Edited for publication

IN THE MATTER OF

THE EXECUTIVE COUNSEL OF THE FINANCIAL REPORTING COUNCIL

-and-

(1) PRICEWATERHOUSECOOPERS LLP

(2) JESSICA MILLER

FINAL SETTLEMENT DECISION NOTICE

Pursuant to Rule 108 of the Audit Enforcement Procedure

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

1. INTRODUCTION

1.1. The Financial Reporting Council (the "**FRC**") is the competent authority for statutory audit in the UK and operates the Audit Enforcement Procedure (the "**AEP**"), revised in June 2023. The AEP sets out the rules and procedure for the investigation, prosecution and sanctioning of breaches of *Relevant Requirements.*

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

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

1.3.1. "**FY2016**" means the financial year ended 30 April 2016, "**FY2016 Financial Statements**" means the financial statements of London Capital & Finance PLC (**"LCF"**) for that period, and "**FY2016 Audit**" means the *Statutory Audit* of the FY2016 Financial Statements.

1.3.2. **“Respondents”** means:

1.3.2.1. PricewaterhouseCoopers LLP (**“PwC”**), which was the *Statutory Audit Firm* for the FY2016 Audit; and

1.3.2.2. Jessica Miller, who was the *Statutory Auditor* for the FY2016 Audit, and signed the FY2016 Audit report on behalf of PwC.

1.4. In accordance with Rule 102 of the AEP, Executive Counsel entered into settlement discussions with the Respondents.

1.5. A *Proposed Settlement Decision Notice* was issued by Executive Counsel on 15 December 2023 pursuant to Rule 103 of the AEP in relation to the conduct of the Respondents in respect of the FY2016 Audit. The Respondents provided written agreement to the *Proposed Settlement Decision Notice* on 20 December 2023, pursuant to Rule 105 of the AEP. The *Convener* subsequently appointed an *Independent Reviewer* to consider the *Proposed Settlement Decision Notice*, pursuant to Rule 106 of the AEP.

1.6. On 29 December 2023 the *Independent Reviewer* approved the issuance of a *Final Settlement Decision Notice* pursuant to Rule 107(a) of the AEP.

1.7. In accordance with Rule 108 of the AEP, this *Final Settlement Decision Notice* sets out:

1.7.1. the breaches of *Relevant Requirement(s)*, with reasons;

1.7.2. the *Sanctions* imposed on the Respondents, with reasons; and

1.7.3. the amount payable in respect of Executive Counsel’s *Costs*.

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

1.8.1. Section 2: Executive Summary of the breaches of *Relevant Requirements*;

1.8.2. Section 3: Background;

1.8.3. Section 4: *Relevant Requirements* to which the breaches relate;

1.8.4. Section 5: Detail of the breaches of *Relevant Requirements*;

1.8.5. Section 6: *Sanctions*;

1.8.6. Section 7: *Costs*.

2. EXECUTIVE SUMMARY OF THE BREACHES OF *RELEVANT REQUIREMENTS*

2.1. LCF’s business involved issuing private bonds to retail investors and lending the proceeds to a small number of commercial clients. LCF went into administration on 30 January 2019, just over two years after the FY2016 Audit was concluded. By that stage,

LCF had grown significantly and issued bonds with a total value of about £237m, to 11,625 individual investors. At the end of FY2016, the cumulative total of the amounts outstanding on the bonds was just under £10m, which had increased from £1m over the period of the FY2016 Audit.

2.2. LCF's borrowers were unable to repay their loans, leaving bondholders with significant losses. These have been partly reimbursed by compensation schemes funded by the financial services industry and the taxpayer. The Serious Fraud Office (the **"SFO"**) has begun a criminal investigation on the basis of suspicion that LCF's bondholders may have been defrauded, but no finding to that effect has been made by any court.

2.3. Against that background, this *Final Settlement Decision Notice* sets out breaches of *Relevant Requirements* in relation to the following matters:

2.3.1. <u>Identifying and assessing the risk of material misstatement through understanding the entity and its environment</u>

2.3.1.1. The Respondents failed to perform adequate risk assessment procedures to form a basis for the identification and assessment of risks of material misstatement in the financial statements.

2.3.1.2. The Respondents failed to gain an adequate understanding of the nature of LCF's business, including its operations, ownership and governance structures, the regulatory framework within which it operated, how LCF was financed, its borrowing activities and the terms of the bonds it issued, and the business risks arising from LCF's objectives and strategies.

2.3.1.3. Further, the Respondents failed to obtain an adequate understanding of internal controls which were relevant to the audit, failed to evaluate the design of those controls, and failed to determine whether those controls had been implemented. They failed to understand or assess controls in place regarding LCF's relationships with its loan debtors, advancing funds to borrowers and the relationship with third-party service organisations. They also failed to consider or adequately understand the potential for management override of controls.

2.3.1.4. An adequate understanding of these matters is essential for an auditor to be able to identify and assess risks of material misstatement in the financial statements.

2.3.2. Exercise of professional skepticism and the risk of fraud

2.3.2.1. The Respondents failed to plan and perform the FY2016 Audit with adequate professional skepticism. In particular, they failed to apply adequate professional skepticism in respect of: (i) the degree of control exercised by the managing director of LCF ("**LCF Director A**"), and the reliance that could be placed on information provided by him; (ii) the commerciality of LCF's business model and operations, and (iii) LCF's cash flows and liquidity. All of these matters were relevant to the possibility of material misstatement due to fraud.

2.3.2.2. Further, the Respondents inappropriately concluded that the presumption that there are risks of fraud in revenue recognition was not applicable in the circumstance of the audit.

2.3.3. Loan debtors

2.3.3.1. The Respondents failed to design and perform audit procedures to obtain sufficient appropriate audit evidence in relation to LCF's borrowers, and particularly in relation to*:* (i) the existence and quantum of the loans, (ii) the interest payable, (iii) the nature and effect of the collateral by which the loans were secured, and (iv) the potential impairment of the loans.

2.3.4. Prepayments

2.3.4.1. The Respondents failed to obtain sufficient appropriate audit evidence about whether the opening balances contained misstatements that materially affected the FY2016 Financial Statements.

2.3.5. Revenue

2.3.5.1. The Respondents failed to design and perform audit procedures to obtain sufficient appropriate audit evidence in relation to the completeness, accuracy and occurrence of revenue, in particular in relation to revenue from interest, commission fees, cost-of-borrowing fees, and consultancy fees.

2.3.6. Financial instrument disclosures

2.3.6.1. The Respondents failed to design and perform audit procedures to obtain sufficient appropriate audit evidence in relation to financial instrument disclosures with regard to credit risk and the loan debtor

balances. They also failed to evaluate whether the financial statements had been prepared in all material respects in accordance with the International Financial Reporting Standards (**"IFRS"**), and whether the financial statements included adequate disclosures to enable the intended users to understand the effect of material transactions and events.

2.3.7. Going concern

2.3.7.1. The Respondents failed to obtain sufficient appropriate audit evidence regarding, and failed to adequately consider, the appropriateness of management's use of the going concern assumption in the preparation of the financial statements.

2.3.8. Related party transactions

2.3.8.1. The Respondents failed to perform audit procedures for the purposes of obtaining sufficient appropriate evidence in relation to LCF's related parties. They failed to remain alert to information indicating the existence of related party transactions and failed to perform appropriate substantive audit procedures relating to newly identified related parties. The Respondents further failed to properly evaluate the related party disclosures in the FY2016 Financial Statements.

2.4. Section 5 of this *Final Settlement Decision Notice* sets out the detail of the breaches of *Relevant Requirements.*

2.5. This *Final Settlement Decision Notice* sets out the following *Sanctions* imposed on the Respondents.

Against PwC:

2.5.1. A financial penalty of £7,000,000, adjusted for aggravating and mitigating factors, and discounted for admissions and early disposal by 30% so that the financial penalty payable is £4,900,000;

2.5.2. a published statement in the form of a severe reprimand;

2.5.3. a declaration that the FY2016 Audit report did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*; and

2.5.4. an order requiring PwC to take action designed to prevent the recurrence of the contravention in the terms set out in paragraph 6.16.6 of this *Final Settlement Decision Notice* below.

Against Jessica Miller:

2.5.5. A financial penalty of £150,000, adjusted for aggravating and mitigating factors, and discounted for admissions and early disposal by 30% so that the financial penalty payable is £105,000;

2.5.6. a published statement in the form of a severe reprimand;

2.5.7. a declaration that the FY2016 Audit report did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*.

3. BACKGROUND

The Respondents

3.1. In 2016 PwC was, and remains, the largest audit firm in the UK by revenue. In 2022 its total fee income for audit work was about £818m, and its total fee income for all work was about £3,875m.

3.2. Ms Miller joined PwC in 2001 and became a Responsible Individual (**"RI"**) qualified to sign statutory audit opinions in 2011. She has been a partner in the firm since 2016.

