

IN THE MATTER OF

THE EXECUTIVE COUNSEL TO THE FINANCIAL REPORTING COUNCIL

-and-

(1) HAYSMACINTYRE LLP

(2) DAVID COX

**EXPLANATORY MEMORANDUM TO
EXECUTIVE COUNSEL'S FINAL DECISION NOTICE**

The FRC has published the Final Decision Notice issued by the Executive Counsel to the FRC to (1) Haysmacintyre LLP and (2) David Cox ("the Respondents").

The Final Decision Notice sets out the Adverse Findings made by Executive Counsel against the Respondents following an investigation relating to, and admissions made by, the Respondents. In reaching the Final Decision Notice it was not necessary for the Executive Counsel to receive or consider any representations from any parties other than the Respondents.

Accordingly this Final Decision Notice has not made, and should not be taken to have made, any finding against any individual or entity other than the Respondents (including Associated British Engineering plc, any of its subsidiaries or any individual who was a director, member of management or employee at Associated British Engineering plc or any of its subsidiaries).

It would not be fair to treat any part of this Final Decision Notice as constituting or evidencing findings against anyone other than the Respondents.

IN THE MATTER OF

THE EXECUTIVE COUNSEL TO THE FINANCIAL REPORTING COUNCIL

-and-

(1) HAYSMACINTYRE LLP

(2) DAVID COX

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 other than the Respondents and it would not be fair to treat any part of this document as constituting or evidencing findings against any other persons or entities since they are not parties to the proceedings.

1. INTRODUCTION

- 1.1. The Financial Reporting Council (the "**FRC**") is the competent authority for statutory audit in the UK and operates the Audit Enforcement Procedure (the "**AEP**"), effective 17 June 2016. The AEP sets out the rules and procedure for the investigation, prosecution and sanctioning of breaches of *Relevant Requirements*.
- 1.2. The AEP contains a number of defined terms and, for convenience, those defined terms are also used within this document. Where defined terms are used, they appear in italics.
- 1.3. This *Final Decision Notice* also uses the following definitions:
 - 1.3.1. "**ABE**" means Associated British Engineering plc;
 - 1.3.2. "**FY2018**" means the financial year ended 31 March 2018;

- 1.3.3. **“FY2018 financial statements”** means the consolidated financial statements of ABE for that period; and
- 1.3.4. the **“Audit”** means the statutory audit of the FY2018 financial statements.
- 1.4. Pursuant to Rule 16(b) of the AEP, Executive Counsel has decided that Haysmacintyre LLP and David Cox are liable for Enforcement Action, having made *Adverse Findings* against each of them.
- 1.5. This *Final Decision Notice* is issued pursuant to Rule 18 of the AEP in respect of the conduct of:
 - 1.5.1. Haysmacintyre LLP (**“Haysmacintyre”**) in relation to the Audit. Haysmacintyre was the *Statutory Audit Firm* for the Audit (at which time the firm practised as a traditional partnership, before the business transferred to the present limited liability partnership on 31 March 2019).
 - 1.5.2. David Cox (**“Mr Cox”**), a partner of Haysmacintyre in relation to the Audit. For FY2018, he was the *Statutory Auditor* of ABE and signed the Audit report on behalf of Haysmacintyre.
- 1.6. In this *Decision Notice*, Haysmacintyre and Mr Cox are referred to together as the **“Respondents”**.
- 1.7. In accordance with Rule 18 of the AEP this *Final Decision Notice* sets out Executive Counsel’s *Adverse Findings* and *Sanctions*, together with reasons.
- 1.8. This *Final Decision Notice* is divided into the following sections:
 - 1.8.1. Section 2: Executive Summary of the *Adverse Findings*;
 - 1.8.2. Section 3: Background;
 - 1.8.3. Section 4: *Relevant Requirements* to which the *Adverse Findings* relate;
 - 1.8.4. Section 5: Detail of the *Adverse Findings*;
 - 1.8.5. Sections 6 and 7: *Sanctions*;
 - 1.8.6. Section 8: Costs.

2. EXECUTIVE SUMMARY OF THE ADVERSE FINDINGS

- 2.1. During FY2018, 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. In FY2018 ABE’s revenue was

£1.6 million. ABE, which is listed on the London Stock Exchange, has subsequently sold its main trading subsidiary [...] (“**[Subsidiary A]**”). Trading in ABE’s shares has been suspended since 1 August 2019.

- 2.2. As is set out in this *Final Decision Notice*, there were pervasive failures by the Respondents in the manner in which they conducted the Audit. The Audit failed in its principal objective: that of providing reasonable assurance that the FY2018 financial statements were free from material misstatement.
- 2.3. Whilst this Notice explains the failings in the Respondents’ audit work, it does not make a finding that the FY2018 financial statements were misstated.
- 2.4. The *Adverse Findings* in this Notice relate to six areas of audit work:
 - 2.4.1. Inventory;
 - 2.4.2. Journal entry testing;
 - 2.4.3. Revenue recognition and debt recovery;
 - 2.4.4. Defined benefit pension scheme;
 - 2.4.5. Documentation of audit work on going concern (a matter of material uncertainty); and
 - 2.4.6. Review and supervision of the audit.
- 2.5. Section 5 of this *Final Decision Notice* sets out the detailed *Adverse Findings*.

