IN THE MATTER OF

THE EXECUTIVE COUNSEL TO THE FINANCIAL REPORTING COUNCIL

-and-

(1) PRICEWATERHOUSECOOPERS LLP

(2) JASKAMAL SARAI

(3) ARIF AHMAD

EXECUTIVE COUNSEL'S FINAL DECISION NOTICE

Pursuant to Rule 18 of the Audit Enforcement Procedure

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

1. INTRODUCTION

1.1. The Financial Reporting Council (the "**FRC**") is the competent authority for statutory audit in the UK, and is responsible for the operation of the Audit Enforcement Procedure (the "**AEP**"), effective 17 June 2016. The AEP sets out the rules and procedure for the investigation, prosecution and sanctioning of breaches of "*Relevant Requirements*".

1.2. The AEP contains a number of defined terms and, for convenience, those defined terms are also used within this document. Where defined terms are used, they appear in italics.

1.3. This *Final Decision Notice* also uses the following definitions:

1.3.1. "**FY2014**" means the financial year ending 31 March 2014, "**FY2014 financial statements**" means Redcentric's consolidated financial statements for that period, and "**FY2014 Audit**" means the statutory audit of the FY2014 financial statements;

1.3.2. "**FY2015**" means the financial year ended 31 March 2015, "**FY2015 financial statements**" means Redcentric plc's ("**Redcentric**") consolidated financial statements for that period, and "**FY2015 Audit**" means the statutory audit of the FY2015 financial statements;

1.3.3. "**FY2016**" means the financial year ended 31 March 2016, "**FY2016 financial statements**" means Redcentric's consolidated financial statements for that period, and "**FY2016 Audit**" means the statutory audit of the FY2016 financial statements;

1.3.4. "**FY2017**" means the financial year ended 31 March 2017, and "**FY2017 financial statements**" means Redcentric's consolidated financial statements for that period; and

1.3.5. **"Redcentric financial statements**" refers to the consolidated financial statements of Redcentric; as distinct from the financial statements of the subsidiaries of Redcentric.

1.4. Pursuant to Rule 16(b) of the AEP, Executive Counsel has decided that the Respondents are liable for Enforcement Action, having made Adverse Findings against each of them. This document is Executive Counsel's *Final Decision Notice*, issued pursuant to Rule 18 of the AEP, in respect of:

1.4.1. PricewaterhouseCoopers LLP's ("**PwC**")[1] and Mr Sarai's conduct in relation to the statutory audit of Redcentric plc ("**Redcentric**") for the financial year ended 31 March 2015 ("**FY2015**"). PwC was the *Statutory Audit Firm* for the FY2014 Audit, the FY2015 Audit and the FY2016 Audit. Mr Sarai is a partner of PwC, being PwC's Industry Leader for Technology, Media and Telecommunications. For FY2015, he was the *Statutory Auditor* of Redcentric and signed off the FY2015 Independent Auditors' Report to the members of Redcentric, on behalf of PwC; and

1.4.2. PwC's and Mr Ahmad's conduct in relation to the statutory audit of Redcentric for the financial year ended 31 March 2016 ("**FY2016**"). Mr Ahmad is a partner of PwC. Between 2013 to 2016 he was the Senior Partner of PwC's Leeds office and he is currently Head of London Region Assurance. For FY2016, he

[1] The terms "Statutory Audit Firm" and "Statutory Auditor" are used as defined in the AEP.

was the *Statutory Auditor* of Redcentric and signed off the FY2016 Independent Auditors' Report to the members of Redcentric, on behalf of PwC.

1.5. In this *Final Decision Notice*, PwC, Mr Sarai and Mr Ahmad are referred to as the "**Respondents**".

1.6. In accordance with Rules 17 and 18 of the AEP this *Final Decision Notice*:

1.6.1. outlines the *Adverse Findings* with reasons;

1.6.2. proposes *sanctions* with reasons;

1.6.3. proposes an amount payable in respect of Executive Counsel's costs of the matter; and

1.6.4. is issued following the Respondents' written agreement to Executive Counsel's *Decision Notice*.

1.7. This *Final Decision Notice* is divided into the following sections:

1.7.1. Section 2: Executive Summary of the *Adverse Findings*;

1.7.2. Section 3: Background;

1.7.3. Section 4: *Relevant Requirements* to which the *Adverse Findings* relate;

1.7.4. Section 5: Detail of the *Adverse Findings*;

1.7.5. Section 6 to 8 (inclusive): Proposed *sanctions*; and

1.7.6. Section 9: Costs.

2. EXECUTIVE SUMMARY

2.1. The FY2016 financial statements of Redcentric were extensively restated[2]. Net assets were written down by £15.8m (to £81.7m) and profit after tax of £5.3m was restated by £9.5m to a loss a £4.2m. [redacted]

2.2. This *Final Decision Notice* sets out details of the numerous breaches of *Relevant Requirements* admitted by Mr Sarai and PwC in respect of FY2015 and by Mr Ahmad and PwC in respect of FY2016.

[2] Details of which are set out in Redcentric's financial statements for the financial year ended 31 March 2017.

2.3. In certain cases the breaches were of a basic and / or fundamental nature, evidencing a serious lack of competence in conducting the audit work.

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

2.5. The *Adverse Findings* in this *Final Decision Notice* relate to the FY2015 and FY2016 Audits. References to the FY2014 Audit are included for context only.

2.6. The FY2015 and FY2016 Audits each failed in their principal objectives of providing reasonable assurance that the financial statements were free from material misstatement. Had the FY2015 and FY2016 Audits been conducted competently, and in accordance with the *Relevant Requirements*, they would likely have detected certain material misstatements of the financial statements which relate to the breaches. Had the material misstatements been detected; either the financial statements would have been corrected or the auditor would have been required to issue an adverse opinion.

2.7. The *Adverse Findings* set out in this *Final Decision Notice* have been organised thematically and relate to the following audit areas:

<u>FY2015</u>

2.7.1. FY2015 - audit planning.

2.7.2. FY2015 – work on cash.

2.7.3. FY2015 – work on revenue and debtors.

2.7.4. FY2015 – work on costs and liabilities.

<u>FY2016</u>

2.7.5. FY2016 - audit planning.

2.7.6. FY2016 – work on cash.

2.7.7. FY2016 – work on revenue and debtors.

2.7.8. FY2016 – work on costs and liabilities.

2.8. Furthermore, this *Final Decision Notice* sets out the *sanctions* in respect of the Respondents:

2.8.1. <u>PWC:</u>

2.8.1.1. a declaration by Executive Counsel that, as a result of the *Adverse Findings* set out in paragraph 5 below, the Statutory Audit Reports did not satisfy the *Relevant Requirements.*

2.8.1.2. A fine of £6,500,000 adjusted for aggravating and mitigating factors and discounted for admissions and early disposal to £4,550,000. The fine shall be paid no later than 28 days after the date of this *Final Decision Notice*;

2.8.1.3. a published statement, in the form of a severe reprimand.

