

ANNUAL ENFORCEMENT REVIEW

2020

JULY 2020

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1 OVERVIEW BY EXECUTIVE COUNSEL

The Covid-19 pandemic has highlighted the vital role directors, auditors, accountants and actuaries play in ensuring financial statements are both accurate and reliable. Now, more than ever, investors, businesses, workers, pension holders and the public are reliant on financial information they can trust as a basis for making informed decisions that protect livelihoods, and support the integrity of our financial system, so encouraging investment and economic growth.

Driving audit quality improvements remains a key priority. This year's review looks at repeated shortcomings and underlying causes. Failure to exercise professional scepticism is an ongoing issue. Reasons for this include auditors being too close to management and creating risks to objectivity and insufficient escalation to and involvement of the audit partner leading to a failure to appreciate the significance of issues in the context of the audit as a whole.

Given the detrimental impact those failings can have on investors and wider society it is in everyone's interest that where standards are not met or ethical failures occur, they are addressed and rectified. Our message to firms last year was to identify, remediate and report. Whilst we have seen examples of good behaviours, it is disappointing that, overall, the response has been mixed. We look forward next year to highlighting firms that have demonstrated their commitment to this approach.

For the FRC's Enforcement Division, the last 12 months have been a period of consolidation in various ways. Cases have entered periods of intensive review and analysis, and new procedures have been embedded. We have continued to strengthen the division, increasing in size by 14%, and to grow the leadership team with the arrival of Jamie Symington as a second Deputy Executive Counsel alongside Claudia Mortimore.

A renewed focus on early resolution of cases has brought a 58% increase in cases resolved through Constructive Engagement. As well as financial sanctions, we have also continued to use bespoke non-financial sanctions to drive the long-term changes in behaviour that we expect following enforcement action. In the last year non-financial sanctions have required firms to undertake firm wide training, to introduce and provide written reports to the FRC on quality performance reviews, and to monitor and support regional offices.

In addition to the published case outcomes included in this Review, major hearings have taken place in the year including proceedings in the Court of Appeal concerning legal privilege and a seven-week hearing before the independent Tribunal in relation to the audit of Autonomy Corporation plc. A vast amount of material and evidence was considered by the Tribunal at what is our longest contested hearing to date.

The increase in resourcing of the division is beginning to deliver an improvement in the timeliness of concluding investigations. Our work continues to be informed by the clear recognition that improving the speed of our investigations and enforcement action, and delivery of published outcomes must remain a key priority, so failings can be addressed, and corrective action taken.

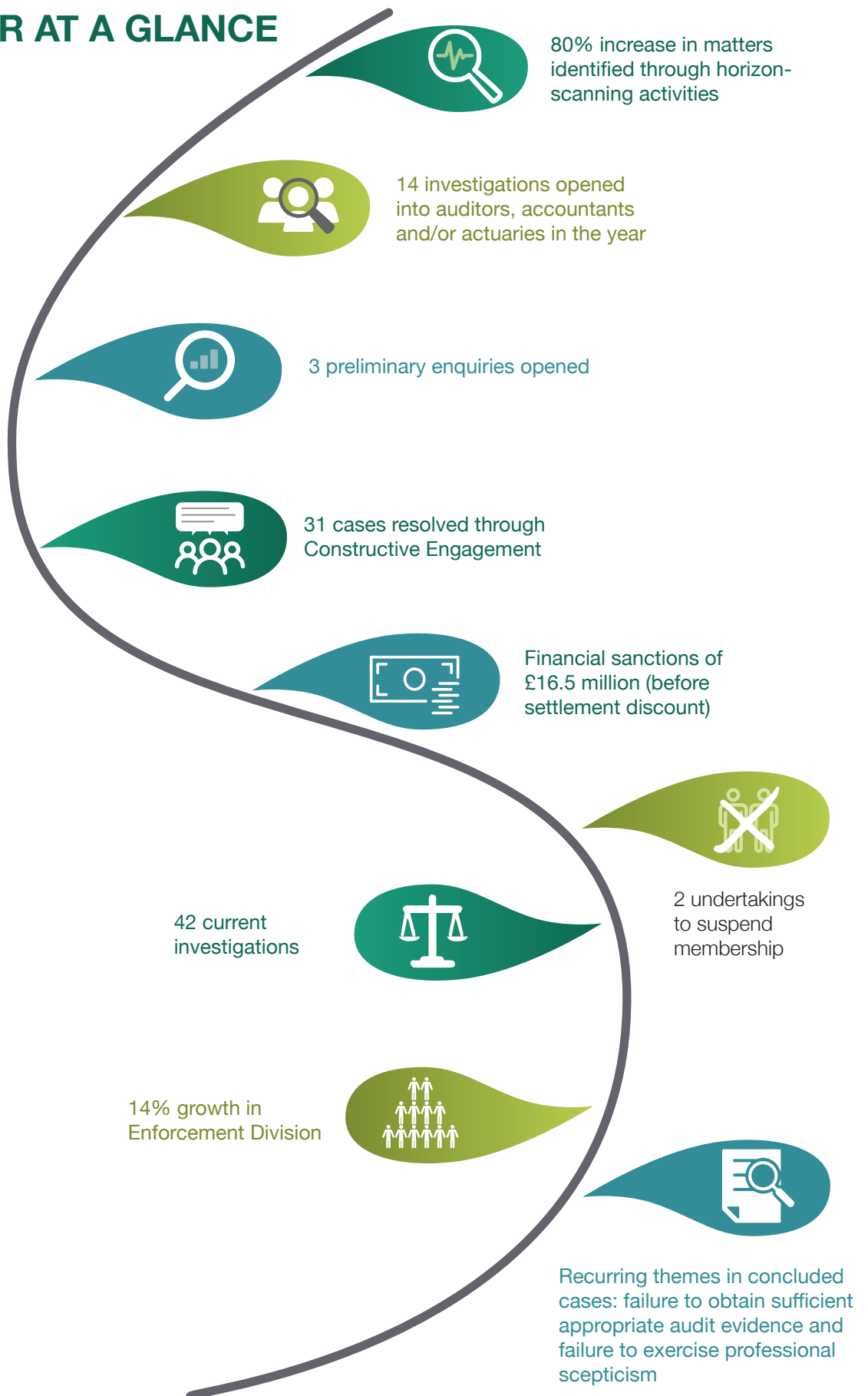
Looking ahead we will continue to monitor the impact of the Covid-19 pandemic, ensuring a proportionate and risk-based response, undertake a revision of the Audit Enforcement Procedure, and hold to account in the public interest those who fail to meet the necessary standards to ensure that financial statements are fit for purpose.



Elizabeth Barrett

Executive Counsel
and Executive Director
of Enforcement

2 THE YEAR AT A GLANCE



3 THEMES

Key underlying reasons for recurring audit failures in cases investigated over the past six years

The audit cases where we have taken enforcement action involve breaches of a number of auditing and ethical standards. However, the overwhelming majority of cases have involved a failure to obtain sufficient appropriate audit evidence (ISA 500) and a failure to exercise professional scepticism when assessing the decisions and judgements made by management (ISA 200).

Applying these auditing standards properly is essential for good audits. Work in other areas cannot compensate for failings in these areas and it is rightly an expectation of the public that, at the very least, these two aspects of audit are achieved.

Despite insufficient audit evidence and a lack of scepticism being a common issue raised in Audit Quality Review (AQR) inspections over a number of years, both Enforcement and AQR continue to encounter deficiencies in these areas.

In order to understand the underlying reasons for these common failures, we analysed our enforcement investigations in audit cases over the past six years. We identified six key themes, which are set out below.

1. Insufficient involvement of the audit partner and over-delegation to junior members of the team

Effective audits require an appropriate delegation and review structure to ensure all work is reviewed and issues are escalated appropriately. We have found a number of cases where the audit partner delegated work to junior members of the audit team, without retaining appropriate oversight.

In one case, the partner and senior manager had left the very junior team member to perform much of the work on the subsidiary audit. The junior was not made fully aware of the fact that the company was about to be sold and did not therefore consider the ramifications of the imminent sale on key audit judgements, such as the appropriateness of the going concern assumption.

We have seen many other audits where junior members of the team (including for example, newly qualified, partly qualified and even unqualified staff) have carried out work which is not checked or properly supervised by senior members of the team, or partners, who are too 'hands-off'.

This most commonly occurs in the areas of the audit which are perceived to be more straight-forward and requiring less judgement.

To be clear, the issue is not necessarily that the junior members of the team have insufficient knowledge. In fact, our experience of interviewing auditors is often that the juniors have good technical knowledge, having trained quite recently. It is the lack of supervision, i.e. ensuring the appropriate types of audit checks are carried out and the lack of proper communication with the junior members of the team, which has caused problems and ultimately audit failings. Where juniors have picked up issues, or raised concerns, in many cases these have not been properly escalated to sufficiently senior members of the audit team.

The overwhelming majority of cases have involved a failure to obtain sufficient appropriate audit evidence and a failure to exercise professional scepticism.

Over-delegation coupled with lack of supervision is a common source of audit failings.

Examples of inadequate work which we have seen as a result include:

- a failure to identify the most basic indicators of potential fraud;
- a failure to verify cash figures by reconciling with independent documentation provided by the bank (instead relying on management's own spreadsheets);
- a failure to properly check and record supplier's rebate figures against independent data, rather than management's own figures; and
- a lack of any challenge or interrogation of project and staff costs submitted by management to justify the treatment of all the costs as intangible assets.

2. Disorganised audit work

We have come across a number of audits where, having analysed the email traffic between the audit team, as well as the audit documentation, it is apparent that the audit work has lacked organisation.

Some audits of large groups of companies involve various teams working on different aspects of the audit or on different subsidiary companies within the group. In all audits, it is essential for the audit testing to be conducted, reviewed, checked and retained in an organised way. In large group audits, where this may be more challenging, we frequently see a lack of communication about the audit test results and sometimes confusion about whether certain tests were completed.

This disorganisation leads to lines of inquiry not being pursued to their conclusion, and parts of the financial statements being signed off without the testing being done properly.

Examples include:

- requests for support from other teams, with no follow-up and the audit being signed off without the work having been finished;
- overly complicated instructions and division of work within the wider audit team, resulting in the teams being unclear about what they were supposed to do, and relevant audit testing being missed;
- poor communication with and oversight of component auditors, with instructions being sent after fieldwork had either finished or was well underway; and
- conducting review work months after the field work was completed, making contemporaneous queries extremely difficult to deal with.

3. Failure to step back and take an overall look at the financial picture

Our experience in many investigations is that the audit work is conducted in silos, either by separate teams or with individual audit areas considered separately, with the risk that the audit partner and team do not stand back and ask themselves if the overall picture presented by the financial statements is sound. Red flags may only become apparent when looking across the audit as a whole.

In one investigation, audit work in various areas of the financial statements was reviewed by the FRC investigation team. In each of the areas, the accounting policies had been revised by management shortly before or during the time of the audit field work. The outcome of the changes all had the impact of increasing the revenue to be recognised (and ultimately increasing profit). In this case, the audit partner should have been aware of the accounting policy changes and should have exercised scepticism about management's motivation for making them. Had that been done, the partner would have identified that the amounts recognised were over-optimistic.

Disorganisation in audit teams leads to financial statements being signed off without lines of inquiry and testing having been properly carried out.

We have also observed a 'tick-box' culture regarding the audit testing in some cases. During interviews conducted of audit team members, it is clear that – whilst the team conducted tests – they were not actively thinking about the reasons for the tests or the bigger picture.

In more than one case where there have been issues regarding going concern, there was a clear failure to stand back and consider whether the going concern work achieved its purpose. In such cases, the audit team did not insist that the client conduct a going concern assessment. Instead they made do with the information presented.

4. Auditor too close to management

There is a common perception that in the past some auditors have been too close to management, which has made them reluctant to challenge management, and overly willing to sign off on accounts without exercising scepticism or scrutiny.

This issue has been extensively discussed over recent years (and has led to changes in law, such as the mandatory rotation of audit firms introduced by the EU audit directive) and we are seeing a shift in the culture of audit firms, such that auditor's independence is being re-asserted.

However, some of the audits we considered as part of this review show auditor/management relationships that are too close to enable auditors to exercise sufficient professional scepticism.

Where companies have been audited by a firm for a number of years, we have identified very close relationships between audit partners and the audited entity's management. This is further exacerbated when the audited entity is very large and the senior members of the audit team need to spend a very high proportion of their time throughout the year on that audit. In a number of cases, audit team members refer to 'we', 'us' and 'our company' when referring to the company they are auditing, indicating that they feel a part of the audited entity rather than seeing it as a separate entity over which their role is to exercise independent oversight.

Sometimes, in addition to thinking of themselves as a 'client' advisor, audit partners were more concerned with maintaining what was viewed as a 'client' relationship and making sure that the key individual at the 'client' viewed the firm favourably, than ensuring the quality of the independent audit work.

The greater the perceived significance of the audited entity to the audit team or to the firm, the greater the potential risk of threats to independence. This can particularly arise where the audit is being conducted by a regional office and the audited entity is significant (for example a large FTSE or a significant private company). In these situations, the audited entity is likely to be a significant source of audit work and fees for that office. Such a situation increases the risk that the audit team, whether consciously or not, seek to retain the important 'client', and are therefore less likely to exercise scepticism, and to risk a disagreement with management.

We have seen a "tick-box" culture to audit testing and a failure to stand back and see the bigger picture.

Auditors who develop close relationships with the companies they audit risk the quality of the independent audit work.

5. Failure to involve the audit quality assurance partner

Under ISQC 1¹, all audits of listed companies require an engagement quality control review, which is described as “a process designed to provide an objective evaluation, on or before the date of the report, of the significant judgements the engagement team made and the conclusions it reached in formulating the report”. Almost all of the audits which we investigate have an obligation to involve an engagement quality control review partner (EQCR).

In some cases, the EQCR failed to conduct an effective review of work done or to question the conclusions reached in the key areas of audit judgement that had been identified by the audit team.

We have seen examples where the EQCR is provided with material so late in the audit process that they are unable to conduct a meaningful review. Email analysis conducted as part of our investigations has shown the EQCR being sent key audit papers the day before they are due to be presented to audit committees.

We have also seen examples where the EQCR has been involved earlier and, in fact, has identified issues and raised questions, but these have not been effectively followed up by the audit team, or acted upon.

6. Use of auditors’ experts and specialists

In complex areas of audits, auditors often bring in expertise or specialists to assist. Common areas where this happens are the use of actuaries in relation to pensions or insurance audits or the use of IT specialists to undertake Computer Assisted Audit Techniques (CAATs) in audits of retail companies.

In our investigations, we have observed a lack of proper communication with the expert or specialist teams and also a tendency to accept their work unquestioningly.

Where experts, such as actuaries, are used it is important for auditors to consider carefully the adequacy of work done, and in particular to assess the reasonableness and adequacy of disclosure of key assumptions, and the consistency of the expert’s conclusions with all the other evidence obtained.²

In one case, reliance on actuaries led to the auditors performing little other work and ignoring numerous red flags on the basis that the actuaries would factor the information into their work. This led to untested assumptions and errors making their way into the audit conclusions.

We have also come across issues in the use of IT analysts in conducting CAATs, especially in the assessment of revenue. Whilst the engagement of specialist data teams can assist an audit, we have seen examples where, having enlisted the help of the specialist team, there is a disconnect between the data team and the audit team. The audit team did not understand what the data team were testing, and the data team did not understand the requirements of the audit.

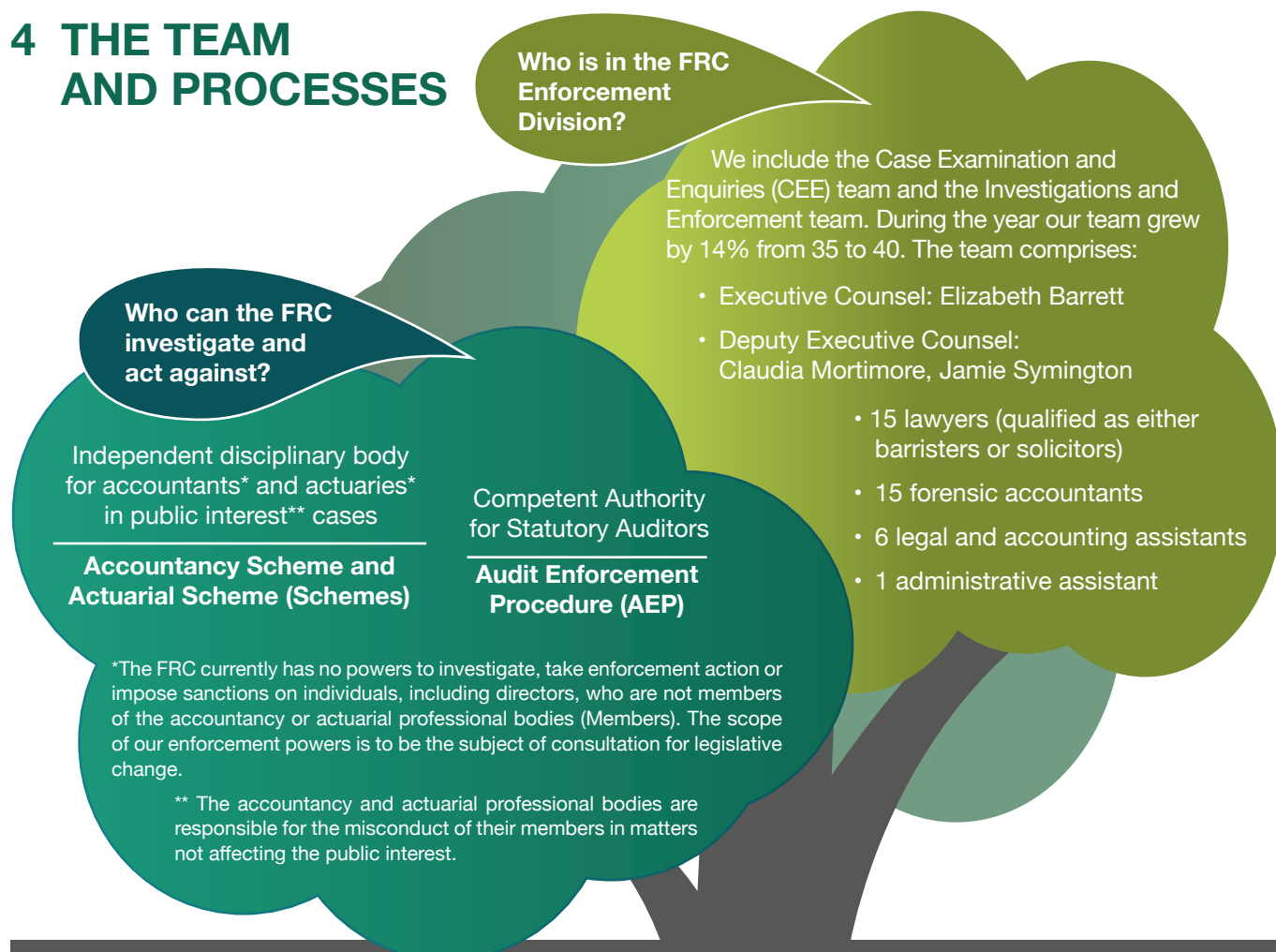
In some cases, auditors fail to involve EQCR partners early enough or meaningfully.