2.6. This *Final Decision Notice* imposes the following *Sanctions* in respect of the Respondents:

Haysmacintyre

- 2.6.1. A declaration that the FY2018 Audit report signed on behalf of Haysmacintyre did not satisfy the *Relevant Requirements*, as set out in this *Decision Notice*;
- 2.6.2. A published statement in the form of a severe reprimand against Haysmacintyre; and
- 2.6.3. A financial penalty of £125,000 adjusted for aggravating and mitigating factors (in particular reflecting an exceptional level of co-operation) by a reduction of 15%, and further discounted for admissions and early disposal by 35% so that the financial penalty payable is £70,000. The financial penalty shall be paid no later than 28 days after the date of the *Final Decision Notice*.

Mr Cox

- 2.6.4. A declaration that the FY2018 Audit report signed by Mr Cox did not satisfy the *Relevant Requirements*, as set out in this *Decision Notice*;
- 2.6.5. A published statement in the form of a severe reprimand against Mr Cox; and
- 2.6.6. A financial penalty of £17,500 adjusted for aggravating and mitigating factors (in particular reflecting an exceptional level of co-operation) by a reduction of 15%, and further discounted for admissions and early disposal by 35% so that the financial penalty payable is £10,000. The financial penalty shall be paid no later than 28 days after the date of the *Final Decision Notice*.

2.7. In determining the *Sanctions* to be imposed on the Respondents, Executive Counsel has noted that in response to the identified failings in the FY2018 Audit, the Respondents have taken the remedial steps set out at paragraph 6.15 below which are subject to review and monitoring by the FRC's Director of Audit Firm Supervision. In those circumstances no further firm-wide non-financial *Sanctions* are required pursuant to this *Final Decision Notice*.

3. BACKGROUND

3.1. In 2019, Haysmacintyre was ranked as the tenth largest audit firm in the UK, with audit revenues of £17 million and twenty-five audit principals. FY2018 was Haysmacintyre's third year as the *Statutory Audit Firm* for ABE.

- 3.2. Mr Cox is a partner of Haysmacintyre with more than fifteen years' auditing experience. On 1 June 2018 he became the firm's Head of Audit and Assurance,. He signed the audit report on 30 July 2018, on behalf of Haysmacintyre, in respect of the FY2018 financial statements.
- 3.3. He had been the *Statutory Auditor* for ABE since 2016.
- 3.4. The Respondents' statutory responsibility was 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 the International Financial Reporting Standards and the Companies Act 2006.
- 3.5. An audit involves obtaining sufficient appropriate "audit evidence" about the amounts and disclosures in the financial statements in order to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.
- 3.6. Audit evidence is defined in ISA 500 as "*information used by the auditor in arriving at the conclusions on which the auditor's opinion is based*". Audit evidence is primarily obtained from audit procedures performed during the course of the audit.

The Audit

- 3.7. The *Adverse Findings* set out in this *Final Decision Notice* relate to the audit of the FY2018 financial statements only. The FY2018 financial statements were prepared on a going concern basis, in respect of which the directors of ABE had disclosed a material uncertainty in the note to the financial statements and in the director's report. The directors' report stated that the directors of ABE had:

"concluded that the need to generate funds from a combination of further fundraising, disposing of investments and from trading activities to satisfy the settlement of its on-going and future liabilities represents a material uncertainty, which may cast significant doubt upon the Group's and the Company's ability to continue as a going concern. Nevertheless after making enquiries and considering this uncertainty and the measures that can be taken to mitigate the uncertainty, the Directors have a reasonable expectation that the Group and the Company will have adequate resources to continue in existence for the foreseeable future. For these reasons they continue to adopt the going concern basis in preparing the annual report and accounts."

The Respondents' audit opinion as to the FY2018 financial statements also contained a paragraph dealing with the material uncertainty in relation to going concern.

- 3.8. In ABE's financial statements for the financial year ended 31 March 2019—i.e. for the next financial year after the Audit that is the subject of this *Final Decision Notice*—the directors considered the company's trading position and liability to its pension fund and, following discussions with various stakeholders, concluded that [Subsidiary A] was expected to be reconstructed, sold or cease trading within a period of 12 months from the date those financial statements were approved and consequently agreed that the going concern basis of preparation was no longer applicable.
- 3.9. In their audit strategy for the FY2018 Audit, Haysmacintyre had identified going concern and also revenue recognition and the recoverability of trade receivables, the carrying value of inventory and the measurement of the defined benefit pension scheme liability as areas of significant audit risk.
- 3.10. In all of the areas mentioned in the last paragraph above, and also in both journal entry testing and the firm's review and supervision of the audit, there were extensive failures constituting breaches of requirements of the audit standards that are listed in paragraph 4.3 below. These failures were particularly serious in relation to the audit of inventory.
- 3.11. It is not alleged that the FY2018 financial statements of ABE in fact contained any misstatement. Nonetheless, it is alleged that the audit team failed to audit the FY2018 financial statements in an appropriate manner and failed to obtain reasonable assurance that the FY2018 financial statements were free from material misstatement.