2.8.1.4. a condition that PwC supplement the monitoring and support of the Leeds Office audit practice (agreed with Executive Counsel in relation to an earlier case) to address the *Relevant Requirements* breached in this case.

2.8.2. <u>Mr Sarai:</u>

2.8.2.1. A fine of £200,000 adjusted for aggravating and mitigating factors and discounted for admissions and early resolution to £140,000 The fine shall be paid no later than 28 days after the date of this *Final Decision Notice*;

2.8.2.2. a published statement in the form of a severe reprimand.

2.8.3. In addition, and as a condition of Executive Counsel accepting the Respondent's agreement to the *Decision Notice*, additional training has been performed by Mr Sarai in relation to:

2.8.3.1. compliance with the requirements of paragraph 15 of ISA 220, as it relates to supervision of the engagement team; and

2.8.3.2. the application of professional scepticism in accordance with ISA 200.

2.8.4. <u>Mr Ahmad:</u>

2.8.4.1. A fine of £200,000 adjusted for aggravating and mitigating factors and discounted for admissions and early disposal to £140,000. The fine shall be paid no later than 28 days after the date of this *Final Decision Notice*;

2.8.4.2. a published statement in the form of a severe reprimand.

2.8.5. In addition, and as a condition of Executive Counsel accepting the Respondent's agreement to the *Decision Notice*, additional training has been performed by Mr Ahmad in relation to:

2.8.5.1. compliance with the requirements of paragraph 15 of ISA 220, as it relates to supervision of the engagement team; and the application of professional scepticism in accordance with ISA 200.

3. BACKGROUND TO THE FY2015 AND FY2016 AUDITS

3.1. Redcentric was incorporated on 11 February 2013. On 8 April 2013, the managed services business of Redstone plc was demerged into Redcentric. Redcentric listed on the Alternative Investment Market ("**AIM**") of the London Stock Exchange on 24 April 2013.

3.2. Redcentric made significant acquisitions in the period 2013 – 2016:

3.2.1. InTechnology Managed Services Limited ("**IMS**") on 6 December 2013, for £64m;

3.2.2. Calyx Managed Services Limited ("**Calyx**" or "**CMS**") on 10 April 2015, for £12m; and

3.2.3. City Lifeline Limited ("**CLL**") on 28 January 2016, for £5m.

3.3. These businesses were integrated into Redcentric. At 31 March 2016, the only significant trading entity within the group was Redcentric Solutions Limited ("**RSL**", formerly IMS).

3.4. As originally issued, Redcentric's financial statements for FY2014, FY2015 and FY2016 set out the following:

	FY2014 **£'000**	**FY2015** **£'000**	**FY2016** **£'000**
Revenue	58,323	94,321	109,526
Profit / (Loss) after tax	1,813	7,977	5,256
Cash and short term deposits	3,914	3,199	8,492
Net assets	87,605	94,737	97,458

<u>Restatement of Redcentric's financial statements</u>

3.5. The FY2016 Redcentric financial statements were signed on 16 June 2016. The audits of its subsidiaries had been substantially performed by this time but were not finalised.

3.6. On 7 November 2016 Redcentric announced that the financial statements for previous years were likely to be restated. On 13 December 2016 Redcentric announced the initial findings of a forensic review which indicated that net assets prior to and including the year ended 31 March 2016 were overstated.

3.7. The results for the six months ended 30 September 2016 were published on 23 December 2016 and contained restatements of amounts for the six months ended 30 September 2015 and twelve months ended 31 March 2016 together with a restated balance sheet as at 31 March 2016. PwC did not issue an opinion or report on the results for the six months ended 30 September 2016 or 2015.

3.8. PwC recommenced work on the FY2016 Audits for the subsidiaries of Redcentric in January 2017. In undertaking this work, they reset materiality levels and audit approach in light of the restatements.

3.9. Redcentric's FY2017 financial statements were audited by KPMG. They were finalised on 27 July 2017. [redacted]

> [redacted]

> [redacted]

3.10. Redcentric explained that:

> "*In order to fully validate the 2016 Income statement it would have been necessary to re-audit the 2015 balance sheet*
>
> *The directors took the view that the timescales (four to five months) and the costs involved to do this were disproportionate and so the 2016 income statement received a qualified audit opinion and this is reflected in this year's accounts*."

3.11. As a result, there has been no independent audit opinion provided in respect of the impact on the FY2015 financial statements. This was reflected in KPMG's qualified audit opinion on the FY2017 financial statements which explained that:

> "*Certain key individuals no longer work for the Group and the Directors have assessed that further investigation into the above misstatements would represent a disproportionate cost and effort to the business. As a result, the Directors have not been able to distinguish whether certain of the adjustments, which in aggregate resulted in a £9,451,000 reduction in profit and net assets, related to the year ended 31 March 2016 or to prior periods, and consequently the income statement effect of these adjustments has been recognised wholly within the income statement for the year ended 31 March 2016.*

We were appointed as auditors subsequent to the 2016 year end and due to the above circumstances we were unable to obtain sufficient appropriate audit evidence in relation to these misstatements. Any adjustments would have a consequential effect on the Group's profit for the year ended 31 March 2016 and its net assets at 31 March 2015".

3.12. The different figures in Redcentric's FY2016 balance sheet as presented in the FY2016 financial statements and as restated in the FY2017 financial statements are as follows:

	FY2016 £'000	**FY2016 restated** £'000	**Restatement amount** £'000
Cash and short term deposits	8,492	0	(8,492)
Total assets	**165,208**	**152,215**	**(12,993)**
Overdraft	0	3,970	(3,970)
Total liabilities	**(67,750)**	**(70,528)**	**(2,778)**
Net assets	**97,458**	**81,687**	**(15,771)**

3.13. The figures for Redcentric's FY2016 income statement as presented in the FY2016 financial statements and as restated in the FY2017 financial statements are as follows:

	FY2016 £'000	**FY2016 restated** £'000	**Restatement amount** £'000
Revenue	109,526	102,363	(7,163)
Cost of sales	(45,050)	(44,553)	497
Gross profit	64,476	57,810	(6,666)
Operating expenditure	(56,037)	(62,756)	(6,719)
Operating profit / (loss)	8,439	(4,946)	(13,385)
Profit / (Loss) after tax	5,256	(4,195)	(9,451)

3.14. As a result of the restatements, banking covenants relating to Redcentric's debt facility were breached. Redcentric secured waivers of those breaches from their banks.

Overview of work done for FY2014 Audit, FY2015 Audit and FY2016 Audit

3.15. PwC was the S*tatutory Audit Firm* for Redcentric and its subsidiaries for the three years ended 31 March 2014, 2015 and 2016. More specifically:

3.15.1. In 2014 separate audits were performed on IMS and Redcentric.

The IMS audit team was led by Mr Ahmad in PwC's Leeds office, reporting to the Redcentric audit team led by Mr Sarai in PwC's Uxbridge office.

Redcentric's FY2014 financial statements were signed on 16 June 2014 and IMS' 2014 financial statements were signed shortly after on 7 July 2014.