The FY2016 Audit

3.3. The FY2016 Audit was the first carried out for LCF by PwC. Before that, the only audit was of one month's financial statements, carried out by the firm of accountants who had prepared the financial statements (and who continued to provide accountancy services to LCF, including preparing the FY2016 Financial Statements).

3.4. The FY2016 Financial Statements reported as follows, in respect of the nature and scale of LCF's business:

> *"The company's principal activities during the period continue to be raising funding through the issuance of private bonds and then lending the proceeds of the bonds to medium sized businesses on a fully secured basis. During the year there were bond additions of £9,269,143 and bond redemptions of £664,483"*
>
> *"The company intends to continue developing their bond and loan books accordingly. The company will raise funds through more bond issues and intends to loan this money to existing and new customers."*

3.5. The FY2016 Financial Statements reported both total assets and liabilities of just over £10m (2015 (as restated): just over £1m (the 2015 comparatives relate to a one month period)), almost exclusively the bond debtors and loan creditors referred to above, with total equity of £25,592 (2015: -£190,324). Revenue of £948,201 (2015: £15,330) and

post-tax profits of £166,916 (2015: £2,040) were reported for the year. The financial statements were signed by LCF Director A, one of five directors of the company during FY2016, and the sole beneficial owner of the company's shares.

3.6. The Respondents issued an unqualified audit opinion on the financial statements on 10 October 2016. The fee for carrying out the audit was £25,000.

Events after the FY2016 Audit

3.7. Following the FY2016 Audit, PwC resigned from the engagement and was replaced by another of the "Big Four" largest accountancy firms, who signed an unmodified audit opinion in respect of the financial statements for the subsequent period ended 30 April 2017, on 14 February 2018. Both the prior period audit and the subsequent year audit by different firms are the subject of separate investigations by the FRC.

3.8. LCF's promotion of its bonds was regulated by the Financial Conduct Authority (**"FCA"**) from June 2016 (after the end of FY2016). LCF went into administration on 30 January 2019, after the FCA imposed restrictions on LCF's ability to issue or approve further financial promotions, and subsequently called into question the viability of LCF's business. The FCA's intervention was prompted by serious concerns regarding LCF's conduct, including issues with the accuracy of the company's financial promotions. By the time it entered administration, LCF had issued bonds with a total value of about £237m, to 11,625 individual investors.

3.9. LCF's administrators have reported that the company had limited immediately realisable assets, and its borrowers were unable to repay their loans. The administrators' latest estimate is that the total return to secured creditors (including bondholders) will be in the range of 10% to 18%, and it is not anticipated that there will be a surplus to enable a dividend to be paid to unsecured creditors. Total compensation of about £172m has been paid to LCF bondholders by the Financial Services Compensation Scheme, either under the general statutory compensation scheme funded by the financial services industry or under a bespoke scheme set up by the Government specifically for LCF investors.

3.10. LCF's administrators also reported that large sums of bondholders' money ended up in the personal possession of a small group of individuals connected to each other and to LCF, as a result of a number of highly suspicious transactions. The administrators have begun legal proceedings to try to recover this money. The SFO has also begun a criminal investigation, in conjunction with the FCA, into individuals associated with LCF. The conduct relates to LCF investments offered between 2013 and 2018. The

investigation is in relation to suspicion that actions relating to the sale of LCF's bonds may have been fraudulent, but this question has not been decided by any court to date.

4. *RELEVANT REQUIREMENTS*

4.1. Rule 1 of the AEP states that *Relevant Requirements* has the meaning set out in regulation 5(11) of the Statutory Auditors and Third Country Auditors Regulations 2016 ("**SATCAR**"). The *Relevant Requirements* applicable to the FY2016 Audit include, but are not limited to, the International Standards on Auditing (UK and Ireland) ("**ISAs**") issued by the FRC.

4.2. The ISAs referred to in this *Final Settlement Decision Notice* are the following:

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

4.2.2. ISA 230 (Audit documentation);

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

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

4.2.5. ISA 500 (Audit evidence);

4.2.6. ISA 510 (Initial Audit Engagements – Opening Balances);

4.2.7. ISA 550 (Related parties);

4.2.8. ISA 570 (Going Concern); and

4.2.9. ISA 700 (The independent auditor's report on financial statements).

4.3. The relevant versions of the ISAs are those effective for audits of financial statements for periods ending on or after 15 December 2010, except in the case of ISA 315, where the relevant version is that effective for audits of financial statements ending on or after 15 June 2014, and ISA 570 and ISA 700, where the relevant versions are those effective for audits of financial statements for periods commencing on or after 1 October 2014.

4.4. Those parts of the ISAs which are of particular relevance to the breaches of *Relevant Requirements* are set out as an **Appendix** to this *Final Settlement Decision Notice*.

4.5. As the Senior *Statutory Auditor* responsible for the Audit, Ms Miller was responsible for the overall quality of the Audit, and the direction, supervision, and performance of the Audit in compliance with professional standards and applicable legal and regulatory requirements.

4.6. As the *Statutory Audit Firm* responsible for the Audit, PwC is responsible for any established breaches of *Relevant Requirements* on the part of its employees.

5. BREACHES OF *RELEVANT REQUIREMENTS*

<u>Breach 1 – Identifying and assessing the risk of material misstatement through understanding the entity and its environment</u>

<u>Risk Assessment</u>

5.1. ISA 315 concerns the auditor's responsibility to identify and assess, through understanding the entity and its environment, the risk of material misstatement in the financial statements and related assertions of the audited entity, whether those risks of misstatement may be due to fraud or error. Paragraphs 5 and 6 of ISA 315 require the auditor to identify and assess risks of material misstatement at the financial statement and assertion levels. The auditor is required to conduct risk assessment procedures to that effect including inquiries of management, analytical procedures, and observation and inspection (of, for example, the entity's operations, documentation, records, internal control manuals and/or the entity's premises).

5.2. Fraud is a particular concern in the conduct of an audit and, when performing the risk assessment required under ISA 315, ISA 240 requires the auditor to carry out specific procedures to obtain information for use in identifying the risks of material misstatement due to fraud. Paragraph 25 of ISA 240 further requires the auditor to identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures.

5.3. Assertions of particular relevance in the FY2016 Audit were:

5.3.1. The existence assertion: the implied assertion made by the management of an entity that assets, liabilities, and equity interests referred to in an entity's financial statements exist.

5.3.2. The valuation assertion: the implied assertion made by the management of an entity that assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation is appropriately recorded.

5.4. LCF's primary liability was to its bond creditors, the individuals who had bought LCF bonds. LCF's debtors were the companies to which it had lent money. Its management impliedly asserted that those loans existed and that their value had been appropriately recorded.

5.5. The risk assessment procedures conducted by the Respondents did not adequately address the implied assertions regarding the existence and valuation of loan debtors.

5.6. LCF Director A was the individual with day-to-day operational responsibility and his complete control of the operations of LCF was a key risk of fraud. The fact that LCF's external accountants processed transactions on the instruction of LCF management would in itself do little to mitigate the risk of fraud. If procedures were put in place within the company (i.e., internal controls) to prevent fraud, it would be simple for him to subvert them because there was no check on his actions. The Respondents failed to address adequately LCF Director A's ability to override internal controls, potentially divert funds or enter loan agreements without carrying out due diligence. LCF Director A's ability to override internal controls does not appear to have been specifically discussed at the planning meeting. This discussion also overlooked several potential indicators of fraud, including the fact that the borrowers were all, save Individual A, connected to LCF Director A, and the fact that the fees charged to borrowers were so high as to be uncommercial for what were said to be fully secured loans. Furthermore, in relation to fraud, the Respondents failed adequately to rebut the presumption that there was a significant risk of fraud, in part as a result of having concluded that income recognition should not be treated as a significant fraud risk in the circumstances and therefore failed to conduct an adequate risk assessment in that regard.

5.7. The Respondents failed to make adequate inquiries of management. Their communication with LCF Director A was limited and the Respondents based their understanding of LCF primarily on discussions conducted with the external firm of accountants engaged by LCF.

5.8. Furthermore, the Respondents did not perform appropriate risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement in relation to the audit of related parties, as set out at Breach 8 below. The assessment which led the Respondents to conclude that going concern risk was not an issue was inadequate and based on several inaccurate assumptions, as set out at Breach 7 below.

5.9. Therefore, in breach of paragraph 5 of ISA 315, the Respondents failed to perform adequate risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement in the financial statements and in relation to individual assertions.

Understanding the entity and its environment

5.10. Paragraph 11 of ISA 315 required the Respondents to gain an adequate understanding of the nature of LCF (including its operations, ownership, governance structures,

investments and the way in which it was financed), and the business risks arising from LCF's objectives and strategies. The purpose was to provide a basis for the identification and assessment of risks of material misstatement in LCF's financial statements.

