ANNEX TO SETTLEMENT AGREEMENT DATED 5 OCTOBER 2015

IN THE MATTER OF

THE EXECUTIVE COUNSEL TO THE FINANCIAL REPORTING COUNCIL

-and-

PHILIP BLACK

PARTICULARS OF FACT AND ACTS OF MISCONDUCT

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 ("**the Scheme**") and the Accountancy Regulations ("**the Regulations**"), both dated 8 December 2014.

2. This is the Executive Counsel's Particulars of Fact and Acts of Misconduct ("**the Particulars**") in relation to the preparation and approval of the financial statements of the Presbyterian Mutual Society ("**PMS**") for the year ends 2007 and 2008 and, more specifically, the allegations of Misconduct relate to PMS's compliance with its own rules and applicable legislation in both 2007 and 2008 and PMS's liquidity in respect of 2008. However, certain facts and matters relating to the period from 2000 to 2008 ("**the relevant period**") are relied on by way of factual background to the allegations of Misconduct, as more particularly set out below.

Mr Black

3. The respondent to the Particulars is Philip Black ("**Mr Black**"), a member of the Institute of Chartered Accountants in Ireland ("**ICAI**")[1]. By virtue of his membership of the ICAI, Mr Black is also a Member for the purposes of the Scheme.

[1] References to "Member" in this document relate to the definition as set out in paragraph 2(1) of the Scheme. References to 'member' denote membership of the ICAI.

4. Mr Black qualified as a chartered accountant in 1982 and remains in practice as a member of the ICAI. As at the time of PMS's year end 2008 financial statements, Mr Black had experience of auditing seven credit unions but no IPSs.

5. Mr Black became a non-executive director of PMS in 1998. Throughout the relevant period he was a director and, from 2004/2005 a member of PMS's Audit Committee and Loans Committee. Mr Black became Vice Chairman of PMS shortly before it went into administration. Throughout the relevant period, Mr Black was the only practising chartered accountant and auditor on PMS's Board, Audit Committee or Loans Committee.

Misconduct under the Scheme

6. Paragraph 2(1) of the Scheme defines "Misconduct" 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."*

PMS

7. PMS was registered in 1982 as an industrial and provident society ("**IPS**") under the Industrial and Provident Societies Act (Northern Ireland) 1969 (as amended by the Industrial and Provident Societies (Amendment) (Northern Ireland) Order 1976) ("**the 1969 Act**").

8. The Board of PMS were volunteers (many of them retired) and comprised prominent members of the Presbyterian community, including clergy, lawyers and accountants (during the relevant period, Mr Black and another accountant who had retired many years before). The Board met four times a year, in addition to the AGM, for no more than about 2 hours on each occasion.

9. PMS had a small staff (as at 2008, a staff of 7, of whom 2 were part time). PMS was managed by the Company Secretary, Colin Ferguson, who did not hold any professional qualifications.

10. As at October 2008, PMS was the largest IPS in Northern Ireland and had 10,500 members, who held some £100 million in withdrawable shares and had made loans to PMS of some £200 million. Mr McClean described PMS in an interview with the FRC as having been a "unique type of organisation in Northern Ireland".

11. The approximately £200 million in loans from members of PMS as at October 2008 were, in fact, deposits which PMS had taken in breach of both the 1969 Act and its own rules, as more particularly set out in Annex A.

12. Since PMS was accepting deposits in breach of the 1969 Act and its own rules, its registration as an IPS was liable to be cancelled or suspended by the Department for Enterprise, Trade and Investment in Northern Ireland ("**DETI**"). Moreover, PMS ought to have been (but was not) authorised to carry on the regulated activity of deposit-taking by the Financial Services Authority ("**FSA**") (as it then was) under the provisions of the Financial Services and Markets Act 2000 ("**FSMA 2000**"). As a consequence of PMS's non-compliance with the applicable legislation and regulatory framework, members of PMS did not have the protection of a guarantee under the Financial Services Compensation Scheme ("**FSCS**") for their deposits, nor was it subject to any prudential supervision.

13. Furthermore, as at its year end 31 March 2008 and indeed throughout the 2007 and 2008 financial years, PMS's liquidity was inadequate and made it particularly vulnerable to a liquidity shock such as a run, as was still the case as at October 2008.

14. Upon discovering that their money was not protected by the FSCS guarantee, members of PMS withdrew their funds, causing a run on PMS during October 2008, which resulted in its entering administration on 17 November 2008. The Administrator's Statement of Affairs estimated the realisable value of PMS's assets at approximately £180 million.

15. Members of PMS have now received back part of their funds as a result of government intervention. Under a Scheme of Arrangement approved in July 2011, PMS has received a loan of £225 million from DETI and has made repayments to those with total holdings of shares and loans under £20,000 of 100% of their shares and 85% of their loans and to those with total holdings above £20,000 of between 77% and 85% of their total holdings. The administration was closed on 7 November 2013. The Joint Supervisors of the Scheme of Arrangement are responsible for the orderly realisation

of PMS's assets and do not anticipate being in a position to make any further repayments to members of PMS before 2021 and whether sufficient funds will be available to repay the loan from DETI and enable them to do so is not certain. The financial statements of PMS for the year ending 31 March 2014 record net liabilities of £130 million.

The Relevant Standards of Conduct

16. The standards of conduct reasonably to be expected of Mr Black included those set out in the ICAI's 2006 Code of Ethics for Members ("**2006 Code**"). Executive Counsel refers to and relies upon relevant extracts annexed to these Particulars at Annex B.

17. The Fundamental Principles set out in Paragraph 100.4 of the 2006 Code required Mr Black, inter alia, to act with "Professional Competence and Due Care". In summary, this required Mr Black to maintain professional knowledge and skill at the level required to ensure that a client or an employer receives competent professional service based on current developments in practice and to act diligently and in accordance with applicable technical and professional standards when providing professional services.

The Relevant Accounting Standards

18. Under the 1969 Act, PMS had a duty to produce a revenue account and balance sheet each year which showed a true and fair view of the financial position of the society and each director, including Mr Black, was obliged to take reasonable steps to secure compliance by PMS with that obligation. Executive Counsel will refer to and rely upon relevant extracts annexed to these Particulars at Annex C.

Mr Black's Misconduct

19. In summary, and as more particularly set out at paragraphs 69 and following, Mr Black's conduct fell significantly short of the standards reasonably to be expected of him in the following respects:

    i. in relation to the PMS financial statements for each of year ends 2007 and 2008, Mr Black erroneously and unreasonably assumed that PMS was complying with the prohibition in its own rules on taking deposits and was in compliance with applicable legislation, without having an adequate understanding of the regulatory framework that applied to PMS and without addressing his own mind to whether the Board of PMS in fact had an adequate basis for reaching any such conclusions, or whether these were questions which required expert legal advice, based on up to date information about PMS's business;

ii. Mr Black failed to take any adequate steps to address PMS's dangerously low liquidity levels during 2008, or adequately to consider the implications for the continued use of the going concern assumption.

20. For the avoidance of doubt:

a. The Executive Counsel limits the allegations of Misconduct to the preparation, approval and audit of PMS's financial statements for the year ends 2007 2008. To the extent that matters relating to prior financial statements/audits are referred to these are as background only to those allegations.

b. As both a practising chartered accountant and an auditor with experience of auditing credit unions, Mr Black should have been familiar with the basic principles and requirements and guidance set out in Annexes B and C and should have appreciated their relevance to the standards that could reasonably be expected of him as a professional accountant in business, in his capacity as a director with those professional qualifications and experience.

c. The Executive Counsel does not seek to establish that it was inappropriate for management to use the going concern assumption in PMS's preparation of its financial statements for the year end 2007 or 2008. Rather the Executive Counsel contends that Mr Black failed to give adequate consideration or obtain appropriate evidence to justify the conclusion that the use of the going concern assumption was appropriate and/or that there was no significant doubt as to PMS's ability to continue as a going concern in 2008.

PMS's Rules

21. The conditions of PMS's registration as an IPS included that it must be a co-operative society (which does not include a society which carries on, or intends to carry on, business with the object of making profits mainly for the payment of interest, dividends or bonuses on money invested or deposited with, or lent to, the society or any other person), or that the business of the society was being, or was intended to be conducted for the benefit of the community (section 1 of the 1969 Act).