4. RELEVANT REQUIREMENTS TO WHICH THE ADVERSE FINDINGS RELATE

- 4.1. Rule 1 of the AEP states that *Relevant Requirements* has the meaning set out in regulation 5(11) of the Statutory Auditors and Third Country Auditors Regulations 2016 ("**SATCAR**"). The *Relevant Requirements* include, but are not limited to, the International Standards on Auditing (UK and Ireland) ("**ISAs**") issued by the International Auditing and Assurance Standards Board.
- 4.2. The ISAs relevant to this *Final Decision Notice* are those effective for audits of financial statements for periods ending on or after 17 June 2016.
- 4.3. The *Relevant Requirements* referred to in this Notice are the following:
 - 4.3.1. ISA 200 (Overall objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK));

- 4.3.2. ISA 220 (Quality Control for an Audit of Financial Statements);
 - 4.3.3. ISA 230 (Audit Documentation);
 - 4.3.4. ISA 240 (The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements);
 - 4.3.5. ISA 330 (The Auditor's Responses to Assessed Risks);
 - 4.3.6. ISA 402 (Audit Considerations Relating to an Entity Using a Service Organisation);
 - 4.3.7. ISA 500 (Audit Evidence);
 - 4.3.8. ISA 530 (Audit Sampling); and
 - 4.3.9. ISA 701 (Communicating Key Audit Matters in the Independent Auditor's Report).
- 4.4. Extracts from the ISAs setting out those parts which are of particular relevance to the *Adverse Findings* are set out in Appendix 1 hereto.

5. ADVERSE FINDINGS

Adverse Finding 1 – Inventory

- 5.1. The carrying value of inventory (i.e. the lower of cost and Net Realisable Value) stated in the FY2018 financial statements, at £1.037 million, represented 55% of current assets and 35% of total assets. There were multiple, serious failures in the Respondents' audit work on inventory/stock valuation.
- 5.2. The testing procedures in question were poorly designed and were inadequate to test the key elements of the provisioning assessments so as to provide sufficient evidence for the relevant assertions in the FY2018 financial statements.
- 5.3. The selected sample size of 30 items was not appropriate, given that inventory was deemed an area of significant risk, and the audit file does not provide a justification for the sample size. The whole population of the items that could have been selected was many times greater than 30; the audit file itself refers to an alternative, balance-sheet measure which might have been adopted and would have involved a sample more than ten times larger than the selected sample.

- 5.4. Execution of the tests by the audit team was deficient. The Respondents communicated to ABE's audit committee that, for each item within the sample of stock lines they had selected, they had traced the cost price both to a purchase invoice, to ensure that costs had been correctly recorded, and to a sales list, to ensure that stock was subsequently recorded at the lower of cost and net realisable value. In fact, the Respondents had not carried out those procedures. Of the 30 items in the sample, only 17 were traced to a purchase invoice and only 10 were traced to a post year-end sales invoice.
- 5.5. The Respondents carried out testing work on the stock ageing data of [Subsidiary A], on which management based their provisioning. The test of [Subsidiary A]'s stock ageing data that the Respondents designed and executed was inadequate in that it did not seek to verify the ageing data by checking the allocation of purchases to their respective financial periods.
- 5.6. The Respondents' work on the carrying value of inventory within the Audit was therefore wholly inadequate. There were extensive and significant failings in this area of the Audit which constitute breaches of the following requirements of the ISAs:
- 5.6.1. ISA 200 (Overall objectives):
- 5.6.1.1. Paragraph 15, by failing to plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated;
 - 5.6.1.2. Paragraph 16, by failing to exercise professional judgment in planning and performing an audit of financial statements; and
 - 5.6.1.3. Paragraph 17, by failing to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion;
- 5.6.2. ISA 500 (Audit Evidence):
- 5.6.2.1. Paragraph 6, by failing to design and perform appropriate procedures to obtain sufficient appropriate audit evidence; and
 - 5.6.2.2. Paragraph 9, by failing to carry out an appropriate evaluation as to whether information produced by the audited entity was sufficiently reliable for the auditor's purposes;

5.6.3. ISA 330 (Response to Risks), paragraph 21, by failing to perform substantive procedures that were specifically responsive to the assessed significant risk of material misstatement in relation to inventory; and

5.6.4. ISA 530 (Audit Sampling):

5.6.4.1. Paragraph 6, by failing to design an audit sample giving consideration to the purpose of the audit procedure in question and the characteristics of the population from which the sample was to be drawn;

5.6.4.2. Paragraph 7, by failing to determine a sample size sufficient to reduce sampling risk to an acceptably low level; and

5.6.4.3. Paragraph 10, by failing to perform on a replacement item an audit procedure which was not applicable to the item first selected.