5.11. In accordance with ISA 315, auditors may consider a wide range of factors when developing their understanding of an entity. For example, they may consider the nature of the industry in which it operates, regulatory factors, external factors such as interest rates, relations between owners and other people or entities, the nature of revenue sources, outsourcing activities, key customers, and debt structure.

5.12. The Respondents failed to gain an adequate understanding of several important aspects of LCF's business including its operations, the regulatory framework in which it operated, its borrowing activities, and the terms of the bonds it issued.

Operations

5.13. In the period under audit, LCF was a recently founded and relatively small financial services firm with only a handful of interest-paying loan borrowers. The Respondents wrongly described it as "*mid-tier*" and "*a leading provider of loans to UK businesses*". LCF was also recorded by the Respondents in their audit working papers as variously "*Well established*", a "*Stable entity with typical low level of change*" and as having "*only started trading*".

5.14. The Respondents failed adequately to understand how LCF was financed and governed. No inquiries were made into the roles conducted by the other directors of LCF, save for LCF Director A and they recorded that he *"(Director) has continued to invest deeply in the business*". In fact, he had only invested £12,500 in LCF personally which was to pay up the minimum share capital required to register as a public limited company, and that amount was not paid in cash but added to the loan balance he owed LCF. The Respondents stated that "*investors/shareholder are actively supporting the entity*". In reality, it was funded almost entirely by bonds invested in by retail investors and had minimal capital resource of its own. The Respondents failed to recognise this at the planning stage of the audit and failed to adapt their procedures to reflect the risks presented.

Regulation

5.15. The Respondents considered that LCF's FCA registration reduced the risk of fraud. However, LCF was not regulated by the FCA until after the period under audit and, even then, regulation applied to its promotions, but not the majority of its business because the issuing of bonds was not a regulated activity, although the marketing of those bonds

was. The mere regulation of marketing activity could not have been a significant factor reducing the risk of fraud in LCF.

5.16. The Respondents therefore failed to gain a proper understanding of precisely how and in what respects LCF was regulated by the FCA, and when that regulation became effective. The Respondents also failed to obtain an understanding of how and when regulation ought to have applied to the business.

Loan debtors

5.17. Several notable aspects of the risks of material misstatement of LCF's financial statements and implications in relation to assessing LCF's ability to continue as a going concern associated with the loans advanced by LCF, were not addressed by the Respondents in their audit working papers. The Respondents failed to understand the nature of LCF's loan debtors and risks associated with the loans made by LCF in the following respects:

5.17.1. LCF's loan debtor balance was concentrated in a small number of borrowers. This created a risk (not addressed by the Respondents) that the failure of just one or two debtors adequately and timeously to service their debts could have serious consequences for LCF's business and put it in a position where it was unable to repay bondholders. It was a risk to both LCF's solvency and its liquidity position.

5.17.2. The Respondents failed to gain an understanding of whether the borrowers had accepted the high costs of lending imposed upon them. The agreements between LCF and its loan debtors stated that the interest payable by borrowers was between 0.5% or 2.75% over the rate paid to bond creditors. The rate paid to bond creditors was not stated. So, the borrowers could not have known the rate of interest they would be charged on the face of their agreements. In fact, borrowers would have been charged rates ranging between 12% and 20%.

5.17.3. Moreover, borrowers were charged an arrangement fee (on which interest was also payable) in the region of 35% charged mostly as a result of passing onto borrowers the fees paid to a third-party service organisation which marketed and administered the bonds. The Respondents appear not to have considered why the third-party service organisation was paid such a large commission and whether (or why) borrowers were willing to accept the costs of that commission being passed on to them.

5.17.4. The Respondents failed to gain an understanding of whether the costs paid by borrowers were commensurate with market rates for similar lending (i.e., whether the loans were made on commercial terms) and why the borrowers were willing to pay the high cost of borrowing from LCF. Rates of 12–20% would not obviously have been the market rates for loans which were said to be fully secured and effectively repayable on demand, especially given that those rates were charged on top of a large arrangement fee.

Bond terms

5.18. The Respondents also failed to gain an adequate understanding of the "non-recourse" nature of the bonds issued. The bonds issued in "Series 5" contained a "non-recourse" clause. The effect of the clause was that, in the event that LCF failed to repay bondholders, the bondholders could not bring insolvency proceedings to enforce the debts payable to them.

5.19. The Respondents understood that the "non-recourse" nature of the bonds meant that non-payment of the full amount of the bonds on maturity was not a risk to the continuing operation of LCF's business. That reveals two serious misunderstandings of LCF's operations. First, only the bonds in Series 5 were "non-recourse". The earlier bonds did not contain a similar limitation on the bondholders' powers to commence insolvency proceedings.

5.20. Secondly, even in the presence of a non-recourse clause, the late or partial payment of bonds would have been a serious threat to the continuation of LCF's operations. If LCF failed to make bond repayments in full, the overwhelming likelihood is that it would not have been able to attract new bondholders and would have been unable to continue as a business since its funding relied entirely on raising money from issuing bonds. Therefore, the non-recourse nature of the bonds ought not to have provided any comfort in relation to the auditor's consideration of the going concern assumption (see Breach 7, below.)

Conclusion

5.21. It follows that, in breach of the requirements of paragraph 11 of ISA 315, the Respondents failed to obtain an adequate understanding of the nature of LCF, including its operations, how it was financed, and the business risks arising from its objectives and strategies which may have resulted in risks of material misstatement.

Internal control environment

5.22. Paragraphs 12 and 13 of ISA 315 required the Respondents to obtain an understanding of LCF's internal controls relevant to the audit, to evaluate the design of those controls, and to determine whether they had been implemented. An understanding of internal controls assists the auditor in identifying types of potential misstatements and factors that affect the risks of material misstatement, and in designing the nature, timing, and extent of further audit procedures.

5.23. Two factors are notable as regards the internal controls of smaller entities. On one hand, the control environment in a smaller entity may be relatively simple. It might not be possible to use internal controls which rely on the segregation of duties because of the limited extent to which that is practicable. However, in a smaller owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a large entity. On the other hand, an owner-manager of a smaller entity may be more able to override controls because the system of internal control is less structured. This is to be taken into account by the auditor when identifying the risks of material misstatement due to fraud. The Respondents paid more heed to the first of those factors than the second. Due to the small size of the business the Respondents determined that no internal controls "relevant to the audit" could be identified and placed no reliance on internal controls in conducting the Audit.

5.24. However, even if a fully substantive audit approach is adopted, without testing or relying on internal controls, it is necessary to understand controls, particularly to understand the effect on LCF's internal control relevant to the audit of the service organisations LCF relied on for accounting services as well as to market and administer its bonds, including the handling and accounting for money received. Those records were fundamental to the accurate recording of monies received as loans from bondholders. This understanding was required in order for the Respondents to design effective substantive procedures.

5.25. Since lending was also central to LCF's business, it would have been important to understand the internal controls which governed LCF's relationships with its loan debtors, notably the processes of carrying out due diligence, credit checks, confirming that security provided was effective and adequate and agreeing loan agreements with new borrowers, together with processes in place for ongoing monitoring of borrowers.

5.26. The Respondents did not carry out any assessment of the controls in place over the receipt of loans from bondholders or advancing funds to borrowers and therefore did not obtain an adequate understanding of those controls or lack thereof. Moreover, the

Respondents failed to consider internal controls relating to LCF's relationships with third-party service organisations, and failed to consider or adequately understand that any controls that were in place could have been overridden by LCF Director A.

5.27. The Respondents conduct thereby breached paragraphs 12 and 13 of ISA 315 by failing to obtain an adequate understanding of internal controls which were relevant to the audit, failing to evaluate the design of those controls, and failing to determine whether those controls had actually been implemented.

5.28. To the extent that the Respondents failed to document their risk assessment and understanding of the entity and its environment, they also breached the requirement in paragraph 8 of ISA 230 to prepare audit documentation sufficient to enable an understanding of the audit procedures performed, evidence obtained, and conclusions reached thereon.

Breach 2 – Exercise of professional skepticism and risk of fraud

5.29. Paragraph 15 of ISA 200 requires an auditor to plan and perform an audit with professional skepticism, recognising that circumstances may exist that cause the financial statements to be materially misstated. Professional skepticism is defined as an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence. Auditors are also required to recognise the possibility that fraud could give rise to a material misstatement, notwithstanding the auditor's past experience of the honesty and integrity of an entity's management, in accordance with paragraph 12 of ISA 240. Paragraph 15 of ISA 240 sets out that, as part of the planning of an audit, the discussion among the auditor's engagement team must place particular emphasis on how and where an entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur. Paragraph 18 of ISA 240 requires auditors to make inquiries of management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity.

Role of LCF Director A

5.30. LCF Director A had, in effect, sole control of LCF. He was also the only director of LCF with whom the audit team would regularly communicate. As set out at paragraph 5.6 above, this gave rise to a clear risk of management override of internal controls. For example, LCF Director A had the ability to authorise loans to entities which might have had difficulties raising funds from another source. The ability of those entities to repay

loans, and the uses to which they would put the loaned funds, were not subject to any further scrutiny from within LCF.

5.31. Over-reliance on LCF Director A was an issue which affected both the planning and performance of the audit. The Respondents placed undue weight on information provided by LCF Director A, and thereby failed to exercise an appropriate level of professional skepticism.

LCF business model

5.32. The commercial rationale of LCF's business model was not obvious. LCF paid exceptionally high costs to obtain debt finance and had minimal capital of its own. Those costs were then passed on to LCF's borrowers, on the basis of loan agreements which allowed LCF to add an unspecified amount in respect of the cost of borrowing to the loan balances. The charges applied were exceptionally high for loans that were supposed to have been fully secured, and the specific amounts do not appear to have been agreed by, or even notified to, the borrowers. What is more, LCF lent funds to a small number of businesses with little or no financial track record, in circumstances where all except one of those businesses had close links with LCF Director A.

5.33. LCF Director A was, according to Companies House records, a director of three of the four loan debtor companies for at least part of the period covered by the 2016 accounts. The fourth company was linked to LCF Director A by the fact that one of the directors, who had previously been a director of LCF, was a co-director of the other three companies along with LCF Director A. LCF Director A also had a financial interest in this fourth company and two of the others. The Respondents failed to adequately question inconsistencies in information received in relation to related parties (see Breach 8, below), and thereby failed to exercise an appropriate level of professional skepticism.

Cash flow and liquidity

5.34. A fundamental risk in LCF's business model was that bond cash outflows were not matched by cash inflows from the loan assets. Absent a clear understanding of how that risk would be met, an auditor considering the matter with an appropriate degree of professional skepticism would call into question the going concern assumption.

Professional skepticism

5.35. The Respondents failed to plan and perform the FY2016 Audit with adequate professional skepticism, in breach of paragraph 15 of ISA 200, in that the following matters required, but did not receive, appropriate professional skepticism from the Respondents:

5.35.1. LCF Director A could have overridden any internal controls that were in place.

5.35.2. The commercial rationale of LCF's business model was unclear.

5.35.3. LCF Director A was unwilling to send requests for external confirmations to debtors together with the fact that, even though confirmations were ultimately requested, no replies were received (see Breach 3, below).

5.35.4. All but one of the loan debtors were related parties or had a link to LCF Director A.

5.35.5. The inconsistencies in information received in relation to related parties.

5.35.6. The loans made by LCF were made on uncommercial terms.

5.35.7. The security provided by borrowers.

5.35.8. There was a mismatch between the maturity profile of bonds and the maturity profile of the loans made by LCF.

5.35.9. The validity of the going concern assessment, which ought to have been called into doubt by questions about the nature of the loans by LCF.

Risk of fraud

5.36. In failing to maintain professional skepticism in relation to the matters set out above, the Respondents failed to recognise that, as a result of those matters, it was possible that a material misstatement could exist due to fraud. The Respondents' conduct thereby breached paragraph 12 of ISA 240.

5.37. In breach of paragraph 15 of ISA 240, the Respondents failed to ensure that, in the discussion required by ISA 315, particular emphasis was placed on the susceptibility of LCF's financial statements to fraud.

5.38. In breach of paragraph 26 of ISA 240, the Respondents inappropriately concluded that the presumption that there are risks of fraud in revenue recognition was not applicable in the circumstances of the engagement. The Respondents did not have sufficient grounds for regarding the presumption as rebutted, and there were in fact good reasons to conclude that there was a risk of material misstatement due to fraud related to revenue recognition, including the unusual nature of the business model, the uncommercial nature of the loans and the high level of income being recognised which was not documented in the loan agreements, which gave rise to the opportunity to inflate revenue over and above that agreed by the borrowers. In addition, the procedures performed by the Respondents in relation to income recognition produced insufficient evidence in relation to revenue.

Inquiries of management

5.39. The Respondents failed to make inquiries of management to determine whether they had knowledge of any actual, suspected or alleged fraud affecting the entity. The only recorded inquiry in that regard was made in a meeting with LCF's external accountants. Such inquiries were therefore made, not to management, but to LCF's accountants. The Respondents' conduct thereby breached paragraph 18 of ISA 240.

5.40. To the extent that the Respondents failed to document professional skepticism, they also breached the requirement in paragraph 8 of ISA 230 to prepare audit documentation sufficient to enable an understanding of the audit procedures performed, evidence obtained, and conclusions reached thereon.

Breach 3 – Loan debtors

5.41. In FY2016, LCF had five loan debtors: four companies and one individual. As at 30 April 2015, LCF only had one debtor, Company A. In August 2015, Company B took on responsibility to repay that debt to LCF. No new loan agreement or assignment of the debt was agreed in relation to that arrangement. LCF created a charge over Company B's assets which was registered at Companies House in August 2015. Further funds generated by LCF from the issue of bonds were loaned to three companies (Company C, Company D and Company E) and an individual (Individual A) in FY2016.

5.42. Auditors are required to design and perform audit procedures to obtain sufficient appropriate audit evidence in relation to loan debtors, and particularly in relation to: the existence and quantum of loans, the nature and effect of the collateral by which loans are secured, and potential impairment of loans.

5.43. Management was initially reluctant to send external debtor confirmations. External confirmation is audit evidence obtained directly from a third party (i.e., the debtor), and may be more reliable than evidence generated internally by the audited entity. Following challenge by the Respondents, management agreed to send out confirmation requests, although no confirmations were in fact received from LCF's debtors.

Loan to Company B

5.44. The Respondents considered the recoverability of the loan to Company B together with the recoverability of the loan to Company C, and mistakenly recorded that Company C was the parent of Company B. In fact, both companies were wholly owned subsidiaries of another group, Group A. Nevertheless, they were separate companies and their obligations to LCF, and their ability to fulfil those obligations, ought to have been

considered separately. At the time of the Audit, the latest accounts filed at Companies House for Company B showed that it was a dormant company, its only asset being a bank balance of £2. The shortcomings in relation to the audit work on the recoverability of the loan to Company C (in relation to which the audit work was in fact carried out) are set out below, and there were similar shortcomings in the audit work relating to the loan to Company B.

Loan to Company C

5.45. The Respondents sought to confirm the loan balance to Company C by testing a sample of payments shown on LCF's bank statement. In short, they sought to match transactions which were recorded as loans to Company C to transactions in LCF's bank statements which appeared, from the narration in the statements, to have been payments to Company C. However, the narration on a bank statement specifying the name of the payee is not reliable as proof that the expected recipient received those funds. It does not preclude money being paid to a fraudulent company set up with a similar name or the possibility that the narrations were wrongly recorded. The Respondents did not obtain further corroborating evidence of the amount drawn down by Company C.

5.46. The Respondents also attempted to test the cost of funds charge added to the loans to Company C, however they did not seek evidence that the Company C cost of funds charge was in accordance with the terms and conditions accepted by Company C. The effect of LCF's approach to the cost of funds charge was that a further 34% was added to the sums advanced and interest was then charged on the full amount. The high cost of borrowing and the apparently uncommercial nature of the loan to Company C was not sufficiently queried by the Respondents. They did not confirm with Company C that it accepted the cost of borrowing charge added by LCF. They did not consider in their audit procedures whether all repayments received by LCF in relation to loan balances had been accounted for and appropriately deducted from the balance outstanding.

5.47. The Respondents considered the recoverability of the loan to Company C, and concluded there were no impairment indicators. There is no evidence that the Respondents considered whether payments from Company C had been made on time. Given the requirement that interest was to be paid quarterly, there should have been at least two interest payments in the FY2016. Only one interest payment is referred to in the Respondents' working papers. Therefore, interest payments were overdue.

5.48. In relation to security, the Respondents only considered the value of properties which were said to have provided security for the loan to Company C. There is no evidence

that the Respondents considered whether the security was in fact in place or that Company C had good title to the assets which were said to stand as security for the loan from LCF. The Respondents considered valuations of two properties in the Dominican Republic. The valuations were addressed to Company B. The valuations did not state the owner of the properties and were clear that the valuers had not seen evidence of title. There was no evidence that the properties were owned by Company C. Moreover, the charge given by Company C to LCF did not specify any of the individual assets charged. Consequently, there appears to be no evidence that the properties valued stood as security for the loan from LCF to Company C. In addition, there were a number of deficiencies in the valuation reports as audit evidence.

5.49. There is no evidence that the Respondents carried out any assessment of Company C's ability to repay its debts as they fell due, i.e., at 14 days' notice. Ms Miller stated at interview that she could not recall the Respondents having assessed the ability of Company C's, and Company B's, parent company to guarantee the loan.

