

IN THE MATTER OF:

THE EXECUTIVE COUNSEL TO THE FINANCIAL REPORTING COUNCIL

- and -

- 1. RUSSELL SINCLAIR MCBURNIE**
- 2. NICHOLAS WILLIAM EDWARD BODEN**
- 3. PRICEWATERHOUSECOOPERS LLP**

FORMAL COMPLAINT

INTRODUCTION

1. The Financial Reporting Council (“**the FRC**”) is the independent disciplinary body for the accountancy and actuarial professions in the UK. The FRC’s rules and procedures relating to accountants are set out in the Accountancy Scheme of 8 December 2014 (“**the Scheme**”).
2. Paragraph 7(11) of the Scheme provides that if the Executive Counsel to the FRC (“**the Executive Counsel**”) considers that there is a realistic prospect that a Tribunal will make an Adverse Finding against a Member or Member Firm¹ and that a hearing is desirable in the public interest, then the Executive Counsel shall deliver a Formal Complaint against the Member or Member Firm to the Conduct Committee of the FRC.
3. This is the Executive Counsel’s Formal Complaint pursuant to paragraph 7(11) in respect of:

¹ References to “Member Firm” and “Member” in this document relate to the definition as set out in paragraph 2(1) of the Scheme. References to “member firm” and “member” denote their membership of the Institute of Chartered Accountants in England and Wales (“**ICAEW**”).

- (1) Mr Russell Sinclair McBurnie (“**Mr McBurnie**”), the former Finance Director of RSM Tenon Group plc (“**RSM Tenon**”)² and a member of the ICAEW;
 - (2) Mr Nicholas William Edward Boden (“**Mr Boden**”), a partner of PricewaterhouseCoopers LLP (“**PwC**”) and a member of the ICAEW; and
 - (3) PwC, a member firm of the ICAEW.
4. As, respectively, members and a member firm of the ICAEW, the Respondents are Members and a Member Firm for the purpose of the Scheme.
5. The Formal Complaint concerns:
 - (1) Mr McBurnie’s conduct in relation to the preparation and approval of the financial statements of RSM Tenon for the financial year ended 30 June 2011 (“**FY11**”).
 - (2) Mr Boden’s and PwC’s conduct in relation to the audit of the financial statements of RSM Tenon for FY11.

Mr McBurnie

6. Mr McBurnie was admitted to membership of the ICAEW in 1999. Between March 2008 and October 2011, he was Finance Director and a member of the board of RSM Tenon having originally joined as the group financial controller in March 2005. He trained with Deloitte and had been financial controller of the London bus division of First Group Plc prior to working at RSM Tenon.
7. As Finance Director, Mr McBurnie was responsible for the oversight of the preparation of the figures on which the draft financial statements of RSM Tenon would be based. Further, the directors of RSM Tenon, including Mr McBurnie, were ultimately responsible for the preparation and approval of

² References to RSM Tenon also include predecessor companies.

the financial statements of RSM Tenon in accordance with the applicable laws and regulations and were not to approve the financial statements unless they were satisfied that they gave a true and fair view of the state of affairs of RSM Tenon and the profit and loss for that period.

PwC and Mr Boden

8. According to its website (as at October 2016) and its annual report for 2016, PwC has 926 UK partners and approximately 21,900 people working in its 64 offices across the UK, Channel Islands and the Middle East. In the year to 30 June 2016, its group revenue was £3,437 million of which £1,241 million was assurance (including audit) revenue. PwC was appointed as RSM Tenon's auditor in 2000 and conducted the audit of the financial statements of RSM Tenon from then until 2012.

9. Mr Boden was PwC's "engagement partner" responsible for signing the audit opinion in the financial statements of RSM Tenon for FY11. The engagement partner is the person in the firm who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm (ISA 220, paragraph 7(a)). Pursuant to ISA 220:

(1) *"The engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned"* (paragraph 8).

(2) *"The engagement partner shall take responsibility for: (a) The direction, supervision and performance of the audit engagement in compliance with professional standards and applicable legal and regulatory requirements; and (b) The auditor's report being appropriate in the circumstances"* (paragraph 15).

(3) *"...the engagement partner shall, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued"* (paragraph 17).

Accordingly, where criticism is made of the performance of PwC's audit in the Allegations made below, Mr Boden bears responsibility for the audit's shortcomings as the engagement partner.

10. Mr Boden was admitted to membership of the ICAEW in 1990. He joined PwC in 1985 and became a partner in 1997. PwC and Mr Boden gave an unqualified audit opinion in respect of RSM Tenon for FY11, which Mr Boden signed personally on behalf of the firm.

THE RELEVANT STANDARDS & NATURE OF MISCONDUCT

The relevant standards of conduct

11. The standards of conduct reasonably to be expected of the Respondents included those set out in the Fundamental Principles contained in Part A of the Code of Ethics ("**the Code**") issued by the ICAEW. The Fundamental Principles contained in the Code are made in the public interest and they are designed to maintain a high standard of efficiency and professional conduct by all members of the ICAEW. Relevant extracts of the Code are extracted and annexed to this Formal Complaint as Annex A.
12. The Fundamental Principles set out in Paragraph 100.5 of the Code required the Respondents, inter alia, to act with:
 - (1) **Integrity** – to be straightforward and honest in all professional and business relationships;
 - (2) **Objectivity** – to not allow bias, conflict of interest or undue influence of others to override professional or business judgements;
 - (3) **Professional Competence and Due Care** – to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards;
 - (4) **Confidentiality** – to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without

proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the professional accountant or third parties; and

- (5) **Professional Behaviour** – to comply with relevant laws and regulations and avoid any action that discredits the profession.

- 13. Paragraph 110.1 states that “[t]he principle of integrity imposes an obligation on all professional accountants to be straightforward and honest in all professional and business relationships. Integrity also implies fair dealing and truthfulness”.

Paragraph 110.2 further requires in relation to the principle of Integrity that: “A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the professional accountant believes that the information:

- (a) Contains a materially false or misleading statement;
- (b) Contains statements or information furnished recklessly; or
- (c) Omits or obscures information required to be included where such omission or obscurity would be misleading.”

- 14. Paragraph 130.1(b) imposes the following obligation on all professional accountants in relation to the principle of Professional Competence and Due Care:

“To act diligently and in accordance with applicable technical and professional standards when providing professional services.”

Paragraph 130.5 further requires that:

“A professional accountant shall take reasonable steps to ensure that those working under the professional accountant’s authority in a professional capacity have appropriate training and supervision”.

- 15. The Fundamental Principles and accompanying Conceptual Framework contained in Part A of the Code are supplemented by Part B of the Code in relation to professional accountants in public practice and Part C of the Code in relation to professional accountants in business.

The relevant accounting standards

16. RSM Tenon, as a listed company, was required to prepare its financial statements for FY11 in accordance with International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board and adopted by the European Union. These standards include International Accounting Standards (“IAS”).

The relevant auditing standards

17. In relation to the conduct of the audit of the financial statements of RSM Tenon for FY11, the relevant auditing framework was the International Standards on Auditing (UK and Ireland) (“ISAs”) and the Ethical Standards issued by the Auditing Practices Board. The purpose of ISAs is to establish standards and general principles with which auditors are required to comply in the conduct of any audit. Together with the Ethical Standards, they form a body of standards that should be applied before an auditor can express an opinion that financial statements give a “true and fair view” within the meaning of section 393 of the Companies Act 2006. Relevant extracts of the accounting standards and auditing standards are extracted and annexed to this Formal Complaint as Annex B.

The Respondents’ Misconduct

18. Paragraph 2(1) of the Scheme provides that an Adverse Finding (referred to in paragraph 2 above) is a finding by a Disciplinary Tribunal that a Member or Member Firm has committed “Misconduct”. Misconduct is defined as:

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

19. As set out more particularly below, it is alleged that the Respondents’ conduct fell significantly short of the standards reasonably to be expected of a Member or Member Firm in the following respects:

(1) **Mr McBurnie** included within the financial statements of RSM Tenon for FY11 a number of misleading and/or incorrect entries all of which had the effect of improving RSM Tenon's financial position at a time when the business was struggling. The specific areas in which Mr McBurnie's conduct fell significantly short of the standards reasonably to be expected of a Member are the following:

- (a) the accrual of bonus payments;
- (b) the recognition of work in progress ("WIP") and amounts recoverable on contracts ("AROC");
- (c) the recognition of prepaid fees for the purpose of obtaining IVA appointments;
- (d) the classification as operating leases of two leases entered into between RSM Tenon and a business called Econocom ("the Econocom Leases");
- (e) the assessment of the impairment of goodwill; and
- (f) the preparation of the financial statements on a going concern basis.

Mr McBurnie's accounting treatment of these matters had the effect of promoting a significantly more positive impression of RSM Tenon's financial position than was the case. In the respects alleged within this Formal Complaint Mr McBurnie was reckless as to whether the financial statements of RSM Tenon for FY11 would give a misleading picture of RSM Tenon's underlying performance.

Taken either individually or collectively, his failings in respect of the matters referred to above constitute conduct by Mr McBurnie which fell significantly short of the standards reasonably to be expected of a Member.

(2) **Mr Boden's** conduct fell significantly short of the standards to be expected of a Member in relation to the audit of the financial statements of RSM Tenon for FY11 in the following areas:

- (a) the accrual of bonus payments;
 - (b) certain aspects in relation to the recognition of WIP and AROC;
 - (c) the Econocom Leases;
 - (d) the assessment of the impairment of goodwill; and
 - (e) the calculation of goodwill in relation the Finance and Management Business School ("**FMBS**")³.
- (3) **PwC's** conduct also fell significantly short of the standards to be expected of a Member Firm. In accordance with paragraph 5(11) of the Scheme, anything said, done or omitted by an employee of a Member Firm shall be taken as having been said, done or omitted by that Member Firm. Therefore, as the conduct of Mr Boden fell significantly short of the standards reasonably to be expected of a Member, then the conduct of PwC also fell significantly short of the standards reasonably to be expected of a Member Firm.

BACKGROUND

RSM Tenon

20. RSM Tenon was an accounting firm that grew rapidly through a series of acquisitions. It was incorporated on 17 February 2000 and its shares were admitted to trading on AIM in March 2000. RSM Tenon later obtained a full listing on the London Stock Exchange in May 2010 at which time the company had a market capitalisation of £140 million.
21. RSM Tenon's acquisitions in the year to 30 June 2010 included the purchase of Vantis plc and RSM Bentley Jennison Limited ("**Bentley Jennison**").
22. From this point in time, RSM Tenon was divided into five service lines: ATA (Audit, tax and advisory), Recovery, Risk Management, Financial Management and Specialist tax.