22. The rules of PMS provided, amongst other things, in summary:

a. that its objects included to promote thrift among its members by the accumulation of their savings; to use and manage such savings for the mutual benefit of members; and to create a source of credit for the benefit of its members at a fair and reasonable rate of interest (rule 3);
b. that membership was only available to members of the Presbyterian Church in Ireland (rule 4);
c. for shares to be issued to members in lots of £100 up to the limit on withdrawable share capital permitted by the 1969 Act (rule 8);
d. that members could apply to withdraw the amount paid in respect of any share or shares, subject to PMS's right to require not less than 21 days' notice (rule 11);
e. that PMS may borrow money for its purposes from members and others and may secure the repayment thereof by mortgages and charges of the Society's property (rule 26);
f. that PMS may make loans to members for the purposes of its objects as set out in rule 3 (rule 28);
g. that PMS shall not receive money on deposit (rule 29).

23. The rules do not prescribe any upper limit on the loans from members, or the terms of such loans.

PMS's treatment of loans from members of PMS and withdrawable share capital

24. Where a member of PMS whose share capital had reached the £20,000 statutory limit under section 6(1) of the 1969 Act wished to place more money with PMS, the member was issued with a loan receipt rather than a share certificate.

25. The loans were treated by PMS in an identical way to the share capital in terms of notice for withdrawal (which in practice was on demand for both, despite the rules allowing PMS to require 21 days' notice of withdrawal of share capital) and the rate and timing of interest paid (an annual payment which was calculated identically for each type of investment and depended on PMS's profits but which was described in the case of loans as 'interest' and in the case of shares as 'dividend').

26. In legal terms, however, there was a distinction between the share capital and the loans from members, in that the share capital was an equity investment in PMS, which was at risk, whereas PMS assumed an obligation to repay the sum loaned (together with interest which was calculated on the same basis as the dividend on shares by

reference to PMS's profits). In the event of insolvency, holders of share capital would not receive their money unless and until the loans had been repaid. After PMS went into administration, there were complaints from members that PMS had not made this legal distinction clear to them and that they had not appreciated their share capital was at risk.

27. Internal auditors, Harbinson Mulholland, were engaged in 2005, but were not instructed to review PMS's regulatory position or compliance, other than in respect of money laundering.

Role of Mr Black

28. Mr Black received no training in his duties as a director or in the laws and regulation which applied to PMS. He had read the Rules of PMS. He had not read the 1969 Act.

29. Mr Black was the only practising chartered accountant on PMS's Audit Committee, Loans Committee and the Board and the only person with experience of auditing credit unions.

30. Mr Black shared the role of alternate director on the Loans Committee with David Clements, who also sat on the Audit Committee and the Board. Whilst Mr Clements had qualified as an accountant in 1953 and was a member of the ICAI, he had been retired from practice since 1990 and, when in practice, he had no clients that were credit unions, IPSs or building societies.

31. The Audit Committee met once a year to discuss and approve the annual financial statements and Letter of Representation and after 2005 also met periodically to discuss the findings of the internal auditors.

32. The Loans Committee met bi-weekly to consider new loan applications but Mr Black attended only when Mr Clements was unable to do so. In the last few months of the relevant period both of them attended in view of the increasing value of the loans under consideration. The only remuneration Mr Black received from PMS was £400 for this extra attendance at the Loans Committee.

Changes in scale and scope of activities of PMS over the relevant period

33. PMS was the largest IPS in Northern Ireland by 2008, having grown with enormous speed over the relevant period. The combined total of share capital and loans from

members in PMS grew from some £13 million at 31 March 2000 to some £310 million on 31 March 2008. The number of members grew from 2,179 as at year end 31 March 2000 to 10,503 as at year end 31 March 2008.

34. As at year end 31 March 2000 PMS held some £4 million as loans and some £8.9 million as withdrawable share capital. By year end 2004, the sums held as loans exceeded sums held as share capital (respectively, some £42.4 million and £42.2 million at that point). During the remainder of the relevant period, the growth in loans significantly outpaced the growth in share capital, which was itself rapid. By year end March 2007, sums held as loans were £190,985,380, more than twice the amount of £92,198,600 held as share capital. By year end 2008, loans were £210,990,892 and share capital was £98,241,700.

Extracts from the financial statements of PMS

	FY00 £'000	FY01 £'000	FY02 £'000	FY03 £'000	FY04 £'000	FY05 restated £'000	FY06 £'000	FY07 restated £'000	FY08 £'000
Income	757	1,039	1,227	2,015	3,702	6,723	9,685	14,628	20,428
Total assets	13,028	14,428	24,242	47,364	85,239	135,049	203,951	296,620	311,164
Called up share capital	8,726	9,058	14,373	25,107	41,804	57,823	75,158	92,199	98,242
Loans from members	4,075	5,102	9,513	21,705	42,426	71,497	118,748	190,985	210,991

35. In addition, as from the year end 31 March 2003 PMS expanded its activities to include investing in a portfolio of commercial property, generating rental income. As at year end 2003 the property portfolio was valued at £9.6 million. By year end 2008 it was valued at £129.5 million.

36. Despite these changes in the scale and scope of its activities, there was no corresponding increase in PMS's resources for managing its activities. From 31 March 2000 to 31 March 2008 the income reported by PMS grew by £19.7 million and over the same period the total assets of PMS grew by £298 million. However, PMS's costs (excluding bad debt) were only some £450,000 in the year ended 31 March 2008 (as compared with approximately £110,000 for the year ended 31 March 2000). [redacted]

[redacted](another director) accurately described PMS in interview as having been "run on a shoestring".

Absence of peers

37. At the relevant time, there was no other IPS in Northern Ireland which was operating on a comparable basis to PMS in terms of the scale and nature of its activities (and no other IPS was FSA authorised). Mr Ferguson recognised in his interview conducted by the FSA that: "We did not have any peers in terms of other mutual societies that were operating on the same basis."

Role of DETI and the "regulatory gap"

38. The Companies Registry of Credit Unions and Industrial and Provident Societies ("**CRCU**"), a part of DETI, is responsible for registering IPSs under the 1969 Act. That responsibility as registrar includes the initial registration and the approval of any changes to the rules of an IPS (as was the case in respect of changes to PMS's rules in 1994 and 2003) and the suspension or cancellation of registrations. The 1969 Act also requires IPSs to prepare audited financial statements giving a true and fair view and to file copies of the financial statements with their annual returns to DETI.

39. DETI was during the relevant period also responsible for carrying out prudential supervision of Credit Unions in Northern Ireland (a role which has subsequently been transferred to the Prudential Regulation Authority). However, DETI's powers as registrar under the 1969 Act did not extend to prudential supervision of IPSs. This was noted in each of CRCU's annual reports, published by DETI under section 100 of the 1969 Act, which after setting out the aims of the Registry (including prudential supervision of credit unions) stated: "The Registry does not have any prudential supervisory role in relation to industrial and provident societies".

40. In the rest of the United Kingdom, the role of registrar for IPSs was fulfilled by the FSA (as it then was), which was also responsible (both in Northern Ireland and in the rest of the UK) for authorisation under the FSMA 2000 of any IPS whose activities were such as to require such authorisation.[2] The FSA's evidence to the House of Commons

[2] It should be noted however that the 1969 Act prohibited any IPS with withdrawable share capital (such as PMS) from carrying on the business of banking, save that the taking of deposits of not more than £2 in any one payment and not more than £50 in total from any one depositor, payable on not less than 2 clear days' notice, was not treated as the business of banking for the purposes of the 1969 Act: see section 7 of the 1969 Act.

Treasury Committee enquiry into the failure of PMS was that (whilst identification of the need for authorisation was primarily a matter for the Society) if, when considering the rules of an IPS as part of its function as registrar, it came across an IPS which needed to be authorised under FSMA 2000, it would raise this with the IPS. DETI's evidence was that it did not accept this was part of its function. The Committee's Report identified this difference in approach as a "regulatory gap".