3.15.2. In 2015, the RSL (formerly IMS) audit team was led by Mr Ahmad as part of the wider, Redcentric audit team led by Mr Sarai. During this year, the two businesses integrated and their accounting functions transferred from Birmingham to Harrogate. As a result, much of the audit work in relation to the subsidiaries moved to PwC's Leeds office, to reflect the change in responsibility and activity within Redcentric. The "IMS audit team" carried out the work on the subsidiaries, and then, separately, performed additional procedures for the purpose of expressing an opinion on the accounts of the now subsidiary, RSL. The "Group audit team" performed work on the consolidation and financial statements to enable the signing of the audit opinion for Redcentric. Redcentric's FY15 financial statements were signed on 15 June 2015.

3.15.3. Mr Sarai stepped down as auditor after the FY2015 Audit in accordance with rotation rules Mr Ahmad was auditor for the FY2016 Audit of Redcentric and its subsidiaries. Redcentric's FY2016 financial statements were signed on 16 June 2016.

3.16. PwC charged the following fees in relation to Redcentric and its subsidiaries:

3.16.1. FY2014: Total = £717,000[3] (£149,000 audit fee);

3.16.2. FY2015: Total = £166,000 (£106,000 audit fee); and

3.16.3. FY2016: Total = £180,000 (£126,000 audit fee).

3.17. A summary of the hours charged by PwC for the FY2014 FY2015 and FY2016 Audits of Redcentric and its subsidiaries is set out below. The substantially higher number of hours charged for the audits of subsidiaries in FY2016 reflects that the work was largely conducted after the discovery of the significant restatements.

[3] The lion's share of the non-audit fees related to transactional services on the acquisition of IMS

Grade	2014 Audit Group	2014 Audit Subsids	2015 Audit Group	2015 Audit Subsids	2016 Audit Group	2016 Audit Subsids
Partner	56	10	58	6	25	145
Director	9	-	1	1	2	-
Senior manager	155	32	234	24	114	505
Manager	241	43	81	19	2	16
Senior associate 1, 2 & 3	558	30	282	102	473	596
Trainee associate / Associate 1 & 2	243	-	398	34	197	203
Associate 1 Undergraduate trainee	-	-	11	14	234	8
Other	76	15	128	50	46	485
Total	1,337	130	1,191	248	1,093	1,957

3.18. As shown above, it is noted that in the FY2016 Redcentric Audit:

3.18.1. significantly fewer hours were charged by senior staff[4] compared to previous years; and

3.18.2. a significant amount of work was performed in FY2016 by an Associate 1 undergraduate trainee, who had received the same in-house and external training as an Associate 1 graduate trainee.

3.19. Notwithstanding these changes, there is no indication that the auditors planned additional review or supervision as part of the FY2016 Redcentric Audit.

4. RELEVANT REQUIREMENTS

4.1. Rule 1 of the AEP states that "*Relevant Requirements*" has the meaning set out in regulation 5(11) of the Statutory Auditors and Third Country Auditors Regulations 2016 ("**SATCAR**"). Those requirements include, but are not limited to, the International Standards on Auditing (UK and Ireland) ("**ISAs**") issued by the FRC.

4.2. The ISAs relevant to Executive Counsel's *Final Decision Notice* are those effective for audits of financial statements for periods ending on or after 15 December 2010.

4.3. The *Relevant Requirements* referred to in this *Final Decision Notice* are the following:

[4] I.e. at manager grade and above

4.3.1. ISA 200 (Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing);

4.3.2. ISA 230 (Audit Documentation);

4.3.3. ISA 240 (The auditor's responsibilities relating to fraud in an audit of financial statements);

4.3.4. ISA 315 (Identifying and assessing risks of material misstatement through understanding the entity and its environment);

4.3.5. ISA 330 (The auditor's responses to assessed risks); and

4.3.6. ISA 500 (Audit Evidence).

4.4. The extracts of the ISAs which are of particular relevance to the *Adverse Findings* are set out in Appendix 1 hereto.

5. ADVERSE FINDINGS[5]

5.1. The *Adverse Findings* are arranged thematically, having regard to the manner in which the audit files were organised.

ADVERSE FINDING 1: FY2015 – Audit planning

The audit work in relation to audit planning for FY2015, breached ISAs 200, 240, 315 and 500 in the following ways:

1. The audit team undertook procedures in relation to acceptance and continuance that also formed part of their overall consideration of risk as required by paragraph 7 of ISA 315. At the audit planning stage the auditors did not assess that the audit was higher risk. This should have been the result of the assessment, based on various factors that were or should have been known to them at the time (paragraph 15 of ISA 200 and paragraphs 3 and 5 of ISA 315). In particular the compounding impact of the following:

    - that Redcentric was a relatively recent entrant to AIM, which can bring with it associated pressure to achieve positive financial results;

[5] In conducting their audit work the Respondents used an electronic audit file comprising electronic workpapers to evidence their audit work. Each workpaper was referred to as an "**EGA**", short for "Evidence Gathering Activity". In setting out the *Adverse Findings* below, this document refers to the deficiencies evidenced within particular EGAs.

- the rapid reorganisation of Redcentric's back office accounting function following acquisitions, which led to pressure on the finance function generally;
- the competitive landscape in which Redcentric's business operated; and
- the structure of certain of Redcentric's management incentives, the vesting of which were directly linked to current year financial performance, rather than longer term measures such as share price growth.

(a) Only two significant risks were identified by PwC, one being fraud risk in relation to accounting control.

(b) The risk assessment affected many aspects of the audit. Accordingly, the work in this area failed to meet the objective of paragraph 3 of ISA 315 and breached the requirements of paragraph 5. Further, in breach of paragraph 15 of ISA 200, inadequate professional scepticism was exercised in assessing the audit risk.

2. The analytical procedures which the audit team applied were superficial and lacked proper analysis. Significant increases in figures such as "Trade and other receivables", "Cash" and "Trade and other payables" were not properly explained (paragraph 16 of ISA 200 and paragraphs 3, 5, and 6(b) of ISA 315).

(a) Paragraph 6(b) of ISA 315 requires the application of analytical procedures as part of the overall risk assessment process. The audit work identified that revenue and profit had increased significantly between 2014 and 2015 and the variances in both the income statement and balance sheet were explained by the audit team as being due to the acquisition of IMS late in FY2014 and the FY2015 incorporation of Redcentric MS Limited ("RMSL") into RSL.

(b) The procedures applied by the audit team were superficial and demonstrated a lack of professional judgment (ISA 200) in addressing the objectives and requirements of ISA 315:

(i) the procedure simply involved the presentation of two columns of figures;

(ii) the two columns were not comparable, not least because they covered financial periods of different length and different balance sheet dates. No attempt was made to reconcile these differences;

(iii) no real analysis had been conducted on the figures;

(iv) the variances were in large part simply attributed to the restructuring of the business;

(v) the figures showed significant increases in “Trade and other receivables”, “Cash” and “Trade and other payables” which were not explained.