We have seen an unquestioning acceptance of the work conducted by auditors’ experts and specialists.

¹ ISQC1 (UK) is the UK’s Quality Control standard for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements. This is based on the IAASB’s International Standard on Quality Control 1 (ISQC1), adopted with minor additional material to reflect UK specific circumstances.

² The FRC AQR team also identified room for improvement in the use of actuaries in the audit of pension balances in their report ‘[The audit of defined benefit pension obligations](#)’ published in July 2018.

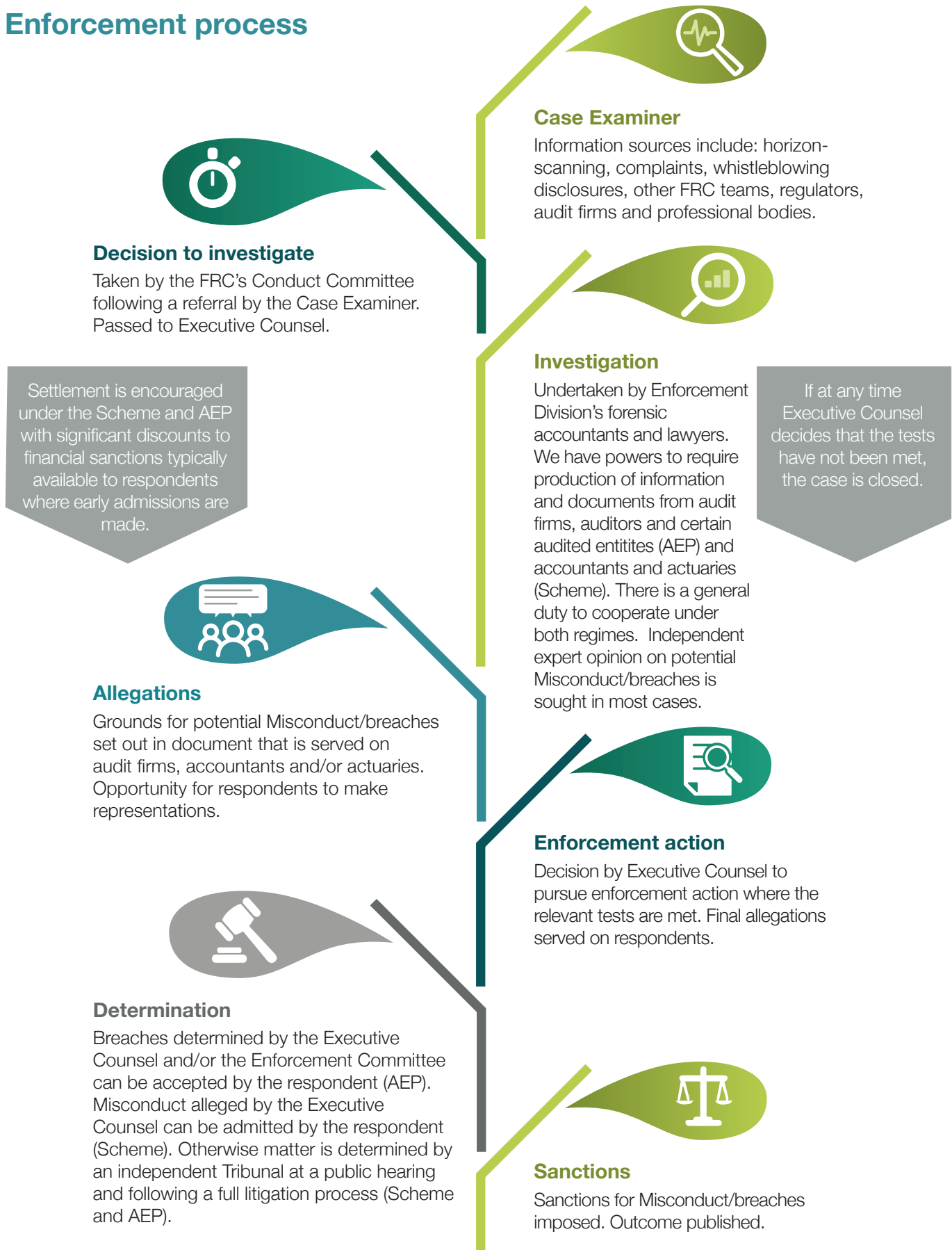
4 THE TEAM AND PROCESSES



Case Examination and Enquiries (CEE) – Intelligence-gathering, initial enquiries			
SOURCES		OUTCOMES	
<ul style="list-style-type: none"> • Horizon-scanning • Complaints • Whistleblowing disclosures • Referrals from other FRC teams, regulators, audit firms and professional bodies 		<ul style="list-style-type: none"> • Referral to Conduct Committee for decision on opening of investigation • Constructive Engagement (AEP only) • Referral to another FRC team • Referral to a professional accountancy or actuarial body or regulator • No further action 	
Investigations and Enforcement – Conduct of investigations referred by Conduct Committee			
OUTCOMES		SANCTIONS	
AEP: <ul style="list-style-type: none"> • Initial Investigation Report (IIR) • Decision Notice and proposed sanction • Accepted or Tribunal convened 	Scheme: <ul style="list-style-type: none"> • Proposed Formal Complaint / Formal Complaint • Settlement or Tribunal convened <p>At any point, Executive Counsel can close a case should the threshold for taking enforcement action not be met.</p>	Financial <ul style="list-style-type: none"> • Unlimited fines • Waiver of client fees 	Non-financial sanctions e.g. <ul style="list-style-type: none"> • Reprimand • Exclusion as a member of a professional body • Other conditions as appropriate
<p>Sanctions are determined by reference to the <i>Sanctions Policy (AEP)</i> and <i>Sanctions Guidance (Scheme)</i></p>			

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

Enforcement process



5 REVIEW OF THE YEAR

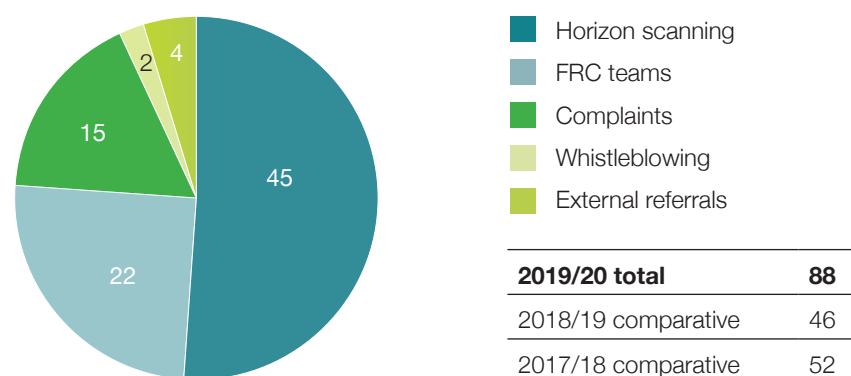
Case Examination and Enquiries (CEE)

2019/20 is the third full year since the Audit Enforcement Procedure (AEP) came into force and CEE was formed.

The AEP brought a significant shift in audit enforcement, with the expansion of the FRC's remit (to all PIEs, large AIM companies and Lloyd's Syndicates) and a change to the threshold for examining potential Statutory Audit failures (to breaches of Relevant Requirements as opposed to Misconduct). The AEP also introduced Constructive Engagement to deal with cases where the audit quality concerns can be appropriately and satisfactorily addressed, and the risk of repetition mitigated, without the time and expense of full enforcement action. Further details of the AEP and Constructive Engagement process are set out in Appendix A.

Cases opened in the year^{3, 4}

CEE cases opened (by source)



Eighty-eight cases were opened by CEE in the year compared to 46 in the previous year, an increase of 42, or 91.3%. There were increases in all source categories, particularly from our enhanced horizon scanning activities and also from other FRC teams, which in the current year comprised those arising from Audit Quality Review (AQR) inspections (13)⁵, from reviews of financial statements by Corporate Reporting Review (CRR) (5) and from existing Enforcement investigations (4)⁶.

Total number of new CEE cases nearly double previous year.

³ The enquires and outcomes data comprises all cases passing through a Case Examination process, including all audit matters dealt with under the AEP, and all Scheme matters progressed to the Conduct Committee, a small number of which were not dealt with by CEE.

⁴ The source category refers to the method by which a matter first came to our attention. It may be that matters we identify through horizon scanning activities are subsequently the subject of complaints or referrals.

⁵ Between July 2018 and December 2019, referrals from the AQR team were handled by a separate Case Examiner in AQR. All AQR referrals are now dealt with by CEE and the data presented here includes cases dealt with by the CEE Case Examiner and the former AQR Case Examiner.

⁶ Referrals from the Enforcement team relate to cases where potential breaches have been identified in additional audit years or where potential additional subjects have been identified in relation to an existing investigation under the AEP or the Schemes.

CEE received almost double the number of complaints and whistleblowing disclosures⁷ compared to the previous year. A similar number of external referrals were received this year from professional bodies and from audit firms (who had identified potential accounting Misconduct by Members employed or formerly employed at their audit clients).

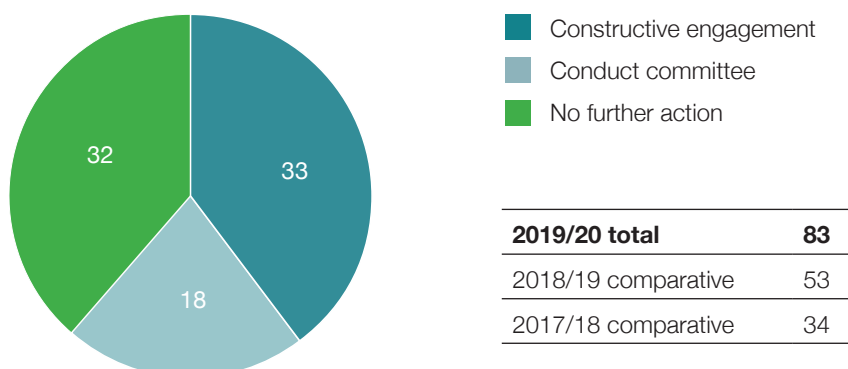
Similar to last year, the majority of cases opened were audit-related matters (89.8% compared to 87.0%). This reflects the lower threshold for examining auditors' conduct. The independent review of the FRC by Sir John Kingman published in December 2018 (the Kingman Review) recommended that the thresholds for examining accountants' conduct should be aligned with that for auditors. More details of the progress made in implementing the Kingman Review recommendations is set out in Section 8.

At 31 March 2020, 28 cases remained open, compared to 23 at 31 March 2019.

Number of new complaints and whistleblowing cases nearly double previous year.

Case outcomes⁸

CEE cases closed (by outcome)



Eighty-three cases were closed in the year, an increase of 30, or 56.6%, on the previous year and relatively in line with the increase in number of cases opened.

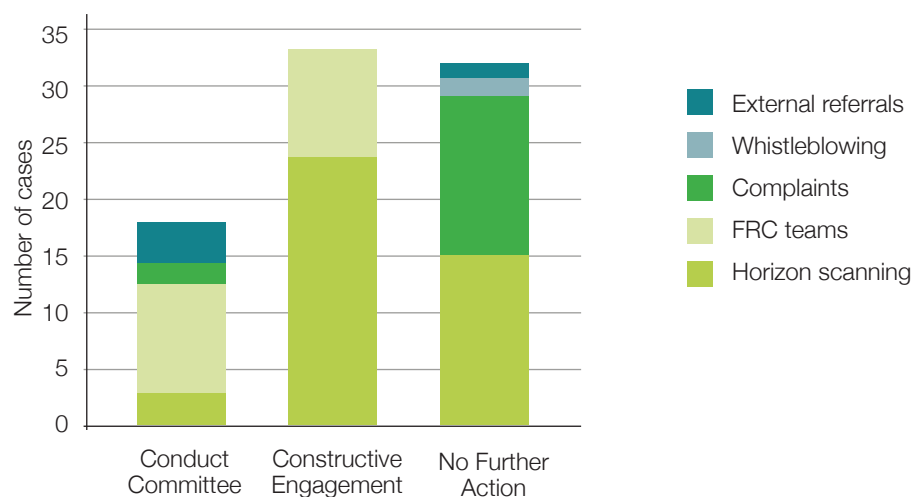
The breakdown of case outcomes has changed compared to 2018/19. A relatively similar number but a lower proportion of cases were referred to the FRC's Conduct Committee this year (21.6% compared to 28.3% in 2018/19), with more cases resolved through Constructive Engagement or closed with no further action being taken by the FRC. More details of the cases in each closure outcome are set out in the following sub-sections.

⁷ We use the term "whistle-blower" to include individuals who appear likely to have met, at any relevant point in time, the definition in the Public Interest Disclosure Act 1998.

⁸ Enquiries are regarded as closed at the point of referral for investigation by the Conduct Committee or when the decision is taken that no further enquiry work needs to be undertaken by the Case Examiner's team. Individual outcomes are not published, except where they lead to the opening of investigations and where, in accordance with the Publication Policies, it is considered appropriate to announce that investigation (see discussion of revised publication guidance on page 21).

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

Outcome of CEE cases with source detail



Referrals to the Conduct Committee

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

	Referred for investigation under the AEP or the Schemes	Referred for a preliminary enquiry under the Schemes	Referral to a professional body	Total
Audit	11	–	–	11
Accountancy	2	–	1	3
Actuarial	1	3	–	4
Total	14	3	1	18

The 18 cases referred to the Conduct Committee came from a variety of sources. Half of them were referrals from other FRC teams (including AQR, CRR and Enforcement), then there were four external referrals opened in the year, three referrals from our horizon scanning activities and two from complaints or whistleblowing disclosures.

All but one of these 18 cases were referred by the Conduct Committee for an investigation (under the AEP or the Schemes) or a preliminary enquiry (under the Schemes). Further details of the new investigations opened (to the extent that details may be given) are shown under Investigations and Enforcement later in this section. The remaining case was referred to an individual's professional body as the Conduct Committee decided it did not meet the criteria for consideration under one of the Schemes.

One further audit case referred to the Conduct Committee following an AQR inspection was referred back to the Case Examiner for resolution through Constructive Engagement. This case has now been closed and is included in the Constructive Engagement outcomes data.

The average time taken to refer a case to the Conduct Committee was just over three months. Only two cases took longer than six months to refer to the Conduct Committee. One of these was a case which was initially being dealt with by Constructive Engagement but events during the course of the Constructive Engagement exercise indicated that a referral to the Conduct Committee was appropriate, and the Conduct Committee decided there was a good reason to open an investigation.

Constructive Engagement

CEE continued its focus during the year on further developing the Constructive Engagement process as an effective and efficient alternative to referring qualifying cases⁹ for investigation.

Last year, we provided details of the most common causes of issues in cases resolved through Constructive Engagement. Building on that information, this year, as well as the continuing inclusion of anonymised case studies, we explain more about the types of cases we have resolved in this way, and the themes or trends arising.¹⁰

Thirty-three cases, involving a wide range of issues, were dealt with through Constructive Engagement during the year, an increase of 73.7% on the previous year. The source of these cases was our horizon scanning activities (24) and cases referred by other FRC teams (9). Two of these 33 cases were those that had been referred to the Conduct Committee which decided that there was not a good reason to open an investigation and referred the matter back to the Case Examiner to seek resolution through Constructive Engagement¹¹.

In resolving the 33 cases, we engaged with nine separate UK accounting firms and one in the Republic of Ireland. Twenty four (72.7%) of the 33 cases involved the “Big Four” accounting firms and 30 of the 33 cases (90.0%) involved the “Big Six”.

After engaging with the firms and reviewing appropriate information, we concluded that there was an Allegation¹² in 31 of the 33 cases. An example of one of the cases where we found no Allegation was an enquiry with an auditor in relation to the audit work conducted on the applicability of the use of the going concern concept and the adequacy of disclosures in the financial statements, in the context that the entity entered administration relatively shortly after the issue of the financial statements. In that case, we concluded that the audit work conducted, and the opinion reached, was reasonable.

⁹ See paragraphs 13 – 15 of the Guidance for Case Examiner which can be found [here](#).

¹⁰ The outcomes of individual Constructive Engagement exercises are not published.

¹¹ One of these was referred back in 2018/19 and one in 2019/20.

¹² Defined in the AEP as information which raises a question as to whether there has been a breach of a Relevant Requirement.