PMS's Annual Returns to DETI

41. In each year, PMS's annual return submitted to DETI answered "no" to the question "Does the society take deposits (excluding withdrawable shares) within the meaning of the Banking Act 1987?" and, likewise, "no" to the question whether PMS held sums previously taken as deposits.

42. The returns were completed and signed by Mr Ferguson for submission to DETI:

    a. without being seen and approved by the Board as a whole; and
    b. without the Audit Committee or the Board having discussed, or taken any expert advice on, what constitutes deposit-taking.

43. On being asked at interview what his understanding was of the rule prohibiting the acceptance of deposits by PMS, Mr Ferguson's response was to the effect that he did not know what the legal definition was but, as a layman, his understanding was that a deposit was for a fixed term and that the loans were not deposits (a) because members had immediate access to them and (b) because the return was not guaranteed, since it was determined by the profit distribution at the end of the year. Mr Ferguson said that he assumed everything was in order because PMS made the returns to DETI every year and heard nothing back from DETI. On being asked why he answered "no" to the question in the annual return as to taking deposits he said: "I didn't sit down and think, right, I'm answering that question. I answered "no" last year, should I still be answering "no" to that because nothing had changed."

Lack of consideration by the Board of, and absence of expert legal advice about, financial services regulatory compliance

44. FSMA 2000 (or indeed the Banking Act 1987) was never considered by the Board. This was so despite the changes in the scale and nature of PMS's activities (paragraphs 32-34 above), the coming into force of FSMA 2000 on 1 December 2000 and the extension of FSA regulation to some mortgages in October 2004.

45. No legal advice was taken on the definition of deposit-taking, or whether any and if so what financial services regulation applied to PMS, at any time during the relevant period (other than advice from the internal auditors on regulation of money-laundering). Although there is some reference in audit papers to a previous legal opinion, no copy was available to the auditors and neither Mr Black nor Mr Clements could recall any such opinion.

46. Whilst other Board members included [redacted] it could not, in the absence of any specific discussion by the Board, and without further enquiry of them, reasonably be assumed by Mr Black and/or Moore Stephens or Mr McClean that any of them was a specialist in financial services regulation and/or that they had directed their minds to these issues and formed a considered view that PMS was in compliance with the applicable legislation and regulation.

47. Moore Stephens Chartered Accountants Northern Ireland (or predecessor firms) ("**Moore Stephens**") acted as auditors to PMS from its inception and throughout the relevant period. In addition to its role as auditor, Moore Stephens was engaged by the Board to provide additional services to PMS including, in 2004, a review of the Society's corporate governance. The Audit Committee was established as a result of the corporate governance review and its functions included overseeing the compilation of a risk register. A draft risk register was prepared by Moore Stephens. The only legislation referred to in the draft risk register under the heading 'regulatory risks' was the Money Laundering Regulations 2003. There are no risks identified in relation to PMS operating within its own Rules, in compliance with the 1969 Act or in compliance with the regulatory requirements of DETI, the FSA or any other regulatory body. Mr Black reviewed this draft risk register in his capacity as a member of the Audit Committee and it was subsequently discussed by the Board. No substantial amendments were made to the draft risk register as far as this heading is concerned following this discussion by the Board.

48. In addition, Mr Black has provided to the Executive Counsel a document entitled 'Developments in Policy from 1982 to Date' which the Executive Counsel understands that PMS maintained to document the developments in the policies of the Society. This document does not appear to have been regularly updated and is contained on only two and a half pages, yet covers the period from 1982, with the latest update in 2007,

and there is only one version contained in Mr Black's File of Papers. Under the heading 'Lending' and sub heading 'R of I' (presumed to refer to Republic of Ireland), the document contains the following entry: "1998 Concerns expressed that the Society is not registered as a lending body in the R of I." There is no further information contained within the document to indicate the nature of such concerns or to record any action taken by PMS as a result of these concerns.

49. There is no evidence that Mr Black or the Board of PMS considered or questioned the laws and regulations applicable to PMS other than as set out above.

Letters of Representation in 2007 and 2008

50. Letters of Representation, drafted by Moore Stephens, were signed by Mr Ferguson on behalf of the directors of PMS (including Mr Black) for the year end 2007 and year end 2008 audits, representing inter alia that:
    a. they had disclosed all known instances of actual or possible non-compliance with laws and regulations which have or could have an effect on the financial statements (2008 letter only);
    b. they were not aware of any events which involved possible or actual non-compliance with laws or regulations which are central to the society's ability to conduct its business or which would otherwise have a potentially material effect on the financial statements (each year);
    c. they had reviewed the going concern considerations and were satisfied that it was appropriate for the financial statements to have been drawn up on the going concern basis having taken account of all relevant matters of which they were aware and having considered a future period of at least one year from the date on which the financial statements were to be approved (each year);
    d. these representations had been made on the basis of enquiries of management and staff with relevant knowledge and experience (and, where appropriate, of inspection of supporting documentation) sufficient to satisfy themselves that they could properly make each of them (2008 letter only).

51. The Letters of Representation were seen by the Audit Committee (of which Mr Black was a member) at their meeting to review the accounts but copies were not sent to the full Board, which resolved that they be signed without having seen them.

52. As Mr Black knew or should have known, there had been no discussion of, or enquiry into, or advice taken by the Board or Audit Committee, or by Mr Black himself, as to

the financial services regulatory position at any time during the relevant period, in order to consider whether the representations at paragraphs 50a or 50b could be made.[3]

53. On being asked at interview as to the basis for the representations made to the auditors as to regulatory compliance, Mr Black's response was to the effect that he assumed PMS was in compliance because annual returns were made to DETI, and there had been "no feedback" from DETI, and because the auditors (internal and external) had raised no issues. Mr Clements made statements to similar effect when he was interviewed.

Liquidity position

54. As noted above, PMS in practice treated both share capital and loans as repayable on demand. PMS's non-cash assets consisted largely in loans to members secured on property and investments in commercial property (as Mr Black would have known, inter alia from his membership of the Loan Committee and/or the Board). There was therefore an obvious mismatch between the short term and on demand nature of PMS's liabilities and the relatively long term nature of its assets, as was recognised by Moore Stephens during the year end 2008 audit in a document entitled "Possible Factors That May Indicate Going Concern Issues".

55. The audit papers record that the Board of PMS had agreed a policy of maintaining liquidity levels at 15% of the aggregate sums due to members in respect of share capital and loans to enable it to meet such demands for repayment. PMS's policy in relation to liquidity levels is also referred to in the document entitled 'Developments in Policy from 1982 to Date'. However, this document records that PMS had an internal policy or target of maintaining liquidity levels at 15% of *"total assets"*, not members' loans and share capital, which level was raised to 20% in 1996 but reduced again to 15% in 1998,[4] where it remained throughout the relevant period. The basis on which that 15% figure was arrived at is not recorded, although Mr Black suggested in his interview that it was derived at least in part from his own experience of auditing credit unions.

[3] See paragraphs 40 to 48 above.

[4] There is no reference to "total assets" as at 1998. The document simply states "15% suggested liquidity ratio" without giving any further indication as to how that ratio was to be calculated.

56. The liquidity position was or should have been evident to Mr Black from the management accounts which were presented at quarterly Board meetings and also from the annual financial statements. Mr Black stated at interview that he received management accounts at every board meeting and he became very concerned about PMS's liquidity position in around March 2008 and spoke to Mr Ferguson about it.

