

**IN THE MATTER OF:**

**THE EXECUTIVE COUNSEL  
TO THE FINANCIAL REPORTING COUNCIL**

- and -

**(1) DELOITTE LLP  
(2) HELEN GEORGE**

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**PARTICULARS OF FACT AND ACTS OF MISCONDUCT**

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***The Settlement Agreement (which includes the Particulars of Fact and Acts of Misconduct) is a document agreed between Deloitte LLP and Helen George (the Respondents) and the Executive Counsel. It does not make findings against any persons other than the Respondents and it would not be fair to treat any part of this document as constituting or evidencing findings against any other persons since they are not parties to this document.***

**I. INTRODUCTION**

1. The Financial Reporting Council ("**FRC**") is the independent disciplinary body for the accountancy profession in the UK. The FRC's rules and procedures governing disciplinary proceedings are set out in the Accountancy Scheme of 8 December 2014 ("**the Scheme**").
2. On 24 May 2016, the Conduct Committee of the FRC directed the Executive Counsel to investigate the conduct of the Respondents (and others) in relation to:

*"the preparation, approval and audit of the financial statements of companies within the Serco group for the financial years ended 31 December 2011 and 31 December 2012."*

3. This is the Executive Counsel's Particulars of Facts and Acts of Misconduct in respect of Deloitte LLP ("**Deloitte**") and Helen George ("**Ms George**", together "**the Respondents**") as regards their conduct in relation to, in the case of Deloitte, the audits of the statutory financial statements of Serco Geografix Limited ("**Serco Geografix**") for the years ending

31 December 2011 (“**the 2011 Audit**”) and 31 December 2012 (“**the 2012 Audit**”) and, in the case of Ms George, the 2011 Audit only. In summary, the planning and conduct of those audits fell significantly short of the standards reasonably to be expected from the Respondents. The audits failed to identify the risk of fraud or material misstatement in Serco Geografix’s financial statements as a result of management charges that were levied between Serco Geografix and its parent company, Serco Limited. Further, the Respondents failed to react sufficiently or at all to indicators of the risk of potential fraud or material misstatement uncovered by the audit work that was subsequently performed. There was no critical consideration by the Respondents of the audit evidence that was obtained, and in all the circumstances, the conduct of the Respondents involved a wholesale failure of professional scepticism in relation to the management charges.

### **The Respondents**

4. Deloitte is a member firm of the Institute of Chartered Accountants in England and Wales (“**the ICAEW**”). At all material times, it was the auditor of Serco Group Plc (“**SGP**”) and its various subsidiaries, including Serco Geografix.
5. Ms George is a partner in Deloitte. She is a member of the ICAEW. She was the engagement partner for the 2011 Audit of Serco Geografix and was responsible for the conduct of that audit and for providing the audit opinion on the financial statements.
6. By virtue of their memberships of the ICAEW, both Respondents are subject to the Scheme in the capacity of Member Firm or Member.

### **The engagement partner on the 2012 Audit**

7. The investigation has also considered the conduct of the engagement partner on the 2012 Audit. The investigation against the partner in question has now concluded and the findings against that person are recorded in a separate document. This document does not make any findings against any persons other than those listed at paragraphs 4 and 5 above.<sup>1</sup>

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<sup>1</sup> The Settlement Agreement accompanying this document was published in July 2019, however the PFAM will be published at a later date. References to the SFO’s investigation in the PFAM, therefore, have been updated to reflect its latter publication date.

## **II. STANDARDS**

### **Misconduct**

8. Paragraph 2(1) of the Scheme provides that an Adverse Finding 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 her professional activities (including as a partner, member, director, consultant, agent, 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 is likely to bring discredit to the Member or the Member Firm or to the accountancy profession”.*

9. Paragraph 5(9) of the Scheme provides that:

*“A Member Firm shall not avoid liability to investigation and disciplinary proceedings under this Scheme by reason of having established and operated appropriate working practices and procedures, if its conduct (by reason of the conduct of any partner, member, director, consultant, agent or employee acting with actual or ostensible authority) may constitute Misconduct.”*

10. Paragraph 5(11)(i) of the Scheme provides that:

*“... anything said, done or omitted by an employee of a Member Firm within the scope of his employment, either actual or ostensible, or as an agent of the Member Firm within the scope of his authority, either actual or ostensible, shall be taken as having been said, done or omitted by that Member Firm ...”*

11. In light of these provisions, Deloitte is responsible for the conduct of all of its employees and agents in connection with the 2011 Audit and the 2012 Audit.
12. Ms George is responsible for her own conduct as the engagement partner for the 2011 Audit.

### **The relevant standards of conduct**

13. The standards of conduct reasonably to be expected of the Respondents in the context of the 2011 Audit and the 2012 Audit include those set out in Part A of the Code of Ethics (“**Code**”) promulgated by the ICAEW at the material time; in particular, those set out in the Fundamental Principles and Statements. 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.
14. At all material times, the Fundamental Principles set out in Paragraph 100.5 of the Code required the Respondents to act with “*professional competence and due care*”. This included an obligation to “*act diligently and in accordance with applicable technical and professional standards*” and as further stated in section 130 of the Code.
15. The Audit Regulations issued by the ICAEW require Member Firms and Members to comply with International Standards on Auditing for the UK and Ireland issued in 2009 (“**the ISAs**”). The ISAs form a key element of the “*applicable technical ... standards*” against which the Respondents’ conduct of the audits falls to be judged.
16. Sections of the ISAs are set out below, in the context of the admitted acts of Misconduct in respect of each of the Respondents.

### **III. BACKGROUND**

17. Serco Geografix is part of the Serco group of companies (“**the Serco Group**”). At all material times, it was wholly owned by Serco Limited; which in turn was wholly owned by Serco Holdings Limited, a wholly owned subsidiary of SGP.
18. Deloitte was the statutory auditor of all relevant Serco Group companies. As explained below, the audits of Serco Geografix were conducted by teams that overlapped with the personnel who had conducted the Group audits for each of 2011 and 2012. Certain Work Papers on the Group audit files were relied upon as audit evidence for the 2011 Audit and the 2012 Audit, as set out in further detail below.

### **The EM Contract**

19. On or around 26 November 2004, the Secretary of State for the Home Office entered into a contract with Serco Limited for the provision of services for the electronic monitoring of

offenders (“**the EM Contract**”). These included the provision and maintenance of electronic monitoring equipment.

20. The EM Contract was “*open book*”. Pursuant to Clause 7.8.5 of Schedule 7 to the contract, Serco Limited was to provide the Home Office with a financial model at six monthly intervals demonstrating the costs that had been incurred in delivering services under the contract.
21. Clause 7.8.4 of Schedule 7 to the EM Contract set out a regime for dealing with “*unanticipated cost efficiencies*”. The regime was that Serco Limited had to share the benefit of costs savings with the Home Office, and that this would be implemented by a reduction to the charges otherwise payable by the Home Office to Serco Limited. Clause 7.8.4 provided that:

*7.8.4.1 The SERVICE PROVIDER [i.e. Serco Limited] shall seek, identify and promptly implement opportunities which are reasonably achievable to reduce the costs of providing the Services without reduction in Service Levels throughout the term of this Agreement.*

*7.8.4.2 The AUTHORITY [i.e. the Secretary of State for the Home Department] shall be entitled to abatement of Charges of fifty percent (50%) of the value of any unanticipated cost efficiencies achieved by the SERVICE PROVIDER. For the purpose of this section 7.8.4, “unanticipated costs efficiencies” shall mean cost efficiencies that were not: a) identified by the SERVICE PROVIDER to the AUTHORITY in its BAFO [i.e. Best and Final Offer]; nor b) within the reasonable contemplation of the parties at that time as likely to be achieved in the normal course of commercial activity during the term of this Agreement (including the renegotiation of existing supply contracts or subcontracts).*

*7.8.4.3 Any cost reduction arising from a change in the methods of delivery of the Services would constitute an unanticipated cost efficiency.*

### **The role of Serco Geografix**

22. On or about 31 March 2005, Serco Geografix (which was then called Premier Geografix Limited) entered into a lease agreement with Serco Limited (“**the Equipment Lease Agreement**”). Pursuant to that agreement, Serco Geografix leased electronic monitoring equipment to Serco Limited for the purposes of performing the EM Contract. Under that contract, monitoring equipment was leased by Serco Geografix to Serco Limited for a fixed cost per unit (referred to in the contract itself as “*Rent*”). Serco Geografix also undertook to sell certain “*Goods*” to Serco Limited and to provide maintenance and repair services.

### **The extension of the EM Contract**

23. In 2010, Serco Limited agreed with the Ministry of Justice (which was by then its counterparty under the EM Contract) that the contract should be extended to 31 March 2013.
24. Serco Geografix continued to supply Serco Limited with electronic monitoring equipment throughout this period.

### **The management charges**

25. In the financial year ended 31 December 2011, Serco Geografix’s revenue included a “*management charge*” of £7,500,000. As set out below, this was said by the finance team of Serco Geografix to be a charge met by Serco Limited (and to represent an increase on a corresponding charge in the prior year of £1,900,000). It was calculated as 12 monthly charges of £500,000 with an additional adjustment of £1,500,000.
26. In the financial year ended 31 December 2012, the management charge was reduced to £4,500,000. This was calculated as 12 monthly charges of £500,000 with a deduction of £1,500,000.
27. For the following year the level of management fee was the subject of internal discussion between individuals of Serco Geografix and Serco Limited. Initially, it was proposed (on 19 February 2014) that the management charge for 2013 should be £2.8 million. In response to that proposal, and following the internal discussion, the monthly charges of £500,000 made by Serco Geografix to Serco Limited were not applied in the financial year ended 31 December 2013 and the management charge was reduced to £785,265.

## **The SFO investigation**

28. The SFO has concluded its investigation into Serco's electronic monitoring contracts in respect of the conduct of Serco Geografix and all Serco Group companies.<sup>2</sup> The SFO entered into a Deferred Prosecution Agreement (DPA) with Serco Geografix on 4 July 2019.<sup>3</sup>
29. For the avoidance of doubt, the admitted acts of Misconduct set out below do not depend either on the findings as to the purpose of the management charges set out in the DPA, or on any further outcomes of the SFO investigation. The Misconduct admitted by Deloitte (and by Ms George in respect of the 2011 Audit) is that they failed to plan or conduct any adequate audit work in relation to the risk of material misstatement of the financial statements or the risk of fraud in respect of the management charges.

## **IV. THE FACTUAL BACKGROUND TO THE ADMITTED ACTS OF MISCONDUCT**

### **The audit of Serco Limited and SGP for the year ending 31 December 2011**

30. Deloitte conducted the audit of SGP and Serco Limited for the year ended 31 December 2011. The revenue from the EM Contract was quantitatively material to the financial statements of both SGP and Serco Limited in that year.
31. Because of the way in which the Serco Group was structured, Deloitte organised its audit by reference to business divisions within the group. The EM Contract was (in the year ending 31 December 2011) administered through the Civil Government Division. The EM Contract was the subject of substantive audit work in the course of the audit of the Civil Government Division.

### **Working Paper 8200A**

32. On or around 17 January 2012, an assistant manager in Deloitte prepared working paper 8200A, entitled "*Civil Government Division – Electronic Monitoring (England and Wales)*"

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<sup>2</sup> <https://www.sfo.gov.uk/2019/07/03/sfo-announces-dpa-in-principle-with-serco-geografix-ltd/>

<sup>3</sup> The SFO proceedings have now concluded. The Settlement Agreement accompanying this document was published in July 2019, however the PFAM will be published at a later date. References to the SFO's investigation in the PFAM, therefore, have been updated to reflect its latter publication date.

(“**Working Paper 8200A**”), setting out Deloitte’s detailed review of the EM Contract. The Executive Summary and Section 1 of this document recorded that:

- (1) There had been an increase in the cost of sales on the EM Contract; and that this was *“largely attributable to an increase in the cost of leasing equipment from Serco Geografix Limited”*.
- (2) Serco Geografix had experienced a corresponding *“significant margin uplift”* of £8 million (or 90%) to £16.797 million.

33. Section 3 of this document was headed *“Analysis of performance in the year”*. This identified that revenue earned by Serco Limited under the EM Contract had increased by 15.42% (from £39,440,000 in 2010 to £45,522,000 in 2011). This increase in revenue was attributed to an increase in *“caseloads”* (i.e. offenders subject to monitoring orders). It also identified that, notwithstanding the increase in revenue, the profit (or EBIT) generated by the EM Contract had fallen from £11,492,000 in 2010 to £7,752,000 in 2011. That represented a reduction in the margin generated on the EM Contract from 29.14% to 17.03%.

34. The working paper then adjusted the profit (or EBIT) generated by the EM Contract. There were three adjustments, the most substantial of which was to add back some £6,555,000 that was described as *“SGL charges increase”*. Following these three adjustments, the revised profit margin for the year ended 31 December 2011 was 29.01%, as compared to a profit margin of 29.14% for the prior year.

35. Section 4 of this document was headed *“Turnover and GM testing performed”*. This recorded that:

*“Increases in the lease charges from SGL have been driven by a number of factors. As Serco approach the rebid for the contract end in March 2013 there have been a number of projects being undertaken by SGL to improve the GEM software that is used. These include work on a PDA solution (so that this will be in house rather than something Serco will have to pay external maintenance for), an automated stock maintenance solution, and major upgrades to the GEM2 software (ie now GEM3). SGL have also been building an interface to enable Serco to use GPS tracking in the*

*GEM solution. This has resulted in a higher charge from SGL to EM for which no extra revenue has been received hence the movement in overall gross margin.*

*SGL send EM a monthly charge sheet which details the extra costs incurred. Deloitte reviewed a charge sheet for December 2010 which totalled £510k. These charges are applied monthly throughout the year thus this been used in the expectation calculation below for EBIT.”*

36. The “*expectation calculation*” set out below this narrative compared the actual results achieved on the EM Contract in 2011 to Deloitte’s expectation of those results based on the prior year revenue and gross margin, and the reported increase in “*caseload*”.
37. In order to develop an expectation of profit (or EBIT, or margin) it took the actual revenue for 2011 of £45,522,000, applied the prior year profit margin of 29.14%, and adjusted the product by “(510 \* 12)” (representing the cost of the management charge). This gave an expected profit of £7,145,000. This was said to “*fall within Deloitte threshold*”.
38. The effect of the adjustment was that the analytical review conducted by Deloitte on the profit generated by the EM Contract stripped out the management charge from audit consideration. The management charge was not itself subject to testing, beyond the audit team obtaining the explanation quoted at paragraph 35 above and reviewing the charge sheet for charge of £510,000 in December 2011 (the reference in the working paper is to December 2010, but that appears to be a typographical error).
39. This working paper was marked as reviewed by Ms George on 2 February 2012.

The audit opinion

40. Deloitte signed an unqualified audit report for the year ended 31 December 2011 for SGP on 27 February 2012 and for Serco Limited on 12 April 2012.

**Audit of Serco Geografix for the year ended 31 December 2011**

41. The management charge was material to the financial statements of Serco Geografix for the year ended 31 December 2011. The total revenue for that year was £21,021,481, of which the management charge of £7,500,000 comprised circa 36%.

Working Paper 3550G

42. A working paper bearing the reference number 3550G (“**Working Paper 3550G**”) sets out details of the substantive procedures performed by the Deloitte team responsible for the audit of Serco Geografix.

43. In a tab entitled “*Turnover – AR*”, there is an analytical review of the revenue generated by Serco Geografix. This analytical review generates an expected revenue figure for 2011. That expected revenue figure is the prior year revenue adjusted for the increase in caseload and increase in price per unit charged to Serco Limited in 2011. Apropos this increase, the file records that:

*“...Through discussion with [A member of SGL Management] and [A member of the finance team] this increase is not reflective of actual price increases in the cost of procuring stock, Geografix has actually been buying more efficiently and saving costs in this respect, instead it is just another way to charge more costs to EM...”*

44. Be that as it may, the expectation is then compared to the actual revenue for 2011. That comparison is conducted after removing the management charge from the actual revenue figure. On that basis, the difference between expected revenue and actual revenue falls within the “*threshold*” and it was concluded on the Working Paper 3550G that this was “*satisfactory*”.

45. This analytical review did not, therefore, provide any comfort as to the legitimacy or amount of the management charge. On the contrary, it stripped it out from consideration.

46. The audit team discussed the management charge with [A member of SGL Management]. A record of that conversation was recorded in a tab within Working Paper 3550G entitled “*Tickmarks*”. The relevant file note is at item (h). It was prepared by a member of the audit team on 8 May 2012 and marked as reviewed by the manager with responsibility for the file on 14 May 2012. It records that:

*“Through discussion with [A member of SGL Management] the charge of £500k per month and the £1.5m top-up were figures that were agreed upon between Serco management. There is no financial basis for any of these numbers. This charge revolves around ensuring that Geografix reduces the perceived profitability of the contract EM holds with the Home Office, and as E-monitoring continue to pay these new charges, no issues have been noted.”*

47. As appears from this note, the management charge was comprised of round numbers: 12 monthly charges of £500,000 and a “*top-up*” of £1,500,000. The working paper records in terms that the management charge was not an arms-length transaction; but rather that it was “*agreed upon between Serco management*”. The Working Paper also records that the charge “*revolves around ensuring that Geografix reduces the perceived profitability*” of the EM Contract. In context, those potentially affected by such perception included the Home Office (or its successor, the Ministry of Justice).
48. The working paper does not record the reason why the audit team did not question the statement that “*Serco management*” had an interest in reducing the perceived profitability of the contract. It does not refer to the terms of the EM Contract, or the fact that there was a risk that (if the EM Contract was perceived to be profitable) the Ministry of Justice might seek a rebate under Clause 7.8.4 of Schedule 7 thereof.
49. The explanations recorded as having been given by[A member of SGL Management] – to the effect that “*there is no financial basis for any of these numbers*” – is inconsistent with the explanation obtained by the team performing the audit of the Civil Government Division, and recorded in Working Paper 8200A (see paragraph 35 above). A copy of that working paper (which, as noted above, had been reviewed by Ms George) was included in the audit file for Serco Geografix in 2011.
50. In the course of performing the audit work referred to above, on or around 8 May 2012, a member of the audit team sent a request for supporting documents to the finance team at Serco Geografix. These requests included a request for “*contractual information to support the monthly management charge of £500k for 2011*”. The response given by Serco Geografix was that “*there was no contractual information relating to this or point 2. It was decided internally that there would be a more equitable allocation of revenue and margin to SGL from the EM contract – this is internal IP*”. The audit team asked for meeting minutes recording the discussions pursuant to which this “*equitable allocation*” was made, but it appears that no such evidence was provided.

Working Paper 1250

51. On 8 May 2012, a member of the audit team completed a working paper entitled “*1250 – Audit programme for wholly owned subsidiaries and intermediate holding companies –*

(“**Working Paper 1250**”), recording the substantive work performed on the audit of Serco Geografix.

52. Section A is headed “*Planning and Risk Assessment Considerations*”. At Item 3(k), this Section records that “*preliminary analytical review*” had been performed “*as part of divisional audit file*” and cross-referred to Working Paper 8200A. As set out at paragraphs 32 to 38, the analytical review in that working paper excluded the management charge when developing Deloitte’s expectation of the profit generated by the EM Contract.
53. In Section C, headed “*Audit Summary Memorandum*”, Working Paper 1250 recorded (amongst other things) that:

*“Serco Premier Monitoring Services’ contract with the Home Office is open-book. This means that the Home Office has access to its financial data; allowing the Ministry of Justice to review profit margins.*

*Geografix’s management take the view that were they not to inflate their costs (charged as revenue) in Serco Premier Monitoring Services through the use of management charges (£7.5 m in 2011, £1.9 m in 2010) they would be penalised for efficiencies.*

*Cost savings have been achieved during the year in the sourcing of the electronic monitoring devices which do not undergo any further work once purchased except for testing by one member of staff.*

*It is understood that Geografix remains as it serves a key purpose within the group structure for profit manipulation; maintenance of margins.”*

54. Under the rubric “*Discussion of results and significant balances demonstrating our understanding*”, Working Paper 1250 stated that:

*“During the year the client conducted an internal review of the intercompany transfer pricing and decided to increase both the underlying cost charged to Electronic Monitoring per unit by 5.5% as well as the management charge (2011 £7.5m)”*

Ms George’s review of Working Paper 1250

55. Although the precise date of her review is unknown, Ms George marked this working paper as reviewed on 24 May 2012. During her review, Ms George commented on the management charge. She asked:

*“is the management charge included in the £19.5 m of revenue from other serco entities above? Assume it is a fee that can be agreed to internal correspondence/invoice etc?”*

56. These questions drew the following response from a Manager on the Deloitte audit team:

*“included in the £19.5 m management charge. No internal correspondence – spoke to [A member of SGL Management] and [A member of the Finance Team] about it – they said it was verbally agreed and as Serco Limited pay this off every month on intercompany this is evidence of their agreement”.*

#### The audit opinion

57. On 31 May 2012, Ms George signed an unqualified auditor’s opinion on the accounts of Serco Geografix for the year ended 31 December 2011 on behalf of Deloitte.

#### **“File on 4”**

58. On 28 October 2012, BBC Radio 4 broadcast an edition of *“File on 4”*, entitled *“Public, Private and Profitable”*. This featured an investigation into government outsourcing. In the course of the programme, Serco Geografix was discussed. It was described as *“the star of Serco”*. The programme stated that profits appeared to have been *“shuffled”* between Serco Geografix and the holding companies, and profits then passed up the corporate chain in the form of dividends. The discussion in the programme was based on the published financial statements of Serco Geografix for the year ended 31 December 2011, which had been audited by Deloitte and which showed the profits in Serco Geografix being passed up to Serco Limited.

59. On 30 October 2012, a director at Deloitte, emailed various partners involved in either the 2011 Audit, the 2012 Audit or the wider audits of the Serco Group, including Ms George, bringing the programme to their attention. The director’s covering email did not detail the negative commentary in the programme. Ms George and those partners who received the email, who were interviewed by the FRC, said that they did not recall

listening to the programme. A recording of it was available at all material times on the BBC Radio 4 iPlayer.

### **The Ministry of Justice audit**

60. On or around 17 May 2013, the Ministry of Justice commissioned the National Audit Office to undertake an audit of the EM Contract. The Serco Group issued a press release on 11 July 2013, recording that the results of that audit had *“highlighted to the MoJ matters of potential concern in relation to billing practices”*; that the Serco Group had agreed with the Ministry of Justice that there should be a detailed investigation; and that *“the MoJ has stated that the amounts involved are in the low tens of millions of pounds”*. The National Audit Office’s report published on 19 November 2013 focused on specific *“charging practices”* which Serco Limited had followed throughout the life of the EM Contract, namely: *“charging on the basis of the number of orders, rather than the number of subjects”*; *“charging a monitoring fee when electronic monitoring had ceased”*; and *“charging monitoring fees after the first attempted installation of equipment, whether installation was successful or not”*. It did not make any reference to the management charges that are now at issue.

### **The audit of SGP and Serco Limited for the year ended 31 December 2012**

61. Deloitte conducted the audit of the Serco Group for the year ending 31 December 2012. The EM Contract revenue was again material to the financial statements of both SGP and Serco Limited.
62. Deloitte again organised its audit by reference to the divisions of the Serco Group. In the year 31 December 2012, following a restructuring of the Serco Group, the EM Contract was administered through the UK & Europe Division.
63. The EM Contract was not selected for review in the course of the audit of that division. There was accordingly no analytical review equivalent to that referred to at paragraph 33 to 38 above.

### **The audit of Serco Geografix for the year ended 31 December 2012**

64. The revenue generated by the management charges was material to the financial statements for Serco Geografix for the year ended 31 December 2012. The total revenue

*Edited for publication*

for the year was £18,299,971 and the management charges were £4,500,000 (circa 25% of the revenue).

The exchange with the [Manager]

65. On 21 May 2013, a member of the audit team emailed a [Manager] of Serco Geografix, and asked about the management charge in the following terms:

*“Included in the turnover for Geographix [sic] 2011 were management charges received from [sic] amounting to 7.5 million. £500k paid on a monthly basis and an additional £1.5 mil at year end.*

*Were such charges received in 2012? If so, what’s the total value?”*

66. The [Manager] responded saying that:

*“There was a monthly charge of 500k a month through 2012 as with last year, however at the end of 2012 we made a £1.2 rebate giving a total Management Charge of £4.8 m for 2012”*

Working Paper 3550G revisited

67. The audit team rolled forward Working Paper 3550.
68. The analytical review of revenue was recorded within a tab entitled “*Expectation*”. This compared actual revenue in 2012 to expected revenue based on the prior year revenue and the change in case load (it did not include an adjustment for any change in unit price). Again, the comparison was conducted after the management charge had been stripped out.
69. The tab entitled “*Tickmarks*” recorded (apropos the management charge, and in the wake of the email exchange referred to above) that “[t]here is no financial basis for any of these numbers”; that “[t]his charge revolves around ensuring that Geografix reduces the perceived profitability of the contract EM holds with the Home Office”; and also that no issue was raised because “*E-monitoring continue to pay these new charges*”.

Working Paper 1250 revisited

70. On or about 28 May 2013, the audit team rolled forward Working Paper 1250.

71. As in the prior year, Section A cross-referred (at item 3(k)) to an analytical review performed for the EM Contract at divisional level and recorded in Working Paper 8200A, even though no such analytical review had been performed for the EM Contract (at divisional level or at all) for the year ended 31 December 2012.
72. In section C, Working Paper 1250 repeated the commentary quoted at paragraph 53 above, with certain amendments. The revised commentary is set out below with the amendments shown here in underlined text:

*“Serco Premier Monitoring Services’ contract with the Home Office is open-book. This means that the Home Office has access to its financial data; allowing the Ministry of Justice to review profit margins.*

*Geografix’s management take the view that were they not to inflate their costs (charged as revenue) in Serco Premier Monitoring Services through the use of management charges (£4.5 m in 2012, £7.5 m in 2011) they would be penalised for efficiencies.*

*Cost savings have been achieved during the year in the sourcing of the electronic monitoring devices which do not undergo any further work once purchased except for testing by one member of staff.*

*It is understood that Geografix remains as it serves a key purpose within the group structure for profit reporting; maintenance of margins. However the contract with the Ministry of Defence [sic] is coming to an end at the end of Dec 2013 and will significantly reduce the level of revenue earned by Geografix as from 2014.”*  
*(emphasis added)*

The approval of the financial statements

73. Although the audit work was performed in May 2013, the file was not reviewed by an engagement partner for the audit until September 2013. By that stage, Deloitte were or should have been aware of the MoJ investigation into Serco’s billing practices (referred to at paragraph 60 above), since it was referred to in Serco Geografix’s financial statements. Working Paper 1250 was signed off as partner reviewed on 11 September 2013. An unqualified auditor’s opinion on the financial statements of Serco Geografix was signed on 24 September 2013.

**V. SUMMARY OF ADMITTED ACTS OF MISCONDUCT BY DELOITTE FOR THE 2011 AUDIT AND THE 2012 AUDIT**

**The audit of Serco Geografix for the years ended 31 December 2011 and 31 December 2012**

74. Deloitte's conduct of the audit of the financial statements of Serco Geografix for the years ended 31 December 2011 and 31 December 2012 fell significantly short of the standards reasonably to be expected of a Member Firm. As paragraphs 5(9) and 5(11) of the Scheme make clear, Deloitte is liable for anything done or omitted by any of its employees or agents in respect of those audits.

75. Particulars of the breaches of specific ISAs are set out below, but in summary:

- (1) The management charge passed to Serco Limited was highly material to the accounts of Serco Geografix. It represented circa 36% of Serco Geografix's revenue for 2011 and circa 25% of Serco Geografix's revenue for 2012.
- (2) The audit files for each year recorded clear indicators of the risk of potential fraud or material misstatement:
  - (a) The management charge represented a transaction with a related party, was fixed by management, and was a round figure sum.
  - (b) The audit teams had been told in terms that the management charge had "*no financial basis*", that its purpose was to reduce the "*perceived profitability*" of the EM Contract, and that the purpose of Serco Geografix as a whole was "*profit manipulation*" (for the 2011 Audit)/"*profit reporting*" (for the 2012 Audit).
- (3) Deloitte did not respond to these clear indicators. No (or no effective) audit work on the management charge was planned or conducted for each of the 2011 Audit and the 2012 Audit.
- (4) To the contrary, the management charge was excluded from revenue for the purposes of the analytical review conducted both in the course of the audit of Serco Geografix and the audit of the Civil Government Division (for the 2011 Audit) (to which the audit file cross-referred). The same process occurred in

respect of the 2012 Audit save that the file cross referred to the analytical review conducted in the audit of the UK & Europe Division. However, the EM Contract was not selected for testing in 2012 and there was no such analytical review.

- (5) For the 2011 Audit Ms George asked whether the management charge could be vouched to "*internal correspondence/invoice*". The response was that it could not, that the management charge was "*verbally agreed*" and that the fact that Serco Limited recorded the charge in its own intercompany account was "*evidence of their agreement*". That reinforced the indications (already on the audit file) that the management charge represented a risk of potential fraud or material misstatement. But no further steps were taken.
- (6) No other audit work was done on the management charge for either the 2011 Audit or the 2012 Audit.

## **VI. ADMITTED MISCONDUCT**

### **Allegation 1 – Failure to identify risk of fraud or material misstatement**

In relation to the audits of the financial statements for Serco Geografix for the years ended 31 December 2011 and 31 December 2012, Deloitte fell significantly short of the standards reasonably to be expected of a Member Firm in that it failed to identify the risk of fraud or material misstatement in those financial statements in respect of the management charge, and thereby failed to comply with the requirements of ISA 240 and ISA 315 (as detailed below), and failed to act in accordance with Fundamental Principle (c) ‘Professional Competence and Due Care’ and section 130 of the Code of Ethics (as referred to at paragraph 14 above).

### **Particulars**

76. ISA 240, entitled “*The Auditor’s Responsibilities Relating to Fraud in the Audit of Financial Statements*”, records at paragraph 10 that “*the objectives of the auditor*” include “*identify[ing] and assess[ing] the risks of material misstatement of the financial statements due to fraud*”.
77. ISA 240 further records, at sub-paragraph 32(c), that:
- “For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor’s understanding of the entity and its environment and other information obtained during the audit, the auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.”*
78. Paragraph A43 of ISA 240 identifies “*characteristics of fraudulent journal entries or other adjustments*”. These include journal entries or other adjustments “*containing round numbers*”.
79. ISA 315, entitled “*Identifying and Assessing the Risks of Material Misstatement Through Understanding of the Entity and Its Environment*” records at paragraph 3 that:

*“The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity’s internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.”*

80. ISA 315 goes on to record, at paragraphs 27 and 28 that:

*“27. As part of the risk assessment as described in paragraph 25, the auditor shall determine whether any of the risks identified are, in the auditor’s judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.*

*28. In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:*

*(a) Whether the risk is a risk of fraud;*

*...*

*(d) Whether the risk involves significant transactions with related parties;*

*(e) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and*

*(f) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.”*

81. In breach of those standards, Deloitte failed to identify a risk of fraud or material misstatement represented by the management charge for each of the 2011 Audit and the 2012 Audit. The following, cumulatively (for each of the 2011 Audit and the 2012 Audit), were clear indicators of the risk of potential fraud or material misstatement:

- (1) In respect of the 2011 Audit, the management charge had increased very substantially since the prior audit year (from £1.9 million to £7.5 million and EBIT had also increased from £8.8 million to £16.8 million).
- (2) The management charge was comprised of round numbers: a monthly charge of £500,000, (i) topped up with a further £1,500,000 to reach a total of £7,500,000 in 2011 and (ii) reduced by £1,500,000 to give a total of £4,500,000 in 2012.
- (3) The management charge was a fee charged between related entities and recorded in their intercompany accounts.
- (4) The management charge was recorded by Deloitte as being set by the subjective judgment of “*Serco management*”.
- (5) In respect of the 2011 Audit, inconsistent explanations were given for the management charge in the context of the Civil Government audit and the audit of Serco Geografix.
- (6) The cost efficiency and profit sharing provisions under the EM contract meant that there was an incentive for Serco Geografix and Serco Limited to inflate the costs charged by Serco Geografix to Serco Limited in order to increase the margin earned by Serco Limited from the UK Government.

82. In any event, in failing to identify the above indicators of the risk of potential fraud or material misstatement Deloitte also failed to maintain sufficient professional scepticism. This point is the subject of allegation 4 below.

**Allegation 2 – Failure to react to indicators of the risk of possible fraud or material misstatement**

In relation to the audits of the financial statements for Serco Geografix for the years ended 31 December 2011 and 31 December 2012, Deloitte fell significantly short of the standards reasonably to be expected of a Member Firm in that it failed to react sufficiently or at all to indicators of the risk of possible fraud or material misstatement uncovered by the audit work that was performed on the revenue of Serco Geografix, and thereby failed to comply with the requirements of ISA 240, ISA 315, ISA 500 and ISA 550 (as detailed below), and failed to act in accordance with Fundamental Principle (c) ‘Professional Competence and Due Care’ and section 130 of the Code of Ethics (as referred to at paragraph 14 above).

**Particulars**

83. ISA 240 records (again at paragraph 10) that *“the objectives of the auditor”* include *“respond(ing) appropriately to fraud or suspected fraud identified during the audit”*.
84. ISA 315 records (again at paragraph 3) that the identification of the risk of misstatement is to *“provid[e]a basis for designing and implementing responses”* to that risk.
85. ISA 500, entitled *“Audit evidence”*, records (at paragraphs 4 and 10) that:
- “4. The objective of the auditor is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor’s opinion.
- ...
10. When designing tests of controls and tests of details, the auditor shall determine means of selecting items for testing that are effective in meeting the purpose of the audit procedure.”

86. ISA 550, entitled “*Related parties*”, records (at paragraph 9) that:

“a) *Irrespective of whether the applicable financial reporting framework establishes related party requirements, to obtain an understanding of related party relationships and transactions sufficient to be able:*

i) *To recognize fraud risk factors...*

...

b) *In addition, where the applicable financial reporting framework establishes related party requirements, to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for and disclosed in the financial statements in accordance with the framework...”*

87. In breach of those standards, Deloitte failed to react to the evidence of the risk of possible fraud (or, at the very least, of the risk that the management charge was being used to move profits from one entity within the Group to another for no proper reason) that it uncovered in the course of the 2011 Audit and the 2012 Audit.

88. During the course of the audits, evidence was uncovered that there was no financial basis for the management charge, and that there was a risk that this item was being used to move profits improperly from one entity within the Group to another. That evidence was as follows:

(1) In respect of the 2011 Audit, the audit team was told in terms that there was no “*contractual information*” against which the management charge could be vouched; and that the management charge was designed to achieve “*a more equitable allocation of revenue and margin*”.

(2) In respect of the 2011 Audit, Deloitte recorded in Working Paper 1250 that Serco Geografix served a key purpose in the group structure for “*profit manipulation*”. In respect of the 2012 Audit, Working Paper 1250 recorded the audit team’s understanding that Serco Geografix served a key purpose of “*profit reporting*”. In both years, Working Paper 1250 recorded that Serco Geografix’s management had taken the view that “*were they not to inflate their costs ...*

*through the use of management charges ... they would be penalised for efficiencies”.*

(3) In respect of the 2011 Audit, Working Paper 1250 also recorded (in response to Ms George’s question) that the management charge was “*verbally agreed*” and that there was no evidence for the charge beyond the fact that it was also recorded in the intercompany account of Serco Limited.

(4) Working Paper 3550 recorded that (as per [A member of SGL Management]for the 2011 Audit/ a [Manager] of the company for the 2012 Audit) “*[t]here is no financial basis for any of these numbers*” and that the management charge was designed to achieve the reduction of the “*perceived profitability*” of the EM Contract.

89. The evidence set out in the preceding paragraph should have been considered by the audit teams in the light of the facts that Serco Limited was party to the EM Contract with the UK Government (acting through the Ministry of Justice, as successor to the Home Office), and that that contract contained profit and cost efficiency sharing provisions whereby Serco Limited would earn more under the EM Contract if its costs remained high.

90. The profit and cost efficiency sharing provisions under the EM Contract ought to have been known to the Serco Geografix audit teams as part of Serco Geografix’s relevant characteristics and environment under ISA 315. Those provisions meant that there was a risk that Serco Geografix might inflate the costs charged to Serco Limited, so that Serco Limited would not have to share any cost efficiencies. If this happened, this could constitute a fraud on the UK Government.

91. Ms George and the audit teams for 2011 and for 2012 ought to have identified or been aware of this risk.

92. In all the circumstances, the matters set out in paragraph 88 were clear indicators of the risk of potential fraud or material misstatement and yet there was no reaction by the 2011 and 2012 Audit teams to them. Any reasonable auditor in the position of Deloitte would have:

- (1) Identified that the management charge represented a “*significant*” and “*unusual*” transaction which posed an enhanced risk of fraud or misstatement; and
- (2) Planned appropriate audit procedures to address that enhanced risk.

93. That conclusion applies *a fortiori* in respect of the 2012 Audit in circumstances where the “*shuffl[ing]*” of profits between Serco entities (including Serco Geografix) had been the subject of negative commentary on a national radio programme (see paragraphs 59 and 60 above).
94. Similarly, after the substantive work had been done, but before the 2012 accounts were signed, the Serco Group announced that the Ministry of Justice had instituted an independent audit of the EM Contract, and that the findings of that audit warranted a detailed investigation (see paragraph 60 above).
95. In breach of the ISAs referred to in this allegation, Deloitte failed to react to these indicators at all.
96. In any event, Deloitte’s failure to react to these indicators was also a failure on its part to maintain sufficient professional scepticism. This point is the subject of allegation 4.

**Allegation 3 – Failure to obtain sufficient appropriate audit evidence**

**In relation to the audits of the financial statements for Serco Geografix for the years ended 31 December 2011 and 31 December 2012, Deloitte fell significantly short of the standards reasonably to be expected of a Member Firm in that it failed to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base its opinion on those financial statements, and thereby failed to comply with the requirements of ISA 500 (as detailed below), and failed to act in accordance with Fundamental Principle (c) ‘Professional Competence and Due Care’ and section 130 of the Code of Ethics (as referred to at paragraph 14 above).**

**Particulars**

97. As quoted at paragraph 85 above, but repeated here for ease of reference, paragraph 4 of ISA 500 records that: *“The objective of the auditor is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor’s opinion”.*
98. As a consequence of the above failures, Deloitte failed (in breach of ISA 500) to obtain sufficient appropriate audit evidence about the management charge.
- (1) In respect of the 2011 Audit, the audit team asked for meeting minutes to vouch the *“equitable allocation”* of revenue and margin between Serco Geografix and Serco Limited; but it does not appear to have pressed for the provision of such minutes.
  - (2) For both the 2011 and 2012 audits, the analytical review in Working Paper 3550G stripped out the management charge from actual revenue before comparing that figure to Deloitte’s expectation.
  - (3) For the 2011 Audit, the planning section of Working Paper 1250 cross-referred to Working Paper 8200A (prepared in the context of the audit of the Civil Government Division). That latter working paper set out analytical review which also excluded the management charge from consideration; and recorded that a monthly cost of £510,000 had been vouched to a charge sheet for December

2011. For the 2012 Audit, the planning section of Working Paper 1250 cross-referred to Working Paper 8200A (said to have been prepared in the course of the audit of the UK & Europe Division). In fact, no analytical review had been conducted at the divisional level and Working Paper 8200A provided no comfort as to the level of revenue generated by Serco Geografix.

- (4) Ms George asked (in the course of her review of Working Paper 1250 for the 2011 Audit) whether the management charge could be agreed to “*internal correspondence/invoice etc*”. The response was that it could not: it was agreed “*verbally*”. This was a further indicator of the risk of potential fraud or material misstatement. It drew no reaction.

99. There was accordingly no (or no effective) audit of the management charge for 2011 and 2012 and (given the materiality of the management charge to revenue) of the principal line item in the profit and loss account.

100. Any reasonable auditor in the position of Deloitte would (in light of the clear indicators of the risk of potential fraud or material misstatement) have taken at least the following steps with a view to obtaining sufficient appropriate audit evidence:

- (1) Taken steps to understand what was meant by the “*profit manipulation*” (for the 2011 Audit)/ “*profit reporting*” (for the 2012 Audit) referred to in Working Paper 1250, including identifying the commercial purpose of such terms. This would have required the Serco Geografix audit team to discuss the EM Contract with the audit team that had performed the audit of the Civil Government Division (for the 2011 Audit)/UK & Europe Division (for the 2012 Audit) to identify the potential ramifications of the “*profit manipulation*”/“*profit reporting*”. In practice, certain of the individuals who conducted the audit of Serco Geografix had themselves participated in the Group audit and the audit of Serco Limited. If they had addressed their mind to the question of the potential for profit manipulation/profit misreporting they would, therefore, have appreciated that no work had been conducted to consider this during the course of the audits of any of SGP, Serco Limited and Serco Geografix. If anyone had considered the potential for profit manipulation or profit misreporting they would have appreciated that the cost efficiency sharing

provisions under Clause 7.8.4 of schedule 7 to the EM Contract gave rise to a risk that costs might be misstated in order to manipulate or misreport profits.

- (2) Reviewed Working Paper 8200A (prepared in the context of the audit of the Civil Government Division for the 2011 Audit and the UK & Europe Division for the 2012 Audit) and identified that this provided no comfort as to the legitimacy of the management charge, with the result that there was no audit evidence that provided comfort in this regard.
- (3) Discussed the basis of the management charge with Serco Geografix's management.
- (4) If no sufficient audit evidence were obtained pursuant to the steps particularised at sub-paragraphs (1) to (3) above, ensured that the engagement partner (Ms George for the 2011 Audit) discussed the management charge with [A member of SGL Management] to obtain a precise understanding of the management charge (in particular, how it was calculated and the basis on which it was levied).
- (5) Obtained documentary evidence to corroborate any explanations given by [A member of SGL Management] (for the 2011 Audit)/a [Manager] (for the 2012 Audit) or any other relevant individual.
- (6) In the absence of adequate explanations or sufficient corroborative documents, raised the issue with the management of Serco Geografix or those charged with the governance of that entity and, if necessary, obtained written management representations about the basis for the charge.

101. Deloitte did not take any of these steps for each of the 2011 and 2012 audits. The discussions with [A member of SGL Management] / a [Manager] recorded on the audit files did not represent a proper or adequate enquiry into the basis of the management charge (as required at item (3) above) and the steps particularised at items (1), (2), (4), (5) and (6) were not taken at all.

102. In any event, failing to take these steps constituted a failure to maintain sufficient professional scepticism. This is the subject of allegation 4.

**Allegation 4 – Failure to maintain professional scepticism**

In relation to the audits of the financial statements for Serco Geografix for the years ended 31 December 2011 and 31 December 2012, Deloitte fell significantly short of the standards reasonably to be expected of a Member Firm in that it failed to maintain an appropriate level of professional scepticism, and thereby failed to comply with the requirements of ISA 200 and ISA 240 (as detailed below), and failed to act in accordance with Fundamental Principle (c) ‘Professional Competence and Due Care’ and section 130 of the Code of Ethics (as referred to at paragraph 14 above).

**Particulars**

103. ISA 200, entitled “*Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK)*”, records (at paragraph 15) that:

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

104. ISA 240 records (at paragraphs 8 and 12) that:

*“8. When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud.*

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

105. The Guidance Notes to ISA 240 state at paragraph A7:

*“Maintaining professional skepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information to be used as audit evidence and the controls over its preparation and maintenance where relevant. Due to the characteristics of fraud, the auditor’s professional skepticism is particularly important when considering the risks of material misstatement due to fraud”*

106. In all the circumstances and as set out above, in breach of ISA 200 and ISA 240, Deloitte failed to maintain the requisite level of professional scepticism. The failures particularised at Allegations 1 to 3 above are each borne of a failure to exercise the appropriate level of professional scepticism. There was no proper consideration of, or reaction to:

- (1) The risk of material misstatement arising from the nature of the management charge, as an intercompany charge;
- (2) In respect of the 2011 Audit, the inconsistency between the explanation for the management charge recorded in Working Paper 8200A in the context of the Civil Government Audit and that recorded in the working papers for the audit of Serco Geografix;
- (3) The significance of the audit evidence recorded by Deloitte in Working Paper 1250 which recorded that Serco Geografix served a key purpose in the group structure for *“profit manipulation”* (the 2011 Audit Work Paper)/*“profit reporting”* (the 2012 Audit Work Paper), and that the management charge was *“inflate[d]”* to avoid being penalised for efficiencies; or
- (4) The significance of the audit evidence recorded in Working Paper 3550G that the company’s own [member of SGL Management] (for the 2011 Audit), [Manager] (for the 2012 Audit) had stated that there was *“no financial basis”* for any of these numbers, and that the management charge *“revolves around ensuring that Geografix reduces the perceived profitability”* of the EM Contract.

107. In all the circumstances, the conduct of the 2011 Audit and the 2012 Audit involved a wholesale failure of professional scepticism by Deloitte in relation to the management charge.

## **VII. THE ADMITTED ACTS OF MISCONDUCT BY MS GEORGE**

### **Allegation 5 – Failure in capacity as audit engagement partner**

In her capacity as engagement partner, Ms George's conduct in relation to the audit of the financial statements for Serco Geografix for the year ended 31 December 2011, fell significantly short of the standards reasonably to be expected of a Member in that she is liable for her own failures to comply with ISA 200, ISA 240, ISA 315, ISA 500 and ISA 550 as particularised in Allegations 1 to 4 above and for Deloitte's breaches of the relevant auditing standards in the 2011 Audit.

She thereby failed to comply with the requirements of ISA 220 (as detailed below), and failed to act in accordance with Fundamental Principle (c) 'Professional Competence and Due Care' and section 130 of the Code of Ethics (as referred to at paragraph 14 above).

### **Particulars**

108. Ms George's conduct of the audit of the financial statements for Serco Geografix for the year ended 31 December 2011 fell significantly short of the standards reasonably to be expected of a Member acting as an engagement partner.

109. In that capacity she performed or reviewed the work of the audit team. As particularised above, in the context of Allegations 1 to 4 (for the 2011 Audit only), her conduct fell significantly short of the standards required by ISAs 200, 240, 315, 500 and 550. She failed to identify the risk of fraud or material misstatement; did not react to indicators of potential risk of material misstatement identified during the course of the audit; failed to obtain sufficient audit evidence on which to base Deloitte's audit opinion (which she signed); and did not maintain an appropriate level of professional scepticism.

110. In any event, ISA 220, entitled "Quality Control for an Audit of Financial Statements", records (at paragraphs 8, 15 and 17) that:

8. *The engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned.*
  
15. *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.*

17. *... 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."*

111. Pursuant to ISA 220, in her capacity as engagement partner, Ms George is responsible for the direction, supervision and performance of the 2011 Audit and for the failings particularised at paragraphs 75 to 107 above. Ms George failed to take proper care to consider whether there was sufficient appropriate audit evidence to support the audit opinion. As engagement partner, she should have concluded that there was insufficient audit evidence in relation to the management charge, and that such evidence as had been obtained indicated a clear risk of misstatement through fraud or error.

112. Ms George was personally responsible for Deloitte's failings, and fell significantly short of the standards reasonably expected of her, because:

- (1) In view of the deficiencies in the audit planning and evidence discussed above, she cannot have adequately addressed her own mind to the risks of material misstatement due to the potential for fraud arising in relation to the management charge, and the work that needed to be done in order to address these risks. As engagement partner for the 2011 Audit, it was her responsibility to ensure that the audit was properly planned and performed. She failed to perform that role.
- (2) According to Ms George's own evidence to the FRC, she did not read the whole of the section entitled "audit summary memorandum" in the Audit Programme Working Paper 1250 before signing off the audit, even though it was a new section of that document that had not been rolled forward from the prior year. This had the effect that she did not identify the clear indicators of the risk of potential fraud or material misstatement on the audit file for the

year ended 31 December 2011; and did not take steps to plan and perform work to address that risk. Any reasonably competent engagement partner would have read this memorandum in full and would have reacted with great concern to the statements that Serco Geografix served a key purpose within the Serco group for “profit manipulation”, and that there was no financial basis for the management charge.