Adverse Finding 2 – Journal entry testing

5.7. The Respondents communicated to ABE's audit committee that "*significant, unusual or unexpected journal postings [had] been investigated and verified*". However, in fact the Respondents' work on journal entry testing failed to meet the *Relevant Requirements* of ISA 240 (Auditor's Responsibilities Relating to Fraud), ISA 500 (Audit Evidence) and 230 (Audit Documentation). This was a result of journal entry testing not having complied with the requirements of paragraph 32 of ISA 240, and thereby failing to respond appropriately to the risk, present in all entities, that arises from the fact that management is in a unique position to perpetrate fraud by overriding controls. The rationale of the *Relevant Requirements* of ISA 240 is that management has the ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

5.8. The work on journal entries that the Respondents carried out did not meet the requirements in that it did not constitute testing across all journal entries made in the year for the purpose of complying with ISA 240 paragraph 32 and was not designed or executed as testing of that kind; the work was confined to entries in discrete parts of the accounts and was directed to objectives other than those of ISA 240 paragraph 32, such as testing year-end journals as part of balance-sheet testing.

- 5.9. The Respondents did not document on the audit file the work done to ensure that significant, unusual or unexpected journal postings had been investigated and verified. Although the relevant workpaper states that journal entries were “*reviewed as part of testing, with no evidence of fraud or bias noted*”, the workpaper does not set out the audit procedures performed, either by explaining the procedures or attaching documents to substantiate the outcome of the procedures and the conclusion reached as to evidence of fraud or bias.
- 5.10. In this area of audit work, the Respondents therefore breached the requirement of ISA 240 paragraph 32(a), by failing to design and perform audit procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements and, in doing so, to make inquiries about inappropriate or unusual activity relating to the processing of the entries, to select entries made at the end of a reporting period and to consider the need to test them throughout the period.
- 5.11. The Respondents also breached the requirements of:
- 5.11.1. ISA 500 (Audit Evidence), paragraph 6, by failing to design and perform appropriate procedures to obtain sufficient appropriate audit evidence; and
 - 5.11.2. ISA 230 (Audit Documentation), paragraphs 8 and 9, in respect of preparing audit documentation that shows the results of audit procedures performed and the audit evidence obtained and documenting the identifying characteristics of the specific items or matters tested.

**Adverse Finding 3 – Audit work on revenue recognition
and recoverability of debtors**

- 5.12. Revenue recognition and recoverability of debtors was a significant audit risk and was identified in the audit file as a key audit matter. Provision against trade debtors was a significant accounting estimate made by ABE's management.
- 5.13. Paragraph 32(b) of ISA 240 (Auditor's Responsibilities Relating to Fraud) requires the auditor to design and perform audit procedures to review accounting estimates for biases and evaluate whether the circumstances producing any bias represent a risk of material misstatement due to fraud. Paragraph 32(b)(ii) requires that such review must include a retrospective review of management judgements and assumptions related to significant accounting estimates reflected in the financial statements of the prior year.

(Paragraph A46 of ISA 240 explains that a retrospective review has the purpose of determining whether there is an indication of a possible bias on the part of management.) In the circumstances of the Audit, the Respondents were required by the said provisions of ISA 240 to perform a retrospective review of management's judgements and assumptions related to the provision against trade debtors in ABE's financial statements for the prior year. The Respondents failed to comply with that requirement. They did not carry out work which met the requirement of paragraph 32(b)(ii) of ISA 240 as to conducting a retrospective review related to the prior year's provision against trade debtors. Such audit work as was carried out was inadequate for the purpose of meeting the requirement in question.

5.14. Paragraph 6 of ISA 530 (Audit Sampling) requires the auditor, when designing an audit sample, to consider the purpose of the relevant audit procedure and the characteristics of the population from which the sample in question will be drawn. The Respondents failed to comply with this requirement in their audit work on revenue recognition and recoverability of debtors, in that they did not appropriately address the difference between the two classes of ABE's sales to its customers, namely products (predominantly engine parts) and services (repair work); they did not consider the respective risks presented by those two revenue streams and they did not differentiate between them in the substantive testing work that was carried out for the Audit.

5.15. ISA 701 (Communicating Key Audit Matters [**"KAM(s)"**] in the Auditor's Report), by virtue of its paragraphs 9, 10, 13 and 18(a), requires the auditor:

5.15.1. to determine, from the matters communicated to those charged with governance, those matters that required significant attention in performing the audit; then

5.15.2. to determine which of those matters were of most significance in the audit and therefore formed the KAMs; and

5.15.3. to record within the audit documentation the significant matters and, in respect of each of them, the rationale for the auditor's determination as to whether or not the matter is a KAM, including (in respect of each matter determined to be a KAM):

5.15.3.1. a reference to any disclosure(s) in the financial statements related to the matter; and

5.15.3.2. information as to:

(a) why the matter was determined to be a KAM; and

(b) how the matter was addressed in the audit.