57. As at both year ends 2007 and 2008 and throughout those financial years PMS's liquidity ratio was far short of the internal target of 15% (whichever method of calculation was used – see paragraph 63 above). There had been a marked worsening of liquidity as compared with the position in prior years.

    a. Over the period from year end 2000 to year end 2005, PMS's liquidity ratio as at the year end (i.e. PMS's cash balances as a percentage of the aggregate sums due to members in respect of share capital and loans) had ranged from 30.80% (in 2002) at its highest to 15.05% at its lowest (in 2001). The equivalent figures calculated on the basis of PMS's cash balances as a percentage of total assets were 30.35% (in 2002) and 14.77% (in 2001).
    b. However, PMS's liquidity ratio as at year end 2007 and year end 2008 was radically lower than at any previous year end over the relevant period:
        i. As at year end 31 March 2007, the cash balance was 3.51% of the aggregate sum due to members (both withdrawable share capital and loans from members) and 3.35% of total assets.
        ii. As at year end 31 March 2008, the cash balance was 1.56% of the aggregate sum due to members (both withdrawable share capital and loans from members), with PMS holding only £4.8 million against £310 million in withdrawable share capital and loans repayable on demand, and 1.55% of the total assets.
    c. The breach of the internal 15% target as at year end 2007 and year end 2008 was not a temporary state of affairs affecting only the year end, as was evident from the management accounts provided to Mr Black. From November 2006 onwards the liquidity ratio was consistently below the 15% threshold, at 10.86% of total assets in November 2006 and then within the range of 2.16% to 6.56% of total assets from February 2007 to September 2008. Furthermore, the breach of the internal 15% target as at year end 2008 was not remedied after the year end. By the end of September 2008, cash of approximately £21.7 million was held; given the level of total assets and/or the members' interests

(i.e. loans and share capital) on the balance sheet, the liquidity ratio of PMS at the end of September 2008 was still significantly below the 15% internal target.

d. Although in May 2003 liquidity was 6.46% it had otherwise been above the internal 15% threshold at all other occasions from January 2003 to September 2006. The position over 2007 and 2008, described above, therefore represented a significant change from prior years.

58. The decline in PMS's liquidity was such as to call in question whether any and if so what prudential supervision applied to PMS and whether the going concern assumption remained appropriate. There appears to have been little or no consideration of the liquidity position or the appropriateness of the going concern assumption by PMS's Audit Committee or Board in 2007 or 2008. Executive Counsel does not assert that use of the going concern assumption was in fact rendered inappropriate by PMS's liquidity position. Rather, the nature of the case advanced by Executive Counsel is that inadequate consideration was given by Mr Black to the implications of PMS's liquidity position and its significance for the continued use of the going concern assumption.

PMS's financial statements

59. Funds received from shareholders exceeding the £20,000 limit were described by PMS in their financial statements as 'loans' (accounts for year ends 2000-2005) or 'loans repayable on demand' (accounts for year ends 2006-2008). The withdrawable share capital was described as "Shareholders funds – equity interests" (accounts for year ends 2000-2006) or "Share capital repayable on demand" (accounts for year ends 2006-2008). Whereas, irrespective of whether the compliance issue should also have been identified by the Respondents (or any of them):

    a. The presentation of the loan liabilities (i.e. the loans accepted from members) and share capital should on any view have reflected the fact the loans and share capital were repayable on demand and they should have been contained within current liabilities rather than in the members' interests section of the balance sheet.

    b. The presentation of the loan assets (i.e. the loans made by PMS) should have included a maturity analysis in the notes to the accounts which would reflect the repayment terms of the loans as long term loans partially repayable in more than one year. This presentation would have demonstrated the long term and illiquid nature of PMS's assets as compared with the short term and on demand nature of its liabilities.

60. In the accounts for each of the years ends 2007 and 2008 the Director's report included a statement in the following terms:

> "**Risk management**
>
> The directors have conducted a review of the major risks to which the society is exposed. These risks are considered regularly by the directors and they have developed systems to monitor and control these risks in order to mitigate any impact they may have on the society.
>
> The main risks arising from the society's financial instruments are interest rate risk, credit risk and liquidity risk.
>
> The policies for managing these risks are summarised below.
>
> Liquidity risk
>
> The directors seek to manage financial risk by ensuring sufficient liquidity is available to meet foreseeable needs.
>
> Interest rate risk
>
> The society finances its operation through a mixture of loans to members[5] and rental income. The interest rate charged is based on the Bank of England base rate.
>
> Credit risk
>
> The society's principal financial assets are cash, investment properties and loans to members. The credit risk associated with cash is limited. The investment properties are revalued annually. The principal credit risk arises from loans to members..."

61. Had PMS been regulated as a bank, as it should have been, it would have been required to make far more detailed disclosures in its financial statements of matters relating to credit risk and liquidity risk. This would have identified to investors and potential investors the potential mismatch between the short term nature of its liabilities and the long term nature of its assets and the consequent risks to liquidity (as more particularly described below).

[5] This is plainly a typing error and should read "loans from members".

Events in Autumn of 2008

62. On 13 September 2007 there was a run on Northern Rock, one of the largest mortgage lenders in the UK. In September 2008 Lehman Brothers filed for bankruptcy. These events, along with other similar events and worsening international economic conditions led to a global financial crisis.

63. Further:

    a. On 30 September 2008, the Irish Government announced its decision to guarantee all deposits and debts of six Irish banking institutions for two years.

    b. On 3 October 2008 the UK Government announced that it was increasing the guarantee on retail deposits from £35,000 to £50,000 through the FSCS with effect from 7 October 2008.

64. Following publicity during September and early October 2008 for the deposit guarantees available from the Irish government and from the FSCS, members of PMS began calling its offices to ask whether their money was guaranteed and, on being told (correctly) that it was not, many of them withdrew their funds.

65. Within 3 weeks, £21 million had been withdrawn, leaving PMS with cash reserves of just £4 million, prompting an emergency Board meeting on 25 October at which it was resolved to suspend payments pending advice and to invoke the 21 day notice period for share capital. By 17 November 2008, over £50 million in further withdrawal requests had been made by members of PMS.

66. On 6 November 2008 the Board resolved to put PMS into administration. Emergency legislation was passed to enable PMS to be put into administration, which took place on 17 November 2008. The administration has now concluded with the putting in place of the Scheme of Arrangement described at paragraph 15 above.

67. In the period after the collapse of PMS, the FSA undertook an investigation of PMS and published the results on its website which included the following statement: “We have concluded our investigation and have decided that [PMS] was conducting regulated activities without the necessary authorisation or exemption.” Further, by a letter dated 23 April 2009, the FSA informed DETI that it considered that PMS had

been accepting deposits in the form of "loans" from members without the required authorisation in breach of section 19 of FSMA.

Directors' Disqualification Proceedings

68. In 2010, Directors Disqualification proceedings were brought in Northern Ireland by DETI against a number of directors of PMS, including Mr Black, and the Company Secretary, Mr Ferguson. Those proceedings were concluded by consent in May 2013, by the directors giving disqualification undertakings. By Mr Black's form of disqualification undertaking, dated 9 May 2013, he undertook not to be a director or receiver of a company or act as an insolvency practitioner for 3 years from 30 May 2013. He accepted responsibility as a director (in summary) for PMS's carrying on a deposit-taking business, in breach of its rules and without authorisation under the Banking Act 1987 or FSMA 2000, for its having entered into regulated mortgage contracts without being authorised under FSMA 2000, for its failure to seek professional or legal advice as to the impact of the coming into force of FSMA and for inadequately monitoring the affairs of PMS in certain other specified respects. DETI accepted that he did not act dishonestly, in bad faith or for his own personal gain.

ALLEGATIONS

ALLEGATION 1

In relation to the approval of PMS's financial statements for the years ended 31 March 2007 and 31 March 2008, Mr Black's conduct fell significantly short of the standards reasonably to be expected of a Member, in that: Mr Black erroneously and unreasonably assumed that PMS was complying with the prohibition in applicable legislation and in PMS's own rules on taking deposits and permitted representations to be made to the auditors as to compliance, without having developed a sufficient understanding of the laws and regulations that applied to PMS, without having an adequate basis for the assumption that PMS was in compliance and without recognising or acting on the need for expert legal advice on that issue, and failed thereby to act in accordance with Fundamental Principle (C) 'Professional Competence and Due Care' of the ICAI's 2006 Code of Ethics for Members.

ALLEGATION 2

In relation to the approval of PMS's financial statements for the year ended 31 March 2008, Mr Black's conduct fell significantly short of the standards reasonably to be expected of a Member, in that: Mr Black failed to take any adequate steps to address or to bring to the attention of the Board the fact that during the financial year 2008 PMS's liquidity ratio was significantly below its own internal target and/or what was reasonable and prudent having regard to the nature of its business and/or he failed to take any adequate steps to evaluate the continued appropriateness of the going concern assumption in the light of this and/or to consider what disclosures were required in the year end 2008 financial statements in respect of liquidity and/or going concern, and failed thereby to act in accordance with Fundamental Principle (C) 'Professional Competence and Due Care' of the ICAI's 2006 Code of Ethics for Members.