Loan to Company D

5.50. The loan to Company D was not originally made by LCF to Company D. Rather, LCF purchased the loan from a third-party company. The asset sale agreement which effected that transfer was signed by LCF Director A on behalf of both the third-party company and LCF.

5.51. No repayments of capital were recorded as having been made on the loan to Company D during FY2016. A repayment of interest totalling £9,000 was recorded, which was tested to a bank statement. The Respondents did not carry out any procedures to ensure that there were no unrecorded repayments.

5.52. The audit work recorded relating to the recoverability of the Company D loan was restricted to assessing the value of the security supposedly given on the loan advanced to Company D. That security was said to comprise four lodges which were said to be owned by Company D. A search of Companies House website indicated that LCF never held a registered charge over these assets. There were two registered charges; one of which was in favour of the third-party company from which LCF purchased the loan. There is no evidence that the Respondents knew about these two charges. The Respondents carried out their own valuation of the four lodges: the assumptions used in that calculation were unexplained and unsubstantiated.

Loan to Individual A

5.53. Interest was payable quarterly under the terms of the loan agreement with Individual A and the first drawdown had been made in November 2015. However, no interest payments are shown as having been made and the Respondents did not record any remarks in that regard. The Respondents did not carry out any procedures to confirm the completeness of loan repayments and no repayments were recorded.

5.54. In terms of testing loan recoverability, the Respondents relied on an uncorroborated signed statement of assets allegedly provided by Individual A, which included assets held by his wife. Individual A's wife's assets would have been irrelevant. The assets listed included a house and the Respondents recorded that they checked the title register to verify that the land on which the house was built was owned by Individual A. The evidence obtained was not on its own sufficient to conclude that the loan was recoverable. The Respondents needed to consider other evidence that was relevant including (i) evidence of Individual A's other indebtedness; (ii) forecasts and other information pertaining to his business; (iii) independent verification that the asset values as stated were fair; or (iv) evidence of a charge, if any, executed in favour of LCF over those assets.

Conclusion

5.55. Therefore, in breach of paragraph 6 of ISA 500, the Respondents failed to perform audit procedures to obtain sufficient appropriate audit evidence in relation to the existence assertion in respect of the loan debtors, and the Respondents failed to design or perform audit procedures to confirm that each of the loans was recoverable. Further, in breach of paragraph 9 of ISA 500, the Respondents failed adequately to evaluate whether the information provided was sufficiently reliable for the auditor's purposes, including obtaining evidence about the accuracy and completeness of the information and evaluating whether the information was sufficiently precise and detailed for the auditor's purposes.

5.56. To the extent that the Respondents failed to document audit evidence in relation to loan debtors, they also breached the requirement in paragraph 8 of ISA 230 to prepare audit documentation sufficient to enable an understanding of the audit procedures performed, evidence obtained, and conclusions reached thereon.

Breach 4 - Prepayments

5.57. ISA 510 requires an auditor to obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements.

5.58. The Statement of Financial Position of LCF as at 30 April 2016 included an asset of almost £1.9 million described as prepayments. This related to commissions paid to a third-party company which were spread over the expected useful life of the bond creditor loans in line with International Accounting Standard (**"IAS"**) 39. LCF treated this amount as an asset under IAS 39, and the Respondents accepted this treatment on the basis that these commissions did not relate exclusively to the cost of raising finance from bond creditors. Had the commissions more properly been treated as transaction costs, however, IAS 39 requires that the amount should have been deducted from the bond creditor liability, which would have impacted both the bond creditors and prepayments balances.

5.59. The Respondents' work on opening balances did not explain how the previous auditors had considered key balances, namely the debtor and bond creditor balances. Nor did the Respondents' initial audit engagements working paper consider whether the evidence seen by them supported the amounts which formed the basis of significant balances included in the FY2016 Financial Statements. A number of prior year adjustments were made in relation to the financial statements for FY2015, including in relation to loans and other receivables to correct the accounting treatment adopted in respect of the cost-of-borrowing fee charged to a borrower. A similar error in the financial statements for FY2015 ought to have been evident to the Respondents in relation to the finance costs attaching to the bond creditors. As per the accounting policy stated in the financial statements for FY2015, the effective interest method had been used in the calculation of bond creditors, but for the reasons given at paragraph 5.58 above, it was not calculated on the correct basis.

5.60. The commissions paid to a third-party company were also incorrectly recorded in the financial statements for FY2015. Those payments were effectively charged against profit and loss at the point of payment rather than being spread over the expected term of the loan. In preparing the financial statements, LCF offset the cost paid to the third-party company against the amount re-charged to the borrower in respect of those costs. LCF's external accountants recognised that error when preparing the Statement of Financial Position at 30 April 2016. However, they did not include an adjustment for the amount that should have been reflected in respect of these "prepayments" at 30 April 2015.

5.61. The Respondents' consideration of the prepayment balance at 30 April 2016 and the fact that a prior year adjustment had been made in relation to the cost-of-borrowing fee re-charged to borrowers ought to have alerted them to the fact that a prior year adjustment was required to include prepayments in respect of the commissions payable in the Statement of Financial Position at 30 April 2015. This prior period adjustment was required to correct the error in applying the accounting policy in relation to finance costs in LCF's financial statements for FY2015. Assuming the period of the loans matched the period of the bonds, the amount of the prior year adjustment required would have been similar in value to the prior year adjustment made in respect of the cost-of-borrowing fee charged to borrowers of approximately £163,000. Had this adjustment been made, the FY2016 opening balance on accumulated losses would have decreased by approximately £163,000 to approximately £28,000 and the reported profit for FY2016 of approximately £148,000 would have become a loss of approximately £15,000.

5.62. Therefore, in breach of paragraph 6 of ISA 510, the Respondents failed to obtain sufficient appropriate audit evidence about whether the opening balances contained misstatements that materially affected the FY2016 Financial Statements. In particular, the Respondents failed to determine whether the opening balances reflected the application of appropriate accounting policies.

5.63. To the extent that the Respondents failed to document audit evidence in relation to opening balances, they also breached the requirement in paragraph 8 of ISA 230 to prepare audit documentation sufficient to enable an understanding of the audit procedures performed, evidence obtained, and conclusions reached thereon.

Breach 5 - Revenue

5.64. LCF's revenue was comprised of five elements:

5.64.1. Interest on loans made;

5.64.2. Fees received in relation to costs of funds, i.e., the interest payable by loan debtors equal to the cost of borrowing paid by LCF;

5.64.3. Commissions receivable on loans, i.e., amounts payable by borrowers equal to the cost of the commission paid by LCF and the administration fee payable to two third-party service organisations;

5.64.4. Loan arrangement fees; and

5.64.5. Consultancy fees.

5.65. The loan debtor amount comprised: (i) amounts drawn down by the borrowers; and (ii) the commission fees charged as a result of those drawdowns (effectively, LCF passing on to borrowers the fees paid to the third-party service organisation). The audit procedures conducted in respect of the loans did not provide assurance that the borrowers had agreed to accept the commission charge, which was not quantified in the loan agreements.

5.66. In relation to the cost of funds element of revenue, the Respondents failed to obtain or consider any evidence:

5.66.1. that the borrower had agreed or even been informed of the interest rate (which was not specified in any of the loan agreements, and the individual bond issues were not clearly linked to individual amounts advanced to borrowers);

5.66.2. that the interest charged was consistent with the loan balance outstanding;

5.66.3. that the amounts received related to the cost of funds part of the interest charge and did not represent a capital repayment or indeed payment for other services such as consultancy.

5.67. Consequently, the audit procedures carried out in respect of interest receivable and the cost of funds element of income received did not provide sufficient appropriate audit evidence that the amounts included in the FY2016 Financial Statements were not materially misstated.

5.68. In relation to consultancy fees, the income statement of LCF for FY2016 included £155,536 described as consultancy fees. The Respondents listed four transactions totalling around £20,000 which they indicated had been agreed to bank statements. A further amount of £135,000 was also identified and linked to an invoice which appears to have been raised to Company C on 30 April 2016. Apart from the inspection of a copy of the invoice, the Respondents did not perform audit procedures to confirm the existence and recoverability of the amount reflected in the invoice, which ought to have been regarded as a material amount for the purposes of the Audit. Checking the invoice would not have proved: (i) that the invoice was validly raised; (ii) that the amount recorded had been agreed with Company C; or (iii) that the amount was recoverable.

5.69. The accounting entry relating to that single invoice contributed over 90% of LCF's reported profit for the year and was one-off in nature. Consequently, the Respondents ought to have made further enquiries as to the validity of the transaction and they did not obtain sufficient appropriate audit evidence of the existence of either the reported revenue or the existence and recoverability of the related debtor balance. Moreover, the

Respondents did not consider the nature of the consultancy services being supplied by LCF or the controls and processes in places for invoicing consultancy clients. The Respondents have therefore not recorded any audit evidence that considers the completeness of consultancy revenue.