3. The record of PwC’s discussions with senior management noted that “*the incentives for fraud are deemed to be low and the controls to avoid fraud are reliable”.* This was contradicted by the available facts and not supported by the available audit evidence (paragraph 16 of ISA 200, paragraph 10 of ISA 240 and paragraph 6 of ISA 500).

(a) The audit team made inquiries of management in relation to the risk of fraud. The statement that, “*the incentives for fraud are deemed to be low*” was not consistent with the fact disclosed in the FY2015 financial statements that certain management share options were, "*linked to the achievement of certain financial performance measures compared to approved budget*".

(b) In assessing the risk of fraud, the auditor should have attached particular significance to the direct linkage between certain management incentives and current year financial performance (i.e. the budget for the current year), as opposed to longer term measures such as share price growth.

(c) These matters evidence a failure to apply sufficient professional judgment as required by paragraph 16 of ISA 200 and a failure to address the objectives of paragraph 10 of ISA 240.

4. The determination of the audit plan demonstrated a lack of understanding as to how fraud can occur (paragraph 10 of ISA 240).

(a) The audit file recorded some consideration of the risk of fraud through manipulation by management. In summary, the auditors deemed management to be competent and lacking in motivation to commit fraud.

(b) The documentation included a number of procedures relevant to ISA 300 (Planning) and also ISA 240 regarding discussions around fraud with the audit team. The latter is minuted in the document titled “Kick off meeting.DOCX”. Under "*Fraud*" the minutes stated, "*Fraud in the financial statements is unlikely due to the competence of the finance team*".

(c) The minutes thereby demonstrate a lack of understanding of how fraud can occur; it is broadly unrelated to competence and, in fact, can be enabled by it.

5. The auditors wrongly concluded that certain management bonuses were “*completely unrelated” to* financial performance, despite this being obviously contradicted by reference to both the financial statements and other parts of the audit file. They failed to identify, or respond to, the risk created by the link. These matters evidence a failure

adequately to understand controls relevant to the audit as required by paragraph 12 of ISA 315 and an over reliance on inquiry as a procedure for understanding the control environment, contrary to paragraph 13 of ISA 315.

6. When evaluating the design of the entity's controls, too much reliance was placed on inquiries of management and sufficient appropriate audit evidence was not obtained for the purposes of paragraphs 12 and 13 of ISA 315.

   (a) The audit file incorrectly stated that the financial statements were prepared by Person B and reviewed by Person A, which "*demonstrates segregation of duties within the finance team*". In fact, Person A prepared the financial statements [redacted].

   (b) Furthermore, the audit team did not identify or record that Person B created most (c.90 – 95%) of the journals and that there was no evidence Person A reviewed them. The EGA incorrectly stated that Person A reviewed any journals posted by the Person B.

   (c) These matters evidence a failure adequately to understand controls relevant to the audit as required by paragraph 12 of ISA 315 and an over reliance on inquiry as a form of procedure in understanding the control environment in contravention of paragraph 13 of ISA 315.

7. The testing of non-standard revenue transactions did not adequately address the revenue fraud risk in relation to ISA 240, or the risk of management override of controls (paragraphs 10 and 26 of ISA 240).

   (a) The audit team used computer assisted audit techniques ("**CAATs**") to "*match all revenue transactions in the general ledger to the expected settlement (i.e. Revenue to AR/Cash) and identify transactions which do not follow the expected transactional flow*". CAATs testing identified non-standard transactions. Six journals were tested, and the audit team identified that one of the journals was posted to the wrong account. The additional testing ultimately comprised inquiry of Redcentric staff and identified that three of four additional journals tested made a similar error, posting amounts to the revenue account instead of the cost of sales account. This resulted in a proposed adjustment of £46,704.

   (b) The auditor's testing of revenue did not consider the risk that revenue could be manipulated by posting fictitious manual sales invoices or accruing revenue. This should have been identified through a proper understanding of the revenue cycle. Such understanding as was obtained was based predominately on inquiry with Redcentric staff.

ADVERSE FINDING 2: FY2015 – Cash

The audit work in relation to cash balances for FY2015 failed to address the objectives of paragraph 3 of ISA 315, and breached the requirements of paragraphs 15 and 16 of ISA 200 and paragraph 6 of ISA 500. In particular:

1. The summary of reconciliations at the year end indicated a very high level of deposits in transit, resulting in a significantly higher reported balance for cash compared to the bank balance at 31 March 2015: £6.5m in transit vs. £446,141 bank balance. The value of deposits in transit at the year end was much higher than in the other month where bank reconciliations were tested by the audit team. There is no indication on the audit file that these matters were noted or the implications for audit testing considered. Whilst reconciling items were tested during the FY2015 audit, in the above circumstances, strong external evidence (e.g. bank statements) should have been obtained by the audit team. There is no evidence this was done, and the audit team relied upon Redcentric-generated excel spreadsheets listing reconciling items.

2. A proper consideration of the audit of cash should have included the possibility that management could have been motivated to misstate (or window-dress) cash, not least to ensure banking covenant compliance. The high level of deposits in transit should have been considered and tested further, especially as the total value of deposits in transit at year end was so much greater than the September reconciliation reviewed by the audit team.

ADVERSE FINDING 3: FY2015 – Revenue & Debtors

The audit work in relation to revenue and debtors for FY2015 breached ISAs 200, 230, 330, and 500 in the following ways:

1. The conclusions as to the testing of bad debt provision relied solely on inquiry with the Redcentric credit controller and finance team (paragraphs 15 and 16 of ISA 200 and paragraph 6 of ISA 500).

   (a) The relevant EGA[6] recited that testing was undertaken on accounts receivables including looking at ageing and assessing the bad debt provision. The provision was very low given the ageing profile and overall balance.

   (b) Furthermore, the only evidence obtained for the conclusion that "*no further work proposed as the provision basis appears reasonable*", was inquiry with the credit

[6] *3030-2000 Test accounts receivable reconciliations*

controller and finance team. This was plainly insufficient and evidences a lack of professional scepticism (paragraph 15 of ISA 200), professional judgment (paragraph 16 of ISA 200), and sufficient appropriate audit evidence (paragraph 6 of ISA 500).

2. PwC's audit work on revenue recognition and cut off tested whether revenue was recorded in the correct accounting period. There were three balance sheet accounts impacted by Redcentric's revenue recognition and cut off policy: accounts receivable, accrued income and deferred revenue. The audit team's testing of these balances had the following shortcomings:

   (a) The relevant EGAs recorded that the audit team identified an increase in revenue in month 12 of the financial year (explained by Redcentric as "catching up"), a backlog of invoice processing and a large accrued income balance. Although not documented in these EGAs, PwC were aware of the January/February transfer of the RMSL finance function operations (formerly based in Birmingham) to Harrogate. PwC understood that this recent restructuring of operations may have been one reason for the backlog of invoicing. However, this backlog may also have been indicative of wider control and accounting issues which should have indicated to the audit team that their assessment of the control environment should have been updated.