³ FMBS was a college established by former RSM Tenon directors in conjunction with RSM Tenon to provide courses to students for the purpose of obtaining accounting qualifications.

23. Set out below are summaries of (i) RSM Tenon's profit and loss account;(ii) balance sheet; and (iii) cash flow, in each case for the 5 years to 30 June 2012⁴:

RSM Tenon Group plc
Summary profit and loss account - five years ended 30 June 2012

	2008 £'000	2009 £'000	2010 £'000	2011 £'000	2011 Restated £'000	2012 £'000
Revenue	160,269	150,809	190,422	249,087	228,422	208,230
Operating profit/(loss) A	17,636	19,008	26,324	30,117	18,538	(8,882)
Operating profit/(loss) B	13,947	14,580	8,822	13,890	3,373	(92,235)
Profit/(loss) before tax	12,435	11,971	7,843	9,457	(1,486)	(101,822)
Retained profit/(loss)	8,723	8,212	4,090	7,462	966	(88,694)
Notes:						
Operating profit/(loss) A is stated before amortisation of acquired intangible assets, deferred consideration interest and exceptional items						
Operating profit/(loss) B is stated after such costs						

RSM Tenon Group plc
Summary balance sheet - five years ended 30 June 2012

	2008 £	2009 £	2010 £	2011 £	2011 Restated £	2012 £
Assets						
Non-current assets	97,547	98,245	189,451	188,179	190,513	129,539
Current assets	68,812	65,613	86,350	88,683	81,455	74,411
Total assets	166,359	163,858	275,801	276,862	271,968	203,950
Liabilities						
Non-current liabilities	32,545	29,819	63,696	72,090	73,303	14,227
Current liabilities	48,787	44,548	65,286	56,815	59,184	140,028
Total liabilities	81,332	74,367	128,982	128,905	132,487	154,255
Total equity	85,027	89,491	146,819	147,957	139,481	49,695
Total liabilities and equity	166,359	163,858	275,801	276,862	271,968	203,950

⁴ By 30 June 2012, RSM Tenon was ranked as the seventh largest accounting firm in the UK.

RSM Tenon Group plc
Summary cash flow statement - five years ended 30 June 2012

	2008 £'000	2009 £'000	2010 £'000	2011 £'000	2011 Restated £'000	2012 £'000
Cash flow from operations A	23,763	5,180	16,782	11,602	10,132	9,062
Cash flow from operations B	18,274	(3,315)	(2,425)	(4,254)	(4,232)	(2,004)
Cash flows from investing	(19,985)	(6,092)	(55,072)	(12,856)	(14,695)	(6,323)
Cash flows from financing	8,358	3,420	51,246	5,226	7,043	(2,722)
Increase/(decrease) in cash	6,647	(5,987)	(6,251)	(11,884)	(11,884)	(11,049)
Cash at start of year	13,434	20,081	14,094	7,843	7,843	(4,041)
Cash at end of year	20,081	14,094	7,843	(4,041)	(4,041)	(15,090)
(Increase)/decrease in debt	(5,807)	(5,925)	(15,758)	(10,789)	(29,006)	977
Debt at start of year	(23,421)	(29,228)	(35,153)	(50,911)	(35,153)	(64,159)
Debt at end of year	(29,228)	(35,153)	(50,911)	(61,700)	(64,159)	(63,182)
Net debt	(9,147)	(21,059)	(43,068)	(65,741)	(68,200)	(78,272)
Notes: Cash flow from operations A is stated before cash flows from exceptional items, interest and income tax Cash flow from operations B is stated after such cash flows						

24. Whilst RSM Tenon's revenue increased across this period on account of its growth through acquisitions, its profit before tax did not increase due to significant exceptional costs relating largely to the cost of assimilating the acquisitions. RSM Tenon's gross assets also increased significantly over this period as a result of these acquisitions and an increase in goodwill on account of RSM Tenon generally paying in excess of the fair value of the book assets on its acquisitions. Throughout the period from 2008 onwards, the net debt position of RSM Tenon deteriorated each year.
25. In May 2011, RSM Tenon issued a profits warning stating that as a result of the uncertain economic outlook, underlying profits for the group for FY11 would be below market expectations. In July 2011, RSM Tenon released its pre-close update for FY11 and stated that underlying profits were in line with the reduced expectations at that time.

26. In October 2011, RSM Tenon's Finance Director (Mr McBurnie) was replaced, very shortly before the financial statements for FY11 were approved on 31 October 2011. Soon thereafter, a number of material accounting errors in the financial statements of RSM Tenon were uncovered. On 23 January 2012, RSM Tenon issued a Trading Update that notified the market that its Chairman and its CEO had resigned.
27. On 29 February 2012, RSM Tenon released its interim results for the six months ended 31 December 2011. These interim results included explanations that the previous financial statements for the financial year ended 30 June 2010 ("FY10") and FY11 required restatement because of material accounting errors and a change in accounting policy. In addition, the interim results for the six months ended 31 December 2011 reflected a write down in goodwill of £60.7 million.
28. The restatements identified in the interim results for the six months ended 31 December 2011 were the following:

The nature of the adjustments and the impact on the group financial statements are set out below:-

	30 June 2011 £000	31 December 2010 £000	30 June 2010 £000
Equity attributable to owners of the parent as previously reported	147,960	147,211	144,751
Restatement of accounting errors			
Finance lease	(336)	-	-
Accrued income	(721)	-	-
Amounts recoverable on contract and associated contingent consideration	(2,946)	(2,103)	(429)
Bank arrangement fees	(509)	-	-
Employee bonuses	(4,350)	(2,707)	(691)
	(8,862)	(4,810)	(1,120)
Restatement for change in accounting policy			
Prepaid referrer costs	(3,253)	(2,324)	(1,629)
	(12,115)	(7,134)	(2,749)
Impact of restatements on taxation	3,356	1,987	770
Net equity attributable to the owners of the parent as restated	139,201	142,064	142,772

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Restatement of accounting errors			
Finance lease	(336)	-	-
Accrued income	(721)	-	-
Amounts recoverable on contract and associated contingent consideration	(2,946)	(2,103)	(429)
Bank arrangement fees	(509)	-	-
Employee bonuses	(4,350)	(2,707)	(691)
	(8,862)	(4,810)	(1,120)
Restatement for change in accounting policy			
Prepaid referrer costs	(3,253)	(2,324)	(1,629)
	(12,115)	(7,134)	(2,749)
Impact of restatements on taxation	3,356	1,987	770
Net equity attributable to the owners of the parent as restated	139,201	142,064	142,772

29. The material accounting errors resulting in restatements were in relation to the following areas:

- (a) the accrual of bonus payments;
- (b) the recognition of WIP and AROC;
- (c) bank arrangement fees; and
- (d) the Econocom Leases.

The change in accounting policy was in relation to the recognition of prepaid fees for the purpose of obtaining IVA appointments.

30. Following the discovery of the material accounting errors, the new RSM Tenon management restructured the business and engaged in a cost cutting exercise, including a reduction in headcount of 10%. On 17 October 2012, RSM Tenon issued their financial statements for the financial year ended 30 June 2012 (“FY12”) which included the effect of the above prior year adjustments and change in accounting policy.

31. In June 2013, RSM Tenon announced that it was in merger discussions with Baker Tilly. On 22 August 2013, RSM Tenon’s parent company entered administration. In September 2013, Baker Tilly bought the trading entities which were not in administration and were free from debt from the administrators.

PwC's Work

32. As stated in paragraph 8 above, PwC had been RSM Tenon's auditor since 2000. It also provided non-audit services from time to time. In FY10, PwC conducted the following non-audit services:
- (1) Acting as reporting accountants on RSM Tenon's admission to the main market of the London Stock Exchange (fee: £405,000).
 - (2) Due diligence services in respect of the acquisition by RSM Tenon of Bentley Jennison (fee: £205,000).
 - (3) Integration advice following the acquisition of Bentley Jennison (fee: £102,500).
33. The audit fee for FY11 was £180,000. Mr Boden was appointed engagement partner for RSM Tenon in 2009. In that capacity, he signed off the audit opinion on the financial statements of RSM Tenon for the financial years ended 30 June 2009, FY10 and FY11.
34. PwC commenced its audit work for FY11 in April 2011 by preparing an Audit Strategy Memorandum which it submitted to the Audit Committee. PwC carried out its audit fieldwork during August and early September 2011 and produced its Audit Committee report on 1 September 2011 (whilst its fieldwork was still ongoing). An update to the Audit Committee was provided on 24 October 2011.
35. For the audit of the financial statements of RSM Tenon for FY11, PwC set overall materiality at £1.48 million and "performance materiality" at £1.1 million (which was a 25% decrease from PwC's overall materiality figure). Performance materiality is determined for "*the purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures*" (ISA 320, paragraph 11).
36. PwC's materiality report also set a de minimis level of £75,000 based on 5% of materiality below which unadjusted misstatements would not be communicated to those charged with governance within RSM Tenon (as compared with a figure of £50,000 contained in PwC's Audit Strategy

Memorandum).

37. PwC's Audit Strategy Memorandum explained PwC's risk-based audit approach whereby it assessed the nature of the class of transaction or balance, considered the magnitude and likelihood of a material misstatement before categorising the risk as:

- (1) **“Significant** – those risks which require special audit consideration (in terms of the nature, timing or extent of testing) because of the nature of the risk, the likely magnitude of the potential misstatements (including the possibility that the risk may give rise to multiple misstatements) and the likelihood of the risk occurring”.
- (2) **“Elevated** – a risk that requires additional audit consideration beyond what would be required for a normal risk, but which does not rise to the level of a significant risk because of its nature, the likely magnitude of the potential misstatements or the likelihood of the risk occurring. Elevated risks frequently will be risks that we will discuss with management and the Audit Committee through our year end findings report, but that do not rise to the level of a significant risk”.
- (3) **“Normal** – relatively routine, non-complex transactions that tend to be subject to systemic processing and require little management judgment”.

38. PwC identified the following significant and elevated risks in its Audit Strategy Memorandum, which were reported on to the Audit Committee:

- | | |
|---|-------------|
| • Management override of controls | Significant |
| • Risk of fraud in revenue recognition | Significant |
| • Revenue recognition and recoverability of AROC balances | Elevated |
| • Carrying value of goodwill and intangible assets | Elevated |
| • Going concern | Elevated |
| • Acquisition accounting | Elevated |
| • Taxation | Elevated |

Both 'management override of controls' and 'risk of fraud in revenue

recognition' are presumed "significant" risks under ISA 240 paragraphs 7 to 8.