5.16. The Respondents' audit work in the area of revenue recognition and recoverability of debtors did not comply with the above requirements of ISA 701. That area was identified, both in the audit file and the auditor's report, as a KAM. However, the reasoning behind that identification was lacking; the audit team's assessment of the risks in relation to revenue recognition had in fact led them to a contrary conclusion; and the identification of this matter as a KAM was an error.

Adverse Finding 4 – Defined benefit pension scheme

5.17. Within the Audit, ABE's defined benefit pension scheme and management's assertion as to the company's pension liability (at £1.35 million) was an area of significant risk. The Respondents' work on this area, which relied on the work of management's expert actuary, in several respects fell far short of what was required.

5.18. This audit work in question was largely conducted within the [Subsidiary A] audit file and attributed to the audit of creditors more generally. The work was not planned and performed in a manner properly directed to the audit of assets, in this case pension fund investments, including the obtaining of independent confirmation of the assets and the use of appropriate audit procedures in relation to their valuation by management's actuary. The Respondents failed to verify the appropriateness of the information provided to management's actuary, to ascertain the basis on which the actuary evaluated and selected comparator investment funds for use as valuation evidence and to challenge or test other assumptions underlying the actuary's valuation work.

5.19. In their work within the Audit on ABE's defined benefit pension scheme, the Respondents failed:

5.19.1. to design and perform appropriate procedures to obtain sufficient appropriate audit evidence and to evaluate the appropriateness of the work of management's actuary for the assertion as to pension liability, in breach of ISA 500 (Audit Evidence), paragraphs 6 and 8(c);

5.19.2. to consider whether external confirmation procedures relied on by management's actuary should be performed by the Respondents as substantive audit procedures, in breach of ISA 330 (Auditor's Responses to Assessed Risks), paragraph 19; and

5.19.3. to determine whether sufficient appropriate audit evidence for the assertion in the financial statements as to pension liability was held by management's actuary (and, if not, conduct remedial audit work), in breach of paragraph 15 of ISA 402 (Audit Considerations Relating to an Entity Using a Service Organisation).

Adverse Finding 5 – Documentation of audit work on going concern (a matter of material uncertainty)

5.20. It was noted that there was a material uncertainty in relation to going concern in the directors' report, the notes to the financial statements, and the audit report on the FY2018 financial statements. The Respondents, in the audit report, drew attention to the directors' consideration of going concern, and the measures which could be taken by the directors of ABE to mitigate the material uncertainty as to going concern. The Respondents' opinion in this regard depended upon their appropriate challenge to management in areas including the feasibility of raising funds and the adequacy of the disclosures related to going concern.

5.21. ABE's management had developed a fall-back strategy to sustain the company as a going concern, for which there were two key dependencies: first, the ability of the group to dispose of shares that it owned in an AIM-listed medical drug-development company to realise the estimated value of the shares and, secondly, the likelihood and feasibility of contributions of funds which shareholders had undertaken to make if required. The Respondents' audit work on going concern included assessment of that strategy.

5.22. Although the Respondents recorded, in the relevant workpaper on the audit file, that they had performed the necessary audit work in this area, including the required challenge to management, the evidence of the work is not otherwise sufficiently documented on the audit file. This deficiency was a breach of the requirements of ISA 230, paragraphs 8, 9 and 10, in relation to preparing audit documentation showing the audit procedures performed, the results of those procedures and the audit evidence obtained, the conclusions reached on significant matters and significant professional judgements made by the auditors in reaching those conclusions (including documentation of discussions of the matters in question with management, with those

charged with governance and with others). Consequently, the audit documentation was insufficient to enable an experienced auditor, having no previous connection with the audit, to understand the inclusion of a material uncertainty paragraph as to going concern in the audit report on the FY2018 financial statements.

Adverse Finding 6 – Review and supervision of the Audit

5.23. In several particulars, in their audit work on inventory, journal entry testing, revenue recognition and debt recovery, defined benefit pension scheme and documentation of work on going concern, the Respondents breached ISA 220 (Quality Control), paragraph 17, concerning review and supervision of the Audit before the signing of the auditor's report. They did not obtain sufficient appropriate audit evidence to support the conclusions reached.

5.24. The work on review and supervision of the Audit in those areas that was carried out, by Mr Cox as the Audit Engagement Partner and Statutory Auditor for the Audit, by the Engagement Quality Control Review (“EQCR”) Partner and by the Audit Manager, was inadequate to meet the *Relevant Requirements* set out in ISA 220. The inadequacy of this work is illustrated by:

5.24.1. the relatively small total number of hours of work recorded by Mr Cox (5.15 hours—nearly 40% of this time being spent in discussions with ABE's management) and by the EQCR Partner (2.5 hours); and

5.24.2. the fact that the Audit Manager for the Audit was not present with the audit team when on-site fieldwork was carried out, did not conduct any review work until several weeks after the fieldwork was done and reviewed certain workpapers that he himself had created (being matters within the Respondents' responsibility for audit quality control through review and supervision of the work of the audit team).