   (b) In relation to the testing of deferred revenue, the EGA recorded that for each item tested the audit team concluded that the accounting treatment was appropriate. However, it is not clear from the EGA how this conclusion was reached: no details of the narrative from the invoice were recorded and it is unclear how the correct period for the income was established.

   (c) The audit team's revenue cut off testing relied, in 11 out of 12 accrued income balances tested, on poor quality audit evidence, for example, unsigned contracts.

   This work demonstrates a breach of paragraphs 15 and 16 of ISA 200, paragraph 5 of ISA 330 and paragraph 6 of ISA 500.

3. The audit team applied insufficient professional scepticism, obtained insufficient audit evidence and failed to record sufficient appropriate audit evidence, when testing credit notes issued after the period end (paragraphs 15 and 16 of ISA 200, paragraph 6 of ISA 500 and paragraph 8(b) of ISA 230).

(a) The audit file[7] recorded that "*Volume of returns/customer complaints after period end is in line with historical levels*". No detail of the evidence that was obtained to support this conclusion was given on the relevant EGA.

(b) The audit team considered credit notes in April and no criticism is made of that specific work. However, they should have also considered May, particularly where their CAATs work indicated an escalating volume of credit notes towards year end.

ADVERSE FINDING 4: FY2015 – Costs and Liabilities

The audit work in relation to costs and liabilities for FY2015 breached ISAs 200 and 500 in the following ways:

1. PwC's testing of prepaid expenses recorded that one item in the sample comprised seven invoices totalling £370,536, which all appeared to relate to a service provided in FY2015. The evidence obtained by the audit team to support the accounting treatment was inquiry made of Redcentric staff. Given the quantum, and explanations given, more work should have been undertaken to ascertain the validity of holding these amounts as prepayments. This represents a breach of paragraph 16 of ISA 200 and paragraph 6 of ISA 500.

2. The auditors searched for unrecorded liabilities by testing invoices paid after the year end. The audit team selected 15 post year end payments ranging in value from £150,000 to £2.2m. Breakdowns were obtained for five items (represented as BACS payments) totalling £4.7m. However, no further testing was performed in respect of these items because they were an aggregation of numerous individual amounts below the performance materiality threshold of £375,000. The result was that these items became part of the untested population of post year end payments. This represents a breach of paragraph 6 of ISA 500 and paragraph 16 of ISA 200.

3. PwC tested year end supplier statement reconciliations (Redcentric's reconciliation between the creditors listing and the supplier's statement of year end balances payable). 11 of the 14 reconciling items tested appeared to relate to FY2015. Although the relevant EGA provided a link to the audit work performed on year end accruals it is not clearly documented whether PwC's testing included verifying whether the items tested were accrued or how the audit trail worked. Furthermore:

   (a) There was insufficient challenge of Redcentric staff as to why the invoices were not recorded in the purchase ledger; and

[7] EGA *3030-2650 Test credit notes issued after period end*

(b) The documentation should have been clearer as to PwC's audit approach for identifying unrecorded liabilities.

This work demonstrates breaches of paragraph 6 of ISA 500 and paragraph 16 of ISA 200.

4. Redcentric's accrual for lease incentives was for a rent-free period and a capital contribution received in December 2013. The audit team did not identify that Redcentric's calculation did not reflect the removal of a break clause and the entire amount of a capital contribution was included in the accrual. This is a misstatement which the audit team failed to identify because they incorrectly interpreted the evidence. However, the impact on the financial statements was not material.

   This work demonstrates a breach of paragraph 16 of ISA 200.

ADVERSE FINDING 5: FY2016 – Audit planning

The audit work in relation to audit planning for FY2016 breached ISAs 200, 230, 240 and 315 in the following ways:

1. As required by paragraph 7 of ISA 315, the audit team undertook procedures in relation to its client acceptance and continuance process that also formed part of their overall consideration of risk. At the audit planning stage, the auditors did not assess that the audit was higher risk. This should have been the result of the assessment, based on various factors that that were or should have been known to them at the time (paragraph 15 of ISA 200 and paragraphs 3 and 5 of ISA 315). In particular the compounding impact of the following:

   - that Redcentric was a relatively recent entrant to AIM, which can bring with it associated pressure to achieve positive financial results;
   - the rapid reorganisation of Redcentric's back office accounting function following acquisitions, which led to pressure on the finance function generally;
   - the competitive landscape in which Redcentric's business operated; and
   - the structure of certain of Redcentric's management incentives, the vesting of which were directly linked to current year financial performance, rather than longer term measures such as share price growth.

   The risk assessment affected many aspects of the audit. The work in this area failed to meet the objective of paragraph 3 of ISA 315 and breached the requirements of paragraph 5 of ISA 315. Further, in breach of ISA 200, inadequate professional scepticism was exercised in assessing the audit risk.

2. The audit work in relation to audit planning for FY2016 breached ISAs 230 and 315 in the following ways:

   (a) The audit team documented the auditor's understanding and evaluation of internal controls. Their conclusions as to Redcentric's control environment were contradicted by the available facts. In particular, working papers reference the preparation of "*Monthly BS reconciliations*", and that "*any deficiencies in internal control would be detected during the review of the financial information of the entity at the monthly board meeting*". The auditor's work did not address whether it was reasonable to conclude that the monthly board review would detect all potential control weaknesses[redacted].

   (b) The audit team recorded that "tone at the top" was "good" and "appropriate". No adequate supporting evidence was documented, and too much reliance was placed on: inquiry with Redcentric staff; and observation of management. Inadequate professional scepticism was applied by the audit team.

   These matters evidence an insufficient understanding of controls relevant to the audit as required by paragraph 12 of ISA 315, an over reliance on inquiry in contravention of paragraph 13 of ISA 315 and a failure to document sufficient appropriate audit evidence contrary to paragraph 8 of ISA 230.

3. The audit team's work in relation to evaluating the design of controls in response to significant risks breached paragraph 13 of ISA 315 and paragraph 16 of ISA 200, and failed to meet the objective of paragraph 10 of ISA 240):

   (a) The audit file sets out key controls around the mandated fraud risks in ISA 240 (revenue recognition and management override of controls). The audit team stated that they had walked through the revenue cycle and it was concluded that there were "*No deficiencies in the design or implementation of relevant control activities*".

   (b) However, the presence of manual invoicing of sales and processes around accruing revenue should have been highlighted by the audit team as part of a revenue walk through. The relevant EGA provided a link to a flow chart of the revenue and receivables cycle. Nevertheless, taken together, the details in the EGA and flow chart lacked the depth necessary to: (i) identify the key control procedures performed in all major aspects of the revenue cycle (including those relating to manual sales invoices and accruing revenue); (ii) assess their appropriateness; and (iii) assess whether they had been implemented.

4. The audit team's planning included analytical procedures, which were superficial and demonstrated a lack of professional judgment. The relevant EGA compares values in the FY2016 Redcentric trial balance to values for FY2015 in respect of RSL, CMS and CLL. There were significant variances for RSL's balance sheet (notably accounts receivable, prepaid expenses and accounts payable) that were simply attributed by the audit team as, "*Due to Hive-up of CMS into Redcentric Solutions during the year*". Whilst this may have partially explained the variances, there is no evidence that the audit team attempted properly to understand the development of the figures and therefore the potential risks that this further work may have identified. The work performed failed to meet the objective of paragraph 3 of ISA 315 and demonstrates breaches of paragraph 16 of ISA 200 and paragraphs 5 and 6(b) ISA 315.