39. PwC also prepared a number of significant matter papers for the audit of the financial statements of RSM Tenon for FY11. PwC's Audit Manual defined a significant matter as "*a finding or issue that in our judgment is significant to the procedures performed, evidence obtained, or conclusions reached*" and "*require consideration by the team manager and review and sign-off by the engagement leader*". PwC prepared significant matter papers for the following issues:

- Summary of uncorrected misstatements
- Management override of controls
- Going concern assessment – 30 June 2011
- Deferred legal costs
- Recoverability of prepaid IVAs
- Accounting for change in control of FMBS
- Goodwill impairment test
- Risk of fraud in revenue recognition
- Hot review comments and resolution

PwC reported all significant matters above to the Audit Committee.

40. As stated in paragraph 34 above, PwC provided a report to the Audit Committee dated 1 September 2011. Matters addressed in PwC's report were in summary the following:

- Impairment review
- Accounting for control of FMBS Joint Venture
- Finalisation of Vantis acquisition accounting
- Recoverability of AROC
- Treatment of deferred costs
- Taxation
- Working capital, banking covenants and going concern
- Management override of control
- Revenue recognition
- Uncorrected misstatements

41. A hot review was performed by PwC on 5 and 6 September 2011. The hot review identified ten major issues and nine other issues, including as a major issue the appropriate treatment for prepaid IVA referral fees.
42. PwC attended the Audit Committee meeting on 7 September 2011 and provided an update dated 24 October 2011 to its report to the Audit Committee. PwC continued to assess subsequent events and the going concern assumption until the date of signing of the financial statements of RSM Tenon for FY11, 31 October 2011. Mr Boden, as engagement partner, signed the auditor's report containing an unqualified opinion in those financial statements.
43. In January 2012, Mr Boden was replaced by Mr Bowker Andrews (another PwC audit partner) as the engagement partner responsible for the audit of the financial statements of RSM Tenon. Mr Andrews signed off the independent review of the interim results of RSM Tenon for the six months ended 31 December 2011, including the restated figures for FY10 and FY11, in February 2012.
44. PwC remained as RSM Tenon's auditors until completion of the audit of the financial statements for FY12. During that period, PwC conducted the independent review of the interim results of RSM Tenon for the six months ended 31 December 2011 in which PwC expressed the opinion that it had no cause to believe that the interim financial information was not prepared, in all material respects, in accordance with IAS 34, Interim Financial Reporting but included an '*emphasis of matter*' paragraph as to going concern in its opinion.
45. In or around February 2012, RSM Tenon informed PwC that it had received legal advice that it may have a legal claim against PwC for compensation in relation to PwC's work, including its audit work, between 2009 and 2011.
46. In May 2012, PwC prepared a second significant matter paper in relation to the testing of management override of controls. In summary, PwC stated in its paper that it had become apparent that a management override of controls had occurred. By July 2012, PwC had signed off the audits of the financial statements of the subsidiaries of RSM Tenon for FY11.

47. In or around June 2012, PwC and RSM Tenon reached a settlement in relation to any potential legal claims that RSM Tenon might be able to bring against PwC. The settlement provided that, in exchange for RSM Tenon not taking legal action against PwC, PwC would waive approximately £300,000 of outstanding fees and would keep the 2012 audit fee at the same level as the 2011 audit fee of £180,000.
48. The financial statements of RSM Tenon for FY12 were issued on 17 October 2012. These included the effect of the prior year adjustments and change in accounting policy that had previously been identified. PwC issued an unqualified audit report, signed by Mr Andrews.
49. PwC was not re-appointed as auditor of RSM Tenon at its Annual General Meeting on 6 December 2012. RSM Tenon announced on 1 February 2013 that it had appointed BDO LLP as its new auditor, following a competitive tender process.

THE ALLEGATIONS⁵

BONUS ACCRUALS (ACCOUNTING)

ALLEGATION 1

In relation to the preparation and approval of the financial statements of RSM Tenon for FY11, the conduct of Mr McBurnie fell significantly short of the standards reasonably to be expected of a Member in that Mr McBurnie was reckless as to whether the level of accrual of bonus payments included within the financial statements was fairly and accurately stated and thereby Mr McBurnie failed to act in accordance with the Fundamental Principle of Integrity contained in the Code and/or section 320 of Part C of the Code.

ALLEGATION 2

In relation to the preparation and approval of the financial statements of RSM Tenon for FY11, the conduct of Mr McBurnie fell significantly short of the standards reasonably to be expected of a Member in that Mr McBurnie caused or permitted a level of accrual of bonus payments to be included in the financial statements that was materially incorrect and in respect of which he had failed to take reasonable steps to ensure that it was fairly and accurately stated and thereby Mr McBurnie failed to comply with the requirements of IAS 19, and/or failed to act in accordance with the Fundamental Principle of Professional Competence and Due Care contained in the Code and/or section 320 of Part C of the Code.

Particulars of Allegations 1 & 2

50. Bonuses within RSM Tenon fell into three categories:

- (1) *Staff bonuses*. The payment of staff bonuses was, according to Mr McBurnie, discretionary with specific bonus pools in place for each service line and by region.

⁵ There is no Allegation 5 or Allegation 13.

(2) *Premier Strategy*⁶ director bonuses. Bonuses for these directors were contractual and, according to Mr McBurnie, formulaic and based on the performance of the business.

(3) *Director bonuses (other than in Premier Strategy)*. There was a bonus scheme in place for these directors, which depended on overall group performance but with separate bonus pools for each service line, albeit that management judgement was required in its application.

51. Mr McBurnie explained that at the year end, he performed a “*very high-level one page calculation*” in terms of the overall bonus pots expected, which he would then adjust downwards for what he described as “*the debt and other values*”.

52. The total accrual for director and other staff bonuses in the financial statements of RSM Tenon for FY11 was £4.8 million. That accrual represented bonuses which were payable to directors and staff in relation to their performance in FY11 but payment may not have in fact been made until after the financial year end.

53. The amount of bonuses actually paid by RSM Tenon for FY11 was £7.7 million. In addition, RSM Tenon subsequently identified £1.4 million that should have been accrued during FY11 which included amounts relating to prior year bonuses which had not been paid. As a result, RSM Tenon’s operating expenses for FY11 and prior years were understated by £4.3 million and profit was overstated by that amount.

54. At the time that the financial statements for FY11 were signed off on 31 October 2011, bonus payments amounting to £5.1 million (i.e. a figure higher than the amount of bonus accruals contained in the financial statements) had already been paid in respect of FY11.

55. The bonus accrual included in the financial statements of RSM Tenon for FY11 was materially incorrect as it was insufficient to cover all of the “*legal*

⁶ Premier Strategy was a subsidiary of RSM Tenon which held its Tax division.

or constructive” obligations (as required under IAS 19, paragraphs 17 and 19) on the company to pay director or staff bonuses for their services during FY11.

56. Further, the amount of bonuses in fact paid after 30 June 2011 but before the financial statements of RSM Tenon for FY11 had been signed (i.e. £5.1 million) was substantially higher than the amount of bonuses accrued as at 30 June 2011 (i.e. £4.8 million). These figures consisted of staff bonuses of £3.3 million which had been paid before the financial statements were signed (compared with an accrual of £2.4 million) and directors’ bonuses of £1.8 million which had been paid before the financial statements were signed (compared with an accrual of £2.4 million). These figures (which should have been known to Mr McBurnie given his responsibilities as Finance Director) clearly indicated that bonuses were under-provided for in the financial statements of RSM Tenon for FY11. Further, Mr McBurnie was aware that directors’ bonuses remained to be paid. Accordingly, to the extent that bonuses that were paid or payable exceeded £4.8 million, they should have been taken into account in the financial statements of RSM Tenon for FY11 unless the excess above the amount accrued related to bonuses that were entirely discretionary (and therefore did not constitute either a legal or constructive obligation) or could not be measured reliably, neither of which was the case.

57. In accordance with paragraph 320.1 and 320.3 of Part C of the Code, Mr McBurnie was required to:

(1) *“prepare or present [financial statements] fairly, honestly and in accordance with relevant professional standards so that the information will be understood in its context”.*

(2) *“take reasonable steps to maintain information for which the professional accountant in business is responsible in a manner that...[r]epresents the facts accurately and completely in all material respects”.*

58. Accordingly, as Finance Director, Mr McBurnie should have ensured that he was satisfied that the bonus accrual was fairly stated in the financial statements of RSM Tenon for FY11. Mr McBurnie failed to act diligently

and in accordance with applicable technical and professional standards and the work he performed was not sufficient to:

- (1) ensure that RSM Tenon presented the financial statements, "*fairly, honestly, and in accordance with relevant professional standards so that the information will be understood in its context*" as required by paragraph 320.1; or
- (2) amount to "*reasonable steps*" to maintain information that represents the facts "*accurately and completely in all material respects*" as required by paragraph 320.3.

59. As a minimum, Mr McBurnie should have:

- (1) in relation to staff bonuses, ensured that the business had the necessary resources available to make the bonus payments;
- (2) in relation to director bonuses, been involved in detailed discussions with Mr Raynor, the CEO of RSM Tenon, together with service line leaders and business unit management and potentially other members of the board, including in consideration of a detailed schedule of amounts proposed to be paid to each director so as to facilitate the calculation, assessment, communication and payment of the agreed and correct bonus amounts to each director.

However, Mr McBurnie did not take the steps described above adequately and he then failed to ensure that the bonuses paid or expected to be paid had been appropriately provided for in the financial statements for RSM Tenon.

60. Mr McBurnie's conduct was in breach of the Fundamental Principle of Integrity contained in the Code, section 110 of Part A of the Code, and paragraphs 320.1 and 320.3 of Part C of the Code because he was reckless as to whether the bonus accrual within the financial statements of RSM Tenon for FY11 was fairly and accurately stated. Mr McBurnie's recklessness should be inferred from the following:

- (1) No Member with the qualifications and experience of Mr McBurnie could have believed that the work he carried out as set out in

paragraphs 151 to 153 of his witness statement would have been sufficient to ensure that the bonus accrual was fairly and accurately stated.

- (2) Any reasonably experienced Member in Mr McBurnie's position should have checked the amount of bonuses actually paid to date and would have appreciated that his calculation was wrong.
- (3) In preparing the financial statements of RSM Tenon for FY11, Mr McBurnie made use of a general provision account made up of unallocated provisions which had the effect of making the inaccurate provisions in the financial statements more difficult to identify. The operation of such an account was inconsistent with accounting standards. On 7 August 2011 and 11 September 2011, Mr McBurnie emailed [REDACTED] [REDACTED] about making use of the general provision (or "slush" account as it was referred to in the emails) specifically in relation to the amount of bonus accruals.
- (4) Each of the errors in the financial statements for FY11 which are the subject of the Allegations resulted in an overstatement of RSM Tenon's profits.
- (5) In the premises, Mr McBurnie was aware that there was a risk that the bonus accrual was not fairly or accurately stated in the financial statements of RSM Tenon for FY11 and that it was unreasonable to take that risk. Nonetheless, he did so.