PARTICULARS

Particulars of Allegation 1 (compliance)

69. Mr Black took no or no adequate steps (whether by seeking appropriate training or advice or assistance or otherwise) to develop a sufficient understanding of the laws and regulations that applied to PMS in order to be able to fulfil his duties as a professional accountant in business.

70. A number of events during the relevant period should have prompted Mr Black to question his understanding of the regulatory environment within which PMS operated. Such events include the coming into force of FSMA 2000, the regulation of mortgage

contracts in 2004, the introduction of ISA 250 in 2005 and the collapse of Northern Rock in 2007.

71. Mr Black does not appear to have considered the limits under the 1969 Act on the amount of withdrawable share capital and on the amounts of deposits that could be taken from members, which should have caused him to ask himself why there should be such limits if unlimited loans from members were permitted. If share capital and loan capital were taken together then by 2007 the average amount per member was significantly in excess of the £20,000 limit. Mr Black ought to have appreciated that the effect of allowing unlimited loans to be accepted from members of the society was to deprive the statutory limit of £20,000 on withdrawable share capital of any practical impact. Mr Black was aware of that statutory limit (which was referred to in the Rules of PMS) yet failed to question how it could be permissible to circumvent it in this way. Mr Black should at least have considered whether there were any material differences between PMS's share capital and loan capital which reasonably justified PMS in treating loan capital as being irrelevant to the application of the statutory limit of £20,000. Even if, contrary to Mr Black's own admissions in his interview with the FRC on 5 May 2010, he was unaware of those limits then he should have informed himself of them.

72. Mr Black failed to question why, despite the similarity in the business that PMS was carrying on, PMS was not subject to similar regulation (i.e. prudential supervision by DETI) to that which applies to a credit union (with which he was familiar from his experience as an auditor of credit unions).

73. Mr Black erroneously assumed that PMS was complying with the prohibition in its own rules on taking deposits and was in compliance with applicable legislation, without recognising as he should have done that he lacked any adequate basis (such as specialist legal advice) for that assumption. He should have identified the need to question his own assumptions.

74. Mr Black appears to have erroneously assumed that, because the rules prohibited deposits, PMS was not taking deposits. He ought to have appreciated that these were distinct questions and that his reasoning was circular.

75. Mr Black could reasonably have been expected to recognise that financial services regulation was a complex and changing field where up to date advice from a specialist

was likely to be needed as to what PMS needed to do to be in compliance. In particular, he could have been expected to recognise that:

a. FSMA 2000 might potentially be relevant to PMS but that PMS had never undertaken a review of its position in the light of FSMA 2000 (or subsequent developments such as the extension of FSA regulation to certain mortgages);
b. PMS had also not undertaken a review of its position in the light of the significant changes in the scale of its activities over the relevant period, or the fact that, by year end 2004, the sums held as loans exceeded sums held as share capital;
c. The fall in PMS's liquidity made it urgent to ensure that, if there were any regulatory requirements that applied to PMS in respect of liquidity (beyond the 15% limit the board had agreed internally), these were identified and complied with (had such an enquiry been made, it might well also have identified the broader issue that PMS needed to be authorised to take deposits).

76. Mr Black should have recognised that:
    a. whether PMS was taking deposits, and its compliance more generally, was a complex and business critical issue where he could not safely rely on his own understanding or assumptions, without proper consideration, discussion with his fellow directors and the benefit of expert legal advice;
    b. there was a need for proper consideration of whether PMS's activities were, in fact, in compliance with its own rules and this could not be presumed;
    c. this in turn required proper consideration of (at the very least) how a deposit and the business of banking was defined for the purposes of the 1969 Act, whether or not Mr Black was also aware (as he should have been at least in very general terms) of the possible relevance of FSMA 2000;
    d. these were legal questions and, unless any member of the Board had the requisite expertise and agreed to advise on these issues (which could not be presumed from silence), these questions needed to be addressed with the benefit of expert legal advice.

77. Mr Black knew that there had been no discussion by the Board or advice to the Board in relation to compliance, at any time during the relevant period.

78. (Alternatively, if he did not know that there had been no discussion by the Board or advice to the Board in relation to compliance at any time during the relevant period, he

ought to have been aware of this fact.) Further, and in any event, Mr Black ought to have recognised and raised with the Board the need for specific consideration by the Board of the issues summarised in the preceding paragraph, with the benefit of expert legal advice.

79. Instead, Mr Black failed to give adequate consideration to the question of what was defined as a deposit or the implications for regulation, failed to identify the fact that this was beyond his own expertise and failed to recognise the necessity for expert advice on this question or its implications for compliance.

80. Mr Black erroneously assumed that DETI was providing some form of prudential supervision without either taking any steps to check the position (such as enquiring of DETI or obtaining and checking DETI's annual report) or having reasonable grounds for concluding that anyone else had done so on behalf of PMS.

81. Mr Black conceded in his interview with the FRC on 5 May 2010, with hindsight, that it was strange that there was never an inspection or investigation from DETI or any other regulator throughout the history of PMS. In fact, he should have questioned at the time whether PMS should be subject to any prudential supervision by a regulator, given the nature and scale of its business and the similarities to the business of a credit union and, on any view, should not have assumed that DETI was providing any prudential supervision without either having carried out any checks to verify that this was indeed so, or having reasonable grounds for concluding that anyone else had done so on behalf of PMS.

82. The primary responsibility for compliance lay on the directors of PMS and Mr Black as a director and a professional accountant in business should have recognised this and addressed his own mind to whether he had an adequate basis for assuming that PMS was in compliance with the prohibition in its own rules on taking deposits. In particular:
    a. Regardless of whether there was a "regulatory gap" (in that DETI was not double-checking the directors' assessment of whether authorisation was required, whereas it appears the FSA would have done so), it remains the case that the directors of PMS, including Mr Black, bore primary responsibility for ensuring that PMS was in compliance with any relevant regulatory requirements. This was accepted by the House of Commons Treasury Committee. Even assuming, therefore, that the Committee's criticisms of DETI in that regard are well founded, it does not follow that Mr Black was relieved of

responsibility his own failure to give these questions any adequate consideration.

b. Mr Black stated in interview with the FRC on 5 May 2010 that he relied on other professional members of the Board with relevant background and knowledge as a banker or as lawyers. However, he did not specifically raise questions in respect of non-compliance with these individuals. He ought not to have assumed, without enquiry, that the lawyers and/or bankers on the Board both had relevant specialist expertise and had actually addressed their minds to the question, such as to make his reliance on them reasonable.

c. Mr Black also stated in interview that the Board placed reliance on both the internal and external auditors. However, as an auditor himself, he should have been well aware of the provisions of ISA 250 Section A and of the fact that "responsibility for the prevention and detection of non-compliance rests with management" (including those charged with governance, such as non-executive directors) and hence that he and his fellow directors could not rely on the internal or external auditors to discharge their own obligations as directors in respect of compliance. Mr Black stated in interview that Moore Stephens did not bring to the Board's attention their obligation under ISA 250 Section A to ensure that an entity is compliant.

d. Whilst members of the public might have been justified in assuming DETI was providing some sort of prudential supervision, the directors, including Mr Black, had a responsibility which the general public did not have to inform themselves as to the true position, which was clearly stated in CRCU's publicly available annual reports (as he ought to have been aware) and should also have been apparent from the lack of any supervisory visits or any information requirements beyond the filing of the annual return.

83. Mr Black (in his capacity as a director and professional accountant in business sitting on the Audit Committee) was or should have been aware of the terms of the Letters of Representation and of the fact that these had not been considered by the full Board. He failed to address his mind sufficiently to whether there was an adequate basis for the representations made in relation to compliance.

84. As a result, Mr Black permitted Letters of Representation to be signed which he knew or should have known contained representations as to compliance as set out at paragraph 49 above:

a. without having taken adequate steps to satisfy himself that there was a proper basis for those representations;

b. in circumstances where he ought to have appreciated they, in fact, had no adequate basis; and

c. without the full Board having considered the representations or the need for advice in respect of them.