5. In assessing the risk of fraud, the auditor should have attached particular significance to this direct linkage between certain management incentives and current year financial performance (i.e. the budget for the current year), as opposed to longer term measures such as share price growth. This evidences a failure properly to identify and assess the risks of material misstatement due to fraud as required by paragraph 10 of ISA 240.

<u>ADVERSE FINDING 6: FY2016 – Cash</u>

The audit work in relation to cash balances in FY2016, breached ISAs 200, 230 and 500 in the following ways:

1. The audit team failed to note, and consider the implications for the following:

   (a) The level of cash at the year end was significantly higher than in other months tested by the audit team. The audit team possessed evidence (bank reconciliations for periods other than year end) that indicated the potential of an inflated year end cash balance. A proper consideration of the audit of cash should have included the possibility that management could have been motivated to misstate (or window-dress) cash, not least to ensure banking covenant compliance. There is no indication on the audit file that any of this was noted or the implications for audit testing considered.

(b) The main Redcentric bank account had a very high level of reconciling items at the year end, representing approximately c.8% of company turnover, or £8.6m. Accounting for such reconciling items meant the bank balance at year end reflected a credit of £5.3m, rather than a debit of £3.3m. There is no indication on file that this was noted or the implications for audit testing considered.

These matters evidence a failure to perform audit procedures that are appropriate in the circumstances for the purposes of obtaining sufficient appropriate audit evidence as required by paragraph 6 of ISA 500 and a failure to exercise professional judgment in planning and performing audit work as required by paragraph 16 of ISA 200.

2. The audit team relied on poor-quality and management-generated evidence when testing bank reconciliations. There is no adequate record of precisely what document(s) were relied upon (paragraph 6 of ISA 500 and paragraph 8 of ISA 230).

(a) Reconciling items were tested during the Redcentric FY2016 Audit by recording the date they cleared the bank and ensuring this was within a few days after the year end. During the FY2016 Audit of subsidiaries it became clear that some of the clearing dates recorded during the Redcentric FY2016 Audit were incorrect and that the items had actually cleared some time later. Had the audit team obtained sufficient appropriate (third-party) evidence, these mistakes should have been identified.

(b) The audit file does not adequately record what document(s) were used by the audit team to identify the clearing date of the reconciling items. The evidence indicates that the audit team relied on management-generated documentation (an excel spreadsheet) rather than obtaining robust third-party evidence (bank statements).

ADVERSE FINDING 7: FY2016 – Revenue and Debtors

The audit work in relation to revenue and debtors in FY2016, breached ISAs 200 and 500 in the following ways:

1. The auditor’s work in relation to the allowance for doubtful accounts comprised discussions with the Redcentric finance team, and limited additional supporting evidence was obtained. Whilst reference is made in the audit file to testing of subsequent receipts, that work does not provide sufficient evidence to support the conclusions made as to allowance for doubtful accounts.

2. The auditor's work in relation to sales/accounts receivable cut off tested whether revenue was recorded in the correct accounting period. There are three balance sheet accounts impacted by Redcentric's revenue recognition policy: accounts receivable, accrued income and deferred revenue. As to this:

   (a) The audit team identified that a risk around cut off arose from the fact that the revenue figures at year end would influence employee bonus levels. The audit team noted a large increase in revenue in the final month of the financial year, but accepted management's explanation, that this was a result of invoice "catching up", without providing any challenge. In light of the identified risk, and the substantial upturn in invoicing at year end, the explanation should have been corroborated.

   (b) Furthermore, the audit team's revenue cut off and accrued revenue testing relied, in certain instances, on poor quality audit evidence, for example unsigned contracts.

   (c) The EGA on deferred revenue recorded that for each item tested the team concluded that the accounting treatment was appropriate. However, it is not clear from the EGA how this conclusion was reached; no details of the narrative from the invoice were recorded and it is unclear how the correct period for the income was established.

   This work demonstrates insufficient professional scepticism or professional judgment and failures to obtain sufficient appropriate audit evidence a breach of paragraphs 15 and 16 of ISA 200 and paragraph 6 of ISA 500.

ADVERSE FINDING 8: FY2016 – Costs and Liabilities

The audit work in relation to costs and liabilities in FY2016 breached ISAs 200 and 500 in the following ways:

1. The audit team failed to exercise sufficient professional judgment in relation to testing accruals for: (a) VAT; and (b) lease incentives (paragraph 16 of ISA 200).

   (a) VAT: Within a sample of "reconciling" items tested by the audit team, the audit team's testing of year end VAT payable identified that a number of the relevant invoices (dated prior to the year end) were approved significantly after the invoice date. This potentially provided evidence that Redcentric may have held certain invoices awaiting approval and, given the amounts involved, the audit team should have investigated whether accruals should have been recognised for these invoices. This represents a breach of paragraph 16 of ISA 200.

(b) Redcentric's accrual for lease incentives was for a rent-free period and a capital contribution received in December 2013 (as was the case in FY2015). The audit team did not identify that, as in FY2015, Redcentric's calculation did not reflect the removal of a break clause and the entire amount of a capital contribution was included in the accrual. This is a misstatement which the audit team failed to identify because they incorrectly interpreted the evidence. However, the impact on the financial statements was not material.

2. PwC's work on employee cost accruals and payroll liabilities failed to obtain sufficient audit evidence to support their conclusions on payroll, and failed to apply sufficient professional scepticism in relation to the explanations received from management (paragraphs 15 and 16 of ISA 200 and paragraph 6 of ISA 500):

(a) After the FY2016 Audit, it was discovered that in the FY2016 Financial Statements, payroll costs had been significantly understated. Such misstatements may have been identified by the audit team during the Redcentric FY2016 Audit had further testing been performed:

(i) No explanation was stated in the audit file for the delay in paying March 2016 salaries (in circumstances where the delay significantly improved Redcentric's cash figure). The delay may have indicated that the business had liquidity issues and it should have been noted and investigated further by the audit team.

(ii) [redacted].

(iii) [redacted]

[redacted].

(b) The audit team's work in relation to the accounts payable identified £922,000 categorised as overdue by more than 180 days. The audit team relied solely on a representation from Redcentric to explain why these balances had not been paid and continued to be held as liabilities. Further explanation and corroboration should have been obtained. This represents a breach of paragraph 6 of ISA 500 and paragraphs 15 and 16 of ISA 200.

3. The audit team identified a difference of £0.7m between the VAT accrual and the amount paid after the year end. The explanation received by the audit team was that this was due to invoices accounted for in the VAT return but not in Redcentric's general ledger. This explanation was unusual and warranted further investigation, which was not undertaken. This represents a breach of paragraph 6 of ISA 500.