BONUS ACCRUALS (AUDIT)

ALLEGATION 3

In relation to the audit of the financial statements of RSM Tenon for FY11, the conduct of Mr Boden and PwC fell significantly short of the standards reasonably to be expected of, respectively, a Member and a Member Firm in that:

- (i) Mr Boden and PwC failed to obtain sufficient appropriate audit evidence from which to draw a reasonable conclusion that the accrual of bonus payments was appropriate; and/or
- (ii) Mr Boden and PwC failed to report to RSM Tenon's Audit Committee the significant difficulties which PwC had encountered during the audit in relation to the testing of accruals of bonus payments,

and thereby Mr Boden and PwC failed to comply with the requirements of ISA 200, ISA 220, ISA 260 and ISA 500, and/or failed to act in accordance with the Fundamental Principle of Professional Competence and Due Care contained in the Code.

Particulars of Allegation 3

61. In its audit working papers, PwC identified that the audit of bonus accruals had been problematic in previous years and accordingly PwC identified additional substantive testing in order to provide audit evidence in relation to the value and completeness of the bonus accrual as at 30 June 2011. The additional testing planned consisted of:

- (1) performing an analysis of current year versus prior year bonus accrual;
- (2) reviewing actual staff bonuses paid as most staff were paid their bonus in July and August payroll; and
- (3) reviewing prior year end accruals against actual bonuses paid to give an indication of management's track record in accurately accruing for bonuses.

62. In respect of each of these three additional tests:

- (1) PwC compared the bonus accrual as at 30 June 2011 to the accrual in place as at 30 June 2010.
- (2) Despite stating in its working papers that it had reviewed actual staff bonuses paid against accrued amounts, there is no evidence that this test was performed by PwC. If it had been, PwC would have discovered that the bonus accrual was too low. It is therefore to be inferred that it was not performed.
- (3) Despite stating in its working papers that it would review prior year end accruals against actual bonuses paid in order to assess management's track record, there is no evidence that this test was performed by PwC. It is therefore to be inferred that it was not performed.
- (4) To the extent that PwC was unable to carry out the tests referred to in (2) or (3) above due to a lack of information, PwC should have: reported these difficulties to the Audit Committee; considered whether the inability to perform these tasks should have led to a limitation of scope; or performed alternative audit procedures to obtain sufficient audit evidence. However, PwC failed to take any of these steps.

63. Instead, PwC received explanations from the finance team of RSM Tenon who stated that:

- (1) In relation to staff bonuses, there had been an overall increase in the number of staff employed by RSM Tenon relative to the prior year, due to acquisitions and general growth. However, there had not been a similar increase in staff bonuses due to the poor performance compared to budget. A cross-entity pay and bonus structure had been announced during the year which would standardise remuneration rates for various levels of staff within the RSM Tenon

group, which would result in staff in some departments being worse off whilst others were better off.

As a result of this explanation, PwC concluded that the increase in the staff bonus accrual appeared reasonable.

- (2) In relation to directors' bonuses, they were influenced by the results of the applicable service line against budget and the fall in accrual was reflective of the poor results of the service lines against budget.

As a result of this explanation, PwC concluded that the reduction in the directors' bonus accrual appeared reasonable.

64. ISA 500, paragraph 6 provides that, *"the auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence"*.
65. The application notes to ISA 500 state that *"[a]lthough inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls"*.
66. The audit evidence that PwC obtained by way of explanations regarding the movements in bonuses amounted to inquiry only and, particularly given the magnitude of the bonus accrual both individually and as a proportion of the total accruals balance at that date, was not sufficient to comply with ISA 500. PwC should have undertaken the additional audit tests which it had previously identified.
67. In its audit working papers, PwC also stated that a management representation would be required in relation to directors' bonus accruals (as had been the case in respect of PwC's audit for FY10). However, no specific management representations were in fact obtained from RSM Tenon in the management representation letter in relation to bonus accrual for FY11.

68. ISA 580, paragraph 4 states that: “[a]lthough written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfilment of management’s responsibilities, or about specific assertions.” Accordingly, even if a specific management representation had been obtained in relation to bonus accruals, this would not have reduced PwC’s obligation to obtain sufficient audit evidence as a result of its general audit testing in order to comply with ISA 500.
69. Under ISA 260, paragraph 16 an auditor is required to report any significant difficulties encountered during the audit to those charged with governance which (as the Application Note 18 to ISA 260 explains) may include “significant delays in management providing required information” or “the unavailability of expected information”. However, in neither PwC’s report to the Audit Committee dated 1 September 2011 nor its update dated 24 October 2011 was reference made to bonus accruals. In failing to report the difficulties in the audit of bonus accruals (namely, the failure and/or inability to perform the planned tests referred to in paragraph 61(2) and (3) above) to those charged with governance, PwC failed to comply with ISA 260.

WIP & AROC (ACCOUNTING)

ALLEGATION 4

In relation to the preparation and approval of the financial statements of RSM Tenon for FY11, the conduct of Mr McBurnie fell significantly short of the standards reasonably to be expected of a Member in that Mr McBurnie caused or permitted revenue to be recognised within the financial statements in respect of:

- (i) the Case Closure Team when it was not probable that RSM Tenon would receive the economic benefits associated with the Case Closure Team; and/or
- (ii) Fleming WIP which was dependent upon a significant act which had not occurred, could not be estimated reliably and was contrary to RSM Tenon's own accounting policy,

and thereby Mr McBurnie failed to comply with the requirements of IAS 8, IAS 18 and IAS 38, and/or failed to act in accordance with the Fundamental Principle of Professional Competence and Due Care contained in the Code and/or section 320 of Part C of the Code.

Particulars of Allegations 4

- 70. WIP (or AROC⁷) balances reflected the value of the time recorded in RSM Tenon's records that, at a particular point in time, was yet to be billed but was expected to be recovered from the relevant clients.
- 71. The financial statements of RSM Tenon for FY11 recorded WIP of £29.759 million.
- 72. Following the review of the financial statements of RSM Tenon in late 2011/early 2012, a prior year adjustment was made to reduce WIP by £3.65 million and decrease operating profit in FY11 by £2.517 million.
- 73. The areas that were identified as having led to the misstatement of WIP

⁷ These two terms are substantially the same and used interchangeably herein.

included the following:

- (1) The financial statements had included the anticipated benefit of deploying a dedicated “**Case Closure Team**” whose sole purpose would be to close and complete existing cases. This team would be made up of administrative staff and thereby free up the time of more senior personnel who were up until then required to carry out this low level work. The impact of this anticipated saving on the WIP figure included in the financial statements of RSM Tenon for FY11 was £1 million. However, no Case Closure Team was in fact ever set up.
- (2) Included within the WIP balance was a balance of £1.909 million, referred to as “**Fleming⁸ WIP**”, which was in respect of contingent WIP connected to work previously carried out by Bentley Jennison in relation to potential retrospective recoveries of VAT from HMRC for clients. According to Mr McBurnie, HMRC had begun to settle similar claims of non-Bentley Jennison clients during 2011.

74. Further, in the financial statements for FY11, RSM Tenon had ceased to apply de minimis levels below which WIP balances were held at cost rather than at retail value. PwC recorded the impact of this change as significant.

Case Closure Team

75. IAS 18, paragraph 20 provides that revenue shall not be recognised until “*it is probable that the economic benefits associated with the transaction will flow to the entity*” and that “*the costs incurred for the transaction and the costs to complete the transaction can be measured reliably*”.

76. Mr McBurnie first accounted for the potential impact of the Case Closure Team in the interim results of RSM Tenon for the six months ended 31 December 2010.

⁸ “Fleming” being a reference to *Fleming (trading as Bodycraft) v Revenue and Customs Commissioners* [2008] 1 WLR 195.

77. In the six months ended 30 June 2011, no Case Closure Team had been set up but a revised plan was formulated for regional teams. However, the calculation of the adjustment to the financial statements for FY11 to reflect this plan did not meet the revenue recognition criteria set out in IAS 18 as it was not “probable” that the economic benefits associated with using the Case Closure Team would be achieved and they could not be “*measured reliably*”.

Fleming WIP

78. IAS 18, paragraph 25 provides guidance on when it is appropriate to recognise revenue and states that: “*[f]or practical purposes, when services are performed by an indeterminate number of acts over a specified period of time, revenue is recognised on a straight-line basis over the specified period unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other acts, the recognition of revenue is postponed until the significant act is executed*”. Furthermore, such revenue should only be recognised if and to the extent that the amount of revenue can be measured reliably (under IAS 18, paragraph 20).
79. According to Mr McBurnie, whilst RSM Tenon was able to invoice former Bentley Jennison clients for the work undertaken in relation to reclaiming VAT following the Fleming case, the invoices would not be paid unless and until HMRC had settled the claims. Further:
- (1) Merely because HMRC had begun paying out settlement monies to some claimants by June 2011, it did not necessarily follow that each individual case under review would be settled by HMRC.
 - (2) It could be reasonably expected that HMRC would scrutinise the amounts being claimed before paying out any settlement monies and therefore it did not necessarily follow that RSM Tenon would be able to recover all of the WIP which it anticipated.
80. Accordingly, in respect of Fleming WIP, the revenue was wholly contingent on settlement of the individual claim by HMRC and the revenue should not have been recognised until this “significant act” had occurred. Secondly, the

amount of revenue could not be measured reliably. Therefore, the recognition of this revenue in the financial statements for FY11 was contrary to the requirements of IAS 18.

81. Further, RSM Tenon already had an accounting policy in place for contingent income (which would include the Fleming cases). That policy stated that: “[r]evenue is recognised...in respect of contingent assignments, on completion of a transaction”. RSM Tenon applied this accounting policy in relation to corporate finance transactions where the income was contingent upon the completion of the transaction on which RSM Tenon had advised. In such cases, the income was not recognised until RSM Tenon had received payment in settlement of its invoice.
82. IAS 8, paragraph 13 provides that a company is required to “select and apply its accounting policies consistently for similar transactions, other events and conditions”. In light of RSM Tenon’s existing accounting policy in respect of recognition of contingent income, IAS 8 required RSM Tenon to apply the same policy to all income streams that were contingent upon events outside of RSM Tenon’s control. Accordingly, by applying a different approach to the recognition of Fleming WIP (from that stated in RSM Tenon’s accounting policy and as applied in relation to corporate finance transactions), this was a breach of IAS 8.
83. Mr McBurnie’s conduct was in breach of the Fundamental Principle of Professional Competence and Due Care and paragraphs 320.1 and 320.3 of Part C of the Code because he acted with insufficient care as to whether the revenue recognised in respect of WIP within the financial statements of RSM Tenon for FY11 was fairly or accurately stated. Mr McBurnie’s lack of care arises from the following:
 - (1) Mr McBurnie should have recognised that there was insufficient evidence to support the inclusion of an adjustment for a revised plan for a Case Closure Team and that the adjustment included in the financial statements for FY11 in respect of it could not be justified.
 - (2) Contrary to the approach adopted by Mr McBurnie, the income from

Fleming related work should have been recognised no earlier than when agreement was reached with HMRC in relation to the individual claims.