85. The Executive Counsel further relies on the matters at paragraphs 86-97 below as matters which collectively should have caused Mr Black to revisit his understanding of the regulation that applied to PMS and to recognise that expert legal advice on this issue was required.

Particulars of Allegation 2 (liquidity)

86. Mr Black was aware of the fact the Board had agreed that PMS would maintain at least 15% cash as against the aggregate sum due to members in respect of shares and loans (or alternatively as against total assets) to meet its liquidity needs and was or ought to have been aware from the management accounts and financial statements for 2007 and 2008 that PMS's actual liquidity was as stated at paragraphs 53-57 above.

87. Northern Rock had experienced a widely-publicised run in September 2007.

88. Mr Black should have recognised that liquidity posed serious risks for PMS as a going concern given the mismatch between the short term nature of its obligation to repay share capital and loans and the long term nature of its asset base as stated in paragraph 53 above. The risk was such that Mr Black should have insisted on a reasoned basis for management of liquidity based on a proper evaluation of what cash holdings would be prudent and appropriate to the scale and nature of PMS's business, having regard to material risks, including the risk of a sudden adverse cash flow. Any such evaluation should have included consideration of what minimum liquidity requirements applied to organisations facing comparable liquidity risks and whether there were any regulatory requirements that applied to PMS in respect of liquidity. It did not follow from the fact that the Board had considered 15% cash to be adequate in the past, that it remained so in the circumstances of the years to 2007 and 2008. The

internal target of 15% was lower than the actual liquidity ratios of most building societies at the relevant time.

89. Neither Mr Black, nor (to his knowledge) the Board as a whole, undertook any such proper evaluation in 2007 and 2008 of what cash holdings were reasonable and prudent and/or were required by any applicable regulation.

90. Not only that, but as at each of year end 2007 and 2008 and throughout the course of those years PMS had (as Mr Black knew or ought to have known) departed radically from the 15% internal target previously applied and, in past years, achieved (see paragraph 56 above). Neither Mr Black nor (to his knowledge) the Board as a whole made any or any adequate enquiry as to the reasons for this departure from PMS's internal target, or as to what steps management had put in place to monitor, mitigate and remedy the deficit in liquidity, or gave adequate consideration to the risks posed by the decline in PMS's liquidity.

91. The deficit in liquidity meant that PMS was particularly vulnerable to a liquidity shock, such as a run, and therefore Mr Black should have made sure that urgent steps had been agreed and were achievable to ensure that the deficit in liquidity was monitored and was fully and swiftly remedied. There is, for example, no evidence that the Audit Committee or the Board required management to supply cash flow forecasts, considered evidence as to historic patterns (such as withdrawals by members) affecting liquidity, subjected cash flow forecasts to stress testing, considered ways in which the liquidity deficit could be mitigated, or otherwise gave these matters adequate consideration, as Mr Black should have ensured was done. Moreover, in addressing this in the context of the year end 2008 financial statements, he needed to have regard to the fact this was the second year in which there had been such a deficit in liquidity (which called in question whether management had the situation under control and whether the Board in turn had sufficient oversight of Mr Ferguson).

92. Management's plans for addressing the deficit in 2008 were, as Mr Black should have appreciated, uncertain to be achievable in that they were dependent on borrowing (in circumstances of a credit crunch) and/or selling property (which was at best a medium term, not short term, solution). In those circumstances, the low liquidity posed a risk to whether PMS could continue as a going concern, which had not been adequately considered or mitigated and the directors had to give adequate consideration to the

appropriateness of the going concern assumption in light of that risk and as to disclosure of that risk in the financial statements, which was not the case.

93. Had PMS been regulated (whether as an FSA authorised deposit-taker or as a Credit Union supervised by DETI) this would have included prudential supervision. The decline in liquidity was also an indicator which taken together with the matters set out at paragraphs 68-83 above should have prompted Mr Black to check whether any such prudential supervision applied and, if so, by which regulator and to what effect. As Mr Black knew or should have known, there was no discussion of, or enquiry into, or advice taken by the Board or Audit Committee, or by Mr Black himself, as to whether PMS was, or should be, subject to any such prudential supervision and, if so, what liquidity requirements might apply to it (see paragraphs 69 to 84 above).

94. Mr Black stated in his interview with the FRC that: "around March 2008 I was very concerned about liquidity because it got down to something like -- I think we were about £1 or £2 million at that date. And I said to Colin [Mr Ferguson], "Look, you need to build up liquidity here" and that's what we did over the next six months." In his response to questions about going concern being a topic of consideration by the Board, Mr Black's answer at interview was that: "going concern became an issue in this -- in September 2008, that's when it became an issue. You know, those accounts were signed off in June 2008 [being the 2008 Financial Statements]." That was an inadequate response to the matters set out at paragraphs 54-58 above and came far too late.

95. The Letters of Representation relating to year end 2008 financial statements contained a representation that the directors had reviewed going concern considerations. In fact there was no, or no adequate, consideration by Mr Black, the Audit Committee or the Board of the continued appropriateness of the going concern assumption, in the light of PMS's low levels of liquidity, prior to approving PMS's financial statements for year end 2008.

96. The only disclosure in relation to liquidity in the financial statements for 2008 stated: "The directors seek to manage financial risk by ensuring sufficient liquidity is available to meet foreseeable needs." The liquidity position was not, in fact, corrected after either year end. Had PMS been regulated as a bank or authorised deposit-taker, as it should have been for the reasons set out above, further disclosures regarding liquidity would have been required.

97. Mr Black failed to give, or ensure that the Board gave, any or any adequate consideration to the reasons for the decline in PMS's liquidity, what liquidity ratio was reasonable and prudent (considering the scale and nature of PMS's business, the long term nature of PMS's investments and the on-demand nature of its liabilities to members), what risks the decline in liquidity posed, what remedial measures were required and with what degree of urgency, what the implications of PMS's poor liquidity were for whether the going concern assumption remained appropriate or what disclosures were required in PMS's financial statements for 2008. After year end 2007 Mr Black's failings in respect of the matters set out above fell significantly short of the standard of competence to be expected of him as an accountant in business.

Annex A

Proper application to PMS of relevant legislation

1. By virtue of section 6(1) of the 1969 Act, no member of PMS could have an interest in PMS's shares exceeding £20,000. That provision was reflected in rule 8 (see paragraph).

2. Section 7(1) of the 1969 Act, provides that a society which has any withdrawable share capital, if registered under the Act, shall not carry on the business of banking. That prohibition applied to PMS, since PMS had withdrawable share capital.

3. Section 7(3) provides a limited carve out from section 7(1) namely that:

   > "The taking of deposits of not more than two pounds in any one payment and not more than fifty pounds for any one depositor, payable on not less than two clear days' notice, shall not be treated for the purposes of subsections (1) and (2) as carrying on the business of banking; but no society which takes such deposits shall make any payment of withdrawable capital while any payment due on account of any such deposit is unsatisfied."

4. The "business of banking" was not defined in the 1969 Act, other than negatively, by reference to the fact that taking the very limited deposits provided for in section 7(2) was not the business of banking for the purposes of that Act. At the time the 1969 Act was passed, the definition was a matter for the common law: see *United Dominions Trust v Kirkwood* [1966] 2 QB 431.

5. However, by the period with which this Complaint is concerned, the 1969 Act had to be read consistently with the Banking Act 1987 and, from December 2001, FSMA 2000. Whatever else may be within the scope of the term "business of banking", taking deposits by way of business (as now successively defined in those two statutes) in circumstances where those deposits are not covered by section 7(3) of the 1969 Act, amounts to carrying on the business of banking in breach of section 7(1) of the 1969 Act.

6. Under section 19 of FSMA 2000 no person may carry on a regulated activity in the United Kingdom unless authorised or exempt.

7. Section 22 of FSMA provides (in summary) that a regulated activity is an activity of a specified kind which is carried on by way of business and relates to an investment of a specified kind. Specified activities and specified investments for the purposes of FSMA 2000 are then defined by way of various statutory instruments so as to include (in summary, and among other matters) accepting deposits and carrying on certain mortgage business.