Average time for CEE to refer cases to the Conduct Committee was just over 3 months.

Number of cases dealt with through Constructive Engagement up 74%.

Over three quarters of the 31 cases where we decided there was an Allegation involved errors in financial statements which led to subsequent restatements. The suitability of each case for Constructive Engagement is determined on its own merits taking into account a range of factors. The reasons we concluded that these cases were appropriate for Constructive Engagement included that, taking into account evidence in the public domain, the errors appeared unlikely to have had a real impact on decisions taken by users of the financial statements. For example, the errors may have been only marginally material in a quantitative sense and they may have been in highly technical areas of the financial statements or in areas that were not of fundamental importance to the measurement of the underlying financial performance of the entity.

In the remaining cases, while there was no apparent underlying financial statement error, potential breaches of auditing standards had been identified through the inspection work conducted by AQR or by events in the public domain which warranted further enquiry as to how the auditors had approached the factors underlying those events. These cases were considered appropriate for resolving through Constructive Engagement as there was no apparent impact of the potential breaches on the financial reporting of the entities. Also, timely intervention through Constructive Engagement could result in remedial actions being taken by the audit firm in time for the following year's audit (as well as on a firm wide basis).

The average time taken to conclude the Constructive Engagement cases was under eight months. Excluding the cases arising from AQR referrals, which tended to take longer as a central part of the Constructive Engagement process involved monitoring the improvements in the following year's audit, the average time taken was seven months.

Across the 31 Constructive Engagement cases where we concluded there was an Allegation, the most common primary accounting areas encountered three or more times, were as follows:

- **revenue:** in these cases, either no evidence was available to us that there had been a material error (but deficiencies in the audit work had been identified), or there was an error which we concluded was likely to have had a relatively low impact, for example, the netting off of revenue or cost items that should have been shown separately with no impact on reported profit (6);
- **fraud or compliance with laws and regulations:** these cases included those where restatements arose after the discovery of relatively limited frauds with only a marginally material impact on group financial statements. They also involved cases where unlawful dividends had subsequently been identified (and rectified) (5);
- **reserves:** the most common issue in this category were errors in the presentation of reserves, particularly merger reserves (4);
- **cash flow statements:** in common with the work of other FRC teams, we followed up on cases involving errors in cash flow statements, often the incorrect classification of cash flows as, for example, operating rather than financing cash flows (3);
- **impairment:** impairment has been a recurring theme in the findings of other FRC teams. These cases involved restatements due to errors in management's impairment models which were subsequently corrected, and lack of challenge by the auditors to assumptions and other elements of impairment models (3); and
- **deferred tax:** these included issues arising in entities whose operations are largely overseas, giving rise to additional complexities in deferred tax computations (3).

Restatement of financial position required in three-quarters of cases resolved through Constructive Engagement.

Average time taken to conclude the Constructive Engagement cases was under eight months.

In these 31 cases, the most common root cause of the Allegations from the perspective of the audit work were as follows:

- insufficient audit testing, hence a failure to identify a material error in the primary financial statements, often in an area not regarded as a significant risk or area of audit focus, for example accounting for reserves, or deferred tax (22);
- failure to challenge or document the challenge to management's accounting treatment (7); and
- insufficient technical knowledge within the audit team (2).

In 27 of these 31 cases, bespoke remedial actions were agreed with the firms, usually on a firm-wide basis but in some cases specific to a particular audit. The latter occurred particularly in cases arising from AQR referrals, to ensure that the risk of repetition was adequately addressed. In the remaining four cases, we were satisfied that steps already taken by the firm had adequately addressed the risk of repetition.

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

- additional requirements for audit teams to consult with a firm's technical team in certain circumstances, for example where quantitatively material errors identified in an audit were not to be adjusted in an entity's financial statements;
- enhanced work to be carried out by specialists attached to an audit team, for example tax or actuarial specialists, and procedures for better communications between audit and specialist teams;
- additional audit procedures to be conducted on cash flow statements, impairment testing, accounting for reserves, distributions and journal entries;
- guidance directed to improving the level of documentation as to the rationale for conclusions reached by audit teams themselves or through consultation; and
- specific additional training on complex accounting or highly judgemental areas, including deferred tax, reserve accounting, compliance with laws and regulations, the identification of fraud and systems and controls testing.

Bespoke remedial actions were agreed with firms in over 87% of cases resolved by Constructive Engagement.

To illustrate the range of Constructive Engagement activity undertaken, three anonymised case examples are set out below:

Case A

A listed company restated its 2016 and 2017 balance sheet to correct an undetected error, which arose from the use of a discount rate that was not compliant with the methodology prescribed by IFRS.

We concluded that the information available amounted to Allegations in relation to the audit of the 2016 and 2017 financial statements on the basis that it raised a question as to whether the audit firm may have failed to comply with the requirements of ISA 620 by not:

- checking the competence of the actuarial expert they had relied upon;
- adequately evaluating “the relevance and reasonableness of the assumptions and methods in the circumstances” underlying the discount rate used; or
- adequately evaluating “the relevance, completeness, and accuracy of that source data” used by their actuarial expert.

One of the main reasons we concluded that the Allegations were suitable for Constructive Engagement was that the error was in an area which did not impact on the fundamental trading performance of the entity and, on that basis, we considered it unlikely that it would have impacted on the decisions made by users of the financial statements.

The remedial actions agreed with the firm were to provide an immediate briefing to:

- all audit partners to consider the methodology behind the assumptions used by an expert;
- all audit teams to consider the relevance, completeness and accuracy of an expert’s source data; and
- all audit teams to consider the competence of the expert, including making further enquiries to ensure the expert is qualified in the relevant area.

The firm also reviewed its audit manual and related guidance to ensure all the above elements were set out explicitly, and met with its external actuarial expert to explain required changes to their approach and the documentation prepared, in order to enable the audit firm to fulfil the ISA 620 requirements.

Case B

A listed company restated its 2016 and 2017 revenue (and cost of sales) due to a material error in the previous two years in its accounting for customer rebates. There was no material impact on reported gross profit and no impact at all on operating (net) profit.

The audit firm had identified the error in both 2016 and 2017 but management had refused to make an adjustment, on the basis that it was not “qualitatively material” as it did not impact net profit. The audit firm agreed with management’s position, allowing the adjustment to be postponed until 2018, when other adjustments would be made because of the introduction of a new accounting standard affecting revenue - IFRS 15.

We concluded that there were Allegations in relation to the audits of the 2016 and 2017 financial statements as the information available raised a question as to whether the firm may have failed to comply with the requirements of ISA 200, to apply adequate professional scepticism, and of ISA 450, to adequately evaluate the effect of a misstatement.

One of the main reasons we concluded that the Allegations were suitable for resolving through Constructive Engagement was that, although the error allowed the entity to report higher revenue growth in 2016 and 2017, which was a key performance indicator, there was no evidence available to us to suggest that this benefited management’s performance related remuneration, which was based on profit.

The remedial actions agreed with the firm comprised the immediate introduction of a requirement to consult with an independent central team before the issuance of an audit report on financial statements where a quantitatively material error has not been adjusted. This measure will provide independent scrutiny of uncorrected material misstatements and, if they remain uncorrected, additional evidence on the audit file to support the auditor’s view.

Case C

A listed company took a material charge to its 2018 income statement for non-compliance with legislation which had a 'direct effect on the determination of material amounts in its financial statements', going back to 2013. Neither the company's management nor the audit firm had identified the risk of non-compliance with the legislation as likely to have a direct effect on the financial statements. The audit firm therefore did not obtain sufficient evidence that the company was complying with the legislation.

We concluded that the information available amounted to Allegations in relation to the 2017 and previous years' audits as it raised a question as to whether the firm had failed to comply with ISA 315 (in terms of the adequacy of the risk assessment conducted) and/or ISA 250A (in relation to compliance with laws and regulations).

One of the main reasons we concluded that the Allegations were suitable for resolution through Constructive Engagement was that the non-compliance was not identified until after completion of the 2017 audit and, up until that point, had not been an area of enforcement focus for the relevant regulator. Therefore, it could reasonably be regarded as a sufficiently grey area for the 2017 and earlier audits as to whether there was a risk attaching to any non-compliance.

The remedial actions agreed with the audit firm to address the risk of repetition, in addition to firm-wide training on ISA 250 that had already taken place (which included a case study and an assessment), were preparation of a detailed technical update to all audit teams on the legislation relevant to this case, as well as further review of the firm's procedures in relation to the requirements of the new ISA 250A by the firm's audit leadership team.

The outcomes of our Constructive Engagement activity may be regarded as similar to the types of non-financial sanctions imposed at the conclusion of AEP investigations, designed to improve audit quality. While Constructive Engagement outcomes do not amount to a sanction, and are not individually published, they can result in potentially onerous requirements for audit firms. The process also requires full and open co-operation by audit firms and, during the year, we were generally satisfied with the level of co-operation and timeliness of responses we received.

The value of Constructive Engagement activity is also dependent on the new measures being appropriately followed by audit teams in practice. CEE monitors this through our ongoing processes and where appropriate will work with the FRC's AQR team in conducting follow up work. CEE will take further action if similar matters are identified in audits conducted by the same audit firms and recurring matters may also be a catalyst for referring a case to the Conduct Committee to consider opening an investigation.

CEE shares the themes arising from our Constructive Engagement work with audit firms in regular meetings, as well as the accountancy bodies, other regulators and other FRC teams. This is an area we shall further develop during 2020/21 as a means of sharing best practice.

No further action

There were 32 cases closed in the year where there was no action for the FRC to take under one of its enforcement schemes. Half of these cases came from complaints and whistleblowing activities, with the other half from our horizon scanning activities and external referrals. The average time taken to resolve such cases was just under three months.

In 20 of these 32 cases, the information which came to our attention involved at least one UK PIE or large AIM listed organisation, whose Statutory Audit would fall within our remit. We consider all such cases carefully and in detail to identify whether there may be underlying issues of relevance to the work conducted by the Statutory Auditors. However, on examination of the information available in these 20 cases, we found that there was no basis to support further enquiry into the audit. The reasons for this included one or more of the following:

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

In the remaining 12 cases, the issues or entities involved were not within the FRC's remit. The reasons for this included:

- the cases involved non-UK auditors or UK audit matters which the FRC has delegated to the Recognised Supervisory Bodies (RSBs)¹³ (for example the audits of privately owned companies);
- the cases involved complaints against individual accountants which were either more appropriately dealt with by their professional body, or there was insufficient evidence of Misconduct; or
- the matters did not involve the conduct of auditors, accountants or actuaries at all.

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

Oversight

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

¹³ Recognised Supervisory Bodies (RSBs) are: the Institute of Chartered Accountants in England and Wales (ICAEW), the Institute of Chartered Accountants of Scotland (ICAS), Chartered Accountants Ireland (CAI) and the Association of Chartered Certified Accountants (ACCA).

Investigations and Enforcement

Investigations opened

	2017/18	2018/19	2019/20
Investigations opened in year	14	15	14
Preliminary enquiries opened in year	-	1	3

The Conduct Committee opened 14 new investigations in the 12 months to 31 March 2020: 11 audit investigations under the AEP, 2 investigations into accountants under the Accountancy Scheme and one investigation under the Actuarial Scheme. Of these 14 investigations, seven were linked with ongoing investigations.

If the Conduct Committee considers that it does not have enough information to decide whether to open an investigation under the Schemes, it can direct Executive Counsel to conduct preliminary enquiries. Three such preliminary enquiries were opened during the year.

The AEP investigations

The 11 investigations concern a wide range of audit issues including revenue recognition, going concern, goodwill impairment, pensions, journal entry testing and inventory valuation. Five of the investigations opened by the Conduct Committee followed referrals to the Case Examiner from the FRC's AQR team, following audit inspections.

In accordance with the FRC's Publication Policies¹⁴, not all investigations are announced at the outset, although if the case leads to enforcement action and the imposition of sanctions, the outcome will be published. The Conduct Committee makes the decision whether or not to announce a new investigation on a case-by-case basis. It will not normally decide to announce the opening of an investigation unless it considers that such publication is necessary in all the circumstances and any potential prejudice to the subject of an investigation is outweighed by the factors in favour of publication (see Revised publication guidance box below).

The two¹⁵ new AEP investigations, both related to the same company¹⁶, which have been announced are:

- Ernst & Young's audit of the financial statements of Thomas Cook Group plc for the year ended 30 September 2018; and
- Ernst & Young's audit of the financial statements of Thomas Cook Group plc for the year ended 30 September 2017.

¹⁴ See revised publication guidance box below.

¹⁵ Four investigations were announced in 2018/19.

¹⁶ Under the AEP, a new investigation must be commenced if additional matters are identified outside the scope of the initial investigation. In this instance, matters in the preceding audit year were identified leading to the opening of a second investigation under the AEP.

Number of new enforcement investigations opened remained steady.

The Accountancy Scheme investigations

Two new investigations under the Accountancy Scheme were opened. In accordance with our Publication Policy, neither of these was announced. Given the differences in the threshold for investigation, it is to be expected that fewer cases satisfy the criteria for opening an investigation under the Accountancy Scheme than under the AEP. One of the new investigations involves the conduct of a Finance Director of a listed company in respect of the preparation of financial statements, and the other concerns the ethical conduct of an accountant.

The Actuarial Scheme investigations

One new investigation under the Actuarial Scheme was opened. This was not publicly announced. Taking into account this investigation and preliminary enquiries, we have seen an increase in our work under the Actuarial Scheme this year, arising from complaints to the Institute and Faculty of Actuaries (IFoA) which have been referred to us and from complaints made directly to us.

Preliminary Enquiries

Three preliminary enquiries under the Schemes were opened in 2019/2020; two concern actuaries. In accordance with the Publication Policy, it will not normally be appropriate for preliminary enquiries to be announced.

Revised publication guidance

The FRC's Publication Policies, which are determined by the Conduct Committee, were amended and reissued in Autumn 2019 and again in June 2020. The current Publication Policies¹⁷ contain further guidance on when it may be appropriate to announce the opening of an investigation.

In order to determine that an announcement is necessary in all the circumstances, the Committee must consider that the announcement will:¹⁸

- help to maintain public confidence in Statutory Auditors, the accountancy or actuarial professions;
- help to maintain public confidence in the regulation of these professions;
- protect users of financial statements;
- protect investors;
- help to prevent malpractice that is potentially widespread;
- contribute to the effectiveness of the investigation itself, for example by bringing forward witnesses;
- help to allay concern; or
- help to contain speculation or rumour.

If an investigation leads to enforcement action and the imposition of sanctions, the sanctions applied, and type and nature of the contravention will be published. While this is a mandatory announcement under the AEP Publication Policy (and there is similarly a presumption in favour of publication under the Accountancy and Actuarial Schemes Publication Policy, which can only be rebutted if the publication is not in the public interest), the FRC is prohibited from publishing the identity of a person sanctioned under the AEP where:¹⁹

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

The identity of third parties will usually be anonymised in any announcements and/or related documents published under this Publication Policy, unless or to the extent that publication of that party's identity is considered fair and necessary in all the circumstances and is in compliance with any applicable data protection laws.²⁰

The identity of the audited entity will usually be published in any announcements in relation to the outcome of investigations, unless and to the extent that identity of the audited entity is considered to be unfair and unnecessary in the circumstances.²¹

The FRC announced sanctions against Grant Thornton and one of its Statutory Auditors during December 2019 in respect of the Statutory Audit of the 2016 financial statements of a publicly listed company²². In this case, the FRC did not publish the name of the Statutory Auditor in accordance with paragraph 18 of the AEP Publication Policy.

¹⁷ Links to the Publication Policies are here: [Schemes Publication Policy \(revised June 2020\)](#); [AEP Publication Policy \(updated June 2020\)](#).

¹⁸ Paragraph 11 of the [AEP Publication Policy \(updated June 2020\)](#) and paragraph 16 of the [Schemes Publication Policy \(revised June 2020\)](#).

¹⁹ Paragraph 18 of the [AEP Publication Policy \(updated June 2020\)](#).

²⁰ Paragraph 28 of the [AEP Publication Policy \(updated June 2020\)](#).

²¹ Paragraph 29 of the [AEP Publication Policy \(updated June 2020\)](#) and paragraph 23 of the [Schemes Publication Policy \(revised June 2020\)](#).

²² Press Notice: [Sanctions against Grant Thornton](#).

Concluded cases

Outcome of investigations

	Closed with no further action	Closed with findings of Misconduct /breaches and sanctions		Total
		Settlement	Tribunal	
2017/18	3	5	1	9
2018/19	1	8	4	13
2019/20	4	8	1	13

Thirteen cases were concluded in the 12 months to 31 March 2020, the same number as in 2018/19. As with last year this is slightly lower than the number of cases opened in the same period, continuing the theme of a build in the net number of open cases.

Preliminary enquiries into one accountant were also closed.

Cases concluded with sanctions

The FRC has published outcomes of nine investigations which have resulted in sanctions being imposed on audit firms and individuals.

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

PwC / Redcentric plc / AEP

In May 2019, a Final Decision Notice was issued following admissions of breaches of Relevant Requirements by PwC and the relevant audit partners for each year in relation to the 2015 and 2016 audits of Redcentric plc.

The breaches concerned failures in four areas of the audit: audit planning; work on cash; work on revenue and debtors; and work on costs and liabilities.

PwC received the following sanctions: a financial sanction of £6,500,000 (discounted to £4,550,000 for settlement), a Severe Reprimand, a declaration that the Statutory Audit reports did not satisfy the Relevant Requirements, and a requirement 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.

Each of the two audit partners received financial sanctions of £200,000 (discounted to £140,000 for settlement), and Severe Reprimands. In addition, and as a condition of Executive Counsel accepting the respondents' agreement to the Decision Notice, additional training has been performed by each audit partner.

KPMG / BNY Mellon entities / Accountancy Scheme

In June 2019, the Tribunal imposed sanctions on KPMG and a partner in relation to their Client Asset Reports in respect of The Bank of New York Mellon entities for 2011. KPMG and the partner had previously admitted Misconduct under the Accountancy Scheme.

The Tribunal found that the Misconduct consisted of a failure to understand and to apply the fundamental rules of the Client Assets Sourcebook (CASS), requiring the banks to keep their own records and carry out their asset reconciliations on their own legal entity basis.

The Tribunal imposed the following sanctions on KPMG: a fine of £5,000,000 (discounted to £3,500,000 for admissions), a Severe Reprimand, and a requirement for a quality performance review process in relation to Client Asset Reports, and written reports to the FRC, for three years.

The Tribunal imposed a fine of £75,000 (discounted to £52,500 for admissions) and a Reprimand on the partner.

Audit Partner / Serco Geografix Limited / Accountancy Scheme

In September 2019, a settlement agreement was approved after the audit partner admitted Misconduct in relation to the 2012 audit of Serco Geografix Limited. Deloitte had previously entered into a settlement agreement in relation to the audit in 2018/2019.

The Misconduct involved a failure to act in accordance with the Fundamental Principle of Professional Competence and Due Care (no further details have been published at this stage).

The audit partner received a fine of £120,000 (discounted to £78,000 for settlement) and a Severe Reprimand.

Grant Thornton / a publicly listed company / AEP²³

In November 2019, a Final Decision Notice was issued in relation to Grant Thornton and one of its audit partners regarding the 2016 audit of a publicly listed company.

The admitted breaches of Relevant Requirements relate to the audit work carried out on the company's principal assets, and an area identified as a significant risk. The breaches included failure to obtain sufficient appropriate audit evidence, failure to exercise sufficient professional scepticism and failure to prepare adequate audit documentation.

Grant Thornton received a financial sanction of £650,000 (discounted to £422,500 for settlement) and a declaration that the Statutory Audit report did not satisfy the Relevant Requirements.

The audit partner received a financial sanction of £20,000 (discounted to £13,000 for settlement) and a declaration that the Statutory Audit report did not satisfy the Relevant Requirements.

²³ This was the first case that engaged the prohibition set out at paragraph 18 of the [AEP Publication Policy \(updated June 2020\)](#). See revised publication guidance box above.

KPMG / a publicly listed company / AEP²⁴

In December 2019, a Final Decision Notice was issued in relation to KPMG and one of its audit partners regarding the 2016 audit of a publicly listed company.

The admitted breaches of Relevant Requirements concerned the failure to apply sufficient professional scepticism, or to obtain and document sufficient appropriate audit evidence, in relation to the Statutory Audit of the company's reporting of two distinct categories of complex supplier arrangements, which were material to the consolidated income statement.

KPMG received a financial sanction of £700,000 (discounted to £455,000 for settlement), a Reprimand, a declaration that the Statutory Audit report did not satisfy the Relevant Requirements, and a requirement for a quality performance review by KPMG's London office of three Statutory Audits undertaken by the relevant audit partner within a period of two years from the date of the Decision Notice, to be reported annually to the FRC.

The audit partner received a financial sanction of £45,000 (discounted to £29,250 for settlement), a Reprimand and a requirement to undertake appropriate training, in a format to be agreed with the FRC.

Grant Thornton / Conviviality Retail plc / AEP

In March 2020, a Final Decision Notice was issued against Grant Thornton following admissions of breaches of Relevant Requirements in relation to (i) firmwide failures in its control environment and policies and procedures designed to ensure compliance with Ethical Standards and requirements between 2014 and 2017, and (ii) the loss of independence in relation to its 2014 audit of Conviviality Retail plc.

Grant Thornton received the following sanctions:

- a financial sanction of £3,000,000 (discounted to £1,950,000 for settlement);
- a Severe Reprimand;
- a declaration that the Statutory Audit report did not satisfy the Relevant Requirements; and
- a package of non-financial sanctions comprising measures to be taken by the firm directed at improving the quality of future audits, including the establishment of an Ethics Board who will report to the FRC for three years, a review of the Ethics Function, increased training and further improvement to policies and procedures.

²⁴ This was the first case that engaged paragraph 28 (formerly paragraph 27) of the [AEP Publication Policy \(updated June 2020\)](#). See revised publication guidance box above.

Former Audit Partner / Conviviality Retail plc / AEP

In March 2020, a Final Decision Notice was issued against a former audit partner following admissions of breaches of Relevant Requirements in respect of Grant Thornton's 2014 audit of Conviviality Retail plc.

The admitted breaches of Relevant Requirements include breaches of Ethical Standards and the fundamental principle of Integrity.

The former audit partner received a Severe Reprimand and a permanent prohibition banning him from signing audit reports.

Former Senior Manager / Conviviality Retail plc / Accountancy Scheme

In March 2020, Executive Counsel entered into a settlement agreement²⁵ with a former senior manager in respect of Misconduct relating to Grant Thornton's 2014 audit of Conviviality Retail plc.

The former senior manager received a Severe Reprimand.

KPMG / Foresight 4 VCT plc / AEP

In March 2020, a Final Decision Notice was issued against KPMG following admissions of breaches of Relevant Requirements in relation to the 2013, 2014 and 2015 audits of Foresight 4 VCT plc.

The admitted breaches of Relevant Requirements related to failures by the auditor to obtain sufficient appropriate audit evidence regarding distributable reserves, and to document their consideration regarding the same.

KPMG received a Reprimand and an order requiring it to monitor its audit teams' adherence to a new standard audit work paper and report to Executive Counsel on that monitoring.

This is the first case resolved where the investigation was conducted by one of the RSBs, in this case the ICAEW, having been delegated by the FRC's Conduct Committee.

Closed cases

Four investigations under the AEP were closed without enforcement action. In all these cases it was determined that the threshold for taking enforcement action was not met. The commencement of these investigations was not announced, and, in accordance with the Publication Policy, it was not considered appropriate to publish the decision to close the investigation.

²⁵ In accordance with paragraph 8(4) of the Accountancy Scheme, the settlement was approved by a legal member of the Tribunal panel.

Ongoing cases as at 31 March 2020

As at 31 March 2020, there were 42 open cases²⁶: 27 investigations into individuals and firms for audit work²⁷; two investigations into individuals and firms for non-audit work and 13 investigations into Members who are either Professional Accountants working in business or actuaries. In addition, there were three ongoing preliminary enquiries. This represents a slight numerical increase in cases when compared to 2018/19 (41 investigations and one preliminary enquiry).

Of the 27 audit investigations, one is being investigated under the Accountancy Scheme and the remaining 26 are under the AEP. Three of the AEP investigations have been delegated to the ICAEW, which conducts the investigation and remits the matter to the Enforcement Division for Executive Counsel to serve the Initial Investigation Report (IIR).

The audit investigation under the Accountancy Scheme relates to Deloitte's audit of the financial reporting of Autonomy Corporation plc between 1 January 2009 and 30 June 2011²⁸.

Of the 26 audit investigations under the AEP, 10 have been announced:

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

²⁶ A case will comprise one of the below: i) an audit investigation into an audit firm and audit partner(s) (under the Accountancy Scheme or the AEP); ii) an investigation into Professional Accountant(s) working in business (under the Accountancy Scheme); iii) a non-audit investigation into Professional Accountant(s) and accountancy firms (under the Accountancy Scheme); iv) an investigation into actuaries (under the Actuarial Scheme). Each case may include multiple subjects, and a case is not deemed to be closed until concluded against all subjects.

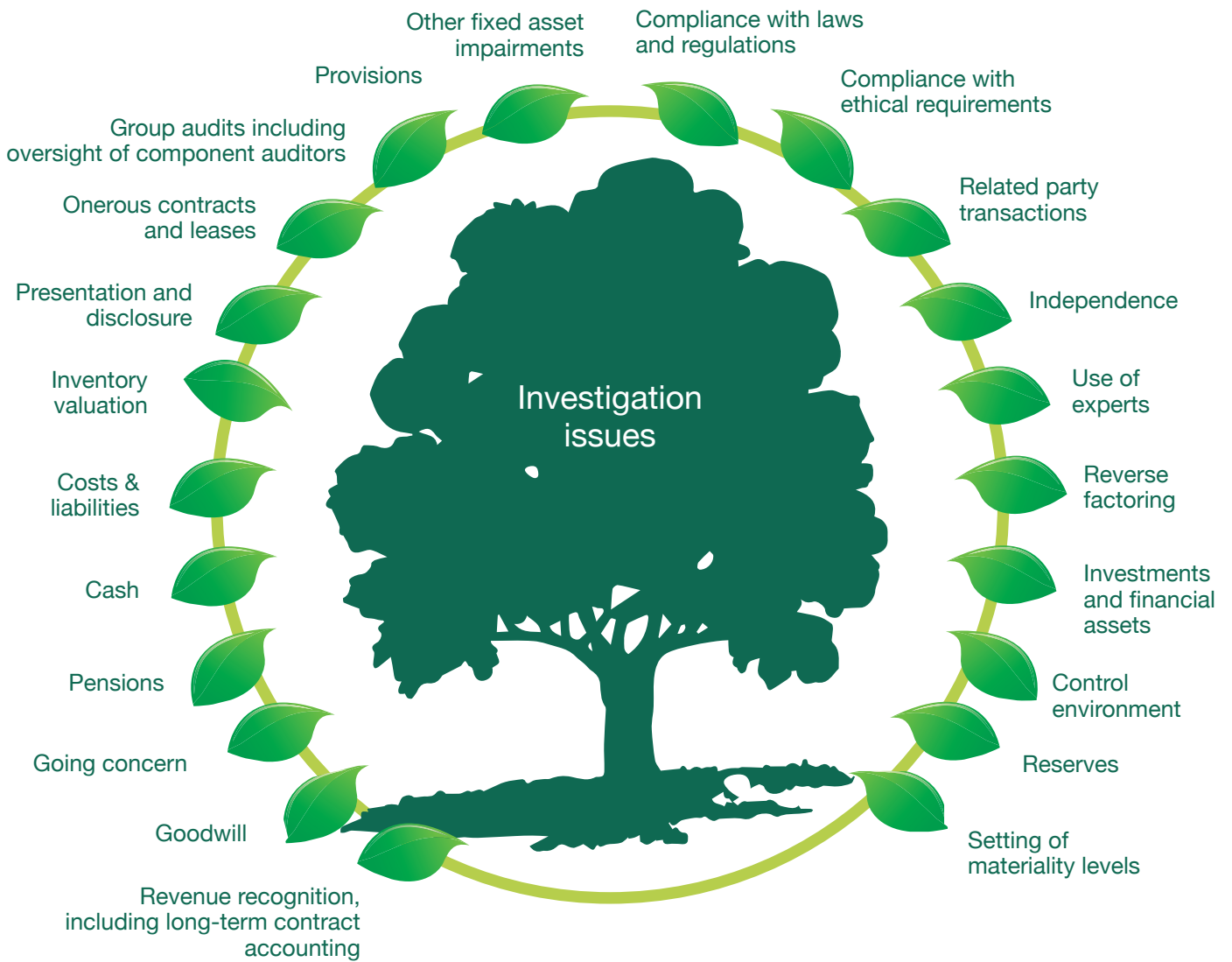
²⁷ Audit work includes audit of Client Asset Reports.

²⁸ See further at page 29.

Number of ongoing cases open at the financial year end rose slightly to 42.

The 27 investigations concern a wide range of areas of the audit.

These are set out below:



All open investigations in relation to Members who are either Professional Accountants working in business or actuaries are linked to audit investigations and therefore concern many of the same issues. Of the 13 investigations, 10 have been announced, and relate to:

- published financial reporting of Autonomy Corporation plc for the period between 1 January 2009 and 30 June 2011;
- preparation and approval of the financial statements of Tesco plc for the financial years ended 25 February 2012, 23 February 2013 and 22 February 2014 and conduct in relation to the matters reported in the company's interim results for the 26 weeks ended 23 August 2014²⁹;
- preparation and approval of the financial statements of Quindell plc for the period ended 31 December 2011 to the year ended 31 December 2013 and the interim results for the half year ended 30 June 2014;
- the conduct of Members of the Actuarial and Accountancy professions in connection with the pension schemes of various companies within the Guinness Peat Group (now renamed Coats Group plc) between 2004 and 2012;
- preparation and approval of the financial statements of Sports Direct International plc for the 52 week period ended 24 April 2016;
- preparation and review of financial information relating to Redcentric plc for the financial years ended 31 March 2015 and 2016;
- preparation and approval of the financial statements for Mitie Group plc for the year ended 31 March 2016;
- preparation and approval of the financial statements of Carillion plc for the years ended 31 December 2014, 2015 and 2016, and the six months ended 30 June 2017, the preparation and reporting of other financial information during the period 2014-2017, and certain matters relating to the financial statements for the year ended 31 December 2013;
- preparation and approval of Conviviality plc's financial statements and other financial information; and
- preparation and approval of Patisserie Holdings plc's financial statements and other financial information.

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

- matters related to an engagement carried out by KPMG LLP and one of its insolvency partners between January 2011 and April 2011 relating to companies trading under the name "Silentnight"; and
- provision of materials to the FRC by KPMG in connection with the FRC's Audit Quality Review into aspects of the audit of Carillion plc for the year end 2016.

It is not uncommon for other regulators to investigate the conduct of individuals, particularly Professional Accountants working in business, who are also subject to FRC investigations. Although all cases are fact specific, there may be circumstances where the FRC decides to pause its investigation due to developments in the parallel proceedings. As part of this process and in order to protect the public, it may be necessary to obtain interim suspensions of membership against those persons whose FRC proceedings are paused.

²⁹ [The FRC announced the closure of this investigation on 8 June 2020.](#)

This year the FRC obtained voluntary undertakings from two Members suspending their accountancy body memberships and restricting their ability to carry out accountancy work, in cases where there is a temporary pause of the FRC's proceedings. There have been no public announcements in relation to these interim outcomes due to the nature of the parallel proceedings.

Preliminary enquiries

As at 31 March 2020, there were three ongoing preliminary enquiries, all of which commenced within the year. Preliminary enquiries will usually be conducted by lawyers and forensic accountants within the Enforcement Division, but assistance from external specialists, for example subject matter experts, can also be sought. Following the conclusion of preliminary enquiries, the Conduct Committee decides whether these matters should be investigated under the Schemes.

High-profile cases

As can be seen from the list of published investigations, we continue to investigate a number of substantial high-profile cases in the public interest which absorb considerable resource to progress alongside all other investigations. It is not appropriate to publish detailed updates on our investigations as this would risk jeopardising the integrity of the investigation and/or potentially causing unfairness to those under investigation. Given the exceptional public interest arising from the collapse of Carillion, the FRC has provided progress updates on the investigation, including most recently in January 2020³⁰. In October 2019, Executive Counsel also appeared before the Select Committee in relation to the Thomas Cook inquiry.

Tribunal hearings

In May 2019, an independent Tribunal chaired by Sir Stanley Burnton was convened to determine appropriate sanctions in relation to the respondents' admitted Misconduct.³¹ The Misconduct related to Client Asset Reports made to the Financial Conduct Authority (FCA) in 2011, in respect of two BNY Mellon entities. At the time of the reports, the BNY entities had custody of client assets valued at over a trillion pounds. The issue of sanctions, including the level of any financial penalty, was highly contentious. The Tribunal sat for three days, hearing expert evidence instructed by both parties and legal submissions from counsel, and considering volumes of contemporaneous material, to determine the seriousness of the Misconduct and the potential risks arising from the respondents' failures.

A Formal Complaint against Deloitte and two audit partners in relation to the audit of Autonomy Corporation plc was heard before an independent Tribunal chaired by Lord Dyson during October and November 2019. The proceedings lasted for seven weeks and we expect to receive a final decision from the Tribunal later this year. A vast amount of material and evidence was considered by the Tribunal at what is our longest contested hearing to date. A significant amount of time and resource was expended by the FRC's internal and external legal teams in order properly to prepare for a hearing of this scale involving serious allegations of lack of integrity, objectivity and competence. A lengthy and complex investigation into the conduct of the respondents preceded the Tribunal hearing.

³⁰ [FRC update on investigation in relation to Carillion.](#)

³¹ A summary of the case is included at Appendix B.

We continue to investigate substantial high-profile cases in the public interest which absorb considerable resource.

High Court litigation

Sports Direct International plc

In February 2019, the Court of Appeal gave their ruling in *Sports Direct International plc v Financial Reporting Council*³², reversing in part the 2018 decision of the High Court. The issue concerned an application to the High Court for an order against an audited entity (Sports Direct) in respect of its failure to comply with a statutory notice requiring the production of documents, pursuant to the Statutory Auditors and Third Country Auditors Regulations 2016/649 (SATCAR) and the AEP.

The Court of Appeal decided that the High Court was wrong to order Sports Direct to disclose privileged documents to the FRC for the purposes of the FRC's investigation into its auditors. In the Court's view, such disclosure would amount to an infringement of Sports Direct's privilege, even though the FRC is not investigating Sports Direct itself.

The Court of Appeal concluded that the fact that the FRC's investigatory powers may be hindered as a result of privilege being asserted is not sufficient to imply an override of privilege given the language of SATCAR.

The Court of Appeal also confirmed that the High Court was correct to find that pre-existing documents which are attached to emails are not necessarily legally privileged just because the covering emails are. Attachments should be assessed independently and, if they are not privileged, they should be provided to the regulator if formally requested. Sports Direct is seeking permission from the Supreme Court to appeal this finding.

The Court of Appeal has ruled that under current legislation the FRC's powers are not sufficient to obtain privileged documents of an audited entity for an investigation into its auditors.

³² [2020] EWCA Civ 177.

6 SANCTIONS

Introduction

During 2019/2020, the FRC imposed sanctions in nine cases in relation to audit matters.