4. The audit team searched for unrecorded liabilities:

(a) The audit team tested purchase invoices posted to the purchase ledger in April 2016. They concluded that all three tested items had been recognised in the appropriate period. However, as the relevant EGA did not record the period of the transaction, it is not possible to ascertain how this conclusion was reached.

(b) PwC tested post year end payments to identify whether the payments represented balances that should have been included in year end accruals and if so whether an accrual had been recognised. For seven BACS payments, the audit evidence was limited to Redcentric produced spreadsheets. However, the auditor failed to undertake further testing in respect of these items, because they were an aggregation of numerous individual amounts below the performance materiality threshold of £375,000. The result was that these items became part of the untested population of post year end payments.

These matters represent breaches of paragraph 6 of ISA 500.

5. PwC's work to test supplier statement reconciliations should have (i) tested and recorded whether an accrual totalling £18,744 had been recognised for two of the 14 items tested; and (ii) for a further five items totalling £200,437, PwC should have obtained evidence that the goods or services were received after the year end and

therefore that no accrual was necessary. These matters represent a breach of paragraph 6 of ISA 500.

6. SANCTIONS - PWC

6.1. Paragraph 12 of the *Sanctions Policy (Audit Enforcement Procedure) (effective from 1 June 2018)* (the "**Policy**") provides that the primary purpose of imposing *sanctions* for breaches of the *Relevant Requirements* is not to punish, but to protect the public and the wider public interest.

6.2. Executive Counsel proposes the following *sanctions* against PwC:

6.2.1. a declaration by Executive Counsel that, as a result of the *Adverse Findings* set out in paragraph 5 above, the Statutory Audit Reports did not satisfy the *Relevant Requirements.*

6.2.2. A fine of £6,500,000 adjusted for aggravating and mitigating factors and discounted for admissions and early disposal to £4,550,000. The fine shall be paid no later than 28 days after the date of this *Final Decision Notice*;

6.2.3. a published statement in the form of a severe reprimand.

6.2.4. a condition that PwC supplement the monitoring and support of the Leeds Office audit practice (agreed with Executive Counsel in relation to an earlier case) to address the *Relevant Requirements* breached in this case.

6.3. In reaching this decision, Executive Counsel has, in summary, considered the following matters in accordance with the Policy.

<u>Nature, seriousness, gravity and duration of the breaches</u>

6.4. As a result of the breaches of *Relevant Requirements*, the FY2015 and FY2016 Audits each failed in their principal objectives, namely to obtain reasonable assurance about whether the financial statements as a whole were free from material misstatement. Whilst noting that the financial statements were prepared and approved by Redcentric's directors; had the FY2015 and FY2016 Audits been conducted competently, and in accordance with the *Relevant Requirements*, they would likely have detected certain misstatements of the financial statements which relate to the breaches. Had the misstatements been detected; either the financial statements would have been corrected or the auditor would have been required to issue an adverse opinion.

6.5. The breaches were repeated over two audit years, and were uncovered by the audited entity through its own investigation.

6.6. The breaches were numerous, and occurred over four important areas of the audit.

6.7. In certain cases, the breaches were of a basic and fundamental nature. In aggregate, the breaches would:

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

6.7.2. harm investor, market and public confidence in the truth and fairness of the financial statements published by *Statutory Auditors* or *Statutory Audit Firms*.

6.8. The breaches adversely affected or potentially adversely affected a significant number of people in the United Kingdom. Redcentric is publicly listed, quoted on AIM and attracted substantial investment[8]. Redcentric's share price fell from 184p[9] to 63p[10] after the announcement of restatements on 7 November 2016 (approximately a 65% drop in market capitalisation). The prior share price reflected, at least in part, financial statements containing an inflated balance sheet and an inflated income statement, which would likely not have been reported in the financial statements absent the breaches.

6.9. A number of the matters to which the breaches relate were material to the financial statements of Redcentric.

6.10. Many of the breaches reflected a failure to exercise professional scepticism, which is at the heart of auditors' duties in discharging their role.

6.11. Mr Sarai had 19 years' auditing experience at the time of the breaches. He was PwC's UK Technology Sector Leader.

6.12. Mr Ahmad had 17 years' auditing experience at the time of the breaches. He was the Senior Partner of the PwC Leeds Office.

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

<u>Identification of Sanction</u>

6.14. Having assessed the seriousness of the breaches, Executive Counsel has identified the following combination of *sanctions* as potentially appropriate: a fine of £6,500,000; a severe reprimand; the supplementation of the monitoring and support of the Leeds Office audit practice; and a declaration that the Statutory Audit Report does not satisfy the *Relevant Requirements* set out in this *Final Decision Notice.*

[8] The market capitalisation was £263.68m at 16 June 2016

[9] On 16 June 2016, the date of publication of the FY2016 Financial Statements.

[10] On 7 November 2016.

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

Aggravating factors

6.16. The breaches of *Relevant Requirements*, as set out in this *Final Decision Notice*, were numerous and occurred over two financial years.

6.17. PwC's disciplinary history:

6.17.1. in 2018, PwC was fined £10m (reduced to £6.5m for settlement) for Misconduct in relation to its statutory audit of Taveta Investments Limited and its subsidiaries, which included BHS Limited, for the financial year ended 30 August 2014. This audit was, in part, conducted from the same PwC office as the *Redcentric* audits;

6.17.2. in 2017, PwC was fined £6m (reduced to £5.1m for settlement and mitigating factors) for Misconduct in relation to the statutory audit of RSM Tenon Group plc for the financial year ended 30 June 2011;

6.17.3. in 2017, PwC was fined £5m for Misconduct in relation to the statutory audit of Connaught plc for the financial year ended 31 August 2009; and

6.17.4. in 2016, PwC was fined £3.5m (reduced to £2.3m for settlement discount) for Misconduct in relation to the statutory audit of Cattles plc for the financial year ended 31 December 2007.

Mitigating factors

6.18. Whilst PwC were paid engagement fees for the relevant audits, they did not stand to gain any collateral profit or benefit from the breaches.

6.19. [redacted].

Deterrence

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

Discount for Admissions and Settlement

6.21. Having taken into account the full admissions by PwC and the stage at which those admissions were made (in Stage 1 of the case in accordance with paragraph 84 of the

Policy), Executive Counsel determined that a reduction of 30% as to the fine is appropriate, such that a fine of £4,550,000 is payable.

Other considerations

6.22. In accordance with paragraph 47(c) of the Policy, Executive Counsel has taken into account the size / financial resources and financial strength of PwC and the effect of a financial penalty on its business.

7. SANCTIONS – MR SARAI

7.1. Executive Counsel proposes the following *sanctions* against Mr Sarai:

7.1.1. A fine of £200,000 adjusted for aggravating and mitigating factors and discounted for admissions and early resolution to £140,000. The fine shall be paid no later than 28 days after the date of this *Final Decision Notice*; and

7.1.2. a published statement in the form of a severe reprimand.