6. SANCTIONS – HAYSMACINTYRE

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

- 6.1.1. to declare and uphold proper standards of conduct amongst Statutory Auditors and Statutory Audit Firms and to maintain and enhance the quality and reliability of future audits;
 - 6.1.2. to maintain and promote public and market confidence in Statutory Auditors and Statutory Audit Firms and the quality of their audits and in the regulation or the accountancy profession;
 - 6.1.3. to protect the public from Statutory Auditors and Statutory Audit Firms whose conduct has fallen short of the *Relevant Requirements*; and
 - 6.1.4. to deter Statutory Auditors and Statutory Audit Firms from breaching the *Relevant Requirements* relating to Statutory Audit.
- 6.2. Paragraph 12 of the Policy provides that the primary purpose of imposing *Sanctions* for breaches of the *Relevant Requirements* is not to punish, but to protect the public and the wider public interest.
- 6.3. Executive Counsel imposes the following *Sanctions* against Haysmacintyre:
- 6.3.1. a declaration that the FY2018 Audit report signed on behalf of Haysmacintyre did not satisfy the *Relevant Requirements*, as set out in this *Final Decision Notice*;
 - 6.3.2. a published statement in the form of a severe reprimand; and
 - 6.3.3. a financial penalty of £125,000 adjusted for aggravating and mitigating factors (in particular reflecting an exceptional level of co-operation) by a reduction of 15%, and further discounted for admissions and early disposal by 35% so that the financial penalty payable is £70,000. The financial penalty shall be paid no later than 28 days after the date of the *Final Decision Notice*.
- 6.4. In determining the *Sanctions* to be imposed on Haysmacintyre, Executive Counsel has noted that in response to the identified failings in the FY2018 Audit, Haysmacintyre has taken the remedial steps set out at paragraph 6.15 below, and in those circumstances no further firm-wide non-financial *Sanctions* are required.
- 6.5. In reaching this decision, Executive Counsel has, in summary, considered the following matters in accordance with the Policy.

Nature, seriousness, gravity and duration of the breaches

- 6.6. As a result of the breaches of *Relevant Requirements*, the FY2018 Audit failed in its principal objective, namely to obtain reasonable assurance about whether the FY2018 financial statements as a whole were free from material misstatement.

6.7. The audit areas relevant to the breaches are important to statutory audits and are required to be audited in accordance with *Relevant Requirements*.

6.8. The breaches of *Relevant Requirements*:

6.8.1. were pervasive, extensive and, in relation to the audit of inventory, serious;

6.8.2. relate only to one audit year;

6.8.3. have not been found to have had an adverse or potentially adverse effect on a significant number of people in the United Kingdom;

6.8.4. have not been found to have led to the FY2018 financial statements being in fact misstated;

6.8.5. in aggregate could, nonetheless, have harmed investor, market and public confidence in the truth and fairness of the financial statements published by Statutory Auditors or Statutory Audit Firms (ABE's shares were listed on the London Stock Exchange at the time of the auditor's report on the FY2018 financial statements);

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

6.9. Executive Counsel considers it likely that the same type of breach would re-occur failing remedial action.

6.10. Haysmacintyre is not a large audit firm. Its UK fee income in 2019 was £33 million and its audit fee income was £17 million. It had twenty-five audit principals. As set out at paragraph 6.24 below, Executive Counsel has taken account of Haysmacintyre's size and financial resources when deciding on the level of financial penalty.

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

6.12. The Adverse Findings indicate that the internal review and quality procedures applied at Haysmacintyre were ineffective.

6.13. Haysmacintyre's management conducted a Root Cause Analysis which was subsequently provided to Executive Counsel on a voluntary and unrestricted basis.

Identification of Sanction

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

- 6.14.1. a declaration that the FY2018 Audit report signed on behalf of Haysmacintyre did not satisfy the *Relevant Requirements*, as set out in this *Final Decision Notice*;
- 6.14.2. a published statement in the form of a severe reprimand; and
- 6.14.3. a financial penalty of £125,000.
- 6.15. The identified failings in the FY2018 Audit are ones which would clearly indicate the need for Executive Counsel to impose a requirement to take appropriate remedial measures, by way of non-financial *Sanction*. However, in determining the *Sanctions* to be imposed on Haysmacintyre, Executive Counsel has taken into account that in response to those identified failings, Haysmacintyre has committed itself to a programme of remedial measures for the improvement of audit quality. Details of that remedial programme have been provided to Executive Counsel. The measures adopted address the following matters: (i) Improvement in audit quality driven from the “tone from the top”, (ii) recruitment of an audit quality support team, (iii) new policies and procedures for the conduct of audit work, (iv) enhanced recruitment of audit staff, (v) improvement of audit training, (vi) additional internal quality control reviews and (vii) root cause analyses. The implementation and effectiveness of this remedial programme are currently under active review by the FRC’s Director of Audit Firm Supervision. In these circumstances, Executive Counsel does not consider that any further non-financial *Sanction* needs to be imposed under the present *Final Decision Notice*.
- 6.16. Executive Counsel has then taken into account any aggravating and mitigating factors that exist (to the extent that they have not already been taken into account in relation to the nature, seriousness, gravity and duration of the breaches).