- (3) In preparing the financial statements of RSM Tenon for FY11, Mr McBurnie made use of a general provision account made up of unallocated provisions which had the effect of making the inaccurate provisions in the financial statements more difficult to identify. The operation of such an account was inconsistent with accounting standards.
- (4) Each of the errors in the financial statements for FY11 which are the subject of the Allegations resulted in an overstatement of RSM Tenon's profits.
- (5) In the premises, Mr McBurnie should have been aware that there was a risk that revenue within the WIP balances in the financial statements for FY11 in relation to the Case Closure Team and/or Fleming WIP was not fairly or accurately stated in the financial statements of RSM Tenon for FY11 and that it was unreasonable to take that risk. Nonetheless, he did so.

WIP & AROC (AUDIT)

ALLEGATION 6

In relation to the audit of the financial statements of RSM Tenon for FY11, the conduct of **Mr Boden and PwC** fell significantly short of the standards reasonably to be expected of, respectively, a Member and a Member Firm in that:

- (i) **Mr Boden and PwC failed to obtain sufficient appropriate audit evidence in relation to WIP balances from which to draw a reasonable conclusion on account of the Case Closure Team adjustment; and/or**
- (ii) **Mr Boden and PwC failed to show sufficient professional scepticism in relation to WIP balances on account of the Case Closure Team adjustment,**

and thereby Mr Boden and PwC failed to comply with the requirements of ISA 200, ISA 220 and ISA 500, and/or failed to act in accordance with the Fundamental Principle of Professional Competence and Due Care contained in the Code.

Particulars of Allegation 6

Case Closure Team

84. Although the Case Closure Team adjustment in isolation was below PwC's overall materiality level, given that the adjustment represented a significant change in accounting estimate which provided a one-off increase in profit at a time when RSM Tenon was under pressure to meet market expectations as to trading performance and that the risk of fraud in revenue recognition was categorised by PwC as "significant", PwC ought to have sought sufficient appropriate audit evidence in relation to the adjustment and ensured that it applied sufficient professional scepticism. Further, PwC ought to have considered the Case Closure Team adjustment in the context of all potential adjustments in relation to the WIP balance when considering materiality and not just that one adjustment in isolation. The introduction of a Case Closure Team was a significant qualitative change in the practice of preparing WIP balances. PwC also prepared a working paper in relation to

the Case Closure Team which demonstrates the significance with which it viewed the adjustment.

85. However, PwC failed to comply with the requirements of ISA 500 by not obtaining sufficient appropriate audit evidence. PwC should have, but failed to:

- (1) review the detailed calculation of the £1.0 million adjustment, including the £1.4 million reduction in negative WIP⁹ and the £0.4 million estimate of costs to complete that RSM Tenon had provided;
- (2) request examples where the Case Closure Team had completed an assignment where there was a negative WIP to demonstrate that RSM Tenon was achieving cost savings as a result of this policy;
- (3) assess whether this saving constituted income in the period, or a prospective future reduction in costs.

86. ISA 200, paragraph 15 requires an auditor to perform an audit with “*professional skepticism* [sic]”. PwC failed to exercise sufficient professional scepticism in relation to the Case Closure Team adjustment so as to comply with ISA 200 by failing to challenge (which it should have done):

- (1) the round sum nature of the adjustment;
- (2) the fact that the amount of the adjustment had not changed since 2010,

despite the fact that PwC had recorded in its working papers that Case Closure Teams were operational in two offices.

87. Further, PwC should have raised the inconsistency between the information that it had received from RSM Tenon (namely, that Case Closure Teams were

⁹ Negative WIP arises where income has been recognised before all of the work in relation to that income has been performed.

operational in two offices) and the adjustment which was based on a single central Case Closure Team.

88. These failures were particularly serious given that PwC had noted that it should consider whether the adjustment may have been an attempt by RSM Tenon to increase profits which should have led a sceptical auditor to pursue the matter further.

PREPAID IVA REFERRAL FEES & LEADS (ACCOUNTING)

ALLEGATION 7

In relation to the preparation and approval of the financial statements of RSM Tenon for FY11, the conduct of Mr McBurnie fell significantly short of the standards reasonably to be expected of a Member in that Mr McBurnie was reckless as to whether the level of prepayment in respect of IVA referral fees and leads included within the financial statements was fairly and accurately stated, and thereby Mr McBurnie failed to act in accordance with the Fundamental Principle of Integrity contained in the Code and/or section 320 of Part C of the Code.

ALLEGATION 8

In relation to the preparation and approval of the financial statements of RSM Tenon for FY11, the conduct of Mr McBurnie fell significantly short of the standards reasonably to be expected of a Member in that Mr McBurnie caused or permitted to be included within the financial statements as a prepayment IVA referral fees and leads the level of which could not be justified and thereby Mr McBurnie failed to comply with the requirements of IAS 38 and IAS 11, and/or failed to act in accordance with the Fundamental Principle of Professional Competence and Due Care contained in the Code and/or section 320 of Part C of the Code.

Particulars of Allegations 7 & 8

89. RSM Tenon's directors within the Recovery service line received appointments as licensed Insolvency Practitioners in Individual Voluntary Arrangements ("IVAs"). These appointments were routinely received following introductions made by third party debt management companies that offered debt solutions to the public. RSM Tenon would pay fees to those third party companies for introductions.
90. RSM Tenon recognised two different types of introduction, known as "referrals" and "leads":

- (1) “Referrals” were introductions where a debt management company had performed a significant amount of work in order to identify the opportunity for an IVA appointment. RSM Tenon paid a fee of approximately £1,100 to £1,800 for a referral which was wholly refundable, or replaced, in the event that an IVA appointment was not made.
- (2) In contrast, “leads” were merely the provision of details of individuals who had previously contacted the debt management company but the debt management company had not investigated the individual’s case to identify whether an IVA opportunity existed. RSM Tenon paid approximately £60 to £90 for a lead. Approximately 5 to 7% of leads resulted in IVA appointments and there was no refund or credit given if the lead did not generate an IVA appointment for RSM Tenon.

91. In FY11 and prior years, RSM Tenon adopted an accounting policy that recognised fees for both referrals and leads as a prepayment and amortised them over the expected life of the IVA appointment. In the financial statements of RSM Tenon for FY11, the amortisation period was 42 months compared with an amortisation period of 24 months used in the financial statements for FY10. In its financial statements for FY11, RSM Tenon recorded prepaid IVA referral fees and leads of £3.404 million within prepayments.

92. Following the review of the financial statements of RSM Tenon in late 2011/early 2012, a change was made to the accounting policy for prepaid IVA referral fees and leads, whereby they were expensed as incurred. This change resulted in a prior year adjustment which served to decrease prepayments and accrued income by £3.253 million as at 30 June 2011 and to reduce operating profits by the same amount for FY11 and prior years.

93. IAS 38, paragraph 69 provides examples of expenditure that should be recognised as an expense in the profit and loss account when it is incurred which includes “*expenditure on advertising and promotional activities*”. Further, IAS 11, paragraph 20(b) gives as an example of costs which cannot be attributed to the capitalised costs of constructing an asset “*selling costs*”

(being all costs relating to the marketing and sale of that asset). IAS 11, paragraph 21, also requires that costs incurred in securing a contract must be “*separately identified and measure reliably*” if they are to be included as part of contract costs. By a parity of reasoning, monies spent on leads should have been expensed as and when they were incurred (albeit it is not alleged that the decision to amortise of itself amounts to Misconduct).

94. The way in which RSM Tenon calculated the prepayment for IVA referral fees and leads grouped together the total amount paid for leads and included the cost of unsuccessful leads. In accordance with IAS 38, paragraph 21(a) a lead would only be recognisable as an asset if it was “*probable that the economic benefits that are attributable to the asset will flow to the entity*”. There was not adequate evidence that the buckets of leads satisfied this test and the accounting treatment was therefore inconsistent with IAS 38.
95. In light of the magnitude of the balance of referral fees and leads, and the change that was made to their useful economic life between FY10 and FY11 (a change from 24 months to 42 months), Mr McBurnie should have reviewed the calculation of the prepayment to ensure that it accorded with applicable accounting standards, including whether it was consistent with the recognition of revenue of IVA appointments in respect of which a nomination fee of £1,600 per case was recognised on appointment with annual supervisory fees of £600. However, he failed to do so, and thereby failed to act diligently and in accordance with applicable technical and professional standards.
96. Mr McBurnie’s conduct was in breach of the Fundamental Principle of Integrity contained in the Code, section 110 of Part A of the Code, and paragraphs 320.1 and 320.3 of Part C of the Code because he was reckless as to whether the level of prepaid IVA referral fees and leads within the financial statements of RSM Tenon for FY11 was fairly and accurately stated. Mr McBurnie’s recklessness should be inferred from the following:
- (1) Mr McBurnie failed to make any review of the underlying calculation of the prepayment of IVA referral fees and leads included within the

financial statements for FY11. No Member with the qualifications and experience of Mr McBurnie could have believed that, despite this failure, he had taken reasonable steps to ensure that the prepayment of IVA referral fees and leads was fairly and accurately stated.

- (2) Mr McBurnie was aware that only about 5 to 7% of leads resulted in IVA appointments and it was inappropriate to include the costs of all leads (including those which were unsuccessful) in calculating the level of prepayment.
- (3) Mr McBurnie failed to establish the correct technical accounting treatment for IVA prepayments.
- (4) In preparing the financial statements of RSM Tenon for FY11, Mr McBurnie made use of a general provision account made up of unallocated provisions which had the effect of making the inaccurate provisions in the financial statements more difficult to identify. The operation of such an account was inconsistent with accounting standards.
- (5) Each of the errors in the financial statements for FY11 which are the subject of the Allegations resulted in an overstatement of RSM Tenon's profits.
- (6) In the premises, Mr McBurnie was reckless as to whether there was a risk that the prepayment of IVA referral fees and leads was fairly or accurately stated in the financial statements of RSM Tenon for FY11 and that it was unreasonable to take that risk. Nonetheless, he did so.