5.70. Therefore, in breach of paragraph 6 of ISA 500, the Respondents failed to perform audit procedures for the purpose of obtaining sufficient appropriate audit evidence in relation to the completeness and occurrence of revenue, in particular in relation to revenue from interest, commission fees, cost-of-borrowing fees, and consultancy fees.

5.71. To the extent that the Respondents failed to document audit evidence in relation to revenue, they also breached the requirement in paragraph 8 of ISA 230 to prepare audit documentation sufficient to enable an understanding of the audit procedures performed, evidence obtained, and conclusions reached thereon.

Breach 6 – Financial Instrument Disclosures

5.72. ISA 700 requires the auditor to evaluate whether the information presented in the financial statements is relevant, reliable, comparable, and understandable, and whether the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements.

5.73. The relevant accounting standard applicable to disclosures about financial instruments in the FY2016 Financial Statements was IFRS 7 which requires extensive disclosures relating to credit risk. Credit risk in the case of LCF related to the loan debtor balances.

5.74. LCF stated in note 10 of the FY2016 Financial Statements:

"The credit risk on liquid funds is limited because security is held over and above the value of the loans and extensive credit checks and due diligence are performed on new and existing customers.
The carrying value of the loans outstanding as at the year end is £7,434,014, the notional value of the loans outstanding as at the year ended is £9,396,814 and the fair value of the assets against which these loans are secured is £60,752,482."

5.75. LCF's disclosures in relation to credit risk were inadequate for the following reasons:

5.75.1. It was not clear that security was held over all of the loans;

5.75.2. The fair value of assets was not supported by adequate evidence;

5.75.3. There is no evidence on the audit file of any credit checks or due diligence at all being carried out by LCF on new and existing borrowers. The Respondents

were advised that financial information was not in fact provided by borrowers before loans are drawn down;

5.75.4. There were just five debtor balances, the largest of which represented approximately 83% of the gross debtor balance at 30 April 2016. However, there was no disclosure concerning the concentration of credit risk.

5.76. IFRS 7 requires an entity to explain how it manages its liquidity risk, that is how it will ensure it has sufficient funds to meet its liabilities when they fall due. LCF's liquidity was uncertain. LCF did not explain how it would ensure sufficient funds would be available to settle the bond creditors as they fell due for repayment. While the loans it made were repayable on 14 days' notice, the ability of its debtors to make repayments at short notice was doubtful. The principal borrower was a property developer and no assessment had been made of its liquidity.

5.77. The Respondents did not properly evaluate whether the financial statements were prepared, in all material respects, in accordance with the requirements of the applicable financial reporting frameworks in that they did not obtain sufficient audit evidence in relation to the financial statements disclosure of the fair value of the assets held as security against the loan advanced. Further, the disclosure made in the FY2016 Financial Statements in respect of the loan to Company B was unclear and inaccurate, and there should have been greater and more detailed disclosure on loan security, and a disclosure in relation to the concentration of credit risk should have been included in the financial statements.

5.78. Therefore, in breach of paragraph 6 of ISA 500, the Respondents failed to perform audit procedures for the purpose of obtaining sufficient appropriate audit evidence in relation to LCF's financial instrument disclosure with regard to credit risk and the loan debtor balances.

5.79. Two further breaches flow from the Respondents' failure to obtain sufficient evidence in relation to LCF's financial instrument disclosures:

5.79.1. In breach of paragraph 8(d) of ISA 700, the Respondents failed to evaluate whether the financial statements had been prepared in all material respects in accordance with IFRS.

5.79.2. In breach of paragraph 9(f) of ISA 700, the Respondents failed to evaluate whether the financial statements included adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements.

5.80. To the extent that the Respondents failed to document audit evidence in relation to financial instrument disclosures, they also breached the requirement in paragraph 8 of ISA 230 to prepare audit documentation sufficient to enable an understanding of the audit procedures performed, evidence obtained, and conclusions reached thereon.

Breach 7 – Going Concern

5.81. Under the going concern basis of accounting, the financial statements are prepared on the assumption that an entity is a going concern and will continue its operations for the foreseeable future. Financial statements are prepared on a going concern basis of accounting unless an entity's management intends to liquidate the entity or to cease trading or has no realistic alternative to liquidation or cessation of operations. An entity's ability to continue as a going concern will therefore determine whether or not it is appropriate for an entity to adopt the going concern basis of accounting.

5.82. Paragraph 9 of ISA 570 requires the auditor to obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern assumption in the preparation of the financial statements. Paragraph 10 of ISA 570 requires that auditors consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

5.83. In the notes of their consideration of the going concern assumption, the Respondents recorded several inaccurate statements:

5.83.1. LCF had not been trading for "*a number of years*", as the Respondents stated. In fact, it began trading during the four-month period ended 31 March 2014.

5.83.2. It had not retained a profitable position, as the Respondents stated. The Statement of Financial Position at 30 April 2016 reports accumulated losses of around £24,000.

5.83.3. LCF's opening balance on retained earnings and reported profit for FY2016 was misstated, due to not properly accounting for the necessary prior year adjustment in respect of loan arrangement fees attributable to bonds in issue. As set out at paragraph 5.68 above, the reported profit included £135,000 in respect of an apparently isolated consultancy fee that could have been an indication that the reported level of profit was exceptional.

5.83.4. The net asset position was incorrectly understated in the Respondents' working papers.

5.84. The basis for the Respondents' conclusion that there were no material uncertainties about the ability of LCF to continue as a going concern was further undermined by the following points:

5.84.1. LCF's reported level of net assets of £25,592 represented an extremely thin margin of solvency for a company with reported total liabilities in excess of £10 million. Even an immaterial bad debt could have caused the liabilities of LCF to exceed its assets, leading to an insolvent financial position.

5.84.2. The audit procedures relating to LCF's accounts receivable were based on insufficient evidence. Therefore, the conclusions reached in relation to accounts receivable could not properly be relied upon in relation to the going concern assumption.

5.84.3. Interest rates had not been agreed to borrower contracts. The Respondents merely confirmed the interest rate over the cost of borrowing to contracts. They did not confirm that the borrowers had agreed to pay the base interest charge equal to LCF's cost of borrowing. They also did not confirm that the borrowers were aware of and had accepted the exceptionally high cost of borrowing equal to the third-party commission that had been added to their loan balances.

5.84.4. The Respondents did not undertake any assessment of the ability of borrowers to make such repayments as were required to fund bond redemptions as they fell due.

5.84.5. Save for Individual A, all of LCF's loan debtors had current or previous related party relationships with LCF Director A.

5.84.6. LCF had failed to carry out due diligence on its borrowers.

5.84.7. No financial forecasts had been prepared to support the going concern assumption or the liquidity of LCF to settle its liabilities as they fell due for payment.

5.85. In reality, the main factors affecting the going concern assumption were as follows:

5.85.1. LCF had obligations to repay bondholders on fixed dates. The loans made by LCF were repayable on 14 days' notice or three years from the initial drawdown. This mismatch in maturity profiles raised a question of whether the timing of loan repayments would have been adequate to make repayments to bondholders.

5.85.2. LCF’s borrowers were engaged, primarily, in property development. That raised a question of whether the borrowers were sufficiently liquid to repay amounts on 14 days’ notice.

5.85.3. The recoverability of loans was fundamental to LCF’s ability to meet the repayments of the bondholders.

5.86. Therefore, in breach of paragraph 9 of ISA 570, the Respondents failed to obtain sufficient appropriate audit evidence regarding the appropriateness of management’s use of the going concern assumption in the preparation of the financial statements. In breach of paragraph 10 of ISA 570, the Respondents also failed to consider adequately the appropriateness of management’s use of the going concern assumption in the preparation of the financial statements.

5.87. To the extent that the Respondents failed to document audit evidence in relation to the going concern assumption, they also breached the requirement in paragraph 8 of ISA 230 to prepare audit documentation sufficient to enable an understanding of the audit procedures performed, evidence obtained, and conclusions reached thereon.

Breach 8 – Related Party Transactions

5.88. ISA 550 addresses the risks associated with related party transactions. Although many related party transactions are in the normal course of business, in some instances the nature of related party relationships and transactions may give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. The reasons for this include the fact that related parties are not independent of each other, and related party transactions may not be conducted under normal market terms and conditions.

5.89. Paragraph 15 of ISA 550 requires that an auditor “*shall remain alert, when inspecting records or documents, for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor*”.

5.90. During the course of the audit, LCF provided the Respondents with a completed related party enquiry form, signed by LCF Director A, which disclosed five related parties including LCF Director A and a person with a close familial connection to LCF Director A, along with two out of five other individuals who were directors for at least part of the period covered by the FY2016 Audit. The Respondents then performed independent procedures to assess the completeness of the list provided by LCF and identified 76

parties related to LCF Director A. They identified that, according to Companies House records:

5.90.1. LCF Director A held several directorships in the year that were not disclosed in the signed related party enquiry form.