Aggravating factors

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

Mitigating factors

- 6.18. Haysmacintyre provided an exceptional level of co-operation 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.
- 6.19. As paragraph 69 of the Policy explains:

“In order for cooperation to be considered as a mitigating factor at the point of determining appropriate sanction it will therefore be necessary for the Statutory Auditors and Statutory Audit Firms to have provided an exceptional level of cooperation. Non-exhaustive examples of conduct which may constitute such cooperation include:

a) self-reporting to the FRC and/or bringing to the attention of the FRC any facts and/or matters which may constitute an allegation of a breach of the Relevant Requirements; and

b) volunteering information or documentation not specifically requested but which the Statutory Auditor/Audit Firm nevertheless considers may assist the investigation.”

6.20. Haysmacintyre did not stand to gain any profit or benefit, beyond the fee chargeable for the FY2018 Audit, from the breach of the *Relevant Requirements*.

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

Deterrence

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

Discount for Admissions and Settlement

6.23. Having taken into account the full admissions by Haysmacintyre and the stage at which those admissions were made (at an early point within Stage 1 of the case in accordance with paragraph 84 of the Policy), Executive Counsel determined that a reduction of 35% as to the financial penalty is appropriate, such that a financial penalty of £70,000 is payable.

Other considerations

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

7. SANCTIONS – MR COX

7.1. Executive Counsel imposes the following *Sanctions* against Mr Cox:

7.1.1. a declaration that the FY2018 Audit report signed by Mr Cox did not satisfy the *Relevant Requirements*, as set out in this *Final Decision Notice*;

7.1.2. a published statement in the form of a severe reprimand against Mr Cox; and

7.1.3. a financial penalty of £17,500 adjusted for aggravating and mitigating factors (in particular reflecting an exceptional level of co-operation) by a reduction of 15%, and further discounted for admissions and early disposal by 35% so that the financial penalty payable is £10,000. The financial penalty shall be paid no later than 28 days after the date of the *Final Decision Notice*.

7.2. In determining the *Sanctions* to be imposed on Mr Cox, Executive Counsel has noted that in response to the identified failings in the FY2018 Audit, the Respondents took the remedial steps set out at paragraph 6.15 above, in which Mr Cox had an integral role, and in those circumstances no further non-financial *Sanctions* against Mr Cox are required.

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 features of the case set out at paragraphs 6.6 to 6.11 above apply equally to Mr Cox.

Identification of Sanction

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

7.5.1. a declaration that the FY2018 Audit report signed by Mr Cox did not satisfy the *Relevant Requirements*, as set out in this *Final Decision Notice*;

7.5.2. a published statement in the form of a severe reprimand against Mr Cox; and

7.5.3. a financial penalty of £17,500.

7.6. 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

7.7. As set out at paragraph 3.2 above, at the time Mr Cox signed the audit report he held a senior position within the firm with supervisory responsibilities.

Mitigating factors

7.8. Mr Cox did not stand to gain any profit or benefit from the breaches of the *Relevant Requirements* (save to the extent that he had an interest in Haysmacintyre being paid engagement fees for the FY2018 Audit).

7.9. Mr Cox has no previous adverse compliance or disciplinary record.

7.10. Mr Cox (through Haysmacintyre) provided an exceptional level of co-operation during Executive Counsel's investigation of the breaches, in that a full and frank Root Cause Analysis was conducted (with which Mr Cox complied) as to how breaches of *Relevant Requirements* had occurred and breaches were self-reported by sharing that document on a voluntary basis (without restriction) with Executive Counsel.

7.11. Paragraph 69 of the Policy, as quoted at paragraph 6.19 above, explains the basis on which cooperation is to be considered as a mitigating factor at the point of determining appropriate *Sanction*.

7.12. In light of the factors set out in paragraphs 7.7 to 7.11 above, Executive Counsel considers that a discount to the financial penalty of 15% is appropriate.

Deterrence

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

Discount for Admissions and Settlement

7.14. Having taken into account the full admissions by Mr Cox and the stage at which those admissions were made (at an early point within Stage 1 of the case in accordance with paragraph 84 of the Policy), Executive Counsel determined that a reduction of 35% as to the financial penalty is appropriate, such that a financial penalty of £10,000 is payable.