ECONOCOM LEASES (ACCOUNTING)

ALLEGATION 9

In relation to the preparation and approval of the financial statements of RSM Tenon for FY11, the conduct of **Mr McBurnie** fell significantly short of the standards reasonably to be expected of a Member in that Mr McBurnie was reckless as to whether the Econocom Leases were fairly and accurately accounted for, and thereby Mr McBurnie failed to act in accordance with the Fundamental Principle of Integrity contained in the Code and/or section 320 of Part C of the Code.

ALLEGATION 10

In relation to the preparation and approval of the financial statements of RSM Tenon for FY11, the conduct of **Mr McBurnie** fell significantly short of the standards reasonably to be expected of a Member in that Mr McBurnie wrongly accounted for the Econocom Leases as operating leases when they should be accounted for as finance leases, and thereby Mr McBurnie failed to comply with the requirements of IAS 17 and/or SIC¹⁰ 27 and/or failed to act in accordance with the Fundamental Principle of Professional Competence and Due Care contained in the Code and/or section 320 of Part C of the Code.

Particulars of Allegations 9 & 10

97. On 1 June 2011, RSM Tenon entered into two agreements with a business called Econocom, as follows:
- (1) An “Equipment Purchase Agreement” under which RSM Tenon sold various assets (mainly office and IT equipment) to Econocom in return for £2 million.
 - (2) A “Systems Lease Contract” under which Econocom leased back the same assets to RSM Tenon in return for 36 monthly payments of approximately £61,000, totalling £2.2 million.

¹⁰ Interpretations issued by the Standard Interpretations Committee (SIC).

98. Accordingly, under these agreements (the Econocom Leases), RSM Tenon raised approximately £2 million in cash to assist its liquidity position whilst retaining use of the assets. In addition, side letters were entered into between RSM Tenon and Econocom which allowed for the repurchase of the leased non-IT assets for £1 and the leased IT assets for approximately £18,000 at the end of the lease term.
99. In its financial statements for FY11, RSM Tenon accounted for the Econocom Leases as “operating” leases and therefore did not recognise the assets or, more particularly, liabilities on its balance sheet but instead the lease payments were accounted through RSM Tenon’s income statement.
100. Following the review of the financial statements of RSM Tenon in late 2011/early 2012, a prior year adjustment was made to reclassify the Econocom Leases as “finance” leases. On this basis, RSM Tenon recognised on its balance sheet the full cost of the assets together with a corresponding liability for the lease payments. This adjustment served to increase net debt at 30 June 2011 by £1.95 million and to decrease profit before tax by £0.336 million.
101. In accordance with IAS 17, the Econocom Leases should have been classified as finance leases within the financial statements of RSM Tenon for FY11. IAS 17, paragraph 10, indicates that a lease will be a finance lease if:
- (1) “[A]t the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset”. Econocom purchased the assets from RSM Tenon for £2.0 million on 1 June 2011 which was an arm’s length transaction and therefore indicated the fair value of the assets. The undiscounted value of the minimum lease payments was £2.194 million. Applying a 6.582% discount factor (which is the interest rate implicit in the Econocom Leases), the present value of the minimum lease payments was approximately £1.991 million (or just under 100% of the fair value of the leased asset) which therefore amounted to substantially all of the fair value of the asset.

- (2) “[T]he lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised”. The side letters between RSM Tenon and Econocom gave RSM Tenon the right to purchase the IT assets for approximately £18,000 and the non-IT assets for £1 at the end of the lease term. This ‘buy back’ price was negligible in the context of a £2 million asset value on inception of the Econocom Leases (three years earlier) and thus “sufficiently” lower than the fair value of the assets at the date that the option became exercisable that it was reasonably certain, at the inception of the Econocom Leases, that the option would be exercised. SIC 27 requires that “a series of transactions that involve the legal form of a lease is linked and shall be accounted for as one transaction”. Accordingly, in determining the accounting treatment of the Econocom Leases, the side letters should have been taken into account.
- (3) “[T]he lease term is for the major part of the economic life of the asset even if title is not transferred”. Alternatively to (2) above, if the ‘buy back’ price was not sufficiently lower than the fair value of the assets, then the lease term was (at least in respect of the computer equipment) for the major part of the economic life of the asset. The assets that were the subject of the Econocom Leases primarily consisted of computer equipment and items for office refurbishment (including associated fixtures and furniture). RSM Tenon’s management’s own assessment of the economic life of such assets was 3 to 5 years for computer equipment and software and 4 to 10 years for fixtures and furniture. Therefore, in the case of computer equipment at least, the Econocom Leases’ term (which was 3 years) was for the major part of the economic life of the underlying leased assets. In relation to the office refurbishment, see paragraph (4) below.
- (4) “[T]he leased assets are of such a specialised nature that only the lessee can use them without major modifications”. As explained above, most of the assets subject to the Econocom Leases that were

not computer equipment were related to office refurbishment (across 12 office locations) and included integral items such as carpets, sockets, cabling, decorating and ceilings. These assets could only ever have been used by RSM Tenon and should have been deemed to be of “*a specialised nature*”.

102. Mr McBurnie’s conduct was in breach of the Fundamental Principle of Integrity contained in the Code, section 110 of Part A of the Code, and paragraphs 320.1 and 320.3 of Part C of the Code because he was reckless as to whether the Econocom Leases had been incorrectly classified as operating leases within the financial statements of RSM Tenon for FY11. Mr McBurnie’s recklessness should be inferred from the following:

- (1) Upon the commencement of the Econocom Leases, Mr Raynor had discussed with Mr McBurnie whether they could be included within the financial statements of RSM Tenon Audit so that RSM Tenon would “*effectively [be] getting it treated as [an] operating lease. I really would like to do it as I’m not seeing £2m [liability] anywhere else, anytime soon*”.¹¹ However, Mr McBurnie told Mr Raynor that this would not work.
- (2) The result of Mr Raynor’s suggestion would have been to reflect the lease liabilities in RSM Tenon Audit (which would not be taken into account in the RSM Tenon group’s financial covenant tests for its banking facilities) whilst the cash received from the lease financing would have been reflected in the Group. Had the Econocom Leases been correctly accounted for as a finance lease within the RSM Tenon financial statements for FY11, there was a significant risk that it might have resulted in a breach of the group’s financial covenant tests.
- (3) Mr McBurnie then took advice on how the Econocom Leases should be classified from [REDACTED] (who provided technical advice

¹¹ Email from Mr Raynor to Mr McBurnie dated 22 May 2011.

to RSM Tenon's finance team). In an email to Mr McBurnie dated 1 June 2011, ██████████ stated:

“the content of the lease agreement in isolation would suggest that it is an operating lease. However, if you were to consider the nature of the equipment being provided, what is not said in the lease agreement together with the content of the side letter then it is more likely that it will be classified as a finance lease”.

- (4) Based on that advice Mr McBurnie should have treated the agreement as a finance lease, absent strong evidence to the contrary, however, he did not to do so. Instead, Mr McBurnie instructed ██████████ to account for the Econocom Leases as operating leases.
- (5) In preparing the financial statements of RSM Tenon for FY11, Mr McBurnie made use of a general provision account made up of unallocated provisions which had the effect of making the inaccurate provisions in the financial statements more difficult to identify. The operation of such an account was inconsistent with accounting standards.
- (6) Each of the errors in the financial statements for FY11 which are the subject of the Allegations resulted in an overstatement of RSM Tenon's profits.
- (7) In the premises, Mr McBurnie was aware that there was a risk that the Econocom Leases had been incorrectly classified as operating leases within the financial statements of RSM Tenon for FY11 and that it was unreasonable for him to take that risk. Nonetheless, he did so.

ECONOCOM LEASES (AUDIT)

ALLEGATION 11

In relation to the audit of the financial statements of RSM Tenon for FY11, the conduct of Mr Boden and PwC fell significantly short of the standards reasonably to be expected of, respectively, a Member and a Member Firm in that Mr Boden and PwC failed to obtain sufficient appropriate audit evidence from which to draw a reasonable conclusion that the classification of the Econocom Leases was appropriate and thereby Mr Boden and PwC failed to comply with the requirements of ISA 200, ISA 220 and ISA 500 and/or failed to act in accordance with the Fundamental Principle of Professional Competence and Due Care contained in the Code.

Particulars of Allegation 11

103. PwC failed to obtain sufficient appropriate audit evidence in order to obtain reasonable reassurance that the Econocom Leases had been appropriately classified as operating leases:
- (1) PwC's planned audit work included testing new lease arrangements based on materiality and inherent risk. The testing would include: "*review lease agreements to determine whether the lease has been appropriately capitalized or expressed in compliance with applicable financial reporting framework [sic]*" and "*[f]or operating leases, test the commitments schedule as appropriate*".
 - (2) As included in RSM Tenon's FY11 financial statements, the Econocom Leases would have had an operating lease commitment value of £2.132 million out of £3.337 million of "*other operating leases*" (with total operating lease commitments of £41.019 million). This was above the overall materiality level (which was set at £1.48 million) and performance materiality (which was set at £1.1 million). Further, a competent auditor, when auditing liabilities, should have considered what might be excluded from the finance lease liabilities within the financial statements. Had the Econocom Leases been correctly treated as finance leases, they would have increased RSM

Tenon's finance lease liabilities by £2m (or approximately 87%). PwC should also have taken into account the potential for the Econocom Leases to impact negatively on the group's financial covenant tests. As stated in paragraph 103(2) above, had the Econocom Leases been correctly accounted for, the financial covenant would have been breached. Therefore, taking into account the materiality of the Econocom Leases (in the context of both operating lease commitments and finance lease liabilities within the financial statements) and their potential impact on the group's financial covenant tests, PwC's planned tests should have been carried out.

- (3) Despite PwC's planned testing, PwC did not then undertake any audit work in relation to the treatment of the Econocom Leases as operating leases although it is recognised that individual Econocom Lease payments were tested within the audit of prepayments.
- (4) Had PwC confirmed the Econocom Leases back to supporting documentation and checked the substance and nature of the assets concerned, this would (and/or should) have led to the conclusion that they were finance leases, with or without the side letters.

IMPAIRMENT OF GOODWILL (ACCOUNTING)

ALLEGATION 12

In relation to the preparation and approval of the financial statements of RSM Tenon for FY11, the conduct of Mr McBurnie fell significantly short of the standards reasonably to be expected of a Member in that Mr McBurnie prepared materially misstated forecasts for RSM Tenon which he relied on in carrying out a goodwill impairment review and then ultimately to conclude that no goodwill impairment charge should be included in the financial statements for FY11, and thereby Mr McBurnie failed to comply with the requirements of IAS 36 and/or failed to act in accordance with the Fundamental Principle of Professional Competence and Due Care contained in the Code and/or section 320 of Part C of the Code.