5.90.2. During FY2016, LCF Director A was a director at two of LCF's borrowers (Company B and Company D).

5.91. The Respondents determined that LCF Director A did not understand the definition of a "related party" and provided guidance in accordance with IAS 24 – Related Party Disclosures. It was agreed that an updated related party enquiry form would be provided that would include a full disclosure of LCF's related parties.

5.92. An updated, unsigned and undated related party form was received by the Respondents, detailing three current directorships "*that he should have resigned from*", and six further resignations "*which all should have been lodged in June* [20]*15 but happened later*". The Respondents were then provided with a letter from Group A to LCF Director A, signed by the company secretary. The letter stated that by the end of June 2015, LCF Director A had resigned from his directorships of Company C and Company D. The letter also stated that the resignations had not been recorded at Companies House due to error on the part of Group A. The Respondents conducted internal consultations with PwC's Company Secretariat team and the Audit Risk and Quality team and concluded that they could accept that the resignations took place on the date stated in the letter rather than the dates recorded at Companies House. However, the Respondents ought to have subjected this point to further scrutiny. There is no explanation of why the resignation dates differed or why they had not been corrected.

5.93. Had LCF disclosed related party transactions as regards Company C and Company D, then LCF's publicly available financial statements would have shown that approximately 95% of LCF's total loan debtor balance at 30 April 2016 was with related parties.

5.94. The FY2016 Financial Statements disclosed related party transactions in relation to LCF Director A and Company B, and noted the loan had been transferred from Company A, of which LCF Director A was also a director. These disclosures were unclear and inaccurate, including in relation to the "taking over" of the loan, the interest rate was incorrect and the disclosed balance is overstated.

5.95. Therefore, in breach of paragraph 6 of ISA 500 and paragraph 9(b) of ISA 550, the Respondents failed to perform audit procedures for the purposes of obtaining sufficient evidence in relation to LCF's related parties. The Respondents failed to obtain sufficient

evidence to substantiate the completeness and accuracy of disclosures made in respect of the related party balance with Company B and hence failed to identify that the disclosures made were both incomplete and inaccurate. The evidence provided as regards LCF Director A resigning certain directorships ought not simply to have been accepted at face value.

5.96. In breach of paragraph 15 of ISA 550, the Respondents failed to remain alert, when inspecting records or documents, for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor.

5.97. Furthermore, in breach of paragraph 22(c) of ISA 550, the Respondents failed to perform appropriate substantive audit procedures relating to newly identified related parties. In particular, the Respondents failed to investigate adequately why the resignation dates set out in the letter from Group A did not agree with the resignation dates set out in the documents filed at Companies House.

5.98. In breach of paragraph 9(e)-(f) of ISA 700, the Respondents failed to evaluate the reliability, comparability and understandability of the FY2015 comparative disclosure relating to the Company B loan in the FY2016 Financial Statements. Further, the Respondents failed to evaluate whether the related party disclosures in the FY2016 Financial Statements were adequate to enable users to understand the effects of material related party transactions on those financial statements.

5.99. To the extent that the Respondents failed to document audit evidence in relation to related parties, they also breached the requirement in paragraph 8 of ISA 230 to prepare audit documentation sufficient to enable an understanding of the audit procedures performed, evidence obtained, and conclusions reached thereon.

6. *SANCTIONS*

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

6.1.1. to declare and uphold proper standards of conduct amongst *Statutory Auditors* and *Statutory Audit Firms* and to maintain and enhance the quality and reliability of future audits;

6.1.2. to maintain and promote public and market confidence in *Statutory Auditors* and *Statutory Audit Firms* and the quality of their audits and in the regulation of the accountancy profession;

6.1.3. to protect the public from *Statutory Auditors* and *Statutory Audit Firms* whose conduct has fallen short of the *Relevant Requirements*; and

6.1.4. to deter *Statutory Auditors* and *Statutory Audit Firms* from breaching the *Relevant Requirements* relating to *Statutory Audit.*

6.2. Paragraph 12 of the Policy provides that the primary purpose of imposing *Sanctions* for breaches of the *Relevant Requirements* is not to punish, but to protect the public and the wider public interest.

6.3. In deciding on *Sanctions*, Executive Counsel has, in summary, considered the following matters in accordance with the Policy.

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

6.4. The breaches were very serious. They included multiple contraventions of requirements which are fundamental to the role of the independent auditor, and they affected the auditing of several areas of the financial statements which were fundamental to LCF's business.

6.5. Executive Counsel is unable to determine whether the Respondents would necessarily have identified that (i) LCF was potentially a fraudulent entity, or (ii) that the financial statements may have been materially misstated, if the breaches had not occurred. Executive Counsel does not, therefore, hold the Respondents directly responsible for the losses resulting from LCF's collapse. However, by failing to gain a proper understanding of LCF and to exercise adequate professional skepticism, in particular, the Respondents were not in a position to detect such matters, and failed to provide the reasonable assurance that is the objective of any statutory audit.

6.6. That failure is made more serious by the fact that the Respondents were aware that LCF was engaged in issuing bonds to retail investors, and that its business was growing rapidly. It should have been obvious to the Respondents that a clean audit opinion issued by one of the top audit firms in the UK might be relied upon by future investors, and could be exploited by LCF to promote its business. On that basis, the breaches risked the loss of significant sums of money and had the potential to adversely impact significant numbers of people. These risks did in fact materialise when LCF collapsed, at least with regard to investors who had bought bonds after the FY2016 Audit. The

breaches also had the potential to significantly undermine public confidence in the standard of UK auditing, and the truth and fairness of financial statements generally.

6.7. Conversely, the breaches were not deliberate, reckless or dishonest and were not committed with a view to financial gain. It is also right to acknowledge that, given the passage of time, there have been changes to PwC's audit methodology, policies and guidance which would mitigate the likelihood of recurrence of the shortcomings found during this investigation. However, Executive Counsel requires further evidence to be satisfied that these steps appropriately mitigate the risk of repetition.

6.8. The financial strength of the Respondents is a relevant consideration when determining the appropriate *Sanctions.* As has been noted, PwC is the largest audit firm in the UK, with total revenue across all of its business of about £3,875m in 2022.

Identification of *Sanction*

6.9. Having assessed the nature, seriousness, gravity and duration of the breaches, Executive Counsel identified the following combination of *Sanctions* as appropriate in the case of each Respondent:

6.9.1. A financial penalty of £7,000,000 in the case of PwC and £150,000 in the case of Ms Miller;

6.9.2. A published statement in the form of a severe reprimand;

6.9.3. A declaration that the FY2016 Audit report signed on behalf of PwC did not satisfy the *Relevant Requirements*; and

6.9.4. An order requiring specified steps to prevent a recurrence of the breaches.

Aggravating and mitigating factors

6.10. Executive Counsel then took into account any aggravating and mitigating factors that exist (to the extent that they have not already been taken into account in relation to the nature, seriousness, gravity and duration of the breaches). No adjustment has been made to the *Sanctions* identified above.

6.11. With regard to aggravating factors, sanctions have been imposed on PwC in relation to six other investigations since 2019:

6.11.1. AEP – 30 November 2018 year-end, settled 30 March 2023: £3.5m fine (discounted to £1.990m for settlement and cooperation).

6.11.2. AEP – 31 March 2017 and 31 March 2018 year-ends, settled 3 January 2023: £7.5m fine (discounted to £5.625m for settlement).

6.11.3. AEP – 31 March 2017 year-end, settled 28 June 2022: £2.5m fine (discounted to £1.75m for settlement).

6.11.4. AEP – 30 June 2018 and 30 June 2019 year-ends, settled 31 March 2022: £5.5m fine (discounted to £3.038m for settlement and cooperation).

6.11.5. AEP – 30 June 2017 year-end, settled 20 December 2021: £3.35m fine (discounted to £1.959m for settlement).

6.11.6. AEP – 31 March 2015 and 31 March 2016 year-ends, settled June 2019: £6.5m fine (discounted to £4.55m for settlement).

6.12. With regard to mitigating factors, Ms Miller has a clean disciplinary record, but this is not regarded as meriting any further reduction in the *Sanctions* against her, in the circumstances.

6.13. The Respondents have provided the level of cooperation required of them during the investigation but not the exceptional cooperation which would amount to a positive mitigating factor.

Deterrence

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

Discount for Admissions and Settlement

6.15. Full admissions were made by the Respondents at an early point in Stage 1 of the case, in accordance with paragraph 84 of the Policy, however the admissions were not all made at the first opportunity. On that basis, Executive Counsel considers that a reduction of 30% to the financial penalty imposed against each Respondent is appropriate.