Sanctions

The overall sanctions imposed during a year depend on the number and nature of cases which have arisen for sanctioning purposes. This year, a range of financial and non-financial sanctions have been imposed on audit firms and individuals, with a key objective of driving audit quality. Sanctions are imposed in accordance with our published Sanctions Policy and Guidance³³ which came into force in June 2018 following the independent review of sanctions conducted by Sir Christopher Clarke.

The number of financial sanctions imposed in the year to 31 March 2020 was the same as two years ago, with a slight increase in the total amount before discount, after 2018/19 which saw both high volumes and larger financial sanctions reflecting the seriousness of the cases concluded in that year. The level of discounts offered has increased from 15% to 32% reflecting improved co-operation and earlier settlement by firms.

	2017/18	2018/19	2019/20
Total financial sanctions imposed:			
• Pre-discount	£15.5m	£42.9m	£16.5m
• Post-discount	£13.1m	£32.0m	£11.3m
Number of financial sanctions imposed	11	27	11
Number of non-financial sanctions imposed	11	38	27
Of which:			
• Exclusions	2	6	-
• Requirements and Undertakings	-	9	10

We imposed sanctions in nine cases in relation to audit matters, with a mix of 11 financial and 27 non-financial sanctions in order to improve audit quality.

The total sum of financial sanctions imposed was £16.5m (£11.3m after settlement discounts).

³³ Links to the sanctions policies are here:

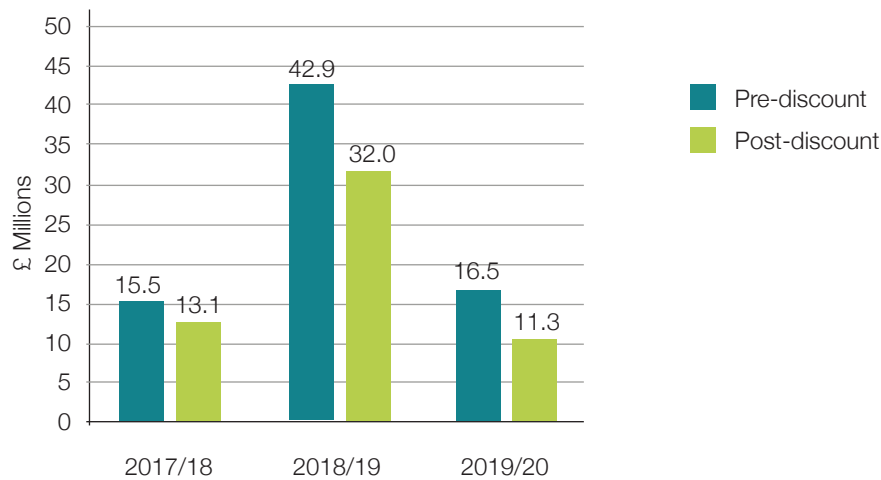
[Sanctions Policy \(Audit Enforcement Procedure\) \(effective from 1 June 2018\).](#)

[Accountancy Scheme Sanctions Guidance \(effective from 1 June 2018\).](#)

[Actuarial Scheme Sanctions Guidance \(effective from 1 June 2018\).](#)

Financial Sanctions

Total Financial Sanctions



Financial sanctions against audit firms

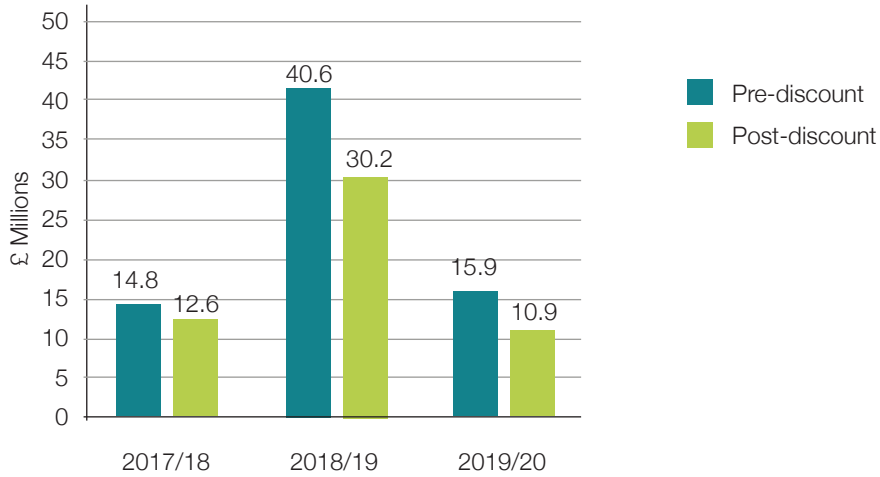
The FRC has imposed financial sanctions on audit firms in five matters during the year. The total amount of financial sanctions on audit firms alone (pre-discount for settlement) was £15.9 million.

Under the AEP, Statutory Auditors and Statutory Audit firms can be liable for enforcement action for breaching auditing and ethical standards. This is a lower threshold test for liability than that prescribed under the Accountancy Scheme where Members are only liable for Misconduct which includes falling significantly short of the standards reasonably to be expected. This lower threshold test for liability under the AEP has seen the FRC take enforcement action in certain cases against firms and individuals for conduct in breach of standards which would not necessarily amount to Misconduct. In these circumstances, and in order to achieve a fair and proportionate outcome that is also in the public interest, lower financial sanctions have been imposed for such breaches. In one case this year, no financial sanction on the audit firm was required to achieve the objectives of the AEP in accordance with the Sanctions Policy.

Four of the five financial sanctions imposed on audit firms in the year were in relation to investigations conducted under the AEP, with one under the Accountancy Scheme.

We imposed financial sanctions on audit firms in five investigations.

Financial sanctions – Audit firms

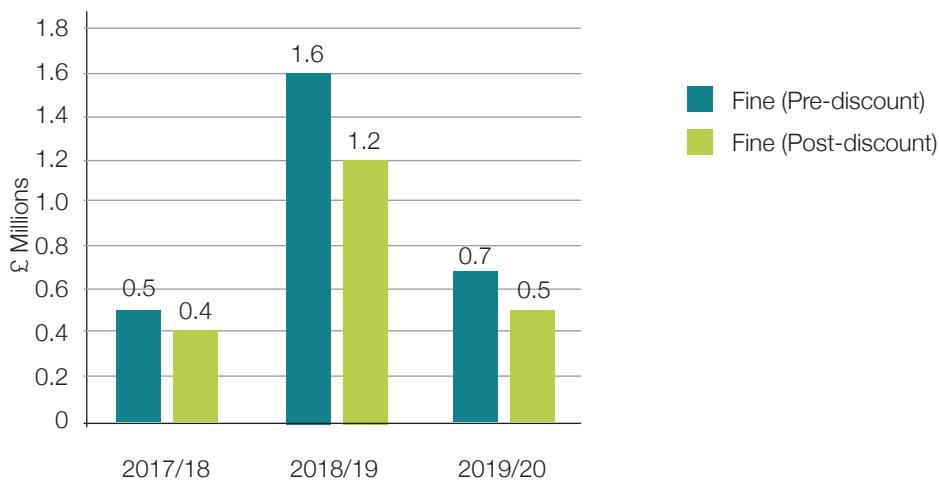


	2017/18	2018/19	2019/20
Number of financial sanctions against audit firms	4	9	5

Financial sanctions against audit partners

The total amount of financial sanctions on audit partners (pre-discount for settlement) was £0.7 million.

Financial sanctions – Audit partners



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

	2017/18	2018/19	2019/20
Number of financial sanctions against audit partners	4	13	6

We imposed financial sanctions on six audit partners.

Financial sanctions against accountants

No financial sanctions have been imposed on Members who are either Professional Accountants working in business or actuaries in the year to 31 March 2020.

Non-financial sanctions

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

- a requirement for a quality performance review process affecting each person who signs a Client Asset Report on behalf of KPMG, and a requirement to provide written reports to the FRC on the details, conclusions and actions arising from the reviews. The review requirement is to last three years. Each person who signs a Client Asset Report during that period shall be subject to at least one quality performance review in respect of their CASS audits;
- a requirement that PwC supplement the monitoring and support of the Leeds Office audit practice on terms which have been agreed with the FRC;
- a requirement for a quality performance review by KPMG's London office of three Statutory Audits undertaken by the relevant audit partner within a period of two years from the date of the Decision Notice, to be reported annually to the FRC;
- a requirement for an audit partner at KPMG to undertake appropriate training, in a format to be agreed with the FRC;
- an agreement that Grant Thornton will establish an Ethics Board who will report to the FRC for three years, will review its Ethics function and will increase training and make further improvements to its policies and procedures;
- a permanent prohibition banning an audit partner from signing audit opinions;
- an order that KPMG monitor compliance with revised audit procedures on company capital and distributions, and report on this to the FRC's Executive Counsel; and
- declarations in four cases that the Statutory Audit reports did not satisfy the Relevant Requirements.

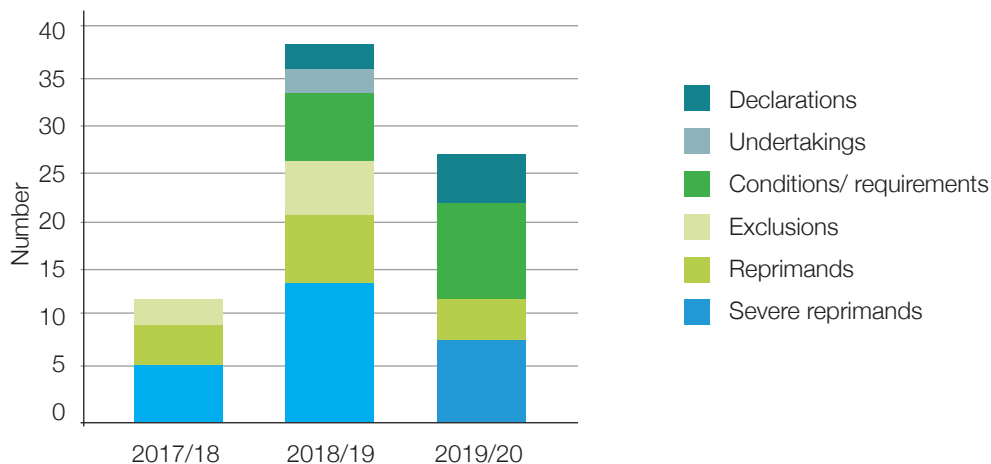
Careful consideration is taken to ensure that the bespoke non-financial sanctions will address underlying causes of the breaches or Misconduct in every case.

Executive Counsel will also take into account other remedial work by firms or individuals which is effective to prevent audit failures recurring, as a condition of Executive Counsel accepting their agreement to the Decision Notice. If sufficient remedial work has been carried out, this may result in no additional non-financial sanctions being required in that respect. An example of this is where the firm has already ensured that additional training has been undertaken by audit partners.

Number of non-financial sanctions

	2017/18	2018/19	2019/20
Severe Reprimands	5	13	8
Reprimands	4	8	4
Exclusions	2	6	-
Requirements	-	7	10
Undertakings	-	2	-
Declarations	-	2	5
Total	11	38	27

Non-financial sanctions



As fewer cases concluded with sanctions in 2019/20 compared with 2018/19, the number of non-financial sanctions is lower. However, our overall use of non-financial sanctions relative to financial sanctions has increased in relation to audit firms and individuals.

Settlement

We continue to encourage firms and individuals to make full and frank early admissions and we look for opportunities to enter into settlements in our cases at an appropriate stage where we have sufficient understanding of the matter to secure the right regulatory outcome in the public interest. Early admissions demonstrate cultural change and an understanding and acceptance by firms and individuals of areas where they have fallen short of the standards. This is a critical first step in driving audit quality as well as a means of delivering earlier published outcomes and driving wider behavioural change. In addition to early settlement discount, an additional reduction to any financial sanction is available where an exceptional level of co-operation is demonstrated by firms and individuals, for example by self-reporting. Whilst we have seen some examples of self-reporting, the approach to providing an exceptional level of co-operation is mixed and in general we are not yet seeing firms co-operate above the base level required.

The published Sanctions Guidance and Policy provides for discounts of up to 35% for early admissions and settlement. All but one of the cases resulting in sanctions in 2019/2020 were as a result of settlements between the respondents and Executive Counsel. Where financial sanctions were imposed, reductions of between 30% and 35% were allowed to reflect the extent, significance and timing of admissions, and early disposal of the matter. In the remaining case (KPMG's Client Asset Reports in respect of two BNY Mellon entities), in which the Misconduct was admitted, and the Tribunal was only asked to determine sanctions, the financial sanction was reduced by 30% to reflect the admission of Misconduct.

Our sanctions policy encourages early settlement and co-operation. Early admissions demonstrate cultural change driving improved standards.

7 TIMELINESS

Introduction

Our work continues to be informed by the clear recognition that improving the speed of our investigations and enforcement action must remain a key priority. We report below on our progress in the year by reference to our main Key Performance Indicator (KPI) – a period of two years between commencement of an investigation and service of either the Proposed Formal Complaint (PFC) or IIR (or closure or settlement if sooner) - and other relevant case length data.

Time to service of PFC, IIR or earlier settlement/closure

The Enforcement Division’s KPI focuses on the investigation stage of our process i.e. up to the delivery of a PFC or IIR (or settlement/closure if earlier). As noted last year, this is because if a matter proceeds to a contested hearing before an independent Tribunal, the directions for the stages leading to the hearing (such as service of witness statements and expert reports) will be set by the Tribunal Chair and accordingly the timetable is not within the control of Executive Counsel³⁴.

In the year to 31 March 2020, 18 enforcement cases fell to be measured against the KPI³⁵ and the table below sets out our performance against this measure.

	Number of cases
PFC/IIR served (or case concluded without PFC/IIR) within two years	8
PFC/IIR not served/case not otherwise concluded within two years due to:	
• Finalisation of settlement process	4
• Size/complexity	3
• Internal resource	2
• Parallel SFO proceedings	1
Total	18

The target has therefore been met in 44% of cases compared to under 35% last year.

The percentage of investigations completed within our target of two years has increased from 35% to 44%.

³⁴ It should be noted that guidance has been issued to Tribunals that matters should progress as expeditiously as possible.

³⁵ i.e. those that either met the KPI, or exceeded 24 months without meeting the KPI, within the year.

Where we have not met the KPI, the reasons for not doing so are similar to those encountered in cases last year. In particular:

- In four cases we were engaged in settlement discussions with the respondents at the date of the KPI and it would not therefore have been appropriate to issue an IIR or PFC. All of those discussions proved successful with the four cases going on to conclude shortly after the two year KPI.
- This year we have dealt with cases of exceptional size and complexity (including Carillion and BT) which has impacted on our ability to comply with the KPI.
- Internal resource has been a reason for missing the KPI in two of our cases this year. While we have already grown substantially over the last few years, significant further expansion of our forensic accounting and legal teams is planned.
- In one case it was necessary to pause our process pending resolution of parallel SFO proceedings relating to the same individual in respect of the same underlying factual matters. We take such a decision after the most careful consideration and where it is deemed necessary in order not to risk prejudicing any criminal process or for some other compelling reason.

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

The average length of time to service of PFC/IIR (or settlement, if earlier) in cases reaching this milestone during the year is set out below. It is encouraging to note both the continuing downward trend and that the average time to service of PFC, IIR or closure/settlement (if earlier) in the year is below our 24 month KPI target.

	2017/18	2018/19	2019/20
Number of cases where PFC/IIR issued (or settled / closed if earlier)	9	6	16
Average length of time to issuance of PFC/IIR (or settlement / closure if earlier) (in months)	31	24	23

Time to complete a case

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

	2017/18	2018/19	2019/20
Average length of cases referred to Tribunal (months)	77	82	48
(Number of cases)	(1)	(4)	(1)
Average length of cases concluded as a result of settlement or service of undisputed Decision Notice (months)	46	42	23
(Number of cases)	(5)	(8)	(8)
Average length of cases closed with no further action (months)	26	31	20
(Number of cases)	(3)	(1)	(4)

The relatively small number of cases from which the figures are derived means that it is necessary to be cautious when attempting to identify meaningful patterns or trends. However, the trend in all three metrics is encouraging.

Average age of cases open at year end

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

	2017/18	2018/19	2019/20
Number of cases open at year end	39	41	42
Number of cases opened in year	14	15	14
Average age of cases open at year end (in months)	27.2	20.9	25.4

It is important to note the very significant impact of the Autonomy Corporation plc matter on these figures, without which the average age of cases open at the year end would have been 22 months. The increase on last year is largely attributable to parallel criminal investigations and/or proceedings which have resulted in ongoing delay. The table below sets out data relating to the age profile of our cases at year end compared to year end last year.

Year investigation opened (to 31 March)	2013	2014	2015	2016	2017	2018	2019	2020	Total
Cases open at 1 April 2019	2	-	-	3	8	13	15	-	41
Cases closed in year	-	-	-	1	3	4	3	2	13
Cases open at 31 March 2020	2	-	-	2	5	9	12	12	42

The average age of cases open at year end has risen slightly, largely due to delays caused by parallel criminal investigations by other agencies.

8 LOOKING TO THE FUTURE

Introduction

Last year we reported on the changing landscape of audit following several high level reviews: the independent review of the FRC by Sir John Kingman (Kingman Review); the Department for Business, Energy and Industrial Strategy (BEIS) Select Committee's inquiry into the Future of Audit; and the review of the audit market conducted by the Competition and Markets Authority (CMA Review). We awaited the findings of Sir Donald Brydon's review of the quality and effectiveness of audit (Brydon Review).

In Enforcement we welcomed the prospect of increased powers to hold non-accountant directors to account in their preparation of true and fair accounts and compliant corporate reports, and to deal openly and honestly with auditors. We looked forward to a period of significant change.

