based in Malaysia.

### The facts

UHY had been the auditor of IKKR since 2007, and it was the fifth year that the audit partner had been responsible for the audit. All of the audit work in relation to IKKR's subsidiaries was performed by overseas component auditors outside of the UHY network. Given the minimal level of activity of the parent company, the component auditors' work covered substantially all the activities of the group.

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## The issues

The breaches in this case relate to a number of areas that were fundamental to the audit: the acceptance, planning and resourcing of the audit; assessing the capabilities of component auditors, instructing the component auditors and involvement in their assessment as to risk; the review of the work of a component auditor; the EQCR and the signing of the audit report. There were also adverse findings in relation to two specific areas of the audit: audit work on an industrial land transaction and on the carrying value of an associate. There was a marked lack of professional scepticism, and the documentation was incomplete and inadequate for the purposes of enabling an understanding of important issues. The deficiencies in the audit work were such that the audit report should not have been signed.

The breaches involved a large number of ISAs, namely:

- ISA (UK) 200 (Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing);
- ISA (UK) 220 (Quality control for an audit of financial statements);
- ISA (UK) 230 (Audit documentation);
- ISA (UK) 240 (The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements);
- ISA (UK) 300 (Planning an audit of financial statements);
- ISA (UK) 315 (Identifying and assessing the risks of material misstatement through understanding the entity and its environment);
- ISA (UK) 330 (The auditor's responses to assessed risks);
- ISA (UK) 500 (Audit evidence);
- ISA (UK) 540 (Auditing accounting estimates);
- ISA (UK) 600 (Special considerations – audits of group financial statements including the work of component auditors);
- ISA (UK) 620 (Using the work of an auditor's expert); and
- ISA (UK) 700 (The independent auditor's report on financial statements).

## The outcome

The following sanctions were imposed on UHY:

- A declaration that the Statutory Audit Report signed on behalf of UHY did not satisfy the Relevant Requirements, as set out in this Final Decision Notice;
- A published statement, in the form of a Severe Reprimand; and
- Non-financial sanctions, in the form of an order pursuant to rule 96(c) of the AEP, requiring UHY to take remedial action to prevent the recurrence of the breaches:

- implement and monitor enhanced mandatory training for all Responsible Individuals, to be reported to the FRC's Executive Counsel and Executive Director of Supervision on an annual basis for a period of three years;
- implement a root cause analysis Programme, whereby all root cause analysis on PIE audits are undertaken by an external provider;
- following an independent review of UHY's audit practice, to report on the implementation of recommended actions to the FRC's Executive Counsel and Executive Director of Supervision within 12 months of the date of this Final Decision Notice;
- to report to the FRC's Executive Counsel and Executive Director of Supervision on an annual basis the outcomes of root cause analysis on PIE audits and a summary of the outcomes of hot and cold files reviews on PIE audits, and any remedial action, for a period of three years.

The partner received the following sanctions:

- A declaration that the Statutory Audit Report signed by Ms Wilson did not satisfy the Relevant Requirements, as set out in this Final Decision Notice;
- A published statement, in the form of a Severe Reprimand; and
- Non-financial sanctions, in the form of an order pursuant to rule 96(c) of the AEP, requiring Ms Wilson to take remedial action to prevent the recurrence of the breaches:
  - shall not act as Statutory Auditor of a PIE nor sign a Statutory Audit Report in respect of a PIE for a period of two years;
  - Ms Wilson is required to have regular external hot and cold reviews on a selection of non-PIE audits for which she is the engagement partner, to be agreed with the FRC's Executive Counsel. The outcomes of these reviews are to be reported to Executive Counsel annually for a period of three years;
  - Ms Wilson is required to provide the FRC's Executive Counsel with ACCA inspection outcomes in relation to any inspections of non-PIE audits for which she is the engagement partner for a period of three years;
  - Ms Wilson is required to agree a training programme with the FRC's Executive Counsel, including periodic reporting. She is required to confirm her completion of training and to provide any certificates of completion (where applicable). The training programme should be completed within 18 months of the date of this Final Decision Notice. Ms Wilson is required to complete training in relation to the following areas: audit quality control, audit documentation, audit evidence and professional scepticism.

The respondents also paid Executive Counsel's costs of the investigation.



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