Other considerations

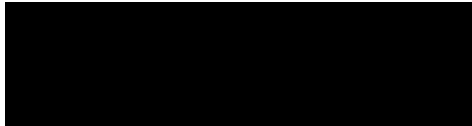
7.15. In accordance with paragraph 47(d) of the Policy, Executive Counsel has taken into account Mr Cox's annual remuneration, the effect of a financial penalty on him and his future employment, and whether he is insured as to any financial penalty.

Edited for publication

8. COSTS

8.1. Executive Counsel requires that the Respondents pay her costs of £43,924. Such costs shall be paid no later than 28 days after the date of this *Final Decision Notice*.

Signed:

A large black rectangular redaction box covering the signature of Claudia Mortimore.

Claudia Mortimore

DEPUTY EXECUTIVE COUNSEL

Date: 30 March 2021

APPENDIX 1 – EXTRACTS OF RELEVANT REQUIREMENTS

International Standards on Auditing (UK and Ireland) (“ISA”)¹

1. ISA 200: Overall objectives of the independent auditor and the conduct of an audit in accordance with ISAs

1.1. Paragraph 15 states as follows:

“The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. In the UK, the auditor shall maintain professional skepticism throughout the audit, recognising the possibility of a material misstatement due to facts or behaviour indicating irregularities, including fraud, or error, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and of those charged with governance.”

1.2. Paragraph 16 states as follows:

“The auditor shall exercise professional judgment in planning and performing an audit of financial statements.”

1.3. Paragraph 17 states as follows:

“To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.”

2. ISA 220: Quality control

2.1. Paragraph 17 states as follows:

“On or before the date of the auditor's report, the engagement partner shall, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.”

3. ISA 230: Audit documentation

3.1. Paragraph 8 states as follows:

¹ As issued, with revisions, in June 2016, effective for audits of financial statements for periods ending on or after 17 June 2017.

“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.”*

3.2. Paragraph 9 states as follows:

“In documenting the nature, timing and extent of audit procedures performed, the auditor shall record:

- a) The identifying characteristics of the specific items or matters tested;*
- b) Who performed the audit work and the date such work was completed; and*
- c) Who reviewed the audit work performed and the date and extent of such review.”*

3.3. Paragraph 10 states as follows:

“The auditor shall document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.”

4. ISA 240: The auditor’s responsibilities relating to fraud in an audit of financial statements

4.1. Paragraph 32 states as follows:

Irrespective of the auditor’s assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to:

- a) Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. In designing and performing audit procedures for such tests, the auditor shall:
 - i. Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;**

6. ISA 402: Audit considerations relating to an entity using a service organisation

6.1. Paragraph 15 states as follows:

“In responding to assessed risks in accordance with ISA (UK) 330 (Revised July 2017), the user auditor shall:

- a) Determine whether sufficient appropriate audit evidence concerning the relevant financial statement assertions is available from records held at the user entity; and, if not,*
- b) Perform further audit procedures to obtain sufficient appropriate audit evidence or use another auditor to perform those procedures at the service organization on the user auditor’s behalf.”*

7. ISA 500: Audit evidence

7.1. Paragraph 6 states as follows:

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

7.2. Paragraph 8 states as follows:

“If information to be used as audit evidence has been prepared using the work of a management’s expert, the auditor shall, to the extent necessary, having regard to the significance of that expert’s work for the auditor’s purposes:

- a) Evaluate the competence, capabilities and objectivity of that expert;*
- b) Obtain an understanding of the work of that expert; and*
- c) Evaluate the appropriateness of that expert’s work as audit evidence for the relevant assertion.”*

7.3. Paragraph 9 states as follows:

“When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor’s purposes, including as necessary in the circumstances:

- a) Obtaining audit evidence about the accuracy and completeness of the information; and*
- b) Evaluating whether the information is sufficiently precise and detailed for the auditor’s purposes.”*

8. ISA 530: Audit Sampling

8.1. Paragraph 6 states as follows:

“When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn.”

8.2. Paragraph 7 states as follows:

“The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.”

8.3. Paragraph 10 states as follows:

“If the audit procedure is not applicable to the selected item, the auditor shall perform the procedure on a replacement item.”

9. ISA 701: Communicating key audit matters in the auditor’s report

9.1. Paragraph 9 states as follows:

“The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

- a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with ISA (UK) 315 (Revised June 2016).*
- b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.*
- c) The effect on the audit of significant events or transactions that occurred during the period.”*

9.2. Paragraph 10 states as follows:

“The auditor shall determine which of the matters determined in accordance with paragraph 9 were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.”

9.3. Paragraph 13 states as follows:

“The description of each key audit matter in the Key Audit Matters section of the auditor’s report shall include a reference to the related disclosure(s), if any, in the financial statements and shall address:

- a) Why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter; and*
- b) How the matter was addressed in the audit.”*

9.4. Paragraph 18(a) states as follows:

“The auditor shall include in the audit documentation:

- a) The matters that required significant auditor attention as determined in accordance with paragraph 9, and the rationale for the auditor’s determination as to whether or not each of these matters is a key audit matter in accordance with paragraph 10 ...”*