7.2. In addition, and as a condition of Executive Counsel accepting the Respondent's agreement to the *Decision Notice*, additional training has been performed by Mr Sarai in relation to:

7.2.1. compliance with the requirements of paragraph 15 of ISA 220, as it relates to supervision of the engagement team; and

7.2.2. the application of professional scepticism in accordance with ISA 200.

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

Nature, seriousness, gravity and duration of the breaches

7.4. The factors set out in paragraphs 6.4, 6.6, 6.7, 6.8, 6.9, 6.10 and 6.13 are repeated, only insofar as they relate to FY2015.

7.5. Mr Sarai had 19 years' experience at the time of the breaches. He was PwC's UK Technology Sector Leader.

Identification of Sanction

7.6. Having assessed the seriousness of the breaches, Executive Counsel has identified the following combination of *sanctions* as potentially appropriate: a fine of £200,000; and a severe reprimand.

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

Aggravating factors

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

Mitigating factors

7.9. Whilst PwC were paid engagement fees for the relevant audits, Mr Sarai did not stand to gain any collateral profit or benefit from the breaches.

7.10. [redacted].

7.11. Mr Sarai held an unblemished compliance history and disciplinary record.

Deterrence

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

Discount for Admissions and Settlement

7.13. Having taken into account the full admissions by Mr Sarai and the stage at which those admissions were made (in Stage 1 of the case in accordance with paragraph 84 of the Policy), Executive Counsel has determined that a reduction of 30% as to the fine is appropriate, such that a fine of £140,000 is payable.

Other considerations

7.14. In accordance with paragraph 47(d) of the Policy, Executive Counsel has taken into account the financial resources of Mr Sarai.

8. SANCTIONS – MR AHMAD

8.1. Executive Counsel proposes the following *sanctions* against Mr Ahmad:

8.1.1. A Fine of £200,000 adjusted for aggravating and mitigating factors and discounted for admissions and early disposal to £140,000. The fine shall be paid no later than 28 days after the date of this *Final Decision Notice*; and

8.1.2. a published statement in the form of a severe reprimand.

8.2. In addition, and as a condition of Executive Counsel accepting the Respondent's agreement to the *Decision Notice*, additional training has been performed by Mr Ahmad in relation to:

8.2.1. compliance with the requirements of paragraph 15 of ISA 220, as it relates to supervision of the engagement team; and

8.2.2. the application of professional scepticism in accordance with ISA 200.

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

Nature, seriousness, gravity and duration of the breaches

8.4. The factors set out in paragraphs 6.4, 6.6, 6.7, 6.8, 6.9, 6.10 and 6.13 are repeated, only insofar as they relate to FY2016.

8.5. Mr Ahmad had 17 years' experience at the time of the breaches. He was the Senior Partner of the PwC Leeds Office.

Identification of Sanction

8.6. Having assessed the seriousness of the breaches, Executive Counsel has identified the following combination of *sanctions* as potentially appropriate: a fine of £200,000 and a severe reprimand.

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

Aggravating factors

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

Mitigating factors

8.9. Whilst PwC were paid engagement fees for the relevant audits, Mr Ahmad did not stand to gain any collateral profit or benefit from the breaches.

8.10. [redacted].

8.11. Mr Ahmad held an unblemished compliance history and disciplinary record.

Deterrence

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

Discount for Admissions and Settlement

8.13. Having taken into account full admissions by Mr Ahmad and the stage at which those admissions were made (in Stage 1 of the case in accordance with paragraph 84 of the

Policy), Executive Counsel has determined that a reduction of 30% as to the fine is appropriate, such that a fine of £140,000 is payable.

Other considerations

8.14. In accordance with paragraph 47(d) of the Policy, Executive Counsel has taken into account the financial resources of Mr Ahmad.

9. COSTS

9.1. Executive Counsel proposes that the Respondents pay her costs in full in this matter, being £366,744.63. Such costs shall be paid no later than 28 days after the date of this *Final Decision Notice*.

Dated 22 May 2019

Signed:

[redacted]

CLAUDIA MORTIMORE
DEPUTY EXECUTIVE COUNSEL

Date: 22 May 2019

APPENDIX 1

EXTRACTS OF THE ISAS RELEVANT TO THE ADVERSE FINDINGS

1. ISA 200 defines "*Professional Skepticism"* as, "*An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence."*
2. Paragraph 15 of ISA 200 requires the auditor to: "*plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated."*
3. Paragraph 16 of ISA 200 states that, "*The auditor shall exercise professional judgement in planning and performing an audit of financial statements*"
4. Paragraph 5 of ISA 230 states that, "*The objective of the auditor is to prepare documentation that provides: (a) A sufficient and appropriate record of the basis for the auditor's report; and (b) Evidence that the audit was planned and performed in accordance with ISAs (UK and Ireland) and applicable legal and regulatory requirements*."
5. Paragraph 8 of ISA 230 states that, *The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand: (a) The nature, timing and extent of the audit procedures performed to comply with the ISAs (UK) and applicable legal and regulatory requirements; (b) The results of the audit procedures performed, and the audit evidence obtained; and (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions*
6. Paragraph 10 of ISA 240 states "*The objectives of the auditor are: (a) To identify and assess the risks of material misstatement of the financial statements due to fraud; (b) To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and (c) To respond appropriately to fraud or suspected fraud identified during the audit."*
7. Paragraph 26 of ISA 240 states that "*When identifying the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks*."
8. Paragraph 3 of ISA 315 provides that, "*The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error…through understanding the entity and its environment, including the entity's internal control*…

thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement"

9. Paragraphs 5 and 6(b) of ISA 315 provides:

> "*5. The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.*
>
> *6. The risk assessment procedures shall include the following:*
> *(b) Analytical procedures*."

10. Paragraph 7 of ISA 315 specifically provides, "*The auditor shall consider whether information obtained from the auditor's client acceptance or continuance process is relevant to identifying risks of material misstatement*."

11. Paragraph 11 of ISA 315 states that "*The auditor shall obtain an understanding of the following: (a) Relevant industry, regulatory, and other external factors including the applicable reporting framework. (b) The nature of the entity, including: (i) its operations; (ii) its ownership and governance structures; (iii) the types of investments that the entity is making and plans to make including investments in special-purpose entities; and (iv) the way that the entity is structured and financed to enable the auditor to understand the classes of transaction, account balances and disclosures to be expected in the financial statements. (c) The entity's selection and application of accounting policies, including changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable reporting framework and accounting policies used in the relevant industry. (d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement. (e) The measurement and review of the entity's financial performance*."

12. Paragraph 12 of ISA 315 states "*The auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgement whether a control, individually or in combination with others, is relevant to the audit*"

13. Paragraph 13 of ISA 315 states "*When obtaining an understanding of controls relevant to the audit, the auditor shall evaluate the design of those controls and determine whether they have been implemented, by performing procedures in addition to inquiry of the entity's personnel*"

14. Paragraph 5 of ISA 330 states "*The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level.*"

15. ISA 500 provides, *inter alia*:

   i) [Paragraph 6] "*The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence";*

   ii) [Paragraph 7]: "*When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence";*