8. More specifically:

   a. So far as relevant, Article 5 of the Financial Services and Markets (Regulated Activities) Order 2001 ("**RAO"**) provides that:

      "(1) Accepting deposits is a specified kind of activity if—

      (a) money received by way of deposit is lent to others; or

      (b) any other activity of the person accepting the deposit is financed wholly, or to a material extent, out of the capital of or interest on money received by way of deposit.

      (2) In paragraph (1), "deposit" means a sum of money, other than one excluded by any of articles 6 to 9, paid on terms—

      (a) under which it will be repaid, with or without interest or premium, and either on demand or at a time or in circumstances agreed by or on behalf of the person making the payment and the person receiving it; and

      (b) which are not referable to the provision of property (other than currency) or services or the giving of security."

   b. Article 2 of the Financial Services and Markets (Carrying on Regulated Activities by Way of Business) Order 2001 ("**By Way of Business Order**") provides that:

      "(1) A person who carries on an activity of the kind specified by article 5 of the Regulated Activities Order (accepting deposits) is not to be regarded as doing so by way of business if—

      (a) he does not hold himself out as accepting deposits on a day to day basis; and

      (b) any deposits which he accepts are accepted only on particular occasions, whether or not involving the issue of any securities.

      (2) In determining for the purposes of paragraph (1)(b) whether deposits are accepted only on particular occasions, regard is to be had to the

frequency of those occasions and to any characteristics distinguishing them from each other."

c. Article 4 of the Financial Services and Markets (Exemption) Order 2001 ("**Exemption Order**") provides that

> "Subject to the limitations, if any, expressed in relation to him, each of the persons listed in Part II of the Schedule is exempt from the general prohibition in respect of any regulated activity of the kind specified by article 5 of the Regulated Activities Order (accepting deposits)."

d. The persons so listed include:

> "An industrial and provident society, in so far as it accepts deposits in the form of withdrawable share capital."

9. Therefore, any sums accepted by PMS as share capital were not deposits. However, under the 1969 Act, there was a limit of £20,000 per member on the sums that could be accepted on that basis.

10. As regards sums accepted by PMS as loans from members, these loans were in substance and form deposits and in accepting them PMS was accepting deposits by way of business, within the meaning of the RAO and/or was carrying on the business of banking within the meaning of the 1969 Act:

    a. The exemption for withdrawable share capital did not apply to the loans (and was subject to the limits imposed by the 1969 Act).
    b. The loans from members satisfied the definition of deposits for the purposes of the RAO:
        i. The loans were made on terms that the sum loaned was to be repaid. (Indeed, in practice, PMS treated them, and described them in its accounts, as loans repayable on demand.) PMS undertook an obligation to repay the capital amount of the loan in full, regardless of the success of the ventures in which it invested those funds (success, or otherwise, in such ventures going only to the amount that would be paid by way of interest and not the member's entitlement to repayment of the capital). In that respect, the loans were legally distinct from PMS's share capital, which represented the members' investment in the

equity of PMS and was at risk (although this was a distinction which it appears PMS did not make clear to its members at the time).

ii. The sums received by way of loan were loaned to others by PMS and/or were applied to finance PMS's business activities (including the purchase of commercial properties with a view to generating returns to be applied in paying dividends or interest to members).

c. PMS held itself out as accepting these deposits from members on a day to day basis. In this respect, the situation differed crucially from that of a mutual society which might borrow from its members only "on particular occasions", in order to raise finance for its activities, without that amounting to deposit taking "by way of business".

d. The loans grossly exceeded the very limited amounts permitted under section 7(3) of the 1969 Act to be taken as deposits, without that causing PMS to be carrying on the business of banking.

11. By accepting these deposits PMS was:

a. Acting in breach of its own rules;

b. Acting in breach of the 1969 Act, by engaging in the business of banking in breach of section 7(1) in a manner not permitted by section 7(3) of the 1969 Act;

c. Acting in breach of the general prohibition under FSMA 2000 (as regards the period after 1 December 2001, when FSMA 2000 came into force).

12. The definition of deposit and deposit taking business under sections 5 and 6 of the Banking Act 1987 were not materially different to that in Article 5 of the RAO and Article 2 of the By Way of Business Order. It follows that the loans were, likewise, deposits within the meaning of the Banking Act 1987 and that by accepting them, as well as acting in breach of its own rules and the 1969 Act, PMS committed an offence under section 3(2) of that Act.

13. Had PMS at any point during the relevant period taken external advice as to its regulatory position from a specialist who was competent to advise it on financial services regulation, that advice would have been to the effect set out at paragraphs 2-12 above and that PMS therefore needed to apply to the FSA (or prior to 1 December 2001, the Bank of England) for authorisation to accept deposits (or, at the very least, that the risk that this was so was sufficiently great that PMS should as a matter of

urgency contact the FSA to discuss its position, at which point the FSA would have told PMS that it needed to be authorised).

14. In addition, with effect from 31 October 2004, under Article 61(1) of the RAO, entering into a regulated mortgage contract as lender became a specified activity for the purposes of FSMA 2000, as did administering such contracts. Regulated mortgage contracts are defined in Article 61(2) as follows:

> "a contract under which—
>
> (i) a person ("the lender") provides credit to an individual or to trustees ("the borrower"); and
>
> (ii) the obligation of the borrower to repay is secured by a first legal mortgage on land (other than timeshare accommodation) in the United Kingdom, at least 40% of which is used, or is intended to be used, as or in connection with a dwelling by the borrower or (in the case of credit provided to trustees) by an individual who is a beneficiary of the trust, or by a related person".

Sections of the 1969 Act relevant to compliance:

1. Under section 6(1) of the Act: *"Where a society is, or is to be, registered under this Act, no member thereof… shall have or claim any interest in the shares of the society exceeding twenty thousand pounds."*

2. Under section 7 of the Act:

"(1) A society which has any withdrawable share capital—

(a) shall not be registered with the object of carrying on, and

(b) if a registered society shall not carry on, the business of banking.

(2)Every registered society which carries on the business of banking shall on the first Monday in February and August in each year make out, and until the next such Monday keep hung up in a conspicuous position in its registered office and in every other office or place of business belonging to the society where the business of banking is carried on, a statement in the form set out in Schedule 2 or as near thereto as the circumstances admit.

(3)The taking of deposits of not more than two pounds in any one payment and not more than fifty pounds for any one depositor, payable on not less than two clear days' notice, shall not be treated for the purposes of subsections (1) and (2) as carrying on the business of banking; but no society which takes such deposits shall make any payment of withdrawable capital while any payment due on account of any such deposit is unsatisfied.

[...]

(6)Any registered society which—

(a)carries on the business of banking in contravention of subsection (1); or
(b)fails to comply with subsection (2); or
(c)makes any payment of withdrawable capital in contravention of subsection (3),
shall be guilty of an offence and liable on summary conviction to a fine not exceeding[F2 level 1 on the standard scale]."

3. *"SCHEDULE 2 FORM OF STATEMENT BY SOCIETY CARRYING ON BANKING*

1 Capital of the society on 1st January or 1st July last previous:—
(a) nominal amount of each share;
(b) number of shares issued;
(c) amount paid up on shares.
2 Liabilities of the society on the same date:—
(a) on judgments;
(b) on speciality;
(c) on notes or bills;
(d) on simple contract;
(e) on estimated liabilities.
3 Assets of the society on the same date:—
(a) government securities (stating them);
(b) bills of exchange and promissory notes;
(c) cash at the bankers;
(d) other securities."

Sections of the 1969 Act relevant to the duties of Mr Black as a director of PMS:

3. Under the Act, an industrial provident society has a duty to produce a revenue account and balance sheet each year which show a true and fair view of the financial position of the society. Sections 35(1)-(4) of the Act provide as follows:

"(1) Every revenue account of a registered society shall give a true and fair view—

a. if it deals with the affairs of the society as a whole, of the income and expenditure of the society as a whole, or
b. if it deals with a particular business conducted by the society, of the income and expenditure of the society in respect of that business,

for the period to which the account relates.

(2) Every registered society shall, in respect of each year of account, cause to be prepared either—

(b) a revenue account which deals with the affairs of the society as a whole for that year, or
(c) two or more revenue accounts for that year which deal separately with particular businesses conducted by the society.

…

(4) Every balance sheet of a registered society shall give a true and fair view of the state of the affairs of the society as at the date of the balance sheet."