Clearly, no-one could have imagined the changes which have, in fact, come about. Covid-19 has not only had devastating consequences at a human level, its impact on the world's economies has been equally significant. There can be few, if any, companies in the UK which have not been affected by the unprecedented events arising from the pandemic, and that in turn presents unique difficulties in the preparation and audit of those company's financial statements.

The FRC has recognised this and made clear that it will give careful consideration to the impact of Covid-19 on the audit market, our stakeholders and the wider economy to help ensure that any reforms resulting from the above reviews are delivered in a proportionate way.³⁶

The impact of Covid-19 on Enforcement activity and heightened risks for those we regulate

Covid-19 has presented significant challenges to individuals, companies and auditors. It has also, inevitably, presented challenges to the conduct of Enforcement activity.

The situation has affected our ability, and that of individuals within firms, to access necessary information. It has also impacted the availability of individual subjects and witnesses to attend for interview. Despite these obvious challenges, we have continued to progress investigations and enforcement action while taking the current situation into account when requesting information and documents, and in responding to requests for extensions of time. We are seeking to keep the inevitable impact on timing to a minimum.

We recognise that the pandemic has not just presented logistical challenges. Accountants, actuaries and auditors will be faced with unique and complex decisions in the context of financial reporting. The FRC as a whole will continue to support the professionals we regulate by providing guidance on how to fulfil their professional responsibilities.³⁷ However, it should be clear that whilst the context in which increasingly difficult judgements are made will be understood, there cannot be individual exceptions made to the standards against which Enforcement will hold accountants, auditors and actuaries to account. Now more than ever users of financial statements, be they individuals, fund managers, employees, suppliers or other stakeholders, need transparency and must know that they can rely on the truth and fairness of those statements.

³⁶ [FRC Update on the FRC Transformation Programme 1 May 2020.](#)

³⁷ [FRC's Financial Reporting Lab publications.](#)

We welcome proposals for new legislation that holds non-accountant directors to account.

Investigations and Enforcement activity have continued since the Covid-19 restrictions have been in place.

We expect the professionals we regulate to keep abreast of the FRC's guidance and that of their professional bodies. In that context we highlight below what we consider to be some areas of heightened risk arising from the impact of the pandemic.

Financial reporting pressures

In these difficult times, some companies may be under pressure to report unreasonably positive results, or indeed unduly negative results to flatter performance in later years. Although the accountant in business does not form an opinion on whether the accounts give a true and fair view, professional accountants at all levels from directors downwards should not be associated with misleading financial information. They should speak up if this occurs in the entity that they work for, either through the whistleblowing processes in place at their organisation or directly to the FRC which is a prescribed body for receiving whistleblowing reports in relation to statutory accounting and reporting, and audit.^{38, 39}

Documentation

Audited entities should maintain proper accounting records and auditing standards require proper evidencing of procedures undertaken by auditors and support for judgments made. The current situation may make it more challenging to obtain that evidence, but the pandemic is not an excuse for not having obtained and retained sufficient and appropriate audit evidence.

Auditors need to think about alternative ways to get the information, demonstrate why they are satisfied with what they have obtained, or consider implications for their opinions. We continue to encounter cases where it is not possible to establish what audit procedures have been carried out because they are not recorded on the file. At the very least, this is a breach of the standards requiring appropriate documentation, but at worst raises the question of whether the work has been done adequately, or at all.

The auditor should also ensure that the rationale for significant audit judgements is appropriately recorded – whilst always necessary, this is of heightened importance given the increased complexity of the judgements likely to be required in these unprecedented times.

Understanding the entity and its environment

Auditors will need to explore and understand how audited entities have changed their operations and the control environment they operate as, for example, business continuity plans are invoked. The audit approach will need to respond to such changes and consider the effects across the financial statements, such as on the carrying value of assets or leases which may have become onerous. The company's disclosure will also need careful review.

Access to audit evidence and use of technology

Restrictions on travel, movement and visiting client sites may mean that audit procedures cannot be carried out as usual or as planned. Auditors will need to think about whether there are other ways for them to obtain and document sufficient and appropriate audit evidence, and this may well require the use of procedures which are currently not typically used under the methodology of a firm, including through the greater use of technology.

³⁸ See [here](#) for information on whistleblowing.

³⁹ A list of prescribed whistleblowing people and bodies is available [here](#).

We expect the professionals we regulate to keep abreast of the FRC's guidance and that of their professional bodies.

Auditors will need to think about whether there are other ways for them to obtain and document sufficient appropriate audit evidence.

If auditors are seeking to gather evidence through increased use of technology, including through the use of secure third party systems to provide confirmations, or by the provision of evidence to the auditor through secure live streaming or screen sharing, then the auditor should consider what factors will allow them to evaluate the appropriateness of that evidence and how it should be documented. This assessment includes the risk that evidence might be manipulated, and how this risk can be mitigated.

Where auditors make use of technology, they should ensure that all parts of the audit team understand the purpose of the testing. We have seen cases where the audit team thought testing being carried out by IT audit staff was for one purpose, and the IT staff designed the test to achieve another. Similarly, auditors must be confident that the evidence to which they have been given access is appropriate. We have seen occasions where auditors have mistakenly assumed that they have been provided with access to a bank's independent records, whereas it was, in fact, the company's own banking information.

Going concern

Importantly, the accounting and auditing standards on going concern have not changed since the onset of Covid-19. Accountants in business should comply with accounting standards when determining whether it is appropriate to prepare the accounts on a going concern basis. Auditors should challenge management appropriately on their judgements, and ensure they have sufficient and appropriate evidence to support their own judgements.^{40, 41}

Accountants should consider, and auditors should review, carefully the reasonableness of assumptions made in management's forecasts, and the sufficiency of disclosures in this regard.

Professional scepticism

Auditors must maintain their independence and objectivity, recognising that it is not the auditor's role to assist the company in presenting an overly optimistic or pessimistic picture, but to assure the truth and fairness of the financial statements.

In Enforcement we often see failures by auditors in the exercise of sufficient professional scepticism. It remains fundamental to the auditor's role, and we will always look for evidence of appropriate challenge of management and a clear explanation of decisions reached by the auditor.

Fraud

The Covid-19 crisis also means that there may be situations where there is a greater risk of fraud.

There are several reasons for this: first, the pressure to report positive results as mentioned above; second, experience shows that periods of severe economic downturn frequently mean that long running frauds, which have previously remained hidden, are exposed; and third, the change of circumstances may mean that the control environment may be operating differently to expectations, for instance impacting on segregation of duties.

⁴⁰ See also the FRC's review of the going concern policies and procedures of the seven largest UK audit firms required in accordance with ISA (UK) 570 [here](#).

⁴¹ [ISA \(UK\) 570](#) was revised in September 2019, effective for year ends after 15 December 2019. See also the FRC Lab report [COVID-19 - Going concern, risk and viability](#).

Professional scepticism remains at the core of an auditor's duty and we will take appropriate action where we find that it has been lacking.

Auditors should consider the need for additional procedures to address the heightened risks of fraud due to the Covid-19 crisis.

Accountants in business must maintain the highest ethical standards in the face of any undue pressure from within the business and the auditor should be alert to red flags and consider the need for additional procedures to address the risks of fraud.

Modifications to audit opinions and other disclosures in the audit report

The need for a modified opinion may arise because certain audit procedures cannot be performed (for example physical inventory testing because of travel restrictions), and no other procedures can be undertaken to produce the required volume or quality of reliable audit evidence. Alternatively, management's key judgements may be difficult to support in the light of wider economic and political uncertainty, or not agreed by the auditor e.g. asset and liability valuations or assumptions underpinning going concern considerations.

Moreover, the need may arise for additional disclosures in the Auditor's Report which are not modifications of the opinion, such as emphases of matter or a material uncertainty related to going concern.

In the UK, audit opinions are rarely modified, but the FRC is increasingly challenging audit firms in this area. This is likely to be of particular relevance this year and auditors are advised to refer to guidance issued by the FRC⁴².

Actuarial work – pensions and insurance

As businesses struggle to come to terms with the impact of Covid-19, actuaries should be aware of the risks of underfunding of company pension schemes, the ability to continue to rely on sponsor covenants and the impact on pension asset valuations. Now more than ever, in all aspects of their work, actuaries need to think carefully about the data and assumptions selected for modelling, to ensure they are appropriate in light of recent events. The effect of the pandemic is to increase the uncertainty in the selection of all assumptions about future experience and actuaries need to remain aware of this increased uncertainty.

Regulatory Reform

As noted in the FRC's Plan and Budget for 2020/21, the FRC is going through a period of significant change. In the last year, three independent reviews have made far-reaching recommendations to the Government which impact on our purpose and objectives, and the roles and responsibilities of those we regulate. These recommendations will, if adopted by the Government, significantly alter and enhance the FRC's enforcement powers.

Covid-19 has impacted the Government's timetable for consultation and implementation of these reviews and we are awaiting the Government's update on the timing for its programme.

Consideration of the need for modifications to audit opinions is likely to be of particular relevance this year.

With the impact of Covid-19, actuaries should ensure that data and assumptions used in modelling are appropriate in light of the increased uncertainty caused by recent events.

Covid-19 has impacted the Government's timetable for consultation and implementation of three recent independent reviews.

⁴² [FRC Guidance on modifications of Independent Auditor's Opinions and Reports.](#)

Kingman Review

In March 2019 the Government issued a consultation document seeking views on the recommendations made by Sir John Kingman in his Review of December 2018. The Kingman Review considered Enforcement specifically and recognised evidence of a positive shift in the FRC's approach since the introduction of the AEP. Nevertheless, it made a number of recommendations to strengthen the enforcement regime including:

- greater powers to hold non-accountant directors to account for their duties to prepare and approve true and fair accounts and compliant corporate reports and to deal openly and honestly with auditors; and
- the current voluntary scheme under which the FRC may take enforcement action against accountants who are members of Participants in the Scheme in relation to apparent wrongdoing in PIEs should be replaced with a statutory scheme similar to the AEP.

The FRC has welcomed these recommendations and continues to work with Government and stakeholders on their implementation and to work internally to plan for reform.

Brydon and CMA Reviews

In February 2019 an independent review led by Sir Donald Brydon (the Brydon Review) considered how the audit process and product could be developed to better serve the needs of users and the wider public interest. The Brydon Review recommended the establishment of a new corporate auditing profession with a unifying purpose and set of principles. It also made recommendations in relation to:

- the prevention and detection of material fraud;
- communication and transparency within the audit process and audit report;
- the role of shareholders and other stakeholders;
- reporting by companies on their approach to assurance and resilience; and
- the effectiveness of companies' internal controls over financial reporting.

In April 2019 the CMA published its final report of its review of the audit industry with recommendations to address "serious competition problems". The CMA Review recommended the separation of audit from consulting services, mandatory 'joint audit' to enable firms outside the Big 4 to develop the capacity needed to review the UK's biggest companies, and the introduction of statutory regulatory powers to increase accountability of companies' audit committees.

Neither the Brydon Review nor the CMA Review made specific recommendations regarding the enforcement regime. Nevertheless, we are giving careful consideration to what the implications would be for Enforcement in giving effect to the recommendations in both of those Reviews and continuing to work with BEIS as they formulate their proposals for consultation.

Review of the AEP

The AEP came into force on 17 June 2016. On the same day, the FRC published a feedback statement which stated that the new procedure would be subject to a post-implementation review. That review has been taking place over the past 12 months and will lead to a public consultation on proposed amendments in autumn 2020.

We are giving careful consideration to what the implications would be for Enforcement of the independent Reviews and continuing to work with BEIS as they formulate their proposals for consultation.

9 GLOSSARY

Term	Meaning
ACCA	The Association of Chartered Certified Accountants.
Accountancy Scheme	A contractual arrangement between the FRC and the accountancy professional bodies which provides for the FRC to investigate (and take enforcement action against) their members in cases which raise important issues affecting the public interest in the UK.
Actuarial Scheme	A contractual arrangement between the FRC and the actuarial professional bodies which provides for the FRC to investigate (and take enforcement action against) actuaries in cases which raise important issues affecting the public interest in the UK.
AEP	Audit Enforcement Procedure, which is the process under which the FRC can investigate Statutory Auditors and audit firms in relation to audits of PIEs, large AIM-listed companies and Lloyd's Syndicates for breach of a Relevant Requirement.
AER	The FRC's Annual Enforcement Review.
AIM	Alternative Investment Market; London Stock Exchange's market for small and medium size growth companies.
AQR	The FRC's Audit Quality Review team. This team is responsible for monitoring the quality of the audit work of Statutory Auditors and audit firms in the UK that audit Public Interest Entities (PIEs) and certain other entities within the scope retained by the FRC.
Audit firm	The sole practitioner, partnership, limited liability partnership or other corporate entity engaged in the provision of audit services.
Audited entity	Entity whose financial statements are subject to audit by the audit firm.
Auditor	Auditor is used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm.
BEIS	Department for Business, Energy and Industrial Strategy.
Big Four	The four largest accounting firms i.e. Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers.
Big Six	The Big Four accounting firms plus Grant Thornton and BDO.
Brydon Review	The Independent review led by Sir Donald Brydon into how the audit process and product could be developed to better serve the needs of users and the wider public interest.
CAI	Chartered Accountants Ireland.
CASS	The FCA's Client Assets Sourcebook.
CASS audit	Engagements to provide assurance on client assets for the FCA.

Term	Meaning
Client Asset Reports	Annual reports on Client Assets required by the FCA.
CEE	The FRC's Case Examination and Enquiries team. This team is responsible for gathering intelligence and conducting initial enquiries on cases arising under the AEP, the Accountancy Scheme or the Actuarial Scheme.
CIMA	The Chartered Institute of Management Accountants.
CMA	Competition and Markets Authority.
CMA Review	'Statutory audit services market study' published by the CMA in April 2019.
Conduct Committee	The Conduct Committee is a committee of the FRC board which decides whether to open investigations under the enforcement schemes and performs an oversight role in relation to the FRC's enforcement work. It is also the body responsible for making decisions about publication of certain case-related matters and issuing guidance.
Constructive Engagement	A process introduced by the AEP for resolving cases with an audit firm where the audit quality concerns do not necessarily warrant a full enforcement investigation.
CRR	The FRC's Corporate Reporting Review team reviews directors' reports and accounts of public and large private companies for compliance with the law. It also keeps under review interim reports of all listed issuers and annual reports of certain other non-corporate listed entities.
Decision Notice	A document issued at the end of an AEP investigation which sets out the allegations against the Respondent, as well as a recommended sanction.
Engagement partner	The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.
Engagement quality control review partner or EQCR	A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments the engagement team made and the conclusions it reached in formulating the report.
FCA	Financial Conduct Authority.
Formal Complaint	A document issued at the end of an Accountancy Scheme investigation which sets out the alleged Misconduct.

Term	Meaning
FRC	Financial Reporting Council.
ICAEW	The Institute of Chartered Accountants in England and Wales.
ICAS	The Institute of Chartered Accountants of Scotland.
IFoA	The Institute and Faculty of Actuaries.
IFRS	The International Financial Reporting Standards issued by the International Accounting Standards Board.
IIR	Initial Investigation Report. Under the AEP, this report is served on the Respondent at the end of an investigation and sets out the allegations against the Respondent, the Relevant Requirements which appear to have been breached and summarises the evidence and documents obtained over the course of the investigation.
ISAs	International Standards on Auditing (UK and Ireland), which are based on standards issued by the International Auditing and Assurance Standards Board. These form part of the Relevant Requirements which apply to Statutory Audit work.
Kingman Review	An independent review of the FRC led by Sir John Kingman which was published in December 2018.
KPI	Key Performance Indicator.
Member Firm	A firm which is subject to the systems of discipline, professional conduct, and regulation of any of the bodies which participates in the contractual arrangement of the Accountancy or Actuarial Scheme.
Members	A member of any of the bodies which participates in the contractual arrangement of the Accountancy or Actuarial Scheme, or a person who is subject to the systems of discipline, professional conduct, and regulation of any such body.
Misconduct	An act or omission or series of acts or omissions, by a Member or Member Firm in the course of his / her or its professional activities (including as a partner, member, director, consultant, agent, or employee in or of any organisation or as an individual) or otherwise, which falls significantly short of the standards reasonably to be expected of a Member or Member Firm or has brought, or is likely to bring, discredit to the Member or the Member Firm or to the accountancy profession.
Misstatement	A difference between the reported amount, classification, presentation, or disclosure of a financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework.

Term	Meaning
Non-audit work	Any engagement in which an audit firm provides professional services to an audited entity, its affiliates or another entity where the subject matter of the engagement includes the audited entity and/or its significant affiliates other than the audit of financial statements of the audited entity.
Objectivity	Acting and making decisions and judgments impartially, fairly and on merit (having regard to all considerations relevant to the task in hand but no other), without discrimination, bias, or compromise because of commercial or personal self-interest, conflicts of interest or the undue influence of others, and having given due consideration to the best available evidence.
Participants in the Accountancy Scheme	Participants in the Accountancy Scheme, that are not also RSBs are: the Chartered Institute of Management Accountants (CIMA) and the Chartered Institute of Public Finance & Accountancy (CIPFA).
Partner	Any individual with authority to bind the firm with respect to the performance of a professional services engagement.
PFC	A Proposed Formal Complaint, which is a draft of a Formal Complaint setting out the alleged Misconduct following an Accountancy Scheme investigation. Under the Accountancy Scheme, a Respondent has eight weeks to make representations in response to the Proposed Formal Complaint. After considering these representations, the FRC may finalise the Formal Complaint.
PIEs	Public Interest Entities. These are: (a) an issuer whose transferable securities are admitted to trading on a regulated market; (b) a credit institution within the meaning of Article 4(1)(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council, other than those listed in Article 2 of Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and investment firms; or (c) an insurance undertaking within the meaning given by Article 2(1) of Council Directive 1991/674/EEC of the European Parliament and of the Council on the annual accounts and consolidated accounts of insurance undertakings. No other entities have been specifically designated in law in the UK as 'public interest entities'.
Professional Accountant	For the purpose of the ISAs (UK and Ireland) and the FRC's Ethical Standard, Professional Accountants are those persons who are members of a professional accountancy body, whether in public practice (including a sole practitioner, partnership or corporate body), industry, commerce, the public sector or education.

Term	Meaning
Professional scepticism	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 evidence.
Relevant Ethical Standards	In the UK the firm and its personnel are subject to ethical requirements from two sources: the FRC's Ethical Standard concerning the integrity, objectivity and independence of the firm and its personnel, and the ethical standards established by the auditor or assurance practitioner's relevant professional body.
Relevant Requirement	A requirement with which a Statutory Auditor must comply. The Relevant Requirements include those set out in: (a) SATCAR; (b) the Audit Regulation (537/2014/EU); (c) the ISAs; and (d) the FRC's Ethical Standard.
RNS	Regulatory News Service: a regulatory and financial communications channel managed by the London Stock Exchange for companies to communicate with the professional investor.
RSB	Recognised Supervisory Bodies (RSBs) are: the Institute of Chartered Accountants in England and Wales (ICAEW), the Institute of Chartered Accountants of Scotland (ICAS), Chartered Accountants Ireland (CAI) and the Association of Chartered Certified Accountants (ACCA).
SATCAR	The Statutory Auditors and Third Country Auditors Regulations 2016/649.
Schemes	The Accountancy Scheme and Actuarial Scheme.
Statutory Audit	An audit performed pursuant to the EU Audit Directive and Regulation or otherwise designated by national law as a statutory audit which in the UK is an audit of financial statements or consolidated financial statements required by the Companies Act 2006 (as amended).
Statutory Auditor	A person appointed as an auditor under the Companies Act 2006 that is approved by or on behalf of the FRC to carry out Statutory Audits.
Sufficiency (of audit evidence)	The measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.
Tribunal	The panel appointed in order to conduct hearings where Executive Counsel has decided to take enforcement action against the subject of an investigation. Tribunals are formed of former auditors, lawyers and lay persons.

Appendix A – Summary of remit and powers

Who can the FRC investigate and act against?

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

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

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

Auditors

The FRC has responsibility for enforcement action in relation to audit firms and individual auditors.

Accountants

The FRC can also take enforcement action in respect of suspected Misconduct by individual accountants and firms of accountants, who are members of the professional accountancy bodies⁴³ in relation to non-audit work in public interest cases. These individuals are often working within businesses preparing financial statements and other financial information.⁴⁴

Actuaries

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

The FRC currently has no powers to investigate, take enforcement action or impose sanctions on individuals, including directors, who are not members of the professional accountancy bodies or the IFoA (Members).

The scope of our enforcement powers is to be the subject of consultation for legislative change.

⁴³ Professional accountancy bodies include the Recognised Supervisory Bodies (RSBs), the Participants in the Accountancy Scheme and other accountancy bodies. A list of the RSBs and the Participants is included in the Glossary.

⁴⁴ Members who undertake audit work but are not a Statutory Auditor also fall within the jurisdiction of the Scheme.

The Enforcement Regimes

The FRC operates three enforcement regimes:

- the **Audit Enforcement Procedure**⁴⁵ in respect of Statutory Auditors and Statutory Audit firms⁴⁶ in relation to audits of PIEs⁴⁷, large AIM-listed companies⁴⁸ and Lloyd's Syndicates⁴⁹;
- the **Accountancy Scheme**⁵¹ in respect of accountants and firms of accountants who are members of the Participants in that scheme, in relation to non-audit work in public interest cases. These individuals are often working within businesses preparing financial statements and other financial information;⁵² and
- the **Actuarial Scheme**⁵³ in respect of individual actuaries who are members of the IFoA.

The Audit Enforcement Procedure (AEP)

An investigation is opened by the Conduct Committee where there is information which “raises a question as to whether there has been a breach of a Relevant Requirement” and it considers that there is a good reason to investigate. Enforcement action can be taken if the Executive Counsel or the Enforcement Committee conclude that the investigation establishes that there has been a breach of a Relevant Requirement under auditing or ethical standards.

As noted earlier, the AEP is currently subject to a post-implementation review and a public consultation on proposed amendments is due to take place in autumn 2020.

The Audit Enforcement Procedure is currently under review.

⁴⁵ [The Audit Enforcement Procedure.](#)

⁴⁶ Before June 2016, all audit and accountant investigations were conducted under the Accountancy Scheme. Following implementation of EU legislation, the FRC became the UK Competent Authority for audit and the AEP replaced the Accountancy Scheme for audit matters. The Accountancy Scheme remains in place for audit investigations which began before June 2016 and all non-audit matters.

⁴⁷ As defined in Regulation 2, SATCAR.

⁴⁸ With a market capitalisation of over 200 million Euros.

⁴⁹ Other audit-related matters are delegated by law to the professional accountancy bodies, although the FRC can investigate such matters where it considers it is in the public interest to do so.

⁵⁰ [The Accountancy Scheme.](#)

⁵¹ Members who undertake audit work but are not a Statutory Auditor, also fall within the jurisdiction of the Scheme.

⁵² [The Actuarial Scheme.](#)

The Accountancy Scheme and Actuarial Scheme (the Schemes)

The Schemes are contractual arrangements between the FRC and the accountancy / actuarial professional bodies and provide for the FRC to investigate and take enforcement action against Members in cases which raise important issues affecting the public interest in the UK.⁵³

Investigations are opened by the Conduct Committee principally where it determines that a matter raises or appears to raise important issues affecting the public interest in the UK and that there are “reasonable grounds to suspect that there may have been Misconduct”.⁵⁴ Misconduct is defined as conduct which falls significantly short of the standards reasonably to be expected of such an accountant/accountancy firm/actuary, or which has brought, or is likely to bring discredit to the accountant/actuary or to their profession.

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

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

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

Subjects of inquiry and investigation	Auditors (firms and individuals)	Accountants	Actuaries
Powers pre 2016	Accountancy scheme ⁵⁵	Accountancy scheme	Actuarial Scheme ⁵⁶
Powers post 2016	Audit Enforcement Procedure ⁵⁷	Accountancy Scheme	Actuarial Scheme

⁵³ Matters not affecting the public interest are dealt with by the professional bodies.

⁵⁴ It is also possible for Executive Counsel to commence an investigation into a firm or individual for an apparent failure to comply with the obligations under paragraphs 14(1) or 14(2) of the Scheme.

⁵⁵ [The Accountancy Scheme](#).

⁵⁶ [The Actuarial Scheme](#).

⁵⁷ [The Audit Enforcement Procedure](#).

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

Current status of audit investigations

As of 1 April 2019, 3 out of 28 of our investigations into audit were under the Accountancy Scheme. Two of those have closed during the year so that at 31 March 2020, only one audit investigation is being conducted under the Accountancy Scheme and 26 under the AEP.

Current status of non-audit investigations

As at 31 March 2020, there were 15 open non-audit investigations into accountants, accountancy firms or actuaries under the Schemes.

Sanctions

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

- unlimited fines;
- Reprimands or Severe Reprimands;⁵⁸
- orders designed to prevent recurrence, such as placing restrictions on the nature of work undertaken or clients represented, and education and training programmes;
- waiver/repayment of client fees;
- prohibition from conducting Statutory Audits/withdrawal of registration or practising certificate; and
- exclusions as a member of a professional body.

Additional sanctions under the AEP include:

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

Details of the sanctions that may be imposed are set out in the relevant published procedural documentation and related guidance.⁵⁹

⁵⁸ The decision as to whether a Reprimand or a Severe Reprimand is appropriate will depend on the facts of individual cases and the seriousness of the Misconduct/breaches.

⁵⁹ [Sanctions Policy \(Audit Enforcement Procedure\) \(effective from 1 June 2018\)](#); [Accountancy Scheme Sanctions Guidance \(effective from 1 June 2018\)](#); [Actuarial Scheme Sanctions Guidance \(effective from 1 June 2018\)](#).

Case Examinations and Enquiries – remit and activities

The Enforcement Division includes the CEE team who gather intelligence and conduct initial enquiries which may lead to the opening of an investigation under the AEP or the Accountancy or Actuarial Schemes.

Sources of CEE enquiries

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

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

Horizon scanning

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

- material misstatements in a company's financial statements which may not have been detected through the Statutory Audit process (including errors in the audited financial statements themselves and in other parts of the annual report which an auditor has a duty to review);
- indications of fraud which may not have been detected by the Statutory Audit process; and
- indications of Misconduct by Professional Accountants or actuaries where it may be in the public interest for the FRC to make enquiries, primarily in relation to the preparation and approval of financial statements which may contain material errors.

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

Complaints and whistleblowing disclosures

Complaints and whistleblowing disclosures are managed centrally by the FRC and are referred to CEE if they appear to relate to audit, accounting or actuarial matters within the FRC's enforcement remit.

Referrals

Other FRC teams may refer matters to CEE if they become aware of matters indicative of auditing, accounting or actuarial irregularities. A primary source of such referrals is from audit inspections conducted by the FRC's AQR team.

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

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

Outcomes of a CEE enquiry

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

- referral to the Conduct Committee for a decision on whether an investigation should be opened;
- in AEP cases only, resolution through Constructive Engagement (more information on the Constructive Engagement process is set out below);
- referral to another FRC team, such as CRR or AQR;
- referral to a professional accountancy body⁶⁰ where that body is better placed to investigate and/or if the matter does not fall within the FRC's remit; or
- no further action by the FRC where the initial enquiry conducted by CEE identified no evidence of acts or omissions likely to amount to potential breaches or Misconduct.

CEE may also make a referral to another regulator or agency, whether or not the matter is also progressed within the FRC.

⁶⁰ Professional accountancy bodies include the Recognised Supervisory Bodies (RSBs), the Participants in the Accountancy Scheme and other accountancy bodies. A list of the RSBs and the Participants is included in the Glossary.

Constructive Engagement

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

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

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

Who conducts Constructive Engagement?

Constructive Engagement decisions are made by the Case Examiner who is assisted by a team of qualified accountants and administrative support.

How does Constructive Engagement work?

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

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

How do we share learnings from Constructive Engagement activities?

Although the FRC does not publish individual outcomes of Constructive Engagement, the Case Examiner communicates themes and learnings to audit firms, accountancy bodies (for circulation to their members), other regulators and other teams within the FRC, who feed the results into their work. More information on the cases dealt with via Constructive Engagement is set out on pages 12 to 17.

The Board

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

Conduct Committee

The Conduct Committee is a committee of the FRC Board, to which its Chair reports on enforcement matters. It comprises Board members and others, such as lawyers and former auditors⁶¹, with a range of skills, experience and relevant technical expertise. It has a majority of lay members and excludes current practising auditors and any officers of the professional bodies it regulates. The Conduct Committee decides whether to open investigations under the AEP and Schemes and performs an oversight role in relation to the FRC's enforcement work, including the work of the Case Examiner. If it considers that an AEP case is suitable for Constructive Engagement, it can refer the matter back to the Case Examiner. If it considers that it does not have sufficient information to open an investigation under the Schemes, it can direct Executive Counsel to conduct preliminary enquiries.⁶² The Conduct Committee is also responsible for making decisions about publication of certain case-related matters and for issuing Guidance.⁶³

Case Management Committee

The Case Management Committee (CMC) supports the Conduct Committee and similarly comprises members with a range of skills and relevant experience: it includes former auditors, lawyers, accountants, actuaries and other relevant professionals. Typically, a group of three or four members of the Committee (the Group of the CMC, or GCMC) will be assigned to each investigation⁶⁴ to provide oversight, support and challenge to the case team throughout the lifetime of a case. Under the Scheme, the CMC has certain specific functions over and above its monitoring role, such as advising Executive Counsel of any factors which should be taken into account when deciding whether to proceed with a Formal Complaint and advising on the appropriateness of settlement discussions. In practice, each case GCMC is updated on at least a monthly basis and will be fully consulted at certain key junctures such as when deciding whether to serve a Proposed Formal Complaint (PFC) under the Schemes or an Initial Investigation Report (IIR) under the AEP.

⁶¹ Who have not carried out Statutory Audits or worked for an audit firm for the previous three years.

⁶² Preliminary enquiries will usually be conducted by lawyers and forensic accountants within the Enforcement Division, but assistance from external specialists can also be sought (see paragraphs 6(10) and 7(7) of the Schemes).

⁶³ All Guidance issued by the Conduct Committee is published on the FRC website.

⁶⁴ Typically, each such group will include an accountant/actuary, a lawyer and a lay member. The CMC's terms of reference can be found [here](#).

Appendix B – Summary of cases concluded and published with sanctions in 2019/20

PWC LLP / REDCENTRIC PLC / AEP

In May 2019 Executive Counsel issued a Final Decision Notice against PwC and Jaskamal Sarai and Arif Ahmad (partners of PwC) following their admissions of breaches of Relevant Requirements in relation to the 2015 and 2016 audits of Redcentric plc.

Points to note

- The financial statements of Redcentric for the 2016 financial year were extensively restated. Net assets were written down by £15.8 million (to £81.7 million) and profit after tax of £5.3 million was restated by £9.5 million to a loss of £4.2 million. Redcentric's 2017 Annual Report explained that the misstatements, "arose due [to] a combination of wilful misstatement and poor application of basic accounting controls and processes."
- The identified breaches of Relevant Requirements were numerous and in certain cases were of a basic and/or fundamental nature, evidencing a serious lack of competence in conducting the Statutory Audit work.
- The 2015 and 2016 audits each failed in their principal objectives of providing reasonable assurance that the financial statements were free from material misstatement. Had those 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.
- This was the second Final Decision Notice involving the PwC Leeds office in recent years, the other being the Final Decision Notice issued against PwC in relation to the 2014 Statutory Audit of Taveta Investments Limited and its subsidiaries.

The Facts

Redcentric is publicly listed, quoted on AIM and by 2016 had attracted substantial investment - the market capitalisation was £263.68 million at 16 June 2016. Redcentric's share price fell from 184p to 63p after the announcement of restatements to the 2016 financial statements on 7 November 2016 (approximately a 65% drop in market capitalisation).

PwC had audited Redcentric and its subsidiaries since 2014. Mr Sarai was the Statutory Auditor for 2015 and at that time he was PwC's Industry Leader for Technology, Media and Telecommunications. Mr Ahmad was the Statutory Auditor for 2016. Between 2013 to 2016 he was the Senior Partner of PwC's Leeds office and subsequently was appointed as Head of London Region Assurance.

The Issues

The breaches of Relevant Requirements were numerous, and occurred over four important areas of the audit. In each audit year, the breaches affected the following audit areas:

- audit planning;
- cash balances;
- revenue and debtors; and
- costs and liabilities.

A number of the breaches related to the auditor's failure to exercise professional scepticism (ISA 200), which is at the heart of auditors' work. The following Relevant Requirements were also breached:

- ISA 230 (Audit Documentation);
- ISA 240 (The auditor's responsibilities relating to fraud);
- ISA 315 (Understanding the entity and its environment);
- ISA 330 (The auditor's responses to assessed risks); and
- ISA 500 (Audit Evidence).

Whilst the breaches evidenced a serious lack of competence in conducting the audit work, they were neither intentional, dishonest, deliberate nor reckless.

The Outcome

PwC and Messrs Sarai and Ahmad accepted that, in aggregate, the breaches would:

- adversely affect or potentially adversely affect a significant number of people in the United Kingdom;
- undermine confidence in the standards of conduct in general of Statutory Auditors and Statutory Audit firms, and/or in Statutory Audit; and
- harm investor, market and public confidence in the truth and fairness of the financial statements published by Statutory Auditors or Statutory Audit firms.

PwC received a fine of £6,500,000 (discounted by 30% to £4,550,000 for settlement), a Severe Reprimand, a requirement that PwC supplement the monitoring and support of the Leeds Office audit practice (on terms which have been agreed with the FRC), and a declaration that the Statutory Audit Reports did not satisfy the Relevant Requirements.

Messrs Sarai and Ahmad each received fines of £200,000 (discounted by 30% to £140,000 for settlement) and Severe Reprimands. In addition, training was undertaken by Messrs Sarai and Ahmad in relation to compliance with the requirements of ISA 220.

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

KPMG AUDIT PLC / BNY MELLON ENTITIES / ACCOUNTANCY SCHEME

In May 2019 the FRC Disciplinary Tribunal heard the Formal Complaint against KPMG and Richard Hinton. That complaint related to their 2011 reports to the FSA (as it then was) on the compliance by The Bank of New York Mellon London Branch and The Bank of New York Mellon (International) Ltd (BNY UK) with the rules of the FSA's Client Assets Sourcebook (CASS). Such work is commonly known as a "CASS audit".

Points to note

- The CASS rules enhance the integrity of the financial system by giving participants confidence that their assets will be protected if a firm becomes insolvent. The CASS rules also seek to ensure that the wind-down of a firm in the event of an insolvency is carried out in as orderly a manner as possible and in a way that reduces the risk of loss of customers' custody assets.

- On 14 April 2015, the FCA issued a final notice against BNY UK, imposing a financial sanction of £126 million for breaches of CASS occurring between 1 November 2007 and 12 August 2013 in respect of custody asset balances which peaked at approximately £1.5 trillion in total. This was the largest fine ever imposed for breaches of the CASS rules.
- Whilst it was not suggested to the FRC Disciplinary Tribunal that the risk of insolvency of BNY UK was significant, the Tribunal noted that the global BNY Mellon group was “of systemic importance in the global financial system, and insolvency could potentially have catastrophic consequences”. The CASS breaches exposed BNY UK’s clients to a risk of loss in the event of an insolvency of BNY UK. However, no BNY UK clients in fact suffered any such loss.
- The Misconduct related to the planning, execution and documentation of the 2011 CASS audits, which failed (amongst other things) to identify certain of the CASS breaches by BNY UK. The Misconduct related solely to client assets, not client money.
- The Misconduct was admitted, and the Tribunal was convened to determine the appropriate sanctions.
- In its report, the Tribunal noted KPMG’s poor disciplinary record in relation to audits.