Particulars of Allegations 12

104. In September 2011, Mr McBurnie performed a goodwill impairment assessment that identified that there was £71 million of total headroom¹² of its expected future cash flows above the book value of the assets and that therefore no goodwill was considered to be impaired. That assessment was based on a profit forecast of £27.999 million which was used as a proxy for expected cash flows.
105. As a result of poor trading in the three months to 30 September 2011, in late October 2011, Mr McBurnie prepared an updated goodwill impairment review. In the updated review, a reduced profit forecast was used (£23.584 million compared with £27.999 million previously). The updated review reduced the goodwill headroom to £31.4 million.
106. The total goodwill net of amortisation recorded in the financial statements of RSM Tenon for FY11, signed on 31 October 2011, was £136.3 million.

¹² 'Headroom' means the excess of calculated value based on forecast cash flows by each CGU over and above the carrying value of the goodwill held in the balance sheet.

107. When the interim results for the six months ended 31 December 2011 were prepared in February 2012, RSM Tenon recorded a goodwill impairment charge of £60.7 million. Accordingly, RSM Tenon's assessment of goodwill fell by c.£90 million between October 2011 and December 2011 (the date of the interim results).
108. As stated in paragraph 105 above, RSM Tenon's initial goodwill impairment assessment carried out by Mr McBurnie in September 2011 included a profit forecast before tax of £27.999 million. That forecast was materially misstated and did not reflect the underlying trading position of RSM Tenon because it contained several material accounting errors for the reasons set out in Allegations 1, 2, 4, 7, 8, 9 and 10 above.
109. Accordingly, that initial goodwill impairment assessment was also misleading because it included profit forecasts that were significantly greater than the true underlying position of RSM Tenon.
110. As Mr McBurnie prepared the goodwill impairment assessment, he would have been aware of the basis of calculation of the financial statements at the time that the impairment assessment was prepared. He, therefore, should have known that the impairment assessment may have been misleading.
111. Further, Mr McBurnie's use of profit forecasts as a proxy for future cash flows in performing the goodwill impairment exercises was fundamentally flawed:
- (1) IAS 36, paragraph 31 requires that an assessment of value-in-use of cash generating assets should be calculated by reference to future net cash flows which are expected to be generated from the asset. Contrary to this requirement, the value-in-use calculation used by Mr McBurnie was based on RSM Tenon's profit before tax.
 - (2) Although profit may be used as a proxy for cash flows in circumstances where cash flows are not materially different from profits, this had not historically been the case for RSM Tenon and there was no reasonable basis for considering that it would be the case going forward.

- (3) Accordingly, the calculations prepared by Mr McBurnie in conducting the goodwill impairment reviews were fundamentally flawed by using profit as a proxy for cash flow.

112. The impairment reviews carried out by Mr McBurnie were also flawed because:

- (1) Mr McBurnie used a discount rate based on RSM Tenon's Weighted Average Cost of Capital ("**WACC**") and applied this to all CGUs¹³ without adjustment. Instead, Mr McBurnie should have used a discount rate reflecting the specific risks associated with each individual CGU.
- (2) In any event, the WACC used by Mr McBurnie was flawed because it was calculated taking into account RSM Tenon's own capital structure whereas, in accordance with IAS 36, paragraph A19, the discount rate should have been entirely independent of RSM Tenon's capital structure.
- (3) RSM Tenon's impairment calculation spreadsheet for FY11 included a note that Corporate Finance profits would be excluded from the impairment calculation (as had been the case in prior years), whereas in fact they were not excluded in FY11.
- (4) Were cash flows rather than profits used, it is highly likely that a material impairment would have arisen.

113. Mr McBurnie's conduct was in breach of the Fundamental Principle of Professional Competence and Due Care and paragraphs 320.1 and 320.3 of Part C of the Code because he failed to ensure that the forecasts for RSM Tenon relied on in the goodwill impairment review for the financial statements of RSM Tenon for FY11 were fairly and accurately prepared. Mr McBurnie's breach of the Fundamental Principle of Professional Competence and Due Care arises from the following:

¹³ A cash-generating unit is the smallest identifiable group of assets that generates cash inflows.

- (1) For the reasons set out above, Mr McBurnie's failures as referred to in Allegations 1, 2, 4, 7, 8 9 and 10 were then relied upon in determining the forecasts for RSM Tenon.
- (2) Further, no member with the qualifications and experience of Mr McBurnie could have reasonably believed that the forecasts used in the impairment review were appropriate given the flaws set out above. All of these flaws had the effect of reducing the risk of an impairment of goodwill.
- (3) In preparing the financial statements of RSM Tenon for FY11, Mr McBurnie made use of a general provision account made up of unallocated provisions which had the effect of making the inaccurate provisions in the financial statements more difficult to identify. The operation of such an account was inconsistent with accounting standards.
- (4) Each of the errors in the financial statements for FY11 which are the subject of the Allegations resulted in an overstatement of RSM Tenon's profits.
- (5) In the premises, Mr McBurnie breached the Fundamental Principle of Professional Competence and Due Care in that the forecasts used to carry out the goodwill impairment assessments were misleading.

114. Further, the updated impairment assessment carried out in late October 2011 relied, as a starting point, on the profit forecast used in the earlier impairment assessment (which was then reduced to £23.584 million as stated above). As a result of the reliance on that earlier profit forecast which was misleading and prepared on a fundamentally flawed basis, the forecast used in the updated impairment assessment was also misleading and fundamentally flawed. Accordingly, the updated impairment assessment was also misleading and fundamentally flawed since it was not based on the true underlying position of RSM Tenon. It was also inconsistent with (by being £2.5 million higher than) the profit before tax figure used for the purposes of the going concern review performed at the same time.

115. Had the profit forecast before tax used in the impairment assessments been consistent with the restated statement of income of RSM Tenon for FY11, which was approximately £9.9 million lower than originally reported, it is likely that there would have been a significant impairment of goodwill at 30 June 2011 in relation to one or more of the CGUs. This is consistent with the actual goodwill impairment of £60.7 million which was included in the interim results of RSM Tenon for the six months ended 31 December 2011.

IMPAIRMENT OF GOODWILL (AUDIT)

ALLEGATION 14

In relation to the audit of the financial statements of RSM Tenon for FY11, the conduct of **Mr Boden and PwC** fell significantly short of the standards reasonably to be expected of, respectively, a Member and a Member Firm in that:

- (i) **Mr Boden and PwC failed to obtain sufficient appropriate audit evidence in relation to the impairment of goodwill; and/or**
- (ii) **Mr Boden and PwC failed to show sufficient professional scepticism in relation to the impairment of goodwill,**

and thereby Mr Boden and PwC failed to comply with ISA 200, ISA 220 and ISA 500, and/or failed to act in accordance with the Fundamental Principle of Professional Competence and Due Care contained in the Code.

Particulars of Allegation 14

116. In light of the profit warning issued by RSM Tenon in May 2011, the limited headroom in RSM Tenon's banking facilities and the deteriorating trading performance of RSM Tenon in the three months to 31 September 2011, PwC should have shown a heightened level of professional scepticism in reviewing RSM Tenon's goodwill impairment calculations. The risk of impairment to goodwill and intangibles should have been categorised by PwC as "significant" (under both Auditing Standards and PwC's own definition of significant audit risk) but was instead only categorised in PwC's Audit Strategy Memorandum as "elevated".

117. Further:

- (1) PwC concluded that it was reasonable for RSM Tenon to use profit as a proxy for cash flow because "*working capitals are incorporated into the allocated book value of segments assets which are subject to impairment testing*". In light of the significant disparity between RSM Tenon's cash flows and profits, and that RSM Tenon had historically reported cash inflows which were significantly lower than

profits, it was wholly inappropriate for RSM Tenon's impairment review to be conducted on this basis.

- (2) PwC failed to identify the inclusion of Corporate Finance profits in the impairment calculations in circumstances where RSM Tenon had itself stated that such cash flows should be excluded.
- (3) PwC failed to challenge whether RSM Tenon's goodwill had been overvalued given that its market capitalisation of £100 million was significantly lower than the value of goodwill.
- (4) PwC failed to take proper account of RSM Tenon's management's poor track record of accurately forecasting future profits by using growth assumptions that were overly aggressive.
- (5) PwC failed to challenge the discount rate used by RSM Tenon which was inappropriate for the reasons set out in paragraph 118(1) and (2) above.
- (6) PwC also failed to challenge the forecasts used by RSM Tenon in its impairment assessments, on the basis of applying market awareness. This could have included consideration of the impact of the clampdown on tax planning, the slow-down of mergers and acquisitions and audit volume and price.

PwC failed to carry out any of the above with sufficient diligence and/or professional scepticism.

118. Furthermore, PwC failed to obtain a sensitivity analysis on RSM Tenon's updated impairment assessment and thus failed to obtain sufficient appropriate audit evidence:

- (1) In its impairment working paper, PwC recorded that the sensitivity analysis in the original impairment review had allowed for a 15% reduction in cash flows. According to PwC:

“this headroom covers the downturn experienced in Q1 and the forecast reduction in cash flows anticipated in the revised forecast of 7%. Accordingly, there remains headroom for a further 8% reduction on revised cash flows prior to an impairment arising, which we consider to be appropriate”.

- (2) A line-by-line (or CGU-by-CGU) analysis showed that the headroom available to each CGU varied from 2% to 39%. Accordingly, certain CGUs were very close to impairment based on the figures that had been prepared and the assumptions that had been adopted at the time of preparing the model.
- (3) PwC was therefore wrong to consider matters on an aggregate basis rather than a CGU-by-CGU basis and to reach the conclusion that a further 8% reduction in the revised cash flows could be absorbed before a potential impairment charge would arise.

119. In light of:

- (1) the “elevated” risk in relation to impairment that PwC had noted (which should in fact have been “significant”);
- (2) the poor trading results in the three months to 30 September 2011; and
- (3) the fact that PwC had such analyses in soft copy format,

PwC should have requested from RSM Tenon appropriate updated sensitivity analyses and then sought to re-perform these updated sensitivity analyses. However, PwC failed to do so.

120. Had PwC obtained and/or re-performed these sensitivity analyses, given the small amount of headroom available in the updated cash flow forecasts for most of the CGUs, these analyses would have demonstrated to PwC that there was a real possibility that the goodwill was impaired.

GOODWILL IN FMBS (AUDIT)

ALLEGATION 15

In relation to the audit of the financial statements of RSM Tenon for FY11, the conduct of **Mr Boden and PwC** fell significantly short of the standards reasonably to be expected of, respectively, a Member and a Member Firm in that:

- (i) **Mr Boden and PwC failed to obtain sufficient appropriate audit evidence from which to draw a reasonable conclusion that the treatment of goodwill in FMBS was appropriate; and/or**
- (ii) **Mr Boden and PwC failed to show sufficient professional scepticism in relation to the treatment of goodwill in FMBS,**

and thereby Mr Boden and PwC also failed to comply with ISA 200, ISA 220 and ISA 500 and/or failed to act in compliance with the Fundamental Principle of Professional Competence and Due Care contained in the Code.