4. With respect to the obligations of committee members, Section 36(6) of the Act states:

"(6) If in relation to any revenue account, revenue accounts or balance sheet of a society a member of the committee of the society fails to take all reasonable steps to secure compliance—

(d) with the provision of subsection (1) or subsection (4) which is applicable in that case, or

(e) in a case falling within subsection (2)(b), with subsection (3),

he shall be guilty of an offence and liable on summary conviction to a fine not exceeding [F1 level 1 on the standard scale], unless he proves that he had reasonable grounds to believe, and did believe, that a competent and reliable person was charged with the duty of seeing that the relevant provision was complied with and was in a position to discharge that duty."

Annex B

Extracts from relevant ethical standards

1. Regulatory provisions applicable to each of the Respondents from 1 July 2006:
    a. Paragraph 1.4 of the 2006 Code of Ethics for Members ("**2006 Code**"), which provides that Professional Accountants (defined as Members and Member Firms) are expected to follow the guidance contained in the fundamental principles in the 2006 Code in all of their professional and business activities whether carried out with or without reward and in other circumstances where to fail to do so would bring discredit to the profession.
    b. Fundamental Principle (c) of Professional Competence and due care (from the 2006 Code), which imposed on each of them "a continuing duty to maintain professional knowledge and skill at the required level to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques" and required each of them to "act diligently and in accordance with applicable technical and professional standards when providing professional services".

2. Additional regulatory provisions applicable to Mr Black from 1 July 2006:
    a. Part C – Professional accountants in Business, section 300, of the 2006 Code illustrates the application of the fundamental principles to Members who are, inter alia, engaged in business in a nonexecutive capacity and includes the following:
        i. (at 320.1): *"Professional accountants in business are often involved in the preparation and reporting of information that may either be made public or used by others inside or outside the employing organisation. Such information may include financial or management information, for example, forecasts and budgets, financial statements, management discussion and analysis, and the management letter of representation provided to the auditors as part of an audit of financial statements. A professional accountant in business should prepare or present such information fairly, honestly and in accordance with relevant professional standards so that the information will be understood in its context."*
        ii. (at 320.2 and 320.3) *"A professional accountant in business who has responsibility for the preparation or approval of the general purpose financial statements of an employing organisation should ensure that*

those financial statements are presented in accordance with the applicable accounting standards.

> *(a) A professional accountant in business should maintain information for which the professional accountant in business is responsible in a manner that:*
>
> *(b) Describes clearly the true nature of the business transactions, assets or liabilities;*
>
> *(c) Classifies and records information in a timely and proper manner; and*
>
> *(d) Represents the facts accurately and completely in all material respects."*

iii. (at 330.1) *"The fundamental principle of professional competence and due care requires that a professional accountant in business should only undertake significant tasks for which the professional accountant in business has, or can obtain, sufficient specific training or experience. A professional accountant in business should not intentionally mislead an employer as to the level of expertise or experience possessed, nor should a professional accountant in business fail to seek appropriate expert advice and assistance when required."*

iv. (at 330.2) *"Circumstances that threaten the ability of a professional accountant in business to perform duties with the appropriate degree of professional competence and due care include:*

> *[...]*
>
> • *Insufficient experience, training and/or education."*

v. (at 330.3) if the threat to professional competence and due care is judged to be anything other than clearly insignificant, the standard requires that safeguards including *"obtaining additional advice or training"*, or obtaining assistance from someone with the necessary expertise, or consulting independent experts, should be considered.

<u>**Annex C**</u>

<u>**Extracts From Relevant Financial Reporting and Accounting Standards applicable to the PMS y/e 07 and 08 financial statements**</u>

Standards relevant to the duties of a director:

1. [Financial Reporting Standard 18 ("FRS 18") sets out the principles to be followed in selecting accounting policies and the disclosures needed to help users understand them. Mr Black and Moore Stephens could be expected to have regard to FRS 18 when considering the financial statements of PMS. It includes passages dealing with the duties of Directors as regards a true and fair view, going concern and disclosures as follows:
   a. (at paragraph 23) *"When preparing financial statements, directors should assess whether there are significant doubts about an entity's ability to continue as a going concern."*
   b. (at paragraph 24) *"If the directors, when making the assessment required by paragraph 23, are aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, paragraph 61 requires them to disclose those uncertainties."*
   c. (at paragraph 61) *"The following information should be disclosed in the financial statements in relation to the going concern assessment required by paragraph 23:*

      (a) any material uncertainties, of which the directors are aware in making their assessment, related to events or conditions that may cause significant doubt upon the entity's ability to continue as a going concern."]

2. The following ISAs include relevant guidance on the responsibility of Directors as regards compliance with law or regulations and on the use of the going concern assumption. Mr Black could be expected to be familiar with, and have regard to, these Standards when considering what the Regulatory Provisions set out above required of him, when acting in his capacity as a non-executive director who was also a qualified accountant. Moore Stephens could be expected to have regard to them in assessing whether or not the directors of PMS had a reasonable basis for the statements they made about compliance and going concern in the Letter of Representations and for concluding that the directors' use of the going concern assumption was appropriate:

a. ISA 250 – 'Consideration of laws and regulations in an audit of financial statements' ("ISA 250"):

    i. (at 250 section A.9) *"It is management's responsibility to ensure that the entity's operations are conducted in accordance with laws and regulations. The responsibility for the prevention and detection of non-compliance rests with management."* Footnote '4' to that text states *"In the UK and Ireland, this responsibility rests with those charged with governance."*[6]

    ii. (at 250 section A.10) *"The following policies and procedures, among others, may assist management in discharging its responsibilities for the prevention and detection of non-compliance:*

        - *Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.*

        - *…*

        - *Engaging legal advisors to assist in monitoring legal requirements.*

        - *Maintaining a register of significant laws with which the entity has to comply within its particular industry and a record of complaints."*

b. ISA 570 - 'Going Concern' ("ISA 570"):

    i. (at 570.3) *"The going concern assumption is a fundamental principle in the preparation of financial statements. Under the going concern assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations. Accordingly, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business."*

    ii. (at 570.4) *"Some financial reporting frameworks contain an explicit requirement for management to make a specific assessment of the*

[6] ISA 250Section A paragraph 1-1 defines governance: "The term 'governance' describes the role of persons entrusted with the supervision, control and direction of an entity." This includes non-executive directors, such as Mr Black.

entity's ability to continue as a going concern, and standards regarding matters to be considered and disclosures to be made in connection with going concern. For example, International Accounting Standard 1 (revised 2003), 'Presentation of Financial Statements,' requires management to make an assessment of an enterprise's ability to continue as a going concern."

iii. (at 570.5) *"In other financial reporting frameworks, there may be no explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern. Nevertheless, since the going concern assumption is a fundamental principle in the preparation of the financial statements, management has a responsibility to assess the entity's ability to continue as a going concern even if the financial reporting framework does not include an explicit responsibility to do so."*

iv. (at 570.6) *"When there is a history of profitable operations and a ready access to financial resources, management may make its assessment without detailed analysis."*

v. (at 570.7) *"Management's assessment of the going concern assumption involves making a judgement, at a particular point in time, about the future outcome of events or conditions which are inherently uncertain. The following factors are relevant:*

   - *In general terms, the degree of uncertainty associated with the outcome of an event or condition increases significantly the further into the future a judgement is being made about the outcome of an event or condition. For that reason, most financial reporting frameworks that require an explicit management assessment specify the period for which management is required to take into account all available information.*

   - *Any judgement about the future is based on information available at the time at which the judgement is made. Subsequent events can contradict a judgement which was reasonable at the time it was made."*

   - *The size and complexity of the entity, the nature and condition of its business and the degree to which it is affected* *by external factors all affect the judgement regarding the outcome of events or conditions."*

vi. (at 570.8) *"Examples of events or conditions, which may give rise to business risks, that individually or collectively may cast significant doubt about the going concern assumption are set out below. This listing is not all-inclusive nor does the existence of one or more of the items always signify that a material uncertainty exists."* [partial extract only]

vii. (at 570.9-2) the auditor must consider *"both of the current and the possible future circumstances of the business and the environment in which it operates."* [partial extract only]