Sanctions

6.16. For the reasons set out above Executive Counsel imposes the following *Sanctions*.

Against PwC:

6.16.3. A financial penalty of £7,000,000, adjusted for aggravating and mitigating factors, and discounted for admissions and early disposal by 30% so that the financial penalty payable is £4,900,000;

6.16.4. A published statement in the form of a severe reprimand;

6.16.5. A declaration that the FY2016 Audit report did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*; and

6.16.6. An order requiring PwC to take the following action designed to prevent the recurrence of the contravention:

6.16.6.1. Within 6 months of the *Final Settlement Decision Notice*, report to the FRC on the following (the "**First Report**"):

(a) The root causes of the breaches identified in the *Final Settlement Decision Notice*;

(b) Improvement measures already in place which address those root causes and would help to prevent a recurrence of the breaches, including in relation to: (i) audit client acceptance; (ii) review of audit portfolios; and (iii) auditor training on professional scepticism and understanding the entity (the "**Remedial Measures**");

(c) An assessment of the effectiveness of the Remedial Measures and the extent to which they have addressed the specific shortcomings in the FY2016 Audit as identified in the *Final Settlement Decision Notice*; and

(d) Any necessary and appropriate further improvement measures to address the root causes and to prevent a recurrence of the breaches (the "**Additional Remedial Measures**").

6.16.6.2. By such deadline as may be agreed by the FRC, which shall not be later than 8 months after the date of the *Final Settlement Decision Notice*, agree the scope of the Additional Remedial Measures to be implemented;

6.16.6.3. By such deadline as may be agreed by the FRC, which shall not be later than 12 months after the date of the *Final Settlement Decision Notice*, implement those Additional Remedial Measures;

6.16.6.4. By such deadline as may be agreed by the FRC, which shall not be later than 18 months after the date of the *Final Settlement Decision Notice*, report to the FRC (the "**Second Report**") on an assessment of the effectiveness of the Remedial Measures and the Additional Remedial Measures; and

6.16.6.5. Provide any further information or report in connection with, or as a result of, the First Report or the Second Report, as required by the FRC.

Against Jessica Miller:

6.16.7. A financial penalty of £150,000, adjusted for aggravating and mitigating factors, and discounted for admissions and early disposal by 30% so that the financial penalty payable is £105,000;

6.16.8. a published statement in the form of a severe reprimand;

6.16.9. a declaration that the FY2016 Audit report did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*.

7. *COSTS*

7.1. Executive Counsel requires that the Respondents pay her *Costs* in full in this matter, being £273,730. Such *Costs* shall be paid no later than 28 days after the date of this *Final Settlement Decision Notice*.

Signed:

[Redacted.]

Jamie Symington
DEPUTY EXECUTIVE COUNSEL

Date: 9 January 2024

APPENDIX – EXTRACTS FROM RELEVANT ISAS

ISA 200: Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing

Paragraph 15 states as follows:

> "*The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.*"

ISA 230: Audit Documentation

Paragraph 8 states as follows:

> "*The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:*
>
> *(a) The nature, timing and extent of the audit procedures performed to comply with the ISAs (UK and Ireland) and applicable legal and regulatory requirements;*
>
> *(b) The results of the audit procedures performed, and the audit evidence obtained; and*
>
> *(c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions*."

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

Paragraph 12 states as follows:

> *"In accordance with ISA (UK and Ireland) 200, the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance."*

Paragraph 15 states as follows:

> *"ISA (UK and Ireland) 315 requires a discussion among the engagement team members and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion.5 This discussion shall place particular emphasis on how and where the entity's*

financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur. The discussion shall occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity."

Paragraph 18 states as follows:

"The auditor shall make inquiries of management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity."

Paragraph 26 states as follows:

"When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give risk to such risks. Paragraph 47 specifies the documentation required where the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud."

ISA 315: Identifying and assessing the risks of material misstatement through understanding the entity and its environment

Paragraph 5 states as follows:

"The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedure by themselves, however, do not provide sufficient appropriate audit evidence on which to case the audit opinion."

Paragraph 6 states as follows:

"The risk assessment shall include the following:

(a) Inquiries of management, of appropriate individuals within the internal audit function (if the function exists), and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error.
(b) Analytical procedures.
(c) Observation and inspection."

Paragraph 11 states as follows:

"The auditor shall obtain an understanding of the following:

(a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework.

(b) The nature of the entity, including:

(i) its operations;

(ii) its ownership and governance structures;

(iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and

(iv) the way that the entity is structured and how it is financed

to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.

(c) The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.

(d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.

(e) The measurement and review of the entity's financial performance."

Paragraph 12 states as follows:

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

Paragraph 13 states as follows:

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

ISA 500: Audit Evidence

Paragraph 6 states as follows:

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

Paragraph 9 states as follows:

> *"When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including as necessary in the circumstances:*
>
> *(a) Obtaining audit evidence about the accuracy and completeness of the information; and*
>
> *(b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes."*

ISA 510: Opening balances

Paragraph 6 states as follows:

> *"The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:*
>
> *(a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, where appropriate, have been restated;*
>
> *(b) Determining whether the opening balances reflect the application of appropriate accounting policies; and*
>
> *(c) Performing one or more of the following:*
>
> *(i) Where the prior year financial statements were audited, reviewing the predecessor auditor's working papers to obtain evidence regarding the opening balances;*
>
> *(ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or*
>
> *(iii) Performing specific audit procedures to obtain evidence regarding the opening balances."*

ISA 550: Related parties

Paragraph 15 states as follows:

"During the audit, the auditor shall remain alert, when inspecting records or documents, for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor.

In particular, the auditor shall inspect the following for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor:

(a) Bank and legal confirmations obtained as part of the auditor's procedures;

(b) Minutes of meetings of shareholders and of those charged with governance; and

(c) Such other records or documents as the auditor considers necessary in the circumstances of the entity."

Paragraph 22 states as follows:

"If the auditor identifies related parties or significant related party transactions that management has not previously identified or disclosed to the auditor, the auditor shall:

(a) Promptly communicated the relevant information to the other members of the engagement team;

(b) Where the applicable financial reporting framework establishes related party requirements:

(i) Request management to identify all transactions with the newly identified related parties for the auditor's further evaluation; and

(ii) Inquire as to why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions;

(c) Perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions;

(d) Reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or

disclosed to the auditor, and perform additional audit procedures as necessary; and

(e) If the non-disclosure by management appears intentional (and therefore indicative of a risk of material misstatement due to fraud), evaluate the implications for the audit."

ISA 570: Going Concern

Paragraph 9 states as follows:

"The objectives of the auditor are:

(a) To obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern assumption in the preparation of the financial statements;

(b) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and

(c) To determine the implications for the auditor's report."

Paragraph 10 states as follows:

"When performing risk assessment procedures as required by ISA (UK and Ireland) 315 (Revised June 2013),[3] the auditor shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. In so doing, the auditor shall determine whether management[1a] has already performed a preliminary assessment of the entity's ability to continue as a going concern, and:

(a) If such an assessment has been performed, the auditor shall discuss the assessment with management and determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern and, if so, management's plans to address them; or

(b) If such an assessment has not yet been performed, the auditor shall discuss with management the basis for the intended use of the going concern assumption, and inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

[1a] In the UK and Ireland those charged with governance are responsible for the preparation of the financial statements and the assessment of the entity's ability to continue as a going concern.

[3] *ISA (UK and Ireland) 315 (Revised June 2013), "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment," paragraph 5."*

ISA 700: Audit Report

Paragraph 8 states as follows:

"The auditor's report on the financial statements shall contain a clear written expression of opinion on the financial statements taken as a whole, based on the auditor evaluating the conclusions drawn from the audit evidence obtained, including evaluating whether:

(a) Sufficient appropriate audit evidence as to whether the financial statements as a whole are free from material misstatement, whether due to fraud or error has been obtained;
(b) Uncorrected misstatements are material, individually or in aggregate. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments;
(c) In respect of a true and fair framework, the financial statements, including the related notes, give a true and fair view; and
(d) In respect of all frameworks the financial statements have been prepared in all material respects in accordance with the framework, including the requirements of applicable law."

Paragraph 9 states as follows:

"In particular, the auditor shall evaluate whether:

(a) The financial statements adequately refer to or describe the relevant financial reporting framework;
(b) The financial statements adequately disclose the significant accounting policies selected and applied;
(c) The accounting policies selected and applied are consistent with the applicable financial reporting framework, and are appropriate in the circumstances;
(d) Accounting estimates are reasonable;
(e) The information presented in the financial statements is relevant, reliable, comparable and understandable;

(f) The financial statements provide adequate disclosures to enable the intended user to understand the effect of material transactions and events on the information conveyed in the financial statements; and

(g) The terminology used in the financial statements, including the title of each financial statement, is appropriate."