The Facts

KPMG had audited BNY UK (and internationally, other BNY entities) for a number of years. It had conducted the CASS audits since 2007. Mr Hinton was a director in KPMG’s audit practice, and the engagement leader for the 2008, 2009, 2010 and 2011 CASS audits.

The purpose of the CASS audit is for the audit firm to report to the FCA (formerly the FSA) on whether the relevant entity:

- has maintained systems adequate to comply with CASS throughout the period covered by the CASS audit; and
- was in compliance with CASS as at the date the CASS audit report is made.

The 2011 CASS audit failed to identify certain CASS breaches relating to client assets.

The Issues

The BNY Mellon Group structured its client custody business on a group basis and so its systems and controls operated across a number of different legal entities in a number of different jurisdictions without distinguishing between them.

Taken in their totality, BNY UK’s records did not enable it, at any time and without delay, to distinguish safe custody assets held for one client from safe custody assets held for any other client. This arose because the records platform did not operate or maintain records on an individual firm basis, but operated in a manner which did not record the identity of the BNY Mellon Group entities with which clients had contracted or any sub-custody relationships that existed between BNY Mellon Group entities in relation to custody assets. That was a breach of the CASS.

Further the BNY Mellon Group did not conduct any external reconciliations (of client asset positions) on an individual firm basis. Specifically, it did not conduct external reconciliations with affiliate entities within the BNY Mellon Group with which the BNY UK entities had sub-custodian relationships. That was also a breach of CASS.

In this context, Executive Counsel's case (which was admitted by the respondents) was that in relation to the planning, execution and documentation of the 2011 CASS audits, conduct fell significantly short of the standards reasonably to be expected in that:

- adequate consideration was not given as to whether the records of custody relationships maintained by the BNY Mellon Group were compliant with the CASS rules and / or as to the implications for CASS compliance by BNY UK of the records platform being maintained and operated by the BNY Mellon Group on a global group (rather than individual firm) basis; and
- as a result, sufficient audit procedures were not undertaken to support the opinions set out in the 2011 CASS audit reports (that BNY UK had both maintained adequate systems and was in compliance with CASS).

Had the Misconduct not occurred, certain of the CASS breaches would or ought reasonably to have been identified and reported to the FSA in the 2011 CASS audit reports.

The Outcome

KPMG received a fine of £5,000,000 (reduced by 30% to £3,500,000 for admissions), a Severe Reprimand, a requirement to undertake quality performance reviews of CASS audits for three years and a requirement to provide written reports to the FRC on the details, conclusions and actions arising from the quality performance reviews. The Tribunal's approach to the sanction imposed on KPMG was set out at paragraph 88 of its report:

"The size of the fine must demonstrate to the Respondents, the profession and the public the very great importance of ensuring that these regulatory rules are correctly applied and complied with. It must act as a deterrent against failures to comply with regulatory requirements. The appropriate fine must take into account KPMG's poor disciplinary record in relation to audits, but also the steps it has taken to prevent a recurrence and its part in promoting effective CASS audits since 2012. We also take into account that a fine should not be such as to deter accountants from accepting audit or CASS audit engagements."

Mr Hinton received a fine of £75,000 (reduced by 30% to £52,500 for admissions) and a Reprimand. The sanctions against Mr Hinton reflected KPMG's admission of its failure to provide for him appropriate training and support; that Mr Hinton was not a partner at the time of the Misconduct; and that Mr Hinton is not presently working as a CASS auditor.

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

DELOITTE LLP / SERCO GEOGRAFIX LIMITED / ACCOUNTANCY SCHEME

In February and September 2019, the FRC announced settlements with Deloitte, Helen George and Ross Howard in respect of Misconduct arising from the 2011 and 2012 audits of Serco Geografix Limited.

Points to note

- The SFO opened an investigation into individuals associated with Serco and its subsidiaries in November 2013 and entered into a Deferred Prosecution Agreement with Serco Geografix on 4 July 2019. The SFO issued criminal charges against two individuals in connection with this matter in December 2019.
- Due to the ongoing SFO proceedings, the FRC was unable to provide any details concerning its settlement agreement with Deloitte and Ms George in last year's AER. That settlement agreement was published in July 2019 and the settlement agreement with Mr Howard was published in September 2019.
- The Particulars of Fact and Acts of Misconduct in relation to both settlement agreements remains confidential.

The Facts

Deloitte had audited the Serco Group for a number of years. Ms George was the audit engagement partner for the 2011 audit of Serco Geografix. Mr Howard was the audit engagement partner for the 2012 audit of Serco Geografix.

The Issues

Although we are not able to set out detailed particulars of the Misconduct, in summary, the Misconduct involved:

- failing to react to clear indicators of the risk of potential fraud on a UK government department despite such indicators being visibly set out on the audit file for both the 2011 and 2012 audits; and
- failing to comply with important auditing standards, including failings in relation to identifying the risk of fraud or material misstatement and the exercise of professional scepticism.

The Outcome

Deloitte received a fine of £6,500,000 (discounted to £4,225,000 for settlement), and a Severe Reprimand and agreed to a requirement that the firm implement suitable training for all audit staff aimed at improving the behaviour that was the subject of the Misconduct. Ms George and Mr Howard received fines of £150,000 (discounted to £97,500 for settlement) and £120,000 (discounted to £78,000 for settlement) respectively and Severe Reprimands. The respondents also paid £300,000 towards Executive Counsel's costs of the investigation.

GRANT THORNTON UK LLP / A PUBLICLY LISTED COMPANY / AEP

In November 2019 a Final Decision Notice was served on Grant Thornton following admissions of breaches of Relevant Requirements by the audit firm and the audit engagement partner in relation to the 2016 audit of a publicly listed company.

Points to note

- The Decision Notice was issued two years after the commencement of the investigation.
- Grant Thornton has taken remedial action including the provision of appropriate training on the use of experts and the challenge of management estimates to all audit staff to prevent reoccurrence of breaches.

The Facts

The matter related to audit work carried out on the company's principal assets, an area identified as a significant risk.

The Issues

The work done on the sampling of those assets was inadequate and the audit team also placed undue reliance on the company's externally appointed experts in the valuation of the assets. The breaches led to a failure to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions about the valuations of the assets. There were also failures to exercise sufficient professional scepticism and to prepare adequate audit documentation.

The Outcome

Grant Thornton received a fine of £650,000 (discounted to £422,500 for settlement) and a declaration that the 2016 audit report did not satisfy certain Relevant Requirements. The audit partner received a fine of £20,000 (discounted to £13,000 for settlement) and a declaration in the terms outlined above. The respondents also paid Executive Counsel's costs of the investigation.

KPMG LLP / A PUBLICLY LISTED COMPANY / AEP

In December 2019, Executive Counsel issued a Final Decision Notice against KPMG and Nicola Quayle following their admissions of breaches of Relevant Requirements in relation to the 2016 audit of a publicly listed company.

Points to note

- In December 2014, the FRC published a statement indicating that it expected to see "high quality disclosure" in relation to "complex supplier income arrangements" in companies' financial statements and that it planned to include these as an area of focus when it reviewed audits and accounts in 2015. Furthermore, in the "Plan & Budget and Levies 2015/2016" (published in March 2015), the FRC confirmed that: "We will pay particular attention in our reviews to ... the reporting of complex supplier income arrangements".

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- The Adverse Findings in this Final Decision Notice relate to the 2016 audit of such “complex supplier arrangements”. In particular, the Adverse Findings concern the 2016 audit of the reporting of two distinct categories of supplier rebates that were recognised by the company, namely “Promotional Income” and “Override Income” (as further explained below).
 - It is not suggested by Executive Counsel that the company’s 2016 financial statements were in any way misstated.
 - The Decision Notice was issued 25 months after the opening of the investigation.

The Facts

Ms Quayle was the Statutory Auditor for the company from 2016 to 2018. She was Chair of KPMG’s Audit and Risk Committee from 1 October 2014 to 30 September 2017 and was appointed Manchester office Senior Partner in October 2017.

The company is a PIE and its shares are listed on the main market of the London Stock Exchange.

The Issues

In 2016, the company recognised two distinct categories of supplier rebates, namely:

- Promotional Income, which consists of supplier-funded rebates connected to specific short term promotional activity. It is calculated as an agreed discount from the units sold by the company and the reporting of such income requires little or no judgment or estimation; and
- Override Income, which consists of supplier-funded rebates calculated by reference to trading performance. It is payable in accordance with contractual arrangements agreed annually with suppliers. The amount of Override Income depends on factors such as the volume of purchases (e.g. sales growth) and relates to longer periods than Promotional Income (e.g. over a year). The reporting of Override Income (unlike Promotional Income) therefore requires judgement and estimation to reflect uncertainty as to future trading activity. It also involves a high level of manual intervention which is susceptible to fraud or error. Override Income is thus an area of higher audit risk than Promotional Income.

The breaches of Relevant Requirements concerned a failure to apply sufficient professional scepticism or obtain and document sufficient appropriate audit evidence. Three adverse findings were made against the respondents, in relation to:

- audit planning and execution;
- audit work conducted on Promotional Income balances; and
- audit work conducted on the reconciliation of Override Income.

The Outcome

KPMG received a fine of £700,000 (discounted by 35% to £455,000 for settlement), a Reprimand, a declaration that the Statutory Audit Report did not satisfy the Relevant Requirements and is required by December 2021 to undertake quality performance reviews of three Statutory Audits for which Ms Quayle is the Statutory Auditor.

Ms Quayle received a fine of £45,000 (discounted by 35% to £29,250 for settlement) and a Reprimand, and she is required to undertake appropriate training. The level of sanctions reflected that Ms Quayle herself had a poor regulatory record.

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

GRANT THORNTON UK LLP / CONVIVALITY RETAIL PLC / AEP

In March 2020, Executive Counsel issued a Final Decision Notice against Grant Thornton in respect of admitted breaches of Relevant Requirements in relation to (i) firmwide failures in its control environment and policies and procedures designed to ensure compliance with Ethical Standards and requirements between 1 April 2014 and 31 March 2017, and (ii) the loss of independence in relation to its 2014 audit of Conviviality Retail plc.

Points to note

- The case was unusual in that many of the findings involved firm-wide failings not linked to any particular audit.
- The case has led, among other things, to the creation of an Ethics Board to oversee the firm's compliance with Ethical Standards.
- The Final Decision Notice was issued 30 months after the opening of the investigation.

The Facts

Between 2014 and 2017, Grant Thornton was a UK top six auditing firm. The referral to Enforcement for investigation resulted from the FRC's AQR team's annual firm-wide review of the firm.

The Issues

Grant Thornton was required to establish a control environment that placed adherence to ethical principles and compliance with the Ethical Standards above commercial considerations, and, pursuant to ISQC1, to establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel would comply with relevant Ethical Standards, including independence requirements. The firm's failure, however, to achieve these requirements between 1 April 2014 and 31 March 2017 was evidenced by the following:

- the under-resourcing of the Ethics function;
- deficiencies in the policies and procedures themselves;
- the lack of effective communication of the firm's policies and procedures to, and understanding by, its staff;
- the inadequate monitoring of compliance with the firm's policies and procedures, including by way of recording breaches and taking remedial action when breaches were identified; and
- the lack of an adequate enforcement mechanism operated by the firm in respect of breaches that the firm itself identified.

Further, in 2014, Grant Thornton seconded a senior manager who had performed limited work on the 2014 audit to Conviviality Retail to assist in the preparation of the company's accounts in breach of relevant Ethical Standards. The firm undertook the 2014 audit and went on to provide an unqualified audit opinion in circumstances where the threats to independence raised by the secondment were so great that Grant Thornton should not have provided an audit opinion at all.

The Outcome

The following sanctions were imposed:

- a fine of £3,000,000 (discounted by 35% to £1,950,000 for settlement);
- a Severe Reprimand;
- a declaration that the 2014 audit did not comply with Relevant Requirements; and
- a package of measures to be taken by the firm directed at improving the quality of future audits, comprising: (1) the establishment of an Ethics Board to oversee the firm's compliance with Ethical Standards and requirements with the Board to provide reports to the FRC for three years; (2) a review of its Ethics function to identify any skills/resource gaps; (3) increased training to staff on relevant ethical issues (4) further improvement to its policies and procedures to ensure compliance with Ethical Standards and requirements.

Grant Thornton also paid Executive Counsel's costs of the investigation.

FORMER AUDIT PARTNER / CONVIVALITY RETAIL PLC / AEP

In March 2020 Executive Counsel issued a Final Decision Notice against Kevin Engel, a former audit engagement partner, following admissions of breaches of Ethical Standards and the fundamental principle of Integrity in respect of the 2014 audit by Grant Thornton of Conviviality Retail plc.

Points to note

- The 2014 audit was also the subject of separate investigation and sanction in relation to Grant Thornton as set out above.
- The Final Decision Notice was issued 5 months after the opening of the investigation.

The Facts

During 2014 Mr Engel arranged for the secondment of a senior manager at Grant Thornton, to Conviviality Retail to assist with the preparation of its 2014 financial statements. The secondee had, to Mr Engel's knowledge, initially been on the audit team assigned to the 2014 audit and had undertaken limited work on the audit prior to the secondment.

The Issues

The threats to independence posed by these circumstances were so great that Mr Engel should not have signed an audit opinion but he in fact signed an unqualified audit opinion confirming, among other things, his and the firm's compliance with all relevant Ethical Standards.

In addition, in breach of the fundamental principle of Integrity, Mr Engel instructed the secondee to transfer a time entry they had recorded against the 2014 audit in order to conceal evidence of the secondee's involvement in both the audit and, subsequently, the preparation of the company's accounts given the threats to independence which he knew these circumstances had created.

The Outcome

Mr Engel received a Severe Reprimand and a permanent prohibition banning him from signing audit reports.

FORMER SENIOR MANAGER / CONVIVIALITY RETAIL PLC / ACCOUNTANCY SCHEME

In March 2020, Executive Counsel entered into a settlement agreement with Natasha Toy, a former senior manager, in respect of Misconduct relating to the 2014 audit by Grant Thornton of Conviviality Retail plc. The settlement agreement was approved by a Tribunal member on 24 April 2020.

Points to note

- The audit was the subject of a separate investigation and sanctions in relation to Grant Thornton and the audit engagement partner (as set out above).
- The settlement agreement was concluded 5 months after the opening of the investigation.

The Facts

In January 2014, Ms Toy was initially allocated as the senior manager for the 2014 audit of Conviviality Retail. She was subsequently seconded to the company to assist with the preparation of its year-end financial statements. This was contrary to requirements of standards designed to preserve the independence and objectivity of audit, given the threats to the Firm's independence such circumstances posed.

The Issues

Prior to her secondment to the company, Ms Toy recorded 4.5 hours of work on the audit file code. However, in breach of the fundamental principle of Integrity, Ms Toy transferred and subsequently sought to remove entirely the time entry she had recorded on the audit file in order to conceal evidence of her involvement in both the audit and subsequently the preparation of the company's accounts given the threats to independence which she knew these circumstances had created.

The Outcome

Ms Toy received a Severe Reprimand.

KPMG LLP AND KPMG AUDIT PLC/ FORESIGHT 4 VCT PLC/ AEP

In March 2020, Executive Counsel issued a Final Decision Notice against KPMG Audit PLC and KPMG LLP (KPMG) following their admissions of breaches of Relevant Requirements in relation to the 2013, 2014 and 2015 audits of Foresight 4 VCT plc.

Points to note

- The company's primary business activity is and was to make investments in companies. Investors in the company obtain returns from its investment portfolio including through dividends. The availability of distributable reserves was therefore a key metric for the company's business.
- The Adverse Findings in the Final Decision Notice relate to KPMG's audit work carried out in relation to the company's reserves.
- It is not suggested by Executive Counsel that any distributions made by the company during the period investigated were unlawful.
- The errors in the company's financial statements which are referred to in the Decision Notice have been restated.
- KPMG sought to take remedial steps, by the adoption of a new standard audit work paper on company capital and distributions.
- The Decision Notice was issued just over 24 months after the opening of the investigation.

The Facts

In 2012, the company completed a cancellation of amounts standing to the credit of its share premium account and capital redemption reserve. This cancellation was not reflected in the 2013 financial statements (the year in which the cancellation was effected) or subsequently in the 2014 or 2015 financial statements.

The 2015 financial statements disclosed a figure for distributable reserves. This disclosure was incorrect.

The Issues

KPMG failed to:

- obtain sufficient appropriate audit evidence in respect of Foresight's share premium account and capital redemption reserve, which may have led to a failure to spot a misallocation of reserves between the share premium account/capital redemption reserve and the profit and loss account;
- document its consideration of the adequacy of Foresight's distributable reserves; or
- obtain sufficient appropriate audit evidence to support the figures disclosed in the financial statements relating to distributable reserves.

The breaches occurred over three consecutive financial years and may have led to KPMG not identifying misstatements in the company's financial statements (which were later corrected when its accounts were restated).

The Outcome

KPMG received a Reprimand and an order requiring it to:

- monitor its audit teams' adherence to its standard audit work paper on company capital and distributions; and
- provide a report to Executive Counsel setting out the results of such monitoring.

The level of sanctions reflected that:

- it was clear that sufficient distributable reserves existed to cover distributions made by the company;
- the misallocation of reserves between the various accounts did not affect Foresight's profits in any financial year or net asset value for any financial year;
- the breaches were neither intentional, dishonest, deliberate nor reckless; and
- in the event of adherence by KPMG to this audit work paper, these breaches of Relevant Requirements are unlikely to be repeated.

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



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