Particulars of Allegation 15

- 121. In 2009, FMBS was established as a college by former directors of RSM Tenon's Risk Management business for the purpose of providing educational courses to students so that they could obtain accountancy qualifications.
- 122. RSM Tenon initially held (or it was initially intended that it would hold) a 60% shareholding in FMBS and the three individual directors who were running the college held (or would hold) the remaining 40%. In October 2010, RSM Tenon increased its shareholding to 75% (or alternatively, its shareholding was finally determined at this level).
- 123. In the financial statements of RSM Tenon for FY10, FMBS was treated as a joint venture. However, in the financial statements of RSM Tenon for FY11, FMBS was instead treated as a subsidiary through stepped acquisition and goodwill in FMBS in an amount of £1.73 million was included in RSM Tenon's balance sheet.

124. Following the review of the financial statements of RSM Tenon in late 2011/early 2012, the FMBS goodwill was then written off in the interim results of RSM Tenon for the six months ended 31 December 2011.
125. In carrying out its audit of the financial statements of RSM Tenon for FY11, PwC failed to obtain sufficient appropriate audit evidence to support RSM Tenon's assertion that there had been a change in the level of control that RSM Tenon exercised over FMBS so as to justify a change from treating FMBS as a joint venture to treating it as a subsidiary or show sufficient professional scepticism in this regard:
- (1) PwC's Audit Strategy Memorandum recorded PwC's risk assessment in respect of acquisition accounting and the carrying of goodwill and intangible assets as "elevated". Accordingly, PwC should have been particularly vigilant in obtaining sufficient audit evidence and have exercised a heightened sense of professional scepticism.
 - (2) PwC prepared a significant matter paper relating to the accounting of the change in control of FMBS. However, in that paper PwC relied on the same reasons for change in control in FMBS as had been included in RSM Tenon's own briefing paper prepared by Mr McBurnie. PwC's significant matter paper stated that PwC had "*obtained and reviewed a paper prepared by the Finance Director outlining the rationale supporting this change in control*".
 - (3) In order to comply with ISA 500, PwC ought to have sought independent corroborating audit evidence that a change in control had occurred to supplement the paper that had been prepared by Mr McBurnie. Reliance on Mr McBurnie's paper alone only amounted to "inquiry" under ISA 500 and was insufficient.
 - (4) Under IAS 27, control is presumed to exist when an entity holds more than half the voting power of another entity unless there are exceptional circumstances. Under IAS 31, paragraph 3, "joint control" over an entity only exists when "*strategic financial and operating decisions require the unanimous consent of all the parties*

sharing control". The factors justifying the treatment of FMBS as a subsidiary existed from the outset of RSM Tenon's acquisition of its shareholding in FY10, namely:

(i) RSM Tenon's shareholding exceeded 50%;

(ii) as majority shareholder, RSM Tenon was entitled to appoint three directors to the board as opposed to the minority shareholders who could appoint two directors to the board;

(iii) no operational or strategic decisions could be made without the consent of RSM Tenon; and

(iv) the only decisions which required minority shareholder approval related to changes to their existing shareholdings or rights of shares, or placing the company into voluntary liquidation.

Accordingly, RSM Tenon controlled FMBS from the outset.

126. PwC also failed to obtain sufficient appropriate audit evidence to support RSM Tenon's assertion, which PwC relied upon in its significant matter paper, that "*FMBS does not generate cash inflows independently of the Risk Management CGU*":

(1) As stated in paragraph 126(1) above, PwC should have been particularly vigilant in obtaining sufficient audit evidence and have exercised a heightened sense of professional scepticism.

(2) Despite this, at most, the only audit procedure performed to verify RSM Tenon's assertion was an oral inquiry of Mr McBurnie.

127. Further PwC failed to exercise sufficient professional scepticism by failing to challenge RSM Tenon's assertion that FMBS did not generate cash flows independently of the Risk Management CGU. PwC overlooked a number of features of the FMBS business which, had sufficient professional scepticism been exercised, would have led PwC to conclude that FMBS was an entirely separate CGU from the Risk Management CGU and that whether goodwill

was impaired should have been assessed at the level of FMBS on its own.

These were the following:

- (1) FMBS was a provider of education services which was an entirely different market to that of the professional services being delivered by the Risk Management CGU.
- (2) FMBS was a separate company which was required by law to report its income and expenditure in isolation from the rest of the Risk Management CGU. Further, separate internal management reporting was prepared by RSM Tenon for FMBS and FMBS was not included in the internal management reporting used for Risk Management.
- (3) FMBS was managed on a day to day basis by an individual who was not employed by RSM Tenon as opposed to the rest of the Risk Management CGU which was managed by RSM Tenon personnel.

GOING CONCERN (ACCOUNTING)

ALLEGATION 16

In relation to the preparation and approval of the financial statements of RSM Tenon for FY11, the conduct of Mr McBurnie fell significantly short of the standards reasonably to be expected of a Member in that Mr McBurnie prepared a materially misstated forecast for RSM Tenon which was relied on to make a going concern assessment in September 2011 and thereby Mr McBurnie failed to comply with the requirements of IAS 1 and/or failed to act in accordance with the Fundamental Principle of Professional Competence and Due Care contained in the Code and/or section 320 of Part C of the Code.

Particulars of Allegations 16

128. During 2011, RSM Tenon's cash flow position significantly deteriorated. RSM Tenon's working capital position had "tightened" due to issues collecting trade debtors, the timing of cash outflows and "seasonality". It was very close to its borrowing limits and anticipated that these would be exceeded in January 2011. In February 2011, RSM Tenon had missed a VAT payment when the payment sent to HMRC for the quarterly VAT amount had not been honoured by RSM Tenon's bank.
129. RSM Tenon documented three going concern¹⁴ assessments for the financial statements for FY11:
- (1) The first going concern assessment was dated 2 September 2011 and signed off by Mr McBurnie. The paper recorded that:
 - (a) RSM Tenon had negotiated additional banking facilities with Lloyds TSB, which provided access to a term loan of £60 million and an overdraft of £28 million. At the end of August 2011, RSM Tenon had utilised £83.3 million of its £88 million total facility.

¹⁴ Financial statements of a company are prepared on a going concern basis when the directors believe that the business will continue to operate for the foreseeable future, being a period of at least 12 months from the date on which they are approved.

- (b) The overdraft facility would be reduced to £22 million during the course of the year. Management predicted that less working capital would be absorbed by the group.
- (c) RSM Tenon concluded that it would continue to be profitable, generate sufficient cash flows to keep within its debt facilities and meet covenant tests; and that its financial statements should be prepared on a going concern basis.

The first going concern paper was supported by forecasts of expected debt levels and quarterly covenant analysis. It included a profit forecast before tax of approximately £27.0 million.

- (2) The second going concern assessment was prepared by [REDACTED]
[REDACTED], and dated 30 October 2011. It was supported by a revised forecast and covenant assessment and stated that trading was below forecast, which had resulted in lower profitability and fewer cash receipts. The revised forecast, prepared on the basis of the accuracy of the underlying financial records prepared by Mr McBurnie, showed RSM Tenon exceeding its overdraft facility and breaching its banking covenant by the end of December 2011. The assessment noted that RSM Tenon was in discussion with Lloyds TSB to establish whether its overdraft could be extended and what the bank's position would be in the event of the covenant breach. The paper concluded that whilst RSM Tenon was seeking comfort from the bank, it was considered unlikely that funding would be withdrawn and therefore the financial statements for FY11 should be prepared on a going concern basis.
- (3) The third going concern assessment was also prepared by [REDACTED]
[REDACTED] and dated 31 October 2011. It identified two areas of additional income and two adjustments to the forecast which served to reduce RSM Tenon's level of Net Debt/EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation) ratio to a level that would not result in a covenant breach. The assessment concluded that, based on the latest forecast, the financial statements for FY11

should be prepared on a going concern basis.

130. The financial statements of RSM Tenon for FY11, which were signed on 31 October 2011, were prepared on a going concern basis.
131. However, following the discovery of accounting errors in the financial statements of RSM Tenon, the interim results of RSM Tenon for the six months ended 31 December 2011 recognised that a material uncertainty existed that may cast doubt on its ability to continue as a going concern.
132. As stated in paragraph 130(1) above, Mr McBurnie was responsible for the preparation of the first going concern assessment dated 2 September 2011, which he signed off. The inclusion of a profit forecast before tax of approximately £27.0 million (which was different from the figure used in the impairment of goodwill assessment) within that assessment was materially misstated because it did not reflect the underlying trading position of RSM Tenon by containing several material accounting errors for the reasons set out in Allegations 1, 2, 4, 7, 8, 9 and 10 above. IAS 1, paragraph 25 required Mr McBurnie to disclose any “*material uncertainties*” which “*may cast significant doubt upon the entity’s ability to continue as a going concern.*” By preparing misstated forecasts, Mr McBurnie failed to comply with IAS 1.
133. Mr McBurnie’s conduct was in breach of the Fundamental Principle of Professional Competence and Due Care and paragraph 320 of Part C of the Code in that the forecasts for RSM Tenon relied on to make a going concern assessment for the financial statements of RSM Tenon for FY11 were not fairly and accurately prepared. Mr McBurnie’s breach of the Fundamental Principle of Professional Competence and Due Care arises from the following:
- (1) For the reasons set out above, Mr McBurnie’s failures as referred to in Allegations 1, 2, 4, 7, 8 9 and 10 above, were then relied upon in determining the forecasts for RSM Tenon.

- (2) In preparing the financial statements of RSM Tenon for FY11, Mr McBurnie made use of a general provision account made up of unallocated provisions which had the effect of making the inaccurate provisions in the financial statements more difficult to identify. The operation of such an account was inconsistent with accounting standards.
- (3) Each of the errors in the financial statements for FY11 which are the subject of the Allegations resulted in an overstatement of RSM Tenon's profits.
- (4) In the premises, Mr McBurnie breached the Fundamental Principle of Professional Competence and Due Care in that the forecast used to undertake the going concern assessment in September 2011 was misleading.

134. The updated forecasts in the second and third going concern assessments prepared by [REDACTED] had in part been based on Mr McBurnie's original forecast and the accuracy of the underlying financial records. Therefore, they were, on account of Mr McBurnie's failures, also misleading.

Signed:

**GARETH REES QC
EXECUTIVE COUNSEL**

Date: