Financial Reporting Council

Annual Enforcement Review 2023

July 2023

Contents

1 Overview by Executive Counsel

The Annual Enforcement Review provides an opportunity to reflect on our performance against the baseline set in our first Annual Enforcement Review in 2019 as well as on our contribution to the FRC's purpose.

The year saw the highest number of investigations concluded in a single year and continued progress in resolving legacy cases. Timeliness rightly remains a key priority and our year-on-year improvement in timeliness was reflected in 75% of investigations meeting our published KPI. This was achieved whilst concentrating on consolidation of resource rather than expansion, keeping headcount growth focused and well within budget.

Non-financial sanctions continue to play a key part of our role as an improvement regulator, to date particularly as regards contributing to improving audit quality. They are carefully tailored to the failures identified and developed in conjunction with the firm's Supervisor to ensure that they are targeted effectively. This year such sanctions included a limitation on a firm accepting further audits of Public Interest Entities and a limitation on the ability of an individual to sign Audit Reports for such entities.

Financial sanctions reflect amongst other things the seriousness of the cases concluded and at £20 million before discount the year included the highest sanction yet imposed on a firm, a sanction imposed by the Independent Tribunal. The case was also notable for the level of cooperation provided by the firm including identification and self-reporting of serious failings and comprehensive admissions.

Both in that case and others we continue to see a strong and growing commitment to insight, self-improvement and in the readiness of parties to identify and address errors, to report them to us candidly and to admit them. Such an approach is consistent with the high standards and high quality rightly to be expected from both the preparers and the auditors of financial statements so that investors and other stakeholders can have a high level of assurance that financial statements are accurate and meaningful. It also assists in delivering timely outcomes.

We therefore welcome and incentivise such positive behaviours. Incentivisation includes settlement discounts which ranged from 25-43% reflecting differences in the timing of admissions and in the extent of cooperation beyond that which is required. Cooperation is assessed in the round and monitored throughout. This year we have included a chapter setting out our expectations and how parties can avoid aggravating their position through poor cooperation and can mitigate their position through exceptional cooperation.

During the year we have continued to liaise with colleagues in our Regulatory Standards Division to help inform their work on relevant and effective standards and we have supported the work of colleagues in our Supervision Division for example when addressing concerns identified through their inspection activities. Whilst the role of enforcement is most obvious in the area of holding to account, as the proportionate and risk focused outcomes detailed below demonstrate we also play an important role in promoting good practice.

No sooner has one busy year finished than the next has started. Over the year ahead our work will include continuing to hone the focus of our investigations, build on the senior auditor expertise introduced within the Division this year, and paying particular attention to issues arising in areas of supervisory focus in delivering fair, robust, and proportionate outcomes.

FRC Executive Counsel
Elizabeth Barrett

2 The year[1] at a glance

38
current investigations

10
investigations opened into auditors, accountants and/or actuaries[2] in the year

16
cases resolved through Constructive Engagement

11
cases resolved with settlement

1
case resolved through Independent Tribunal proceedings

7
cases closed with no further action

Financial sanctions of
£40.5 million
(before settlement discount)

75%
of cases met the key performance indicator[3]

8%
headcount increase in the Enforcement Division

Recurring themes in audit investigations: lack of scepticism, insufficient audit evidence, audit of inventory, audit planning, going concern, revenue recognition, disclosures and audit documentation.

1 Year ended 31 March 2023.
2 No investigations into actuaries were opened during the year.
3 A period of two years between the notification of the commencement of an investigation and service of either the Proposed Formal Complaint or Investigation Report (or closure or settlement if sooner). Further details can be found in Section 7 of this Review.

3 The team and processes

Who are the members of the FRC Enforcement Division?

The Division handles case examination and enquiries, investigations and enforcement action.

During the year, our team grew from 64 to 69.

The team comprises:

- **Executive Counsel:** Elizabeth Barrett
- **Deputy Executive Counsel:** Claudia Mortimore, Jamie Symington
- 30 lawyers (qualified barristers or solicitors and trainee solicitors)
- 23 forensic accountants
- 1 senior audit advisor
- 5 legal assistants
- 2 case examiner and assistant case examiner
- 5 operations and administrative

Who can the FRC investigate?[4]

Accountants, accountancy firms and actuaries under the Accountancy Scheme and Actuarial Scheme

Statutory audit firms and auditors under the Audit Enforcement Procedure (AEP)

Case Examination and Enquiries (CEE)[5] – intelligence gathering, initial enquiries

Sources

- Horizon scanning
- Referrals from other FRC teams, regulators, audit firms and professional bodies
- Complaints
- Whistleblowing disclosures

Outcomes

- Referral to Conduct Committee for decision on opening of investigation
- Constructive Engagement (AEP only)
- Referral to another FRC team
- Referral to a professional accountancy or actuarial body or other regulator
- No further action

Investigations and Enforcement – conduct of investigations referred by Conduct Committee

Outcomes

AEP:

- Investigation Report (IR)
- Decision Notice and proposed sanction
- Accepted or Independent Tribunal convened

Scheme:

- Proposed Formal Complaint (PFC)/Formal Complaint (FC)
- Settlement or Independent Tribunal convened

At any point, Executive Counsel can close a case should the threshold for taking enforcement action not be met

Sanctions

Financial:

- Unlimited financial sanctions

Non-financial sanctions e.g.

- Reprimand
- Exclusion as a member of a professional body
- Other remedial actions as appropiate

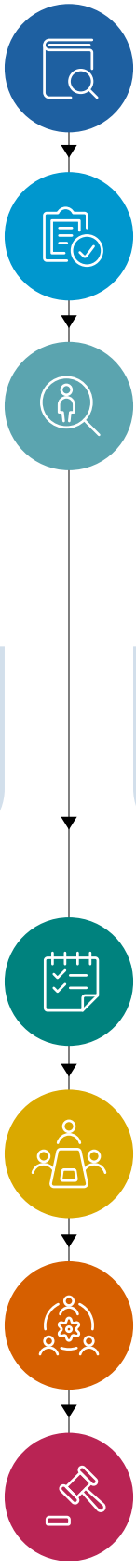
Sanctions are determined by reference to the Sanctions Policy (AEP), Accountancy Sanctions Guidance (Scheme) and Actuarial Sanctions Guidance (Scheme)

4 Who can the FRC investigate and act against?

5 From October 2020, case examination and enquiries into audit matters has been handled in the Audit Firm Supervision team within the Supervision Division. The Case Examiner for such cases remained in the Enforcement Division until 31 March 2023. The Case Examiner and CEE function moved to the Supervision Division on 1 April 2023 and has been renamed Case Assessment.

Enforcement process

A high-level overview of our enforcement process is set out in the flow chart below. A definition of terms we use within this publication can be found in the Glossary on our website.



Case Examiner

Information sources include: horizon scanning, complaints, whistleblowing disclosures, other FRC teams, regulators, audit firms and professional bodies.

Decision to investigate

Taken by the FRC's Board or Conduct Committee following a referral by the Case Examiner. Passed to Executive Counsel.

Investigation

Undertaken by Enforcement Division's forensic accountants and lawyers. We have powers to require production of information and documents from audit firms, auditors and certain audited entities (AEP) and accountants and actuaries (Schemes). There is a general duty to cooperate under both regimes. Independent expert opinion on potential Misconduct/ breaches is sought in most cases.

Settlement is encouraged under both the Schemes and AEP with significant discounts to fines typically available to respondents where early admissions are made. Under all regimes, settlements are approved by an independent reviewer.

If at any time the Executive Counsel decides that the tests have not been met, the case is closed.

Proposed allegations

Grounds for potential Misconduct/breaches set out in document that is served on audit firms, accountants and/or actuaries. Opportunity for respondents to make representations.

Enforcement action

Decision by Executive Counsel to pursue enforcement action where the relevant tests are met. Final allegations served on Respondents.

Determination

Breaches determined by the Executive Counsel can be accepted by the Respondent. Independent Reviewer approves (AEP). If breaches (AEP) or allegations of Misconduct (Schemes) are not accepted the case will be referred to the Independent Tribunal. The Independent Tribunal will conduct full hearing and determine if breaches or Misconduct. Public will have access.

Sanctions

Sanctions for Misconduct/breaches imposed. Outcome published.

Further details of the FRC's remit and powers can be found in The Enforcement regimes and Information gathering powers on the FRC's website.

4 Review of the year

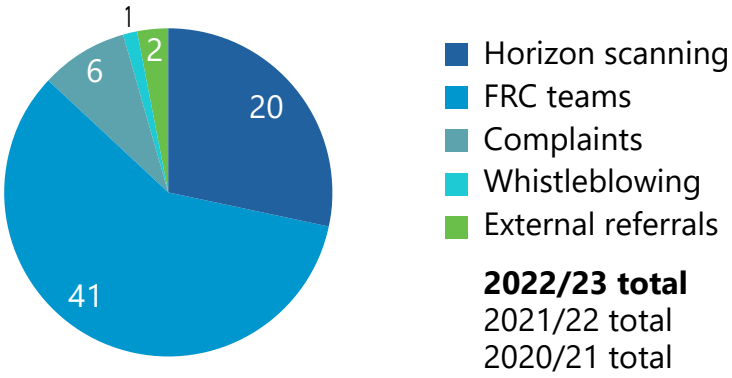
Case Examination and Enquiries

The Case Examiner is responsible for the initial assessment of all matters and for referring appropriate matters to the Conduct Committee to decide whether an investigation should be opened. The below table summarises the number of cases opened and closed by the Case Examiner in the current and preceding two years.

Cases	2020/21	2021/22	2022/23
Open at start of the year	28	20	27
Opened in the year	95	69	70
Closed in the year	(103)	(62)	(57)
Open at end of the year	**20**	**27**	**40**

Cases opened in the year[6,7]

Cases opened (by source)



70
cases opened during the year

Seventy cases were opened in the year, compared with 69 in the previous year.

Referrals from FRC teams remained the largest source of CEE cases. These mostly arose from Audit Quality Review (AQR) inspections of individual audits, with a smaller number from reviews of financial statements by the Corporate Reporting Review (CRR) team and matters identified by Audit Firm Supervision (AFS).

The number of complaints and whistleblowing disclosures passed to CEE for initial assessment remained consistent with those received in the previous year.

6 The enquiries and outcomes data comprises all cases passing through the case examination process, including all audit matters dealt with under the AEP, and all Scheme matters progressed to the Conduct Committee.
7 The source category refers to the method by which a matter first came to the FRC's attention. It may be that matters we identify through horizon-scanning activities are also subsequently the subject of complaints or external referrals.

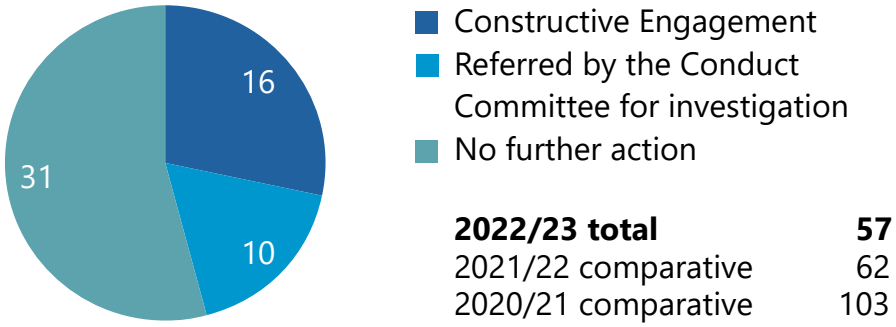
Most cases opened by CEE were audit-related, although this percentage was lower than the prior year (79% compared with 94%). Higher numbers of audit cases reflect the lower threshold for opening investigations under the AEP than under the Accountancy and Actuarial Schemes. The reduction in the percentage of audit cases opened by CEE in the current year reflects an increased focus on non-audit related matters. In addition, four Accountancy Scheme cases were linked to ongoing AEP cases.

At 31 March 2023, 40 cases remained open compared with 27 at 31 March 2022. Eight of these had been open for less than one month.

79%
of cases opened in the year were audit-related

Outcome of CEE cases[8]

Cases closed (by outcome)



2022/23 total	**57**
2021/22 comparative	62
2020/21 comparative	103

During the year, 57 cases were closed by CEE, a decrease of five, or 8%, on the previous year (62 cases closed). The table on page 8 summarises the number of cases opened and closed in the current and preceding two years. Of the cases closed by CEE:

- Ten (15 in 2021/22) were referred by the Conduct Committee to Executive Counsel for investigation.
- Sixteen (24 in 2021/22) were resolved through Constructive Engagement.
- Thirty-one (23 in 2021/22) resulted in no further action by the Case Examiner, two (1 in 2021/22) of which were referred to a professional body.

More details of the cases in each closure outcome are set out in the subsections below.

16
cases were resolved through Constructive Engagement

8 Cases are regarded as closed at the point the Conduct Committee refers the case for investigation or when the decision is taken that no further enquiry work needs to be undertaken by the Case Examiner. Individual outcomes are not published, except where they lead to the opening of investigations and where, in accordance with the Publication Policies, it is considered appropriate to announce that investigation.

Referrals to the Conduct Committee to consider opening an investigation

The cases referred to the Conduct Committee, and its decisions in the year, are shown below:

	Investigations opened under the AEP or the Schemes	Returned for Constructive Engagement or no further action	Total referred to the Conduct Committee
Audit	8	5	**13**
Accountancy	2	0	**2**
Actuarial	0	1	**1**
Total	**10**	**6**	**16**

Ten of these cases were referred by the Conduct Committee to Enforcement for investigation (under the AEP or the Schemes). Further details of the new investigations opened (to the extent that details may be given) are included later in this section.

While the overall number of cases opened and closed by CEE during the year has remained largely consistent, the number where an investigation has been opened has decreased from the previous year (10 versus 15). There does not appear to be any one contributing factor for the drop in number of investigations opened.

The average time taken to refer a case to the Conduct Committee was just over three months, which was slightly longer than last year (just over two months). All cases, except two, were referred within six months of the date the case was opened.[9]

Constructive Engagement

During the year, we continued our focus on further developing the Constructive Engagement process for qualifying[10] cases as an effective and efficient alternative to investigation.

Sixteen cases (28% of all cases in 2022/23), involving a wide range of issues, were resolved through Constructive Engagement (24 cases, or 39%, in 2021/22).

In resolving these, we engaged with 11 separate Statutory Audit firms. Seven (44%) of the cases involved the Big Four accounting firms and nine (56%) involved the seven largest firms.

9 A case is opened on the date the complaint is either received, referred from another division, referred from another regulator or identified through horizon-scanning activities.

10 Guidance for the Case Examiner (AEP), paragraphs 13 to 15 outline where a case may be suitable for Constructive Engagement.

Most cases resolved through Constructive Engagement included potential breaches of auditing standards identified through AQR inspections. The others involved potential breaches of auditing standards identified through CRR reviews, or restatements and/or events in the public domain that warranted further enquiry into the auditors' work.

Timely intervention through Constructive Engagement enables the audit firm to take remedial action in time for the following year's audit (and improves the firm's overall audit quality control procedures).

The average time taken to conclude the Constructive Engagement cases was just under seven months.

Across the 16 Constructive Engagement cases, the most common accounting areas were:

- **Revenue (five cases):** although deficiencies in the audit work had been identified, either we saw no evidence that there had been a material error, or the likely impact of any error was low. Examples included weaknesses in relation to audit procedures over the completeness of revenue, or failure to adequately evidence the challenge of key judgements involving revenue recognition.
- **Impairment (four cases):** these cases presented insufficient evidence to show the appropriate allocation of corporate costs or net corporate assets in impairment reviews, or lack of challenge by the auditors of impairment methodology, assumptions or sufficiency of financial statement disclosures.

The most common issues underlying the potential breaches of Relevant Requirements were:[11]

- **Lack of professional scepticism (eleven cases):** failure to challenge, or document the challenge to, management's accounting treatment, key judgements or methodology; overreliance on management or its advisors; or failure to consider the need for independent advice and insufficient quality review.
- **Insufficient audit procedures (eight cases):** not performing sufficient procedures over material populations or failing to adequately test and consider the nature of reconciling items.
- **Lack of professional judgement (five cases):** failing to consult technical experts in complex areas or failing to adequately evaluate whether the experts' report provided sufficient appropriate audit evidence.

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

Most cases resolved through Constructive Engagement cases were identified through AQR inspections

Average time taken to conclude cases through Constructive Engagement was just over seven months

11 There may be multiple underlying issues connected to a single case.

Examples of remedial actions included:

- Providing training and guidance on designing appropriate substantive analytical procedures, such as setting expectations for account balances and the threshold to corroborate any variances identified.
- Introducing a dedicated work programme and additional guidance on the audit of impairment.
- Expanding guidance and audit methodology for procedures in assessing management's forecasts.
- Updating a firm's audit methodology to increase the level of detail in procedures.

While each case is considered on its own merits, to illustrate the type of Constructive Engagement activity undertaken, two anonymised examples are set out below.

Case A

We made enquiries of a firm regarding its FY2020 audit of a listed company. Our main concerns related to group audit oversight.

Group oversight

There was insufficient evidence of the group audit team's oversight, evaluation and challenge of the key judgements in the impairment review performed by the component audit team. This was particularly notable in relation to the revenue growth rates, discount rate and forecast period applied in the impairment model.

The matter was suitable for Constructive Engagement because there was no evidence to suggest the financial statements were materially misstated. Despite the weaknesses in group oversight, there was no apparent financial detriment or adverse investor, market or public comment on the audit resulting in a possible loss of confidence in the auditing profession.

The Constructive Engagement process resulted in the firm strengthening its procedures on group oversight and impairment, including the release of revised templates and development of good practice guidance. The firm also held an in-person training event that included a root cause analysis session designed in response to the FRC's findings, and shared key learnings from this case.

The firm strengthened its procedures on group oversight and impairment

Case B

In a case involving a firm's FY2020 audit of a listed company, we made enquiries in relation to revenue recognition and goodwill impairment.

Our enquiries identified a lack of challenge of management and a failure to consider alternative treatments beyond those proposed by management.

In relation to revenue, the audit team failed to adequately document its analysis of performance obligations and therefore whether revenue could be recognised. Regarding goodwill impairment, it failed to challenge several fundamental aspects of management's goodwill impairment assessment.

The matter was suitable for Constructive Engagement because there was no evidence to suggest the financial statements were materially misstated, and there was no apparent financial detriment or adverse investor, market or public comment on the audit resulting in a possible loss of confidence in the auditing profession.

As part of the Constructive Engagement, the firm issued guidance on the documentation of challenge and the application of professional scepticism in relation to the audit of judgements and estimates. It also provided training on the financial reporting requirements related to revenue recognition, and its audit. A new work programme for the audit of goodwill impairment was introduced, supported by training and good practice examples.

The firm issued guidance on the documentation of challenge and the application of professional scepticism in relation to the audit of judgements and estimates

Certain actions agreed through Constructive Engagement, which is designed to improve audit quality, are similar to non-financial sanctions imposed at the conclusion of enforcement action. While Constructive Engagement outcomes do not amount to a sanction, and are not individually published, they can result in significant additional requirements for audit firms.

The process requires full and open cooperation by audit firms. During the year, we were generally satisfied with the level of cooperation and the timeliness of responses.

The value of Constructive Engagement also depends on the new measures being appropriately followed by audit teams in practice. This is monitored by a firm's dedicated Audit Firm Supervisor within the AFS team. Where appropriate, the supervisors work with the FRC's AQR team to conduct follow-up activity. CEE also monitors where similar matters are identified in audits conducted by the same firms, and recurring issues will be taken into account when deciding whether to refer a matter to the Conduct Committee to consider opening an investigation.

No further action

There were 31 cases closed in the year by the Case Examiner, with no further action.

In 23 of these, the information that came to our attention involved the Statutory Audit of a UK Public Interest Entity (PIE) or large AIM-listed organisation. We consider all such cases carefully to identify whether there may be underlying issues relevant to the work conducted by the Statutory Auditors. However, on examination of the information available, we found no basis to support further enquiry into the audit. The reasons for this included one or more of the following:

- There was no substantive financial reporting error at the entity.
- There was no indication of a breach of a Relevant Requirement by a Statutory Auditor, for example, where the underlying issue was not within the scope of a Statutory Audit.
- The complaint related to the conduct of an entity's directors or other personnel outside the FRC's remit.

In the remaining eight cases, the reasons for no further action included:

- The presence of UK audit matters that the FRC has delegated to the Recognised Supervisory Bodies (RSBs),[12] for example, the audits of privately owned companies.
- Insufficient evidence to demonstrate failings by the auditors, accountants or actuaries.

Where a case raised issues outside of the FRC's remit, we directed complainants to other bodies that may address their complaints. This year, they included the RSBs, the Financial Conduct Authority and the Insolvency Service.

31

cases were closed with no further action

Oversight

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

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

Future developments

From 1 April 2023, the Case Examiner and CEE became a separate team within AFS in the Supervision Division and has been renamed Case Assessment (CA). Following this, the identification of cases and initial enquiries will in substance remain unchanged, except that the work will now be carried out by a dedicated team. The Supervisor team within AFS is now separately responsible for conducting Constructive Engagement.

The FRC has recently consulted publicly on changes to the decision-making remit of the Board and the Case Examiner under Part 2 of the AEP. Under the AEP dated January 2022, where the Case Examiner determines that information raises a question as to whether a Statutory Auditor has breached a Relevant Requirement, the Case Examiner has the discretion to determine whether to take no further action, arrange Constructive Engagement or refer the matter to the Board. The amendments agreed give the Board a power to issue guidance, which the Case Examiner would have to take into account before exercising their Rule 5 powers. This change is expected to enhance the Board's ability to oversee and engage with the Case Examiner's activities. Certain other amendments have also been agreed. The Board's functions under the AEP have been delegated to the FRC's Conduct Committee. The amended AEP, Guidance to the Case Examiner and Hearings Guidance came into effect on 30 June 2023.

Investigations and Enforcement

Investigations opened

	2020/21	2021/22	2022/23
Investigations opened in year	16	15	10

The Conduct Committee opened ten new investigations in the 12 months to 31 March 2023: eight audit investigations under the AEP and two into accountants under the Accountancy Scheme.

10
investigations opened in the year

AEP investigations

The audit investigations concern a range of issues, including professional scepticism, audit evidence and documentation, audit planning, revenue and revenue recognition, going concern, compliance with the Ethical Standard and compliance with laws and regulations. Three investigations followed referrals to the Case Examiner from the FRC's AQR team, after audit inspections.

In line with the FRC's Publication Policies,[13] not all investigations are announced at the outset, although if the case leads to enforcement action and the imposition of sanctions, the outcome will be published. The Conduct Committee makes the decision whether or not to announce a new investigation on a case-by-case basis. It will decide to announce if it considers that publication is necessary in all the circumstances and any potential prejudice to the subject of an investigation is outweighed by the factors in favour of publication.

Listed in order of opening, the eight[14] new AEP investigations that have been announced are:

Audit firm	Audited entity	Scope
Mazars	Studio Retail Group plc	Audit of the financial statements for the period ended 26 March 2021
EY	Stirling Water Seafield Finance plc	Audit of the financial statements for the year ended 31 December 2019
Shipleys	Zaim Credit Systems plc	Audit of the consolidated financial statements for the year ended 31 December 2021
PwC	Intu Properties plc	Audit of the consolidated financial statements for the years ended 31 December 2017 and 31 December 2018
KPMG	Carr's Group plc	Audit of the consolidated financial statements for the period ended 28 August 2021
EY	A company	Audit of the financial statements for the year ended 31 December 2021
EY	Made.com Group plc	Audit of the consolidated financial statements for the year ended 31 December 2021
Deloitte	Joules Group plc	Audit of the consolidated financial statements for the year ended 30 May 2021

Accountancy Scheme investigations

Two new investigations were opened under the Accountancy Scheme. In line with the FRC's Publication Policy, neither was announced. Given the higher threshold for opening investigations under the Accountancy Scheme, it is to be expected that fewer cases meet the criteria than under the AEP.

Actuarial Scheme investigations

No new investigations were opened by the Conduct Committee under the Actuarial Scheme in 2022/23.

13 Publication Policy (Accountancy and Actuarial Schemes), Publication Policy (Audit Enforcement Procedure)
14 As a comparison, 13 investigations were announced in 2021/22. A list of current FRC investigations that have been publicly announced is available on our website.

Concluded cases

Outcome of investigations

	Closed with no further action	Closed with findings of Misconduct/ breaches and sanctions		Total
		Settlement	Independent Tribunal	
2020/21	3	6	1	**10**
2021/22	3	13	1	**17**
2022/23	7	11	1	**19**

19
cases were concluded in the year

Nineteen cases were concluded in the 12 months to 31 March 2023, two more than in 2021/22 and the highest in any year to date. For the second year running, concluded cases exceeded the number opened in the same period, with a decrease in the number of open investigations. Seven of the concluded cases were opened in or before FY2019[15] (Legacy Investigations).

Cases concluded with sanctions

The FRC concluded 12 investigations that resulted in sanctions being imposed on audit firms and individuals. Eleven were settled while one had sanctions imposed by the Independent Tribunal. The cases are listed below and details are set out in Appendix A.

12
published outcomes of investigations resulting in sanctions

Audit firm	Audited entity	Audit of the financial statements	Date of sanction
UHY Hacker Young	Laura Ashley Holdings plc	Year ended 30 June 2018	6 June 2022
UHY Hacker Young	Laura Ashley Holdings plc	Year ended 30 June 2019	6 June 2022
PwC	BT Group plc	Year ended 31 March 2017[16]	28 June 2022
Deloitte	SIG plc	Years ended 31 December 2015 and 2016	31 October 2022
PwC	Babcock International Group plc	Year ended 31 March 2018	3 January 2023
PwC	Babcock International Group plc	Year ended 31 March 2017	3 January 2023
PwC	Devonport Royal Dockyard Limited	Year ended 31 March 2018	3 January 2023

15 FRC year ended 31 March 2019.
16 These breaches concern the audit of BT for the financial year ended 31 March 2017, which formed part of a wider investigation and included within its scope PwC's audits of BT's financial statements for the years ending 2015 and 2016. The investigation in relation to those earlier years was closed without enforcement action.

Audit firm	Audited entity	Audit of the financial statements	Date of sanction
KPMG	Luceco plc	Year ended 31 December 2016	30 January 2023
KPMG	TheWorks.co.uk plc	Period ended 26 April 2020	10 February 2023
PwC	Eddie Stobart Logistics plc	Year ended 30 November 2017	30 March 2023
KPMG	Eddie Stobart Logistics plc	Year ended 30 November 2018	31 March 2023

Audit firm	Audited entity	AQR of the audit	Date of sanction
KPMG	Carillion plc Regenersis plc	Year ended 31 December 2016 (audit of Carillion plc); and the year ended 30 June 2014 (audit of Regenersis plc)	30 May 2022

These cases included three linked to PwC's audit of Babcock International Group plc and two concerning UHY Hacker Young's (UHY) 2018 and 2019 audits of Laura Ashley Holdings plc. We published eight Final Settlement Decision Notices (FSDNs) and one Independent Tribunal Report (see Appendix A).

The range of cases reflected the wide scope of our enforcement work and the audits that fall within our remit. They included audits of FTSE 100 companies, FTSE 250 companies, audits of AIM-listed companies and the audit of one subsidiary company (Devonport Royal Dockyard Limited).

Three of the investigations had been opened following earlier inspections by the FRC's AQR team (Babcock International Group plc, Laura Ashley Holdings plc and TheWorks.co.uk plc).

Five investigations (into audits of four entities) were opened following publicly reported restatements to the year in question, or previous years' financial statements of the entities (BT Group plc, SIG plc, Luceco plc and Eddie Stobart Logistics plc).

Two had been delegated to the Institute of Chartered Accountants in England and Wales (ICAEW), as part of an agreement between the FRC and the RSBs signed in 2016.[17] This meant that the initial information gathering phase and preparation of a draft Investigation Report were carried out by ICAEW investigators. The matters were then passed to us for analysis and review, and all subsequent steps including preparation and delivery of the Investigation Report and case conclusion. These are the last two of the four cases delegated in this way and we will review the benefits of this process in due course. Our initial view, however, is that the process has not delivered the intended efficiencies.

17 FRC and RSB Delegation Agreements (as amended 2022)

Closed cases

Four investigations under the Accountancy Scheme and three under the AEP were closed without enforcement action. In all seven cases, the test for enforcement action was not met.

Common issues from cases concluded in the year

Consistent with previous years, breaches sanctioned in concluded cases overwhelmingly concerned failure to apply sufficient scepticism; failing to obtain sufficient, appropriate audit evidence; and insufficient audit documentation.

Spotlight on inventory

In three cases where we imposed sanctions, the firms admitted breaches in relation to their audit of inventory.

What is inventory?

Inventory is an asset held on a company's balance sheet. It includes finished goods held for sale, goods in the process of production, and materials or supplies used in that production. Inventory is measured at the lower of cost or net realisable value. The cost of inventory includes all costs incurred in bringing it to its present location and condition, including manufacturing inputs. If an entity expects to realise an amount lower than cost when inventory is sold, it should reduce the value at which the asset is recorded to reflect this lower amount. The carrying amount of inventory is recognised as an expense when the sale occurs.

Why audit of inventory is important?

For entities in sectors including retail, distribution and manufacturing, inventory is a significant asset on the balance sheet. It is therefore an important area of audit focus. Inventory can consist of large volumes of items across many locations. Complexity and judgement can arise in determining the cost of inventory and in assessing the amount expected to be realised when it is sold. Audit over existence of inventory should ordinarily be more routine. The existence and valuation of inventory can be susceptible to misstatement, further increasing the importance of audit work over this balance.

3

cases where we imposed sanctions related to the audit of inventory

Breaches

In KPMG's audit[18] of TheWorks.co.uk plc, there were many problems with the way the audit team carried out and documented its testing regarding the existence of inventory. This included failing to investigate and react appropriately to discrepancies apparent in controls testing, not recording the controls test results on the audit file, and using a skewed, rather than random, sample for substantive testing, when it was decided that the controls could not be relied on.

An important feature of inventory audits is the 'rollback procedure' whereby auditors remove transactions that post-date the year end (or other cut-off date). When testing the existence of inventory at a warehouse location, the KPMG audit team also failed to conduct any rollback procedure to reconcile the warehouse stock count, despite planning to do so.

In UHY's audit of Laura Ashley Holdings plc,[19] the auditors failed to carry out steps they had planned in relation to testing the controls over the stock recording systems. Also, having identified stock valuation as a 'key risk' because the provision for slow-moving, damaged or obsolete stock might be misstated, the auditors failed to obtain sufficient evidence to test whether the provisions were appropriate.

In KPMG's audit of Luceco plc,[20] a group of companies that included manufacturers of lighting and wiring products in China and a distribution network that included the UK, the audit of the costs of inventory was complicated by the application of local accounting principles in China resulting in a lower calculated cost than International Financial Reporting Standards (IFRS). Therefore, the cost of inventory held by group companies, but manufactured by one of the Chinese entities, required an uplift to comply with IFRS. Prior years' accounts had needed adjustments to ensure that stock purchased from that entity was recorded at the correct cost. The agreed methodology used to calculate the uplift was complex.

KPMG did not carry out any tests to confirm whether the correct methodology had been used. This was despite KPMG being aware of the prior-year errors and the need to make sure the correct methodology developed in 2015 was followed in 2016, and treating the cost of inventory as an 'other area of audit focus'.

18 For year ending 26 April 2020.
19 For year ending 30 June 2018.
20 For year ending 31 December 2016.

Ongoing cases at 31 March 2023

As of this date, there were 38 open investigations.[21] Thirty-two concerned individuals and firms for audit work, one was into an individual and a firm for non-audit work, and five into professional accountants working in business.[22] This was a significant reduction on the number of investigations open at 31 March 2022 (47) and results from our ongoing focus on timely conclusion of investigations, combined with fewer investigations opened during the year compared with previous years.

Of the 32 audit investigations, one is being investigated under the Accountancy Scheme and the remaining 31 under the AEP. Thirty[23] have been announced and are included in the list of current enforcement cases on the FRC's website. These cover a wide range of audit areas, including:

Investigation issues	
Goodwill	Application of professional scepticism
Going concern	Integrity and objectivity
Pensions	Revenue recognition
Inventory valuation and provisions	Related party transactions
Presentation and disclosure	Compliance with laws and regulations
Costs and liabilities	Audit documentation
Cash	Compliance with ethical requirements
Other fixed asset impairments	Audit planning
Onerous contracts and leases	Group audits, including oversight of component auditors
Long-term contract accounting	

All open Accountancy Scheme investigations in relation to members who are professional accountants working in business are linked to audit investigations (some current; others concluded) and therefore concern many of the same issues. Of the five investigations, three have been announced and can be found in the list of current enforcement cases on the FRC's website.

The investigation into an individual and a firm for non-audit work has not been announced.

Application of professional scepticism continues to be an issue

21 An investigation will comprise one of the following: (1) an audit investigation into an audit firm and Audit Partner(s) (under the Accountancy Scheme or the AEP); (2) an investigation into professional accountant(s) working in business (under the Accountancy Scheme); (3) a non-audit investigation into professional accountant(s) and accountancy firms (under the Accountancy Scheme); or (4) an investigation into actuaries (under the Actuarial Scheme). Each investigation may include multiple subjects, and an investigation is not considered closed until concluded against all subjects.

22 Further details of the FRC's remit and powers can be found in The enforcement regimes and information gathering powers on the FRC's website.

23 EY/Thomas Cook comprises two open investigations. In October 2019, an investigation was opened in relation to the audit of the financial statements of Thomas Cook Group plc for the year ended 30 September 2018. In December 2019, a second investigation was opened in relation to the audit of the financial statements of Thomas Cook Group plc for the year ended 30 September 2018. Under the AEP in force in December 2019, a new investigation is commenced if additional matters are identified outside the scope of the initial investigation. In this instance, matters in a later audit year were identified, leading to a second investigation under the AEP.

Independent Tribunal hearings

KPMG/Regenersis plc and Carillion plc

In May 2022, the Independent Tribunal made findings of Misconduct, under the Accountancy Scheme, and imposed sanctions on KPMG, a former KPMG partner and four former KPMG employees.

The Misconduct related to the provision of false and misleading information and documents to the FRC in connection with AQR inspections of two audits carried out by KPMG. These were the audit of the financial statements of Regenersis plc for the period ended 30 June 2014, and the audit of the financial statements of Carillion plc for the period ended 31 December 2016.

The Independent Tribunal[24] made findings of Misconduct in respect of multiple breaches of the fundamental principle of integrity, which requires an accountant to be straightforward and honest in all professional and business relationships.

Findings of Misconduct in relation to the provision of false and misleading information and documents to the FRC

Spotlight on the ethical standards for accountants – Carillion plc/Regenersis plc

In this case, the Independent Tribunal made a number of important findings as to the standard of behaviour expected of individual accountants, regardless of seniority, and of audit firms when they discover what may be Misconduct involving their own personnel. The Independent Tribunal also considered the proper application of the Sanctions Guidance where findings of dishonesty have been made and exclusion as a member of one or more RSB is likely to result.[25]

Expected behaviour of individual accountants

The Independent Tribunal found that the former KPMG Partner and four former KPMG employees had:

- Assisted or encouraged the creation of false or misleading meeting documents, intending to mislead, or as a party to the deliberate misleading of the AQR inspectors or being reckless as to whether they would be misled.
- Made, or connived in, or were knowingly associated with making, certain false or misleading representations to the AQR inspectors as to when and in what circumstances documents were created, intending to mislead, or as a party to the deliberate misleading of, them or being reckless as to whether they would be misled.

24 Report of the Disciplinary Hearing in KPMG/Regenersis & Carillion
25 For more detail see Section 6, sanctions against firms and accountants in respect of non-audit matters, page 39.

The Independent Tribunal found that each individual had acted with a lack of integrity, thereby committing Misconduct as defined in paragraph 2(1) of the Accountancy Scheme. In the case of the KPMG Partner and three of the KPMG employees, the Independent Tribunal also found that their conduct was dishonest.

Regarding one further KPMG employee, who had performed the role of Audit Engagement Partner on the Regenersis audit, the FRC reached agreed terms for settlement that were approved by the Independent Tribunal. The employee admitted that he made, or was responsible for, representations to the FRC's AQR inspectors that were misleading and that he was reckless as to whether those representations were misleading and whether the inspectors would be misled by them. He also admitted that his conduct amounted to a lack of integrity and therefore Misconduct.

The principle of integrity is set out in the Code of Ethics of the ICAEW and requires a professional accountant to be 'straightforward and honest in all professional and business relationships'. It applies to all members of the ICAEW, including provisional members. The Independent Tribunal heard evidence concerning the ethics training that the individuals completed with the firm, but were of the opinion that 'no accountant should require any education or training to realise that deliberately misleading anyone, but especially a regulator, is at least incompatible with integrity.'

The Independent Tribunal took a robust stance on the behaviour expected of all audit team members when responding to the AQR team and interacting with senior members of their own team. It made clear that all team members will be expected to recognise the risks and act appropriately. This includes receiving instructions that, if followed, may cause them to act unethically, and that after the event explanations will be rigorously scrutinised.

The ICAEW requires members (including provisional members) to be 'straightforward and honest in all professional and business relationships'

5 Cooperation in our investigations

Introduction

Our enforcement regimes require the subjects of our investigations (both individuals and firms) to cooperate fully.[26] The Independent Tribunal has confirmed that cooperation is required as a matter of course.[27] It was also spelled out in the Clarke Review,[28] which stated that cooperation can be shown by:

> 'Dealing timeously, properly and fully with requests by investigators, not placing inappropriate obstacles in the way of progress; or seeking without good reason to delay either the investigation or the disciplinary proceedings.'

Given that cooperation is required, this alone will not amount to mitigation, which attracts a discount to the financial sanction. Conversely, failure to provide the required level of cooperation will be considered an aggravating factor at the point of determining the sanction.

Cooperation alone will not amount to mitigation which attracts a discount to the financial sanction

Both the Sanctions Guidance (for Schemes cases) and the Sanctions Policy (for AEP cases) set out non-exhaustive examples of failures to provide cooperation, which will be considered aggravating factors.[29]

Required cooperation

To help those under investigation understand our expectations, and what might amount to poor cooperation, we have outlined below the minimum level of cooperation we expect from subjects during the typical stages of an investigation.

Our approach to information gathering

Throughout the investigation, the team will typically send formal notices to subjects requiring the provision of information and production of material.

In audit cases, it is important that we receive the audit files as soon as possible, as these form the bedrock of our investigation. Very shortly after an investigation is opened, we will send a notice requesting these files. We usually request that they are uploaded to a firm's laptop, with the relevant audit software, and that the same information is transferred directly to our data hosting platform. This allows our forensic accountants to review the files in the same way as the audit team and carry out searches on the data hosting platform.

26 Paragraphs 14(1) of the Accountancy and Actuarial Schemes mandate that Members and Former Members of the Schemes cooperate with the FRC's Executive Counsel, and with any Tribunal appointed.
27 PwC/Connaught Report of the Disciplinary Tribunal, paragraph 348; Deloitte/Autonomy Report of the Disciplinary Tribunal, paragraph 907.
28 Independent review of the FRC's Enforcement Procedures Sanctions, Review Panel Report (October 2017)
29 Accountancy Scheme Sanctions Guidance, paragraph 64; AEP Sanctions Policy, paragraph 70.

In addition to audit files and working papers, requests will usually be made for other categories of information, including contemporaneous audit material not saved on the file, presentations to audit committees, communications with firms' management and technical departments, details of non-audit work carried out, and firms' manuals and guidance.

In investigations into accountants and actuaries, requests will be made for information and company documents in the subjects' possession, whether electronic or hardcopy, such as material on computers or in files and notebooks.

In most investigations, targeted requests are made for emails and other electronic communications, such as text and WhatsApp messages and material from other messaging platforms. Before requesting emails, our usual practice is to ask subjects, or their lawyers, to carry out some preliminary analysis and provide number counts of emails falling into certain categories. We use this iterative process to refine and prioritise the production of emails so they are given to us in batches, which is more manageable for all parties.

Notices will often require written answers to specific questions about the accounting, actuarial and audit work. We also conduct interviews with subjects of our investigations and witnesses, for example, junior colleagues or other members of an audit team.

Targeted requests are made for emails and other electronic communications, such as text messages, WhatsApp messages and material from other messaging platforms

Our expectations of subjects in relation to information gathering

1. Time and resources

We expect all subjects to invest the resources necessary to ensure timely, complete and accurate compliance with our notices.

We always seek to agree a reasonable period for compliance with notices. Where agreed deadlines cannot be met, we expect the subject to notify the investigation team well in advance of the compliance date and provide a reasoned request for an extension.

Case teams will typically build a timetable from when material is expected to be received, factoring in dates for review by forensic accountants and external advisors, and will schedule time accordingly. Late notice on, or after, the compliance date can severely disrupt our timetable causing delay and the misalignment of resources, which can affect other investigations.

Failure to comply with deadlines specified in notices and other written requests is one example of a failure to provide cooperation.

2. Providing material in the form requested

We expect the subjects of our investigations to provide digital evidence competently, efficiently and in accordance with our specifications.

Effective use of technology is essential to conducting timely investigations. We use an external data hosting platform and specify to firms, in detail, how data is to be formatted to aid our forensic review.

Large audit firms will have access to their own data hosting platforms to analyse and review material. It is expected that audit firms, in particular, will put the necessary technical support in place at the outset of an investigation, so any issues with the nature and format of data, especially in relation to providing audit files and electronic communications, can be addressed immediately. Where an individual or smaller firm without its own technical support is under investigation, we expect them to seek assistance from their legal advisors or a third party regarding storing and searching relevant databases and electronic communications.

It is common for issues and queries about our specifications to arise. Matters are resolved most satisfactorily when the subject's technical expert speaks directly with our forensic accountants and, if necessary, technicians from our data hosting platform.

3. Early identification of material subject to Legal Professional Privilege (LPP)

We do not require privileged material to be given to us, in the absence of a waiver being provided by the relevant party.[30]

We expect the subjects of our investigations to be proactive in identifying LPP material and informing the case team at the earliest opportunity.

Whenever an information request is made, we expect the subjects to take steps to identify the existence and extent of responsive material over which the relevant party (typically the audited entity) asserts LPP and to satisfy itself that the assertion is validly made.

We expect the subjects of our investigations to be pro-active in identifying LPP material

In audit investigations, a firm should identify whether the audit files contain material subject to LPP as soon as it is notified of the scope of an investigation. The earlier we are informed of any potentially privileged material, the earlier we can progress discussions with the privilege holders.

Where a small number of items are identified over which privilege is asserted, we would expect the firm to redact these, and provide us with the audit files immediately. This allows us to start the review work as soon as possible (and, if we decide to seek a waiver of privilege from the third party, we can do this simultaneously).

30 We do not consider provision of legally privileged material as an indicator of good cooperation, though waiving of privilege over a subject's internal investigations has been considered as evidence of exceptional cooperation and proactivity by subjects in putting in place a privilege waiver with a relevant third party may also be relevant to determining exceptional cooperation. Similarly, we do not consider withholding privileged material as poor cooperation.

We expect subjects, especially accounting and audit firms, to invest sufficient resource so that privilege reviews, whether conducted in-house or by a third party, are of sufficiently high quality and completed in a reasonable time.[31]

> Example: In past cases too few, or too inexperienced reviewers have been used. This has led to delays and errors in provision of material.

Some audit files, for example in cases involving accounting for long-term contracts or compliance with laws and regulations, may contain a significant amount of privileged material, or material that is difficult to redact. If it is extensive, the FRC case lawyer will seek to agree a limited waiver of privilege with the privilege holder.[32] In some situations, which we expect to be rare, the terms of the waiver may need to be agreed before the audit file is produced.

While the FRC case lawyer will usually take the lead in seeking waivers from third parties, in some cases we will ask the audit firm to assist, for example, by joining tripartite calls.

4. Provision of digital material

Where we request subjects to perform an initial analysis of email and other digital data, we expect this preliminary work to be done carefully and accurately.

When we request emails, care should be taken to identify all potentially relevant email repositories and to confirm the correct spelling of names in email addresses, as well as the correct application of agreed search terms. All relevant accounts (including personal, if used for work purposes) should be subjected to searches. If multiple repositories of documents are identified, we expect thorough checks to make sure all responsive documents from each source have been provided in response to requests, and records of the dates and specifics of searches are maintained. It should not be assumed that the repositories are duplicative.

Care should be taken to identify all potentially relevant email repositories

> Example: In several investigations firms or legal advisors have made errors in the email counts. This has meant, at a later stage of the investigation, there have been more emails to be reviewed. At best this causes delay and, at worst, risks relevant material not being considered.

> Example: An Independent Tribunal considered that a firm failed to cooperate with our investigation when searches for emails from a personal account were not carried out, despite the firm being asked specifically whether a subject used a personal account. By the time this omission came to light, some of the emails had been deleted.

31 We consider that, in general, a review rate of c.350-400 documents per reviewer, per day, is reasonable, while maintaining quality.

32 A limited waiver of privilege will enable the LPP material to be used in our investigations and enforcement action, but not referred to in public or published.

> Example: In past cases, relevant material that was incorrectly presumed to be duplicative was identified at a much later stage in the investigation, causing a delay to our review and incurring additional costs.

If a document or email is responsive to a notice, it should be provided. It is for the investigation case team, not subjects, to identify relevance and they must not withhold material based on their own views.

> Example: In some instances, subjects or their legal advisors have removed emails from production batches and, on challenge, asserted that they are not relevant. As the particular areas of investigation interest will not necessarily be apparent to those under investigation, it is important that this sifting process is not carried out by subjects or their legal advisors.

Subjects may only withhold a document if it is a false positive from another unrelated engagement, or they have themselves assessed the material for LPP and they consider (on proper grounds) that LPP applies. If a subject is in any doubt whether or not material should be withheld, they should discuss this with the case team.

We expect the case team to be informed at the earliest opportunity if errors in production are subsequently identified and for these to be rectified without delay.

The case team will require a comprehensive explanation of the issue, and a review to be conducted for any missed documents responsive to our requests, so the material can be provided as soon as possible. We will also require a root cause analysis to establish the reasons for the errors and assurance that there are no other such errors and that such issues will not be repeated.

Incomplete provision of documents and information, and a failure to conduct an adequate search, are examples of a failure to provide cooperation.

5. Complete, accurate and clear responses to written questions

We expect subjects to provide responses to written questions that are complete, accurate, understandable and clearly structured.

The use of written questions narrows the issues that will need to be addressed by interviewing subjects and witnesses. It is, therefore, essential that subjects carefully consider the written questions raised and seek early clarification if necessary.

It is also essential that individual subjects and witnesses personally ensure that responses provided on their behalf are accurate and complete.

We will often ask questions about the preparation of the financial statements or the audit process, or about why a particular judgement was made.

We expect the answers to reflect the evidence that was considered by the subject or audit team at the relevant time, or when the relevant judgement was made, rather than a reconstructed or hypothetical analysis after the event.

If, in exceptional circumstances, it is considered relevant to raise an 'after the event' explanation, this should be clearly labelled as such for the investigation team.

> Example: In some investigations, we have received detailed responses to notices that contained explanations appearing to reflect the audit team's considerations at the time of the audit, only to be informed subsequently that they were drafted as a result of discussions years later. This inevitably delayed the investigation as the case team had to reconsider the findings.

It will rarely be appropriate for material to be created after the event. However, should there be a good reason, for example preparation of a verbatim typed transcript of handwritten notes, the date, time and purpose of that document should be clearly disclosed, together with the contemporaneous document.

> Example: In one investigation, a meeting note was provided to the investigation team without explaining that it had been written more than a year after the meeting. The Independent Tribunal found that the failure to reveal the timing amounted to a lack of cooperation.

It is also vital that internal or external legal advisors who provide written responses on behalf of subjects make sure these are accurate.

> Example: In one audit investigation, in the absence of a final settlement document involving a claim (which was initially withheld from us by the audit firm for legal reasons), the firm's written response described the final agreed settlement as being 'without variation' to an earlier version on the audit file. This was inaccurate. When the final version was provided, the differences between the two had a material bearing on the audit issue being considered as part of the investigation.

Those who draft written responses to our notices should take care not to provide answers based on assumptions.

> Example: In one investigation, when assessing the auditors' work in relation to the revenue recognised by the audited entity, the firm's written response cited a specific revenue approval documentation process. The response was inaccurate and misleading because, it later transpired, no such approvals had been viewed as part of the audit. The written answer had been drafted based on an incorrect assumption.

Answers should reflect the evidence which was considered by the subject or audit team at the relevant time

Responses should seek to advance the investigation team's understanding of the facts. This includes proactively providing explanations, relevant documents and an indication as to which particular parts of documents are salient.

> Example: In one investigation a firm responded to a request to 'set out in detail the clauses (if any) of [the Agreement]', which had supported the auditor's judgement by providing a very lengthy schedule without identifying any specific clauses. This was an unconstructive approach, aggravated by the fact that the case team later discovered the schedule had not been considered by the audit team at the time.

Providing incomplete information and a failure to provide adequate explanation of the information given are examples of a failure to provide cooperation in both the Sanctions Guidance (for Schemes cases) and the Sanctions Policy (for AEP cases).

6. Proper preparation for interviews

We expect interviewees to be well prepared for interview. They should be familiar with the materials provided in advance of the interview and able to provide an accurate and full explanation of documents and actions based on their personal knowledge and recollection. It is not appropriate for any party, including internal or external legal advisors, to suggest explanations, influence, train or coach an interviewee to provide answers, reconstructions or arguments that are manufactured or altered from the evidence the individual would otherwise have given.

Interviewees should be able to provide an accurate and full explanation of documents and actions based on their personal knowledge

Unless it is an early overview interview, where we do not ask about specific documents, we will provide pre-interview bundles in advance. We expect those invited for interview to familiarise themselves with the contents and, in doing so, refresh their memories of what they knew at the relevant time.

In some cases, full interview responses that follow good preparation have provided satisfactory answers, leading to the investigation being closed without action. However, where interviewees have not read the documents provided in advance, and therefore cannot offer assistance, the interview will be ineffective.

Where the subjects of investigations deliberately withhold information during their interview responses, or provide a materially incomplete or inaccurate account of their conduct, this will be viewed as an aggravating feature.

Failure to properly prepare for interviews (including failure to review material provided by the Executive Counsel in advance of such interviews) is an example of a failure to provide cooperation.

7. Remedial action

Where subjects wish to draw remedial action to our attention as relevant to cooperation, we expect the information provided to clearly explain the action, when it was taken and the reason for it.

As soon as they have been alerted to matters of concern, subjects will rightly want to implement and highlight any remedial actions they have taken promptly to reduce the risk of recurrence. Appropriate, targeted responses will be viewed as good cooperation and may, depending on their nature and extent, be treated as exceptional cooperation.

In any event, when subjects provide details of remedial actions they have taken, it is important to be clear whether the actions were unprompted, or were taken specifically to address the risks of recurrence.

> Example: In a written response to a notice, an audit firm indicated that it had taken action at firm-wide and audit engagement level to make improvements following the results of a poor FRC audit inspection and internal reviews that involved replacing the Audit Partner on the particular engagement. However, the investigation team subsequently learned from emails that the removal of the Audit Partner was not in response to the reviews but would have happened anyway due to the five-year mandatory rotation rule.

Appropriate, targeted remedial actions will be viewed as good cooperation and may be treated as exceptional cooperation

Exceptional cooperation

The Sanctions Policy[33] and Sanctions Guidance[34] state that:

'In order for cooperation to be considered as a mitigating factor at the point of determining appropriate sanction it will therefore be necessary…to have provided an exceptional level of cooperation.'

The Independent Tribunal in the Autonomy proceedings stated, 'what is exceptional is a question of fact and degree and to some extent a matter of judgement.' The Sanctions Policy and Guidance cite non-exhaustive examples of 'exceptional' cooperation as:

(i) Self-reporting to the FRC and/or bringing to the attention of the FRC any facts and/or matters which may constitute an Allegation of Misconduct/a breach of a Relevant Requirement.

(ii) Volunteering information or documents not specifically requested but which may assist the investigation.

33 Sanctions Policy (AEP) (paragraph 69).
34 Accountancy Scheme Sanctions Guidance (paragraph 63).

We continue to encourage and incentivise full and frank cooperation including self-identification and reporting of issues, and prompt implementation of remedial actions. These demonstrate self-awareness and an improvement culture, which are essential to consistent upholding of high standards of behaviour and delivery of high-quality financial statements and audit. Such cooperation can also lead to a significant reduction in the time taken to conclude investigations, saving resources and permitting case outcomes to be published earlier. This allows lessons to be shared more quickly with the wider regulated community, which plays an important part in improving audit quality through deterring similar actions and supports our role as an improvement regulator.

We have cited exceptional cooperation as a mitigating factor, leading to sanction reductions, in ten AEP cases and one Accountancy Scheme case over the past three years.

Examples of cooperation that have been treated as exceptional are set out below:

Self-reporting

The most exceptional cooperation is self-reporting of issues at an early stage, coupled with admission of breaches and providing relevant contemporaneous supporting evidence.

> Example: A firm alerted us to serious issues shortly after they came to light as part of its own internal investigation and provided detailed supporting information. Following further reviews by the firm's lawyers at its own expense, which uncovered additional matters, the firm made a second self-report and provided evidence to the FRC. This formed the basis of evidence for Misconduct allegations.

Own initiative activity

Exceptional cooperation can be shown where, having been alerted to an issue by the FRC, firms conduct their own investigation into what went wrong, identify breaches and provide relevant material, as well as candid and full admissions.

This sort of information can form the basis for findings of breaches, following consideration by our investigation team.

> Example: In some cases, firms have carried out internal investigations or a root cause analysis at the outset, or before our investigation has commenced. If the product is comprehensive and candid, breaches have been identified and remedial action has been put in place to avoid a recurrence, this is likely to be a good basis for settlement discussions, and result in a significant shortening of the investigation.

Candid and full admissions can amount to exceptional cooperation

Example: In other cases, once an investigation was under way, firms have been asked to review the audit work for an additional year to establish whether the breaches identified in our investigation had been evident earlier or later. In those instances, the firms conducted this work in a timely way, provided detailed reports identifying breaches, and conducted follow-on work.

Example: In another case, once the investigation team had identified breaches in relation to the audit of certain contracts, we asked the firm to review its work on additional contracts. The firm provided a full and frank report, which demonstrated awareness and saved time and resource.

Firms are likely to receive credit for exceptional cooperation when their internal investigations are comprehensive. This includes providing us with the underlying documents, making specific and comprehensive admissions of breaches, and identifying remedial action taken or to be taken to prevent recurrence.

Where firms have conducted a thorough internal investigation but stop short of making specific admissions about their conduct, or make limited admissions confined to less serious issues, it will be a matter of fact and degree whether or not the cooperation shows the necessary self-awareness and determination to improve and has meaningfully impacted on the investigation.

Firms that want to carry out such work should discuss their plans with the investigation team, so the precise scope, format and timing of the investigation can be agreed. This is likely to lead to the most positive impact on mitigation.

Activity carried out on an individual's own initiative can include a readiness to acknowledge failings at an early stage, learn from them through unprompted additional training, and share their experience with others to help them avoid similar issues arising.

Assistance in resolving privilege issues

Voluntary privilege waiver, assistance with obtaining waivers of privilege from third parties or expediting access to non-privileged documents within a population of documents containing privileged material are matters that can amount to exceptional cooperation.

The waiving of an audit or accountancy firm's LPP in relation to its internal investigations has been recognised as exceptional cooperation.

Also, in cases where there are third-party claims to LPP material on an audit file, proactivity by audit firms to make sure the appropriate material is provided to the investigation team has been treated as exceptional cooperation, leading to a reduction in the financial sanction. This may include, for example, the firm proactively conducting its own assessment of the entity's assertion of privilege to ensure non-privileged material is provided to the FRC quickly, or the firm proactively seeking and obtaining, or helping to facilitate, a waiver.

Material voluntary waiver of privilege can amount to exceptional cooperation

Assessment of cooperation

Instances of poor and exceptional cooperation are carefully recorded by the case team throughout the investigation and any enforcement proceedings.

The nature and level of cooperation (whether poor, as required or exceptional) is generally assessed against four categories, although relevant matters that do not fall within these will also be taken into account. The categories are:

- **Timeliness**, for example, full, helpful and timely responses, and it being apparent that sufficient resource has been allocated to the investigation.
- **Engagement**, for example, being fully prepared for interview with a helpful and constructive approach.
- **Transparency**, for example, self-reporting, voluntary waiver of privilege.
- **General approach**, for example, self-awareness of issues encountered, a desire to learn from previous criticisms to improve quality of work, and proactive identification and implementation of effective remediation.

This information is considered when deciding the overall level of cooperation demonstrated, for the purpose of imposing sanctions. It is assessed to determine, in particular, whether it fails to meet the required level and, if so, should be treated as an aggravating factor, and/or whether it amounts to exceptional cooperation constituting a mitigating factor.

We will continue to take into account the level of cooperation demonstrated by subjects in our sanctioning process and set out details in published Decision Notices to further encourage the positive engagement and behaviours which distinguish those who are self-aware and improvement-minded, and who help to achieve timely and efficient outcomes.

6 Sanctions

Introduction

As in previous years, in this section we provide an overview of the financial and non-financial sanctions that were imposed in the year at both an aggregate level and in individual cases, and draw out matters of particular interest or significance. Sanctions are imposed in accordance with our published Sanctions Policy and Guidance.[35]

Sanctions summary for FY2022/23

As set out in the table below, the number of financial[36] and non-financial sanctions, together with the total value of financial sanctions, were lower this year, but remain significantly above the equivalent figures for FY2020/21. The aggregate figures reflect both the number and seriousness of cases that arise for sanctioning in any given reporting year. They also reflect the proportionality of the impact of the sanction on the party in question.

The figures include a £20 million sanction imposed by the Independent Tribunal, the highest financial sanction yet.

£20m

the highest financial sanction yet imposed

During the year, sanctions were imposed in twelve cases, eleven of which were audit matters dealt with under the AEP. The other case was KPMG/Carillion plc & Regenersis plc, which culminated in proceedings under the Accountancy Scheme heard by the Independent Tribunal. The details of this matter are set out in Independent Tribunal Hearings on page 22 and in Appendix A.[37] The financial sanction of £20 million imposed by the Independent Tribunal on KPMG in that case represented a sizeable proportion of the total financial sanction figure for the year, both before and after the application of settlement discounts (£20 million and £14.4 million against total FY2022/23 figures of £40.5 million and £28.5 million respectively).

Other notable matters which fell to be sanctioned this year included PwC's audits of Babcock International Group plc (FY2017 and FY2018) and Devonport Royal Dockyard Limited (FY2018) in which a total £7.5 million sanction was imposed (adjusted to £5.625 million after settlement discount); PwC's audit of BT Group plc (FY2017) in which PwC accepted a financial sanction of £2.5 million (reduced to £1.75 million after settlement discount); PwC's audit of Eddie Stobart Logistics plc (FY2018) (£3.5 million reduced to £1.9 million for settlement and cooperation); KPMG's audit of Eddie Stobart plc (FY2017) (£1.35 million reduced to £877,500 after settlement discount); and KPMG's audit of TheWorks.co.uk plc (£1.75 million reduced to £1.02 million for settlement and cooperation).

35 Links to the sanctions policies are here: Sanctions Policy (Audit Enforcement Procedure) (effective from January 2022); Accountancy Scheme Sanctions Guidance (March 2021); Actuarial Scheme Sanctions Guidance (March 2021)

36 The proceeds of financial sanctions imposed in AEP matters are remitted to the government, while in cases under the Schemes the proceeds of such sanctions are remitted to the professional body of the firm or individual that has been sanctioned, in accordance with the contractual arrangements by which the Schemes operate.

37 This matter did not involve alleged breaches in the execution of audit and was not therefore within the jurisdiction of the AEP. Accordingly, it was dealt with under the Accountancy Scheme and the case is covered in the non-audit cases section below.

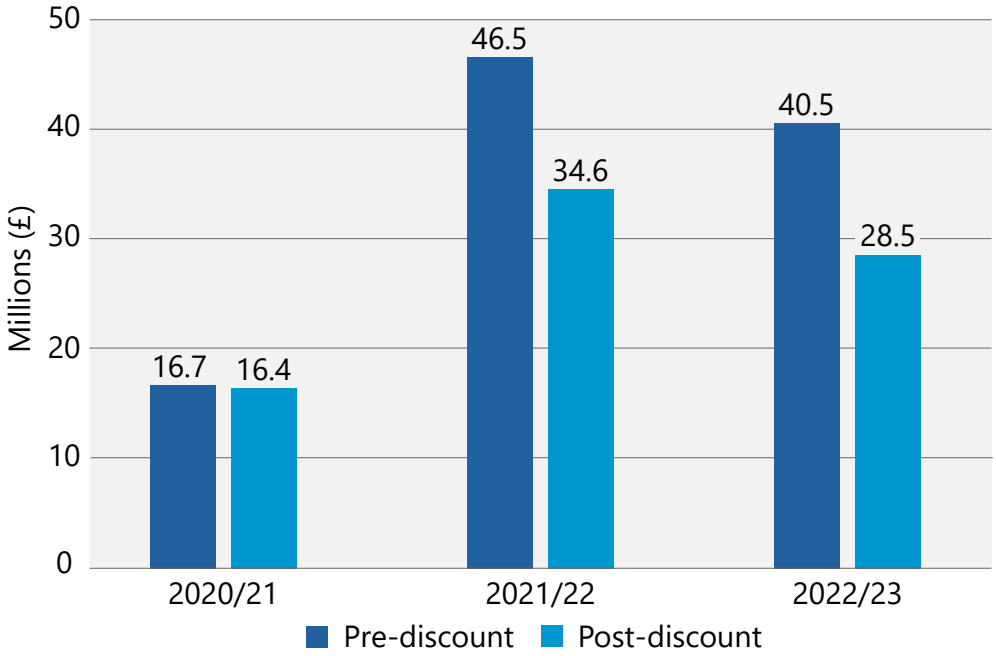
The level of discounts awarded in accordance with the Sanctions Policy (AEP) in settled cases ranged from 25% to 43%,[38] reflecting differences in the timing of admissions made, and the extent of mitigation (including cooperation).

No sanctions were imposed on members who were professional accountants in business or on actuaries in the year to 31 March 2023.

	2020/21	2021/22	2022/23
Total financial sanctions imposed:			
Pre-discount	£16.7m	£46.5m	£40.5m
Post-discount	£16.4m	£34.6m	£28.5m
Number of financial sanctions imposed	8	25	22
Number of non-financial sanctions imposed	28	62	49
Of which:			
Exclusions	1	5	4
Requirements and undertakings	11	15	10

Sanctions imposed of
£40.5m
(£28.5m after settlement discounts)

Total financial sanctions



38 The maximum adjustment awarded for mitigation was 20%, and the maximum discount for admissions and early disposal was 35%. The highest overall discount was in a case where a 12.5% discount was applied for mitigation and an additional 35% for admissions and early disposal. As the early disposal discount is applied to the figure after mitigation, the overall discount in this case amounted to 43%.

Financial sanctions imposed on audit firms

During the year, eight financial sanctions were imposed on audit firms in respect of eleven audit cases and one financial sanction was imposed on an audit firm concerning a non-audit case.[39] Together, they totalled £39.4 million prior to applying any settlement discount.[40] As we noted last year, our focus on securing the future quality of audit through carefully tailored non-financial sanctions should be seen as complementing rather than replacing financial sanctions. The latter remain an important element of our sanctioning regime and continue to play a key role in securing the aims and objectives of that regime, not least by virtue of their powerful deterrent effect.

Non-financial sanctions will typically complement rather than replace financial sanctions

The audit case settlement that attracted the highest financial sanction in the year was PwC's FY2017 and FY2018 audit of Babcock International Group Plc and the FY2018 audit of its subsidiary Devonport Royal Dockyard Limited. Details of this important case are set out in Appendix A, page 65. Breaches were identified in respect of several areas of the audit under investigation, including in relation to the audit of seven long-term contracts totalling 25% of group revenue for FY2018. There were repeated failures to exercise professional scepticism and challenge management, and a failure to follow basic audit requirements, which evidenced a lack of competence, care and diligence. In determining the starting point of the financial sanction, Executive Counsel took into account (in addition to the gravity of the conduct as described above) that the breaches had the potential to undermine investor confidence, the failure to follow relevant guidance issued by the FRC following the insolvency of Carillion plc, the financial strength of PwC, and that similar deficiencies had been identified in the course of AQR inspections of PwC audits during FY2015 to FY2017.

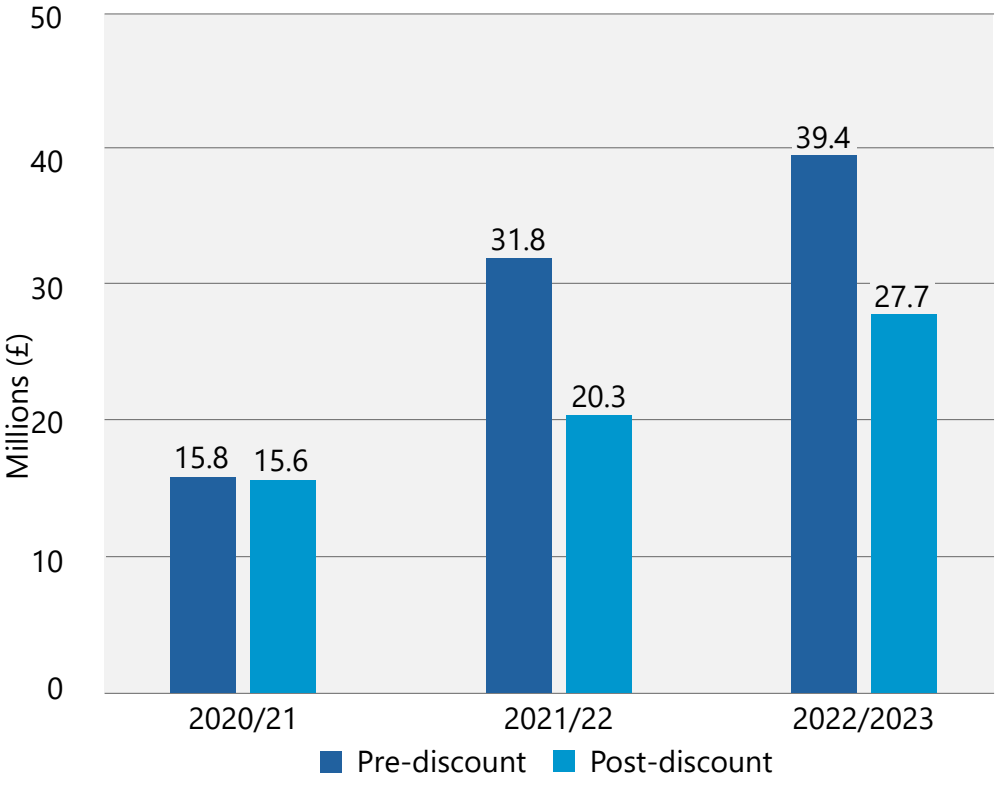
Another noteworthy feature of this case is that while PwC carried out a candid and self-critical internal review that identified the facts underlying many of the breaches and which facilitated the resolution of the matter, the investigation was hampered by a number of instances of non-cooperation, which served to reduce the cooperation discount that would otherwise have been awarded.[41]

39 Details relating to the non-audit case are included in the section below headed 'Sanctions against firms and accountants in respect of non-audit matters,' see page 39.

40 Extensions to existing cases in the AEP in effect in 2021 were counted as new cases, as the AEP did not make provision for amendments to scope. In 2022/23, one set of sanctions was imposed in relation to two AEP cases, where the two cases were in respect of the Statutory Audit of the financial statements for different financial years of the same entity. Another set of sanctions was imposed in relation to three AEP cases, where the cases were in respect of the Statutory Audit of the financial statements for different financial years of the same entity and a subsidiary of that entity.

41 Further detail on cooperation in our investigations can be found in Section 5. Additional information on the case can be found in Appendix A on page 65.

Financial sanctions – audit firms

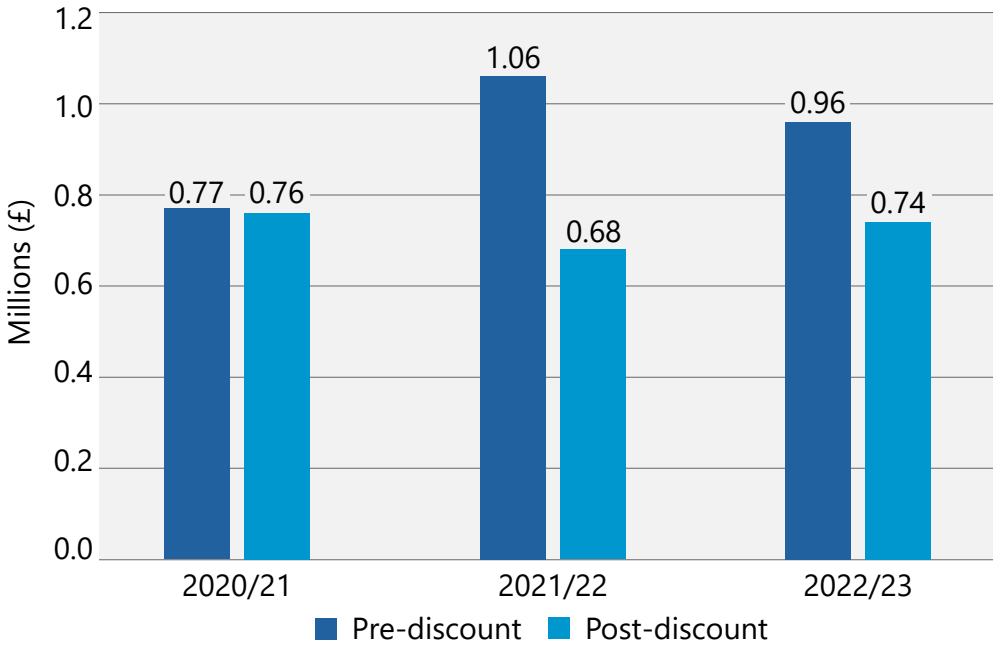


	2020/21	2021/22	2022/23
Number of financial sanctions against audit firms	4	11	9

Financial sanctions against Audit Partners

The total amount of financial sanctions on Audit Partners was £1 million prior to the application of any settlement discount.

Financial sanctions – Audit Partners



£39.4m
financial sanctions imposed on audit firms

Sanctions imposed consider the seriousness of the breaches as well as the financial resources of the Audit Partner.

	2020/21	2021/22	2022/23
Number of financial sanctions against audit partners	3	11	10

Sanctions against firms and accountants in respect of non-audit matters

As noted above, the KPMG/Carillion plc & Regenersis plc matter saw the largest financial sanction yet imposed on a firm. It related to providing false and misleading information and documents to the FRC in connection with our AQR inspections of KPMG's audits of Carillion plc and Regenersis plc.

The details of this major and serious matter are set out in page 22 and in Appendix A. However, we highlight here certain key matters relating to the sanction in the Independent Tribunal's ruling.

The Independent Tribunal noted that the seriousness of the Misconduct in providing deliberately misleading information to the FRC's AQR team was self-evident. It recorded that effective audits are essential to the financial system, and that the effectiveness of the regulation of auditors and audits depends on accurate disclosure to AQR of the audit work carried out by the auditor. It stated that misleading the AQR team undermines the effectiveness of its work and may deprive it of any useful result. It further noted that dishonesty was at the top end of the spectrum of Misconduct and that KPMG accepted liability for the conduct of the individual Respondent audit team members.

The Independent Tribunal endorsed the statement in the Clarke Review[42] that 'Dishonesty is so inimical to everything that a profession stands for, and so destructive of public confidence, that those who are guilty of it have no place in the profession and should normally be excluded for a substantial period and, quite possibly, never admitted to it again.' However, it bore in mind when considering periods of exclusion that the Accountancy Scheme contained no provision for an individual to apply to shorten a period of exclusion, even if they could later show their commitment to honesty and competence.

In its ruling, the Independent Tribunal also referred to the statement in the Clarke Review that, 'if one of the Big Four were guilty of seriously bad incompetence in respect of an audit of a major public company, where the errors were measured in nine figures or more and there had in consequence been either widespread actual loss or the risk thereof, a financial penalty of £10 million or more would be appropriate as being (a) commensurate with the seriousness of the wrongdoing, (b) a meaningful deterrent, and (c) sufficient to meet the primary objectives of sanctions. That assumes that the failings did not involve dishonesty or conscious wrongdoing. If they did, the figure could be well above that.'

£20m

the largest sanction yet imposed on an Audit Firm

42 The report of an 'Independent review of the FRC's Enforcement Procedure Sanctions' chaired by former Court of Appeal Judge Sir Christopher Clarke, October 2017.

The Independent Tribunal noted that although the Misconduct failings involved dishonesty by four of the five individuals, and lack of integrity by the fifth which, though less grave was nonetheless serious, the Misconduct was not committed for immediate financial gain, and was not intended to cause financial loss. It also took into account the 'impressive' actions KPMG had taken when it became aware of the issues, including self-reporting and taking steps to make sure there was no recurrence, including revising its procedures for providing information to the AQR team. In assessing the quantum of the financial sanction, the Independent Tribunal was also mindful of KPMG's very substantial financial resources. Taking all those factors into account, and given KPMG's contrition and admissions, it considered the appropriate sanction was £20 million discounted to £14.4 million.

In terms of non-financial sanctions, an order was made to appoint an Independent Reviewer to conduct a review to consider the effectiveness of KPMG's current policies and procedures in supporting high-quality engagement with the AQR inspectors.

For the five individual Respondent members of the Carillion plc and Regenersis plc audit teams, the sanctions imposed ranged from a £250,000 financial sanction and a ten-year exclusion to a Severe Reprimand. The range reflected the different considerations relevant to each individual, including the seriousness of their Misconduct, their seniority and their financial means. The Independent Tribunal made a number of points in its report relating to the sanctioning of the individuals, including the observation that while sanctions should act as a deterrent rather than a punishment, it must be recognised that it is difficult to impose a sanction that is a deterrent without a degree of punishment. It also emphasised that a sanctions package imposed on an individual must be viewed as a whole and no sanction can be considered in isolation. The Independent Tribunal viewed its findings and exclusion, particularly for the younger Respondents, as a grave sanction and very considerable deterrent, the personal and financial effects of which would be greater than imposing a financial sanction.

Non-financial sanctions

These are a key element of our role as an improvement regulator and continue to play an important part of our approach as we focus on increasing the quality of financial reporting and audits. They are carefully tailored to the facts giving rise to the failures identified in a given case and designed to include measurable outcomes. They will typically be developed in consultation with the relevant firm's Supervisor. This holistic approach across the FRC helps to make sure they are targeted effectively, avoiding duplication of other sanctions that have already been imposed on the firm in question.

Non-financial sanctions are a key element of our role as an improvement regulator

The number of non-financial sanctions decreased this year reflecting the lower number of cases which fell to be sanctioned. It should also be noted that we do not impose such sanctions automatically in every case, but rather consider each matter on its own merits. The number in any given year, therefore, will in part be determined by the nature of the audit failures identified.

There are several types of non-financial sanction that can be imposed to reflect the wide variety of issues and circumstances we encounter, and they vary in severity. They include the ability to prohibit an audit firm from carrying out Statutory Audits and/or signing audit reports. We will not hesitate to use such powers where we consider it necessary to do so to fulfil the aims and objectives of the sanctioning regime. In the past year, for example, a firm was prohibited from undertaking Statutory Audits of PIEs for a certain period. This is the first time we have imposed such a sanction and further details are provided below.

As well as the imposition of Severe Reprimands and Declarations that audit reports did not satisfy certain Relevant Requirements, non-financial sanctions published in the year[43] included:

- An order that UHY shall not accept appointment as Statutory Auditor to any PIE for which it is not currently acting as Statutory Auditor, until the later of: (i) 11 May 2024; and (ii) such time as the prevailing registration body for PIE Statutory Audit registration is satisfied that it has the necessary competence to conduct high-quality Statutory Audits of PIEs in compliance with Relevant Requirements.
- An Audit Engagement Partner shall not sign any Statutory Audit Report for a PIE for a period of two years.
- An order that an Audit Engagement Partner undertakes training, in a form agreed with the FRC, in relation to the application of ISAs (UK) 220, 315 and 570.
- An order to appoint an Independent Reviewer to conduct a review to consider the effectiveness of KPMG's current AQR policies and procedures in supporting high-quality engagement with the AQR inspectors.
- Exclusions from membership of the ICAEW for periods ranging from seven to ten years in relation to four individuals.
- An order requiring Deloitte to take specified action to mitigate the effect or prevent the occurrence of the contravention in relation to the audit of supplier rebates and cash.
- An order requiring review and amendment of certain PwC training programmes.

The Independent Tribunal imposed exclusions from ICAEW membership on individuals for periods of between 7-10 years

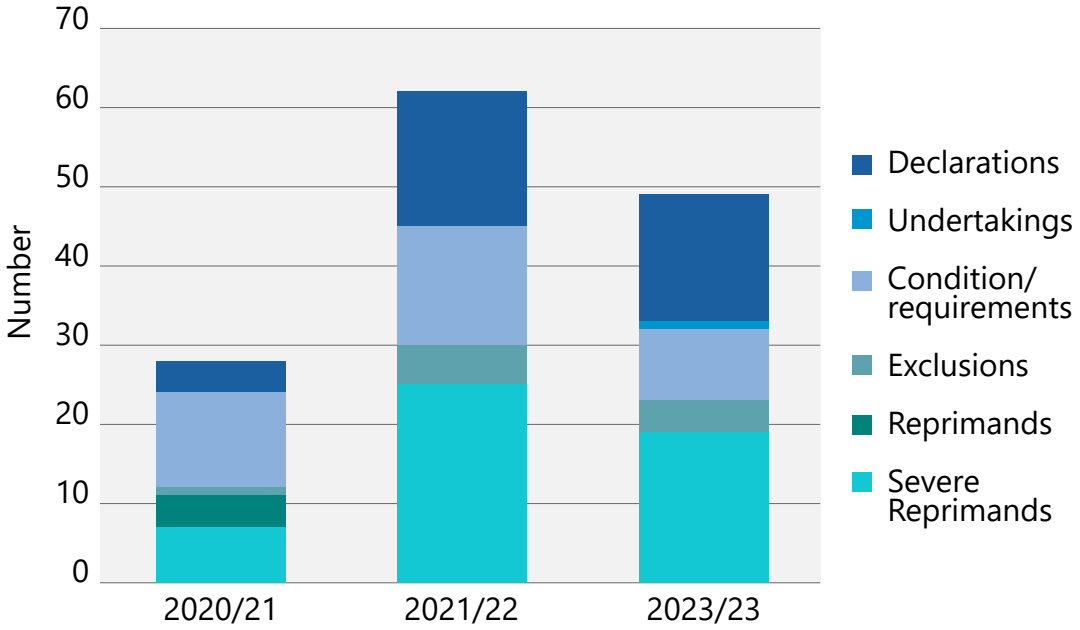
43 In addition to the one imposed on KPMG in the Carillion plc/Regenersis plc matter referred to above.

- A requirement for KPMG to analyse the underlying causes of the breaches of Relevant Requirements and whether the firm's current processes would lead to a different outcome, to identify and implement any further remedial measures necessary to prevent a recurrence, and to report to the FRC at each stage of the process.
- A requirement for PwC to report to the FRC on (i) its monitoring of its audit teams' compliance with its policies regarding consultations; and (ii) its training in this area of new audit partners.

Number of non-financial sanctions

	2020/21	2021/22	2022/23
Severe reprimands	7	25	19
Reprimands	4	–	–
Exclusions	1	5	4
Conditions/requirements	12	15	9
Undertakings	–	–	1
Declarations	4	17	16
Total	**28**	**62**	**49**

Non-financial sanctions



7 Timeliness

Introduction

In previous years we have highlighted the central importance of timely investigative and enforcement action and the steps being taken to further improve our performance in this area. This has included substantial growth in the Division's headcount and new internal measures and initiatives, including steps to assist in monitoring and honing case focus throughout our investigations, for example by introducing in Division specialist senior audit expertise. As set out in more detail below, it is encouraging to report that these steps appear to be having a real impact. There has been an improvement in the percentage of cases meeting the KPI[44] in each of the past five years, with the KPI in this reporting year met in 75% of cases.

Year-on-year timeliness improvement in cases meeting KPI over past 5 years

Time to service of PFC, IR or settlement or closure (if earlier)

As explained in previous years, the KPI relates to the investigation stage of our process given that in later phases the timetable will largely be set by others (for example, the Independent Tribunal Chair), so is not within the control of Executive Counsel.[45]

KPI measurement

In last year's Review, we reflected on the most appropriate way to measure our performance against the KPI. We introduced a comparative KPI measure that was based on all cases where the KPI fell due in the year, irrespective of whether it was achieved in-year, in a previous year or not yet met. This ran alongside the historical KPI, adopted since the inception of the AER, which included all cases where the KPI either fell due or where it had been met in the reporting year. We consider that the comparative measure offers richer and more meaningful data, particularly in the longer term, and it is against this that we report this year and intend to report in future years.

Sixteen enforcement cases were opened between 1 April 2020 and 31 March 2021 and were measured against the comparative KPI. The table below sets out our performance against this measure.

44 Our established KPI measures a period of two years between the notification of the commencement of an investigation and service of either the PFC or IR (or closure or settlement if sooner).
45 Guidance has been issued to Tribunals that matters should progress as expeditiously as possible.

	Number of cases
PFC/IR served (or case concluded without PFC/IR) within two years	12
PFC/IR not served/case not otherwise concluded within two years due to:	
Size/complexity	3
Priority given to settlement discussions	1
Total	**16**

Our target has therefore been met in 75% of cases. Where we did not meet the KPI, the reasons were as follows:

- In three cases, the exceptional size and complexity of the matters investigated meant that it was not possible to achieve the KPI.
- As noted in previous years, where we are in settlement discussions at the date of the KPI, we assess whether the public interest appears more likely to be served by continuing those discussions, or by serving an IR or sometimes both. Settlement discussions in one case this year were given priority over service of an IR.

The 2 year KPI was met in

75%

of cases

The table below sets out our performance over the past three years.

Financial year KPI falls due	2020/21	2021/22	2022/23
Percentage of cases meeting the KPI within two years	44%	57%	75%

The trend is encouraging and reflects the Division's ongoing focus on improving the timeliness of our process while maintaining the rigour and quality that is essential to delivering the fair and robust outcomes required.

Review of KPI measure

The use of a one-size-fits-all KPI has significant limitations given our wide and varied portfolio of cases. As we have explained in previous AERs, the progress of cases can be affected by a number of external factors outside of our control, such as parallel or satellite proceedings. Additionally, the size and complexity of certain matters referred to us means that a period of two years from commencement to settlement, closure or service of the IR or PFC is not realistic. We consider that a calibrated benchmark is therefore needed to reflect these realities and recognise that our performance can be more effectively measured against both a two and three-year KPI. Therefore, from FY2023/24 we will report against the following KPIs:

Calibrated KPI introduced from FY2023/24

1. A period of two years between notification of the commencement of an investigation and service of either the PFC or IR (or closure or settlement if sooner) in 50% of cases in a financial reporting period (1 April to 31 March).

2. A period of three years between notification of the commencement of investigation and service of either the PFC, IR (or closure or settlement if sooner) in 80% of cases in a financial reporting period (1 April to 31 March).

Applying these revised KPIs to cases opened from FY2017/18 onwards, we would have met both targets in the last two reporting years. The first KPI measure (50% of cases in two years) was met in relation to cases opened in FY2019/20 and FY2020/21, while the second (80% of cases in three years) was met in relation to cases opened in FY2018/19 and FY2019/20.

KPI due in year to 31 March	KPI met within 2 years (new target 50%)	KPI met within 3 years (new target 80%)
2019/20	21%	45%
2020/21	44%	71%
2021/22	57%	81%
2022/23	75%	86%

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

The average length of time for cases reaching this milestone during the year is set out in the table below. There has been an increase in this reporting year, which is largely attributable to three Legacy Investigations, two of which closed without sanctions after being paused for more than two and six years respectively. This was due to parallel proceedings brought by another regulator. The other matter was PwC's audit of BT Group plc for the financial years ended 31 March 2015, 2016 and 2017, which resulted in sanctions being imposed after an exceptionally large and complex investigation. Without these four Legacy Investigations, the average would have been 25 months.

	2020/21	2021/22	2022/23
Number of cases where PFC/IR issued (or settled/closed, if earlier)	13	14	20
Average length of time to issuance of PFC/IR (or settlement/closure, if earlier) (in months)	26	33	34

Time to complete a case

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

	2020/21	2021/22	2022/23
Average length of cases referred to Tribunal (months)	91	68	42
(No. of cases)	(1)	(1)	(1)
Average length of cases concluded as a result of settlement or service of undisputed Decision Notice (months)	31	39	35
(No. of cases)	(6)	(13)	(11)
Average length of cases closed with no further action (months)	31	26	48
(No. of cases)	(3)	(3)	(7)

In the first row of the above table, the single case referred to the Independent Tribunal that concluded this year in the KPMG/Carillion plc & Regenersis plc matter. Although complicated by the involvement of multiple Respondents, resolution, including Independent Tribunal hearings, was achieved in three and a half years. As will be noted, this was a significantly shorter period than the two cases that were resolved by Independent Tribunal hearings in the two preceding reporting years.

The second row includes the settlement of two investigations that were delegated to the ICAEW. As the Institute was not in a position to provide us with draft IRs within the agreed timeframe, there were consequential delays in reaching settlement with the Respondents. Excluding these, the average length of cases concluded as a result of settlement or service of an undisputed Decision Notice in the year would have been 31 months.

The final row of the table includes matters that, prior to their closure, were subject to unavoidable delay pending the conclusion of parallel or satellite proceedings, such as the Member in Business cases relating to Serco, Quindell and Sports Direct. Without these three cases, the average length of matters in this category would have been 26 months.

Average age of cases open at year end

The table below sets out the number and average age of cases that remain open at the year end, over the last three years. It shows the average age has fallen this year as a result of ongoing positive progress in concluding Legacy Investigations.

	2020/21	2021/22	2022/23
No. of cases open at year end	42	49	38
No. of cases opened in year	14	16	10
Average age of cases open at year end (in months)	25.4	25.4	23.8

The data shown below relates to the age profile of our cases at year end compared with year end last year.

As a result of our continued drive to resolve Legacy Investigations (as well as maintain progress on newer investigations), seven were closed during the year, with opening years ranging from FY2016 to FY2019. This is an improvement on the five Legacy Investigations closed last year. Five Legacy Investigations remain open; two were paused pending resolution of parallel criminal or other proceedings, while the other three cases are the exceptionally large and complex Carillion plc investigations.

7

legacy cases were closed during the year

Year investigation opened (to 31 March)	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Total
Cases open at 1 April 2022	1	–	–	2	3	6	12	9	16	–	–	**47**
Cases closed in year	–	–	–	1	1	3	7	3	2	–	–	**19**
Cases open at 31 March 2023	1	–	–	1	2	3	5	6	14	15	10	**38**

8 Looking to the Future

Introduction

This section of the AER last year referred to the challenges experienced by business due to hybrid working; the economic impact of ending government pandemic support; inflation, particularly in the energy sector; and geopolitical turmoil. While the detail of the headlines has changed, many of these issues and uncertainties continue to create challenges for preparers, audit committees and auditors of financial statements, particularly in the areas of going concern, assessment of risk (whether economic, fraud, climate-related or otherwise) and judgements and estimates. Understanding each entity, its environment and its systems of internal control is, therefore, of critical importance.[46]

In December 2022, the FRC announced its areas of supervisory focus for 2023/24 for corporate reporting reviews and audit quality inspections. CRR will conduct thematic reviews on insurance contracts (IFRS 17), large private companies, Task Force on Climate-Related Financial Disclosures (TCFD) focusing on targets and metrics, and fair value measurement (IFRS 13). Thematic reviews of audit will cover sampling, hot reviews, network resources and service providers, and root cause analysis. Audit quality inspections will pay particular attention to going concern, fraud risks, climate-related risks, including the links between the audited financial statements and climate-related disclosures elsewhere in the Annual Report, and the application of the revised Auditing Standard on risk identification and assessment (ISA (UK) 315).

In keeping with the FRC's holistic regulatory approach, Enforcement will pay particular attention to issues arising in these areas. We will also continue to liaise with colleagues across the FRC to share learnings and concerns and assist in maintaining a coherent and consistent approach to those we regulate and the wider stakeholder community.

Quality management

In December 2022, the International Standard on Quality Management (UK) 1 (ISQM (UK) 1) became effective, replacing the International Standard on Quality Control (UK) 1 (ISQC (UK) 1). This new standard deals with a firm's responsibility to design, implement and operate a firm-wide system of quality management for audits or reviews of financial statements, or other assurance or related services engagements. ISQM (UK) 1 has a focus on the delivery of high-quality engagements, embedding a culture of quality and understanding, and responding to risks around audit quality. This goes beyond the requirements of ISQC (UK) 1 by requiring a proactive and comprehensive focus on the management of risks to quality, with greater accountability and leadership, and a system that delivers continuous improvement through a monitoring and remediation feedback loop.

46 ISA (UK) 315: Identifying and Assessing the Risks of Material Misstatement

ISQM (UK) 2, the new standalone standard for engagement quality reviews (EQRs), emphasises the importance of EQRs as part of the firm's system of quality management. Revisions to ISA (UK) 220 deal with the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements, emphasising the importance of the appropriate application of professional judgement and exercise of professional scepticism. It also clarifies the roles and responsibilities of the Engagement Partner.

These standards underline the need for a firm to embed within its culture a commitment to quality as a key element of its role in serving the public interest. ISQM (UK) 1 emphasises how important it is that the firm and its people understand and fulfil their responsibilities according to relevant ethical standards. The standards are expected to be of particular relevance in today's environment, where the assessment of risks from the combination of geo-political, economic, environmental and social issues present uncertainties and increased challenges for preparers, audit committees and auditors, in relation to quality financial statements.

Sustainability/ESG reporting assurance

The demand for reliable and useful environmental, social and governance (ESG) information is growing as sustainability-related issues become increasingly significant to investment decisions. Investors are keen to understand how ESG risks and opportunities may affect companies' financial position, performance and reputation. This demand for credible and comparable ESG information is driving the development of sustainability reporting standards and assurance standards in many jurisdictions. The government's Green Finance Strategy,[47] published in March 2023, outlines new requirements for UK companies to disclose their climate transition plans and to assess the suitability of the International Sustainability Standards Board (ISSB) standards for adoption in the UK. This year also saw the first mandatory reporting by premium listed companies against the TCFD framework.

The FRC has published thematics, guidance and examples of best practice on ESG and related reporting over the past year to support preparers and auditors in meeting their obligations under the evolving landscape of ESG regulation. For example, in 2022 we released a staff guidance note to assist auditors in determining their responsibilities under ISA (UK) 720 in their audits of financial statements of companies that are required to include climate-related disclosures consistent with TCFD Recommendations and Recommended Disclosures.

The regulatory framework and standards will continue to evolve. It is crucial for all preparers and auditors to remain informed of changes.

47 Mobilising Green Investment, 2023 Green Finance Strategy

Regulatory reform

The FRC is continuing its strategy of taking the organisation through a period of significant change pending the creation of the Audit, Reporting and Governance Authority (ARGA).

In May 2022, the Government Response to its white paper, Restoring trust in audit and corporate governance, was published (the Government Response). This includes far-reaching proposals affecting the FRC's purpose and objectives, and the roles and responsibilities of those we regulate. The new legislative proposals contained in the Government Response have the potential to significantly alter and enhance our enforcement powers.

Over the course of the year, the FRC has continued to work closely with the government to develop these proposals. The availability of parliamentary time has been affected by a number of extraordinary factors. In the continued absence of a firm legislative timetable, we pushed our published planning assumption back by one year to April 2024. Since the draft publication of our 2023-2026 Plan, changes to the parliamentary timetable began to cast some doubt over this date. After considering the alternatives, we opted to retain the 2024 assumption for the purposes of our 3-Year Plan, while recognising the continued uncertainty around the timing of legislation.

Proposals for enhanced enforcement powers for ARGA

Directors' enforcement regime

The Government Response includes proposals for a new directors' enforcement regime that would provide ARGA with powers to investigate and sanction directors of PIEs in relation to corporate reporting and audit-related responsibilities. The government is also considering whether, in exceptional circumstances, ARGA's powers could be applied to a non-PIE's directors, if doing so was justified by the public interest (for example, if it appears that a large group is structured in such a way as to frustrate proper scrutiny). It proposes that the directors' duties within the scope of the new regime would include the existing statutory duties and the new corporate reporting duties proposed elsewhere in the Government Response.

Statutory enforcement powers against accountants and actuaries

The Government Response also proposes legislation giving ARGA statutory powers to take enforcement action in relation to accountants who are members of professional bodies that require them to hold professional-level accountancy qualifications. These powers will be exercisable in cases that give rise to public interest concerns, principally those arising out of corporate reporting by PIEs. The government expects that those powers will be similar to the investigatory and sanctioning powers exercisable in relation to Statutory Auditors. The government also proposes that ARGA will use the International Ethics Standards Board for Accountants' (IESBA) International Code of Ethics as the basis for enforcement action.[48]

Similarly, the Government Response proposes to introduce a strengthened, statutory basis for the regulation of the actuarial profession, with clear and defined roles and responsibilities. The government proposes that ARGA should have statutory powers to take action against individuals (and, in exceptional cases, entities) responsible for breaches of technical actuarial standards when public interest actuarial work is carried out by, or for, PIEs, large pension schemes or large funeral trusts. Consistent with ARGA's ability to require individuals carrying out public interest actuarial work to comply with the Institute and Faculty of Actuaries' (IFoA's) ethical standards, ARGA may also take action against the individuals responsible for breaches of ethical standards.

As we continue to work with government, we are giving careful consideration to what the implications would be for Enforcement in carrying out the legislative proposals arising from the Government Response.

48 International Code of Ethics for Professional Accountants

Appendix A – summary of cases concluded and published with sanctions in 2022/23

UHY Hacker Young/Laura Ashley Holdings plc/AEP[49]

This comprises two investigations.[50]

In June 2022, a Final Settlement Decision Notice (FSDN) was issued following admissions of breaches of Relevant Requirements by UHY and the Audit Partner in relation to the Statutory Audits of the financial statements of Laura Ashley Holdings plc (LAH) for the financial years ended 30 June 2018 and 30 June 2019.

Points to note

- The breaches of Relevant Requirements were both serious and widespread across nine separate areas of the FY2018 audit, and were repeated in six of the same areas in the FY2019 audit. These audit areas included, among others, determination of audit materiality (FY2018 only), going concern assessment and revenue.
- The FY2018 and FY2019 audit reports were unmodified and noted no material uncertainty related to the use of the going concern assumption, despite LAH's declining performance, which ultimately resulted in administrators being appointed in March 2020.
- FRC's AQR team raised specific concerns regarding the FY2018 audit work in respect of going concern. Despite this finding, failings in relation to professional scepticism, obtaining sufficient appropriate audit evidence, and acting diligently were repeated in FY2019.
- The audits each failed in their principal objective, namely to obtain reasonable assurance about whether the financial statements as a whole were free from material misstatement.
- During the investigation, UHY and the Audit Partner voluntarily undertook to withdraw from accepting appointment to certain Statutory Audits of PIEs for a period of at least two years.

49 Press notice: Sanctions against UHY Hacker Young LLP and a Partner

50 In October 2016, an investigation was opened in relation to the Statutory Audit of the financial statements of Laura Ashley Holdings plc for the year ended 30 June 2018, and in May 2020 a second investigation was opened in relation to the Statutory Audit of the consolidated financial statements of Laura Ashley Holdings plc for the year ended 30 June 2019. Under the AEP issued in March 2021, a new investigation is commenced if additional matters are identified outside the scope of the initial investigation. In this instance, matters in a later audit year were identified, leading to a second investigation under the AEP.

Facts

LAH was a well-known high-street retail group. As at 30 June 2019, it had 155 high street stores in the UK and international operations in 25 countries, employing over 2,700 people. Its shares were listed on the Main Market of the London Stock Exchange, and as such the company was a PIE.

Between FY2015 and FY2018, LAH's revenue, operating profit, profit before tax and profit after tax all declined, with the group making a loss after tax of £1.4 million in FY2018. During this period, it changed its Statutory Auditors twice before appointing UHY as its Statutory Audit firm in May 2018. Before UHY carried out the FY2018 audit, LAH announced three profit warnings between February 2017 and February 2018. Against this backdrop of declining performance, its management continued to make ambitious forecasts around the time of the FY2018 audit, which anticipated significantly improved performance over the next two years.

The FY2018 auditor's report dated 21 September 2018 was unmodified and noted no material uncertainty relating to going concern. In August 2019, AQR subsequently assessed UHY's FY2018 audit at the worst available grading – Significant Improvements Required. The matter was referred to the Conduct Committee, which opened an investigation (in respect of the FY2018 audit) in October 2019.

The financial performance of LAH continued to deteriorate in FY2019, with revenue falling by almost 10% compared with FY2018 and its loss after tax increasing ten-fold from £1.4 million in FY2018 to £14 million in FY2019. LAH announced two further profit warnings shortly before UHY carried out the FY2019 audit.

As with FY2018, the FY2019 auditor's report was unmodified and noted no material uncertainty relating to going concern. The financial statements were published on 15 October 2019.

On 23 March 2020, administrators were appointed to LAH and various subsidiary companies. It is not suggested that the administration of LAH was caused by the breaches of Relevant Requirements by UHY in its execution of the relevant audits.

Issues

The breaches of Relevant Requirements in the FY2018 audit concerned nine areas, six of which were repeated in the FY2019 audit: These were, (i) materiality (FY2018 only); (ii) going concern assessment; (iii) revenue; (iv) inventory; (v) journal entry testing and fraud risk assessment; (vi) property, plant and equipment adjustments/other comprehensive income; (vii) pension scheme assets and liabilities; (viii) carrying value of investment in subsidiaries (FY2018 only); and (ix) long-standing debtors (FY2018 only).

The failings were most prevalent in the FY2018 audit. However, the FY2019 audit also showed a large number of significant failings including in relation to most of the same areas as the FY2018 audit, even though the FY2019 later audit was carried out after aspects of the FY2018 audit work had been heavily criticised by the AQR team. In light of these criticisms, Executive Counsel would have expected the audit work for the FY2019 audit to have been of a much higher quality.

The breaches of Relevant Requirements related to audit procedures of fundamental importance, and many concerned matters crucial to the proper conduct of an audit including, for example, the determination of materiality and the assessment of going concern. In a number of cases, basic audit requirements were not followed, evidencing a significant lack of competence and basic challenge in conducting the audit work. UHY failed to challenge management appropriately, exercise professional scepticism and/or seek or obtain sufficient appropriate audit evidence.

In particular:

- **Materiality:** UHY failed to select an appropriate benchmark and percentage to calculate overall materiality for the FY2018 audit. As a result, overall materiality for the FY2018 audit was set at about five times the level that would have been calculated using 5% of estimated profit before tax, the common approach for a profit-oriented entity in the retail sector. Consequently, UHY failed to determine adequately, or at all, whether uncorrected misstatements were material and whether the audit strategy and plan needed to be revised. UHY also failed to report to those charged with governance that uncorrected misstatements were in fact material.

- **Going concern:** At the end of FY2018, LAH had issued three profit warnings and its share price had fallen significantly from c.30 pence in late 2014 to c.4 pence by the end of June 2018. It had also experienced a recent decline in cashflow. Despite this, in the FY2018 audit UHY failed to (among other things) maintain sufficient professional scepticism by failing to challenge or investigate adequately, or at all, the assumptions underlying LAH's working capital forecast. UHY also failed to obtain sufficient appropriate audit evidence to support its conclusion as to the appropriateness of LAH's use of the going concern basis of accounting in preparing the FY2018 financial statements, and/or whether a material uncertainty existed about LAH's ability to continue as a going concern. For example, approximately two-thirds of the products it sold were paid for in US dollars or euros. It was not hedged against foreign exchange movements nor did it carry out forward-purchasing. The effect of foreign exchange volatility was, therefore, a significant consideration for the Respondents to take into account for the audit of the going concern assessment. However, there is no evidence on the FY2018 audit file that they gave this adequate consideration.

LAH's financial performance continued to deteriorate in FY2019, with revenue declining by approximately 10%, despite LAH having forecast an increase. UHY failed again to maintain professional scepticism in FY2019 in concluding, incorrectly, that there was no material uncertainty related to going concern, despite the presence of numerous warning signs at the time of the FY2019 audit.

The FSDN identifies extensive breaches of multiple Relevant Requirements, including: ISA (UK) 200 (Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing); ISA (UK) 220 (Quality Control for an Audit of Financial Statements); ISA (UK) 240 (The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements); ISA (UK) 500 (Audit Evidence); and ISA (UK) 570 (Going Concern), in addition to the requirement to exercise 'professional competence and due care,' as stated in paragraph 130.1(b) of the ICAEW Code of Ethics.

Outcome

The following sanctions were imposed on UHY:

- An order that UHY take action to prevent the recurrence of the breach of the Relevant Requirements, namely that the firm shall not accept appointment as Statutory Auditor to any PIE for which it is not currently acting as Statutory Auditor, until the later of: (i) 11 May 2024; and (ii) such time as the FRC is satisfied that UHY has the necessary competence to conduct high-quality Statutory Audits of PIEs in compliance with Relevant Requirements. By agreement, a condition shall be applied to UHY's audit licence to that effect.
- A financial sanction of £300,000 adjusted for admissions and early disposal to £217,500.
- A published statement in the form of a Severe Reprimand.
- A declaration that the FY2018 and FY2019 audit reports signed on behalf of UHY did not satisfy the Relevant Requirements, as set out in the FSDN.

The following sanctions were imposed on the Audit Partner:

- An order that he take action to prevent the recurrence of the breach of the Relevant Requirements, namely that he does not sign any Statutory Audit Report for a PIE for a period of two years from 11 May 2022.
- A financial sanction of £45,000 adjusted for admissions and early disposal to £32,625.
- An order that he take action to prevent the recurrence of the breach of the Relevant Requirements, by undertaking training in a form agreed with the FRC, in relation to the application of ISAs (UK) 220, 315 and 570.

- A published statement in the form of a Severe Reprimand.
- A declaration that the FY2018 and FY2019 audit reports signed by the Audit Partner did not satisfy the Relevant Requirements, as set out in the FSDN.

KPMG/Carillion plc & Regenersis plc/Accountancy Scheme[51]

In May 2022, the Independent Tribunal made findings of Misconduct, under the Accountancy Scheme, and imposed sanctions on KPMG, a former KPMG partner and four former KPMG employees. The Misconduct related to providing false and misleading information and documents to the FRC in connection with our AQR inspections of two audits carried out by KPMG: the audit of the financial statements of Regenersis plc for the period ended 30 June 2014; and the audit of the financial statements of Carillion plc for the period ended 31 December 2016.

The Formal Complaint was heard over a five-week period commencing in January 2022. The Independent Tribunal reconvened in May 2022 to hear submissions on sanctions.

Points to note[52]

- The allegations concerned providing false and misleading documents and information to the FRC AQR teams. The Formal Complaint did not allege Misconduct arising from the performance of the relevant audits, nor did it allege that in either case the financial statements had not been properly prepared.
- The Independent Tribunal Report describes KPMG's actions on identifying the issues that gave rise to the proceedings as impressive. They included bringing the matter to the attention of the FRC, conducting three separate reviews at an early stage following consultation with the FRC, admitting responsibility for the acts of the individuals, and later admitting in advance of the Independent Tribunal hearing that Misconduct had occurred and expressing contrition. These strong mitigating features served to reduce the sanctions that might otherwise have been imposed on KPMG.

Facts

The allegations in the Formal Complaint related to the conduct of two separate FRC audit inspections, namely the AQR of KPMG's audit of the financial statements of Regenersis plc for the year ended 30 June 2014, and the AQR of KPMG's audit of the financial statements of Carillion plc for the year ended 31 December 2016.

51 Press notice: Sanctions against KPMG and others in connection with Regenersis & Carillion audits

52 Proceedings between the Executive Counsel and the Regenersis plc Audit Engagement Partner, who had been the seventh Respondent in the Formal Complaint, were the subject of a settlement agreement dated 11 January 2022 and this case was therefore included in the 2021/2022 Review.

It was alleged that the former Partner and four former KPMG employees:

- On one or more occasions during those inspections were involved in the creation of false and/or misleading documents, either with the intention that the FRC would be misled into accepting them as genuine, or being reckless as to whether the FRC would be so misled.
- On one or more occasions during those inspections, made or were knowingly associated with false and/or misleading representations to the FRC concerning documents alleged by them to have been created during the course of audits, either knowing that the representations were false and/or misleading, or alternatively, being reckless as to the truth of the representations.

Each of the individuals thereby acted dishonestly, or with a lack of integrity, and thereby committed Misconduct as defined in paragraph 2(1) of the Accountancy Scheme.

Outcome

Regenersis plc AQR inspection

The Independent Tribunal found that there had been Misconduct in respect of the Regenersis plc AQR inspection, in that the manager and assistant manager (at the time of the audit) had:

- Created or had a role in creating a false or misleading audit working paper on goodwill (the Goodwill Paper).
- Made or had a role in the making of false or misleading representations to the AQR inspectors as to when, and in what circumstances, the Goodwill Paper was created.
- Made false representations in the Goodwill Paper that certain audit work had been performed during the Regenersis plc audit.

It also found that, in each case, they were party to the deliberate misleading of the FRC's AQR inspectors, and that their conduct was dishonest.

As for the Regenersis plc AQR, the assistant manager's evidence was that he complied with instructions he received from the more senior manager, which included inserting false statements in an email to the AQR team. The Independent Tribunal did not believe 'that a man of [the assistant manager's] intelligence would not have appreciated that this statement was false. Having done so, he should have refused to insert it into the email…We reject his evidence to the effect that he acted under instructions which he did not question during these events.'

The KPMG employee who had performed the role of Audit Engagement Partner on the Regenersis audit reached agreed terms for settlement with Executive Counsel that were approved by the Independent Tribunal. He admitted that he made, or was responsible for, representations to the FRC's AQR inspectors that were misleading and that he was reckless as to whether those representations were misleading and whether the inspectors would be misled by them. He also admitted that his conduct amounted to a lack of integrity and therefore Misconduct.

Carillion plc AQR inspection

The Independent Tribunal found that there had been Misconduct in respect of the Carillion plc AQR inspection concerning minutes of year-end 'clearance' meetings and an audit working paper on the selection of contracts for audit testing (the CCS Paper). These were presented to the AQR inspectors as having been created during the Carillion plc audit.

In respect of the meeting minutes, the Independent Tribunal found that Misconduct had been committed by the former KPMG Partner and four former KPMG employees in that:

- Two of the former employees had created, and the former Partner and two other former employees had assisted or encouraged the creation of, false or misleading meeting minutes, intending to mislead, or as a party to the deliberate misleading of the AQR inspectors, or being reckless as to whether they would be misled.
- They had made, or connived in, or were knowingly associated with making certain false or misleading representations to the AQR inspectors as to when, and in what circumstances, the meeting minutes were created, intending to mislead, or as a party to the deliberate misleading of them, or being reckless as to whether they would be misled.

The Independent Tribunal also found that the former Partner and three of the former KPMG employees were party to the dishonest misleading of the AQR inspectors. One of the former employees had already admitted these allegations and that his conduct was dishonest.

While the Independent Tribunal recognised that the former employee who was an assistant manager was expected to carry out the instructions of his superiors, it found that those instructions made it obvious that the documents he helped to create were intended to be falsely represented to the AQR as having been created during the audit. The assistant manager's evidence was that he complied with the instructions he was given without thought as to their propriety, but the Independent Tribunal rejected that evidence. It found that the assistant manager was 'an intelligent man, and the instructions he says he was given by [one of the senior managers] were highly unusual and would have raised questions in anyone's mind. [He] chose to implement them.

We find that [the assistant manager] should have questioned [the senior manager's] instructions, and if he received no appropriate answer (and we cannot see what that could have been) he should have raised their propriety with his performance manager or KPMG's Ethics and Independence Partner.'

The Independent Tribunal found that the assistant manager, by implementing without question the instructions given to him by the manager to create false minutes, acted without the integrity required of an accountant and became a party to the deliberate misleading of the AQR. However, he was not found to have acted dishonestly.

A further allegation of Misconduct in relation to the content of the meeting minutes made by Executive Counsel against the former Partner and two of the former employees was found not proved by the Independent Tribunal.

Regarding the CCS Paper, the Independent Tribunal found that Misconduct had been committed by the former Partner and two of the former employees in that:

- One of the former employees had created, and the former Partner and the other former employee had assisted or encouraged the creation of, a false or misleading audit working paper on the selection of construction contracts.
- They had made, or had connived in or were knowingly associated with making, false or misleading representations as to when, and in what circumstances, the audit working paper was created.

The Independent Tribunal found that the former Partner and former employee who had assisted and/or encouraged the creation of the false or misleading working paper acted without the integrity required of an accountant, but not dishonestly. The former employee who created the false or misleading working paper was found to have been dishonest.

The Independent Tribunal also found, in respect of the former employee who created the document, that he had made false representations in the CCS Paper that certain audit work had been performed during the Carillion plc audit and that his conduct was dishonest.

KPMG admitted its liability for the acts of all the individuals set out above and that those acts amounted to Misconduct.

Sanctions

KPMG received a financial sanction of £20 million, reduced to £14.4 million to reflect its self-reporting, cooperation and admissions, and a Severe Reprimand. As a non-financial sanction, it was ordered to appoint an Independent Reviewer to consider the effectiveness of KPMG's current AQR policies and procedures in supporting high-quality engagement with the AQR inspectors. KPMG agreed to pay £3.95 million towards Executive Counsel's costs of the investigation, together with the costs of the Independent Tribunal.

The former KPMG Partner was excluded from membership of the ICAEW for a period of ten years and fined £250,000. Two of the former employees were excluded from membership of the ICAEW for a period of eight years and fined £45,000 and £40,000 respectively. One former employee was excluded from membership of the ICAEW for a period of seven years and fined £30,000. The other former employee received a Severe Reprimand.

The KPMG employee who had acted as Engagement Partner for the Regenersis audit and agreed terms of settlement with Executive Counsel following his admissions of Misconduct received a financial sanction of £150,000. He was also excluded from the ICAEW for a recommended period of three years.

PwC/BT Group plc/AEP[53]

In June 2022, a FSDN was issued and sanctions imposed against PwC and the Audit Engagement Partner in relation to the Statutory Audits of the financial statements of BT Group plc (BT) for the financial year ended 31 March 2017.

Points to note

- The initial scope of the investigation included PwC's audits of BT's financial statements for FY2015 and FY2016. The investigation in relation to these earlier years was closed without enforcement action.
- The breaches had the potential to cause loss to a significant number of people in the UK, although it was not alleged that there was such loss.

Facts

BT is a telecommunications business headquartered in the UK. It has a primary share listing on the London Stock Exchange and is a constituent of the FTSE 100 Index. PwC was appointed as its auditor in 1984.

53 Press notice: Sanctions against PwC and a Partner

In July 2016, BT received a whistleblower report disclosing accounting adjustments required within BT Italy. Following this, BT appointed an accountancy firm to analyse the impact. It found that there had been a serious breakdown of accounting processes and controls at BT Italy and the irregularities were the result of misrepresentation and fictitious transactions (namely fraud). On 24 January 2017, BT announced to the market that the investigation into the financial position of its Italian business was substantially complete, and that the total financial impact of the identified accounting irregularities totalled around £530 million. However, BT was still evaluating what proportion of the total should be treated as corrections of prior-year errors, and what proportion should be treated as changes in accounting estimates. BT subsequently disclosed in its FY2017 financial statements that the overall adjustments necessary as a result of the fraud amounted to approximately £513 million, split between corrections of prior-period errors totalling £268 million and changes in accounting estimates of £245 million (the BT Italy Adjustments).

Issues

The sum of the BT Italy Adjustments disclosed in the FY2017 financial statements as a result of the fraud was nearly four times group materiality. These were made up of (i) corrections of prior-period errors and (ii) changes in accounting estimates. Of the total sum, the receivables balance, comprising two adjustments, amounted to €91 million (£72 million) (the Debt Adjustments). The most serious breaches related to PwC's audit of the Debt Adjustments, though documentation breaches were found in relation to the BT Italy Adjustments.

PwC had identified the accounting treatment and related disclosures for the impact of the fraud as a significant risk in its FY2017 audit. There was a need for heightened professional scepticism in relation to BT's treatment of the Debt Adjustments, and in particular the relative amounts attributed to the correction of prior-period errors and changes in accounting estimates, given: (i) the particular requirements of the applicable accounting standard, IAS 8; (ii) queries raised by PwC USA's Regulatory Advisory team as to the ratio of the adjustments and whether they were fully supported by evidence; and (iii) if the errors were material in any prior period a 'restatement' would be required for US reporting purposes and BT had stated the value of the errors to fall short of the materiality thresholds in all relevant years (FY2012 to FY2016), and only just short (by approximately £1 million) of the materiality threshold in FY2016.

The breaches of Relevant Requirements in this case reflected the Respondents' failures in relation to the Debt Adjustments to:

- Subject BT's approach to distinguishing between corrections of prior-period errors and changes in accounting estimates to adequate scrutiny or critical assessment, and to approach this aspect of the audit with the requisite professional scepticism;

- Perform audit procedures that were appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.
- Properly determine whether management had appropriately and consistently applied the relevant accounting standard, or whether the Debt Adjustments were appropriate in the circumstances.

Moreover, in relation to the total BT Italy Adjustments, there was a failure to prepare audit documentation in relation to the split between corrections of prior-period errors and changes in estimates, that were sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing and extent of the audit procedures performed.

The standards found to have been breached in the matters covered by the FSDN were:

- ISA (UK) 200 (Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing);
- ISA (UK) 230 (Audit Documentation);
- ISA (UK) 500 (Audit Evidence); and
- ISA (UK) 540 (Auditing Accounting Estimates and Related Disclosures).

Outcome

The sanctions imposed on PwC were a financial sanction of £2.5 million, adjusted for admissions and early disposal to £1.75 million; a Severe Reprimand; and a declaration that the Statutory Audit Report did not satisfy the Relevant Requirements.

For the Audit Engagement Partner, there was a financial sanction of £60,000 adjusted for admissions and early disposal to £42,000; a Severe Reprimand; and a declaration that the Statutory Audit Report did not satisfy the Relevant Requirements.

Deloitte/SIG plc/AEP[54]

On 31 October 2022, a FSDN was issued following admissions of breaches of Relevant Requirements by Deloitte and a Partner in relation to the Statutory Audit of the financial statements of SIG plc for FY2015 and FY2016.

Points to note

- The breaches affected two different areas of the audits and occurred over two audit years. They concerned matters that were the subject of material restatements in the company's FY2017 financial statements, and Relevant Requirements fundamental to the work of the independent auditor.
- Conversely, the breaches were not deliberate, reckless or dishonest and were not done for financial gain, and Deloitte had taken steps to mitigate the risk of any repetition and learn from the mistakes.
- This is another case in which there were deficiencies in the auditing of complex supplier arrangements (on this occasion, rebates) – an area previously highlighted by the FRC as requiring particular attention.
- The other breaches concerned the auditing of cash – an area to which auditors do not always dedicate the necessary attention and resources.

Facts

The FY2017 financial statements for the company (a leading distributor of specialist building products throughout Europe) included adjustments of the FY2015 and FY2016 figures to correct historical issues. Profit had been overstated due to overstatement of balances recognised in relation to supplier rebates (financial incentives paid to the company by its suppliers), and cash and trade payables had been overstated due to the incorrect application of cash cut-off procedures relating to cheques issued around the year ends.

The overstatements of profit were material to the FY2016 financial statements, and the overstatements of cash and trade payables were material to the financial statements for FY2015 and FY2016.

Deloitte had audited the FY2015 and FY2016 financial statements.

Issues

Deloitte admitted that in both years its auditing of financial rebates and cash was deficient, in that it failed to:

- Adequately test the percentage terms for supplier rebate agreements, as set out in the company's rebate workbooks.

54 Press notice: Sanctions against Deloitte and a Partner

- Perform adequate alternative testing procedures for those rebate debtor balances that had not been confirmed by the relevant supplier via a circularisation process.
- Adequately investigate indications that rebate debtor balances may have been overstated, by accepting explanations given by the company for discrepancies in the recorded figures for rebate earnings and debtor balances without further enquiry.
- Properly test whether sums had been correctly included in cash, due to errors in the testing of unrecorded liabilities and creditor balances.
- Enquire into indicators that certain cheque payments had been made pre- rather than post-year end.

The breaches related to the duties of the auditor to plan and perform the audit with professional scepticism, to design and perform appropriate audit procedures for the purpose of obtaining sufficient appropriate audit evidence, and to prepare sufficient audit documentation, under the following International Standards on Auditing (UK and Ireland) (ISAs):

- ISA (UK) 200 (Overall objectives of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing);
- ISA (UK) 500 (Audit Evidence); and
- ISA (UK) 230 (Audit Documentation).

Outcome

Deloitte accepted that, in aggregate, the breaches:

- Resulted in the FY2015 and FY2016 audits failing in their principal objective of obtaining reasonable assurance as to whether the financial statements were free from material misstatement.
- Had the potential to adversely affect a significant number of people in the UK (such as the public, investors or other market users).
- Could have harmed confidence in the truth and fairness of financial statements and the standards of conduct of Statutory Auditors, in general.

The breaches regarding supplier rebates were made more serious by the fact that they were an important feature of the company's business, had been identified by Deloitte as an area of significant audit risk, and had been highlighted in guidance issued by the FRC in December 2014 as an area requiring particular care.

The following sanctions were imposed against Deloitte:

- A financial sanction of £1.25 million adjusted for admissions and early disposal to £906,250.
- A published statement in the form of a Severe Reprimand.
- A declaration that the FY2015 and FY2016 audit reports signed on behalf of the firm did not satisfy the Relevant Requirements.
- An order requiring the firm to take specified action to mitigate the effect or prevent the occurrence of the contravention.

The following sanctions were imposed against the Partner:

- A financial sanction of £50,000 adjusted for admissions and early disposal to £36,250.
- A published statement in the form of a Severe Reprimand.

PwC/Babcock International Group plc/AEP[55]

This comprises three investigations.[56]

In January 2023, a FSDN was issued following admissions of breaches of Relevant Requirements by PwC and two former Partners in relation to:

- The Statutory Audits of the group consolidated financial statements of Babcock International Group (Babcock) for the financial years ended 31 March 2017 ('FY2017') and 31 March 2018 ('FY2018').
- The Statutory Audit of the FY2018 financial statements of Devonport Royal Dockyard Limited (DRDL), a significant component of Babcock.

Points to note

- Numerous, serious breaches were admitted by the Respondents. They were identified in every area of audit investigated, including seven long-term contracts comprising approximately 25% of the FY2018 Babcock revenue. The breaches included:

55 Press notice: Sanctions against PwC and two former Audit Partners

56 In July 2019, an investigation was opened in relation to the Statutory Audits of the group financial statements of Babcock International Group plc for the year ended 31 March 2018. In March 2021, two additional investigations were opened in relation to the Statutory Audit of the group financial statements of Babcock International Group plc for the year ended 31 March 2017, and in relation to the Statutory Audit of the financial statements of Devonport Royal Dockyard Limited for the year ended 31 March 2018. Under the version of the AEP in force at March 2021, a new investigation had to be commenced if additional matters were identified outside the scope of the initial investigation. In this instance, matters in a later audit year and in a component audit were identified, leading to the new investigations.

- Repeated failures to challenge management and obtain sufficient appropriate evidence. These failures to challenge management and obtain sufficient appropriate evidence were repeated across a variety of contracts and transactions, reflecting a general reluctance to challenge management on these parts of the audits.
- Examples of failure to follow basic audit requirements, evidencing a lack of competence, care or diligence. For example, there was no evidence the audit team had, in FY2018 or before, obtained and read a 30-year Public Private Partnership contract with FY2018 revenue of c.£77 million and lifetime revenue of £3 billion. One contract with an initial value of c.€640 million was written in French, but the audit team did not speak French and failed to get a translation of the contract.
- A breach of the Overarching Principle of Independence in respect of the inappropriate provision of accounting advice to the audit client on one issue, and in respect of the FY2018 DRDL audit, the 'prepopulation' of an audit workpaper relating to a sensitive government contract, which created a false record of the audit evidence actually obtained.

- Many of the matters to which the breaches relate were qualitatively material to users of the financial statements. Altogether, the breaches ran the risk that a material misstatement in the FY2017 and/or FY2018 Babcock financial statements may have gone undetected.
- An aggravating factor was that sanctions have been imposed on PwC in relation to four other investigations since 2019.
- PwC, however, provided an exceptional level of cooperation during the investigation by conducting candid and self-critical self-reviews of the FY2018 Babcock audit work. Nevertheless, this was countered by errors and delays in document production, and by providing unclear, non-specific or inaccurate responses. These matters were serious and led to delays in the investigation. Despite these significant shortcomings, a reduction in the financial sanction would have been appropriate to recognise the firm's exceptional cooperation.

Facts

Babcock is a multinational corporation headquartered in the UK providing, among other things, engineering services. Its main business is with public bodies, particularly the UK's Ministry of Defence (MoD). It has a number of highly sensitive UK government contracts, so its work attracts significant public interest in the UK.

Babcock's shares are listed on the Main Market of the London Stock Exchange and, as at 31 March 2017, it was a constituent of the FTSE 100 Index with a market capitalisation of c.£4.5 billion. There was, and is, an evident public and market interest in the truth and fairness of the Group's financial statements and its Statutory Audit.

DRDL is, and was at all material times, a subsidiary of Babcock. Its principal activity is the maintenance and refit of Royal Navy warships and submarines and providing support services to the MoD in relation to the operation of the Devonport Naval base. It was a significant company in its own right, with revenue of over £700 million and c.5,550 employees as at 31 March 2018.

On 7 May 2019, the FRC's AQR team issued its review of PwC's work on the FY2018 Group audit. AQR assessed the work within the scope of their review as being the lowest grade – Significant Improvements Required. Consequently, Executive Counsel's investigation into the FY2018 Babcock audit was opened in July 2019. The investigation was expanded to include elements of the FY2017 Babcock audit and FY2018 DRDL audit in light of matters uncovered by Executive Counsel.

Issues

Breaches of Relevant Requirements were identified in every area of audit investigated by Executive Counsel, including seven long-term contracts comprising approximately 25% of the FY2018 Babcock revenue. Breaches were also identified in the following areas:

- Assessment of goodwill impairment.
- Impairment of aviation assets.
- Onerous lease assessment.
- Accounting for a receivable contrary to IAS 37. The receivable related to monies that were to be paid once a legal settlement agreement had been concluded.
- Disclosure of key accounting judgements. These related to disclosure of accounting judgements and disclosure of sources of estimation uncertainty.
- Overall direction and supervision of the Babcock audit (ISA (UK) 220).

In particular, the breaches included:

- Twelve breaches of ISA (UK) 200.15 – the requirement for the Statutory Auditor to exercise professional scepticism.
- A breach of the Overarching Principle of Independence in respect of the inappropriate provision of accounting advice to the audit client on one issue.
- In respect of the FY2018 DRDL audit, the 'prepopulation' of an audit workpaper, which created a false record of audit work undertaken, and the evidence obtained in respect of the HMS Vanguard contract.
- Eight breaches of ISA (UK) 700 – the requirement to evaluate whether the financial statements were prepared in accordance with the financial reporting framework.

- Eleven breaches of ISA (UK) 500 – the requirement to obtain sufficient appropriate audit evidence.
- Six breaches of ISA (UK) 540, which relates to the auditing of accounting estimates and related disclosures.

In January 2018, following the insolvency of Carillion plc, the FRC issued guidance to auditors requiring that they (among other things) 'obtain sufficient appropriate audit evidence to support and challenge the judgements and estimates reached on key long-term contracts.' In FY2018, PwC had sought to take account of this guidance but the lack of challenge regarding the audit of long-term contract accounting remained in respect of the matters to which the FSDN relates.

Furthermore, certain deficiencies, similar to the breaches of Relevant Requirements in this case, were identified by the FRC's AQR team in the course of its FY2015, FY2016 and FY2017 PwC inspections.

Outcome

The Respondents accepted that:

- The breaches were serious and numerous, and were not isolated incidents resulting from one-off oversights. Altogether, the breaches:
  - Ran the risk that a material misstatement in the FY2017 and/or FY2018 Group financial statements may have gone undetected and had the potential to adversely affect a significant number of people in the UK (such as the public, investors or other market users).
  - Had the potential to undermine: (a) investor, market and public confidence in the truth and fairness of the financial statements audited by Statutory Auditors or Statutory Audit firms; and (b) confidence in the standards of conduct in general of Statutory Auditors and Statutory Audit firms and/or in Statutory Audits.
- As a result of the breaches of Relevant Requirements, the FY2017 and FY2018 Group audits failed in their principal objectives, namely to obtain reasonable assurance that the financial statements as a whole were free from material misstatement.
- Many of the matters to which the breaches relate were (individually or in aggregate) qualitatively material to users of the financial statements. In particular:
  - The increase in operating profit between FY2016 and FY2017 was £7.1 million. In the FY2017 Babcock audit, there was a failure to apply sufficient professional scepticism in respect of management's recognition of a receivable of £22 million from Supplier X. If this receivable had been accounted for in the correct accounting period, operating profit in FY2017 would have been reduced by £22 million to below FY2015 levels. In terms

of operating profit, management's assertion in the FY2017 financial statements that it was 'a year of progress' would have been contradicted, as the picture of financial performance would have been different.

- The increase in operating profit between FY2017 and FY2018 was £11 million. In the FY2018 financial statements, management asserted that FY2018 was also 'a year of progress'. The increase in operating profit reflected, among other things, significant one-off items with a value over £11 million. Had the auditor appropriately applied the ISAs they would have required Babcock to make clear disclosures explaining the positive impact of these significant one-off items.

The following sanctions were imposed on PwC:

- A financial sanction of £7.5 million, adjusted for aggravating and mitigating factors and discounted for admissions and early disposal by 25%, so that the financial sanction payable is £5,625,000.
- A Severe Reprimand.
- An order requiring review and amendment of certain PwC training programmes.
- A declaration that the audit reports signed on behalf of PwC did not satisfy the audit reporting requirements, as set out in the FSDN.

The following sanctions were imposed on the FY2017 and FY2018 Babcock Audit Engagement Partner:

- A financial sanction of £200,000, adjusted for aggravating and mitigating factors and discounted for admissions and early disposal by 25%, so that the financial sanction payable is £150,000.
- A Severe Reprimand.
- A declaration that the FY2017 and FY2018 Babcock audit reports signed by the FY2017 and FY2018 Babcock Audit Engagement Partner did not satisfy the audit reporting requirements, as set out in the FSDN.

The following sanctions were imposed on the DRDL Audit Engagement Partner:

- A financial sanction of £65,000, adjusted for aggravating and mitigating factors and discounted for admissions and early disposal by 25%, so that the financial sanction payable is £48,750
- A Severe Reprimand.
- A declaration that the FY2018 DRDL audit report signed by the DRDL Audit Engagement Partner did not satisfy the audit reporting requirements, as set out in the FSDN.

PwC was also required to pay Executive Counsel's costs of the investigation.

KPMG/Luceco plc/AEP[57]

In January 2023, a FSDN was issued against KPMG and a former KPMG employee following their admissions of breaches of Relevant Requirements in relation to the Statutory Audit of the financial statements of Luceco plc (Luceco) for the year ended 31 December 2016.

Points to note

- The audit client was a newly listed and relatively small company.
- The breaches occurred in relation to one financial year, but they extended over the whole of the audit. This was due to failures in the design of audit procedures, failures in performance of the procedures used, and failures to adequately review and critically assess the audit evidence that the Respondents obtained, prior to the audit opinion being signed. The breaches also involved failings of professional scepticism.
- The breaches of these Relevant Requirements are made more serious by the fact that each of the audit areas in which they were identified related to aspects of the entity's accounting. These were important to the preparation of its financial statements as, if either one contained material errors, the financial statements would likely be materially misstated.
- Certain breaches occurred despite the Respondents realising that one of the areas of the audit in which they occurred (namely the accuracy of the cost of inventory) needed particular focus following prior-year errors.

Facts

During FY2016, Luceco was the ultimate parent of a group of companies (the Group) that produced and distributed lighting products and accessories. Its subsidiaries included a manufacturing company in China and two distribution companies in the UK. Luceco listed on the Main Market of the London Stock Exchange in October 2016.

KPMG had been the auditor of Luceco from 2014, and the former employee performed the role of Responsible Individual from 2014 until 2017. Although he was not a Partner in KPMG, he had the grade of director and was eligible to act as Audit Engagement Partner and sign the relevant audit report on behalf of KPMG.

The FY2016 financial statements included many material[58] misstatements in relation to two areas of the audit. They were subsequently identified by the Group's management and had to be corrected by restatement in FY2017.

57 Press notice: Sanctions against KPMG LLP and a former employee
58 The overall materiality level for the audit was £714,000. Performance materiality was set at £500,000.

Issues

The breaches of Relevant Requirements related to intercompany transactions and year-end balances, and the accuracy of the cost of inventory and year-end balances.

Intercompany transactions

The Group's operations in FY2016 included a large number of intercompany transactions. Many of these were from the sale of products by the manufacturing entity in China to the Group's UK trading entities. While the intercompany transactions were not inherently complex, the way the Group handled the transactions increased the complexity of the reconciliation of intercompany accounting.

The audit procedures designed and performed failed to provide sufficient evidence that intercompany balances reconciled, and in places audit documentation was insufficient. Specifically:

(i) The intercompany 'matrix' used for the purposes of auditing the reconciliation did not contain all of the intercompany balances, which the Respondents knew.

(ii) The intercompany balances that were not included in the intercompany matrix were manually adjusted for, and eliminated on, consolidation. An adjustment of £4,459,894 (approximately 6.25 times materiality), posted at the FY2016 year end, was not tested for accuracy, nor agreed to supporting documentation.

(iii) During the testing of supplier statements, the Respondents failed to test a material amount ($3.2 million) with notable features.

(iv) The supplier statement testing working paper was difficult to follow and omitted relevant information.

(v) The Respondents did not test intercompany items included in a Goods Received Not Invoiced accrual of £2.1 million (approximately 2.9 times materiality).

In addition, a cut-off difference arose from the fact that the Chinese manufacturing entity and the UK distribution entities recognised different points of sale for intercompany transactions. The adjustment made on consolidation for the cut-off treatment was limited to reflecting the (immaterial) profit element of these transactions and did not reflect the (material) balance sheet impact of the difference.

The following adjustments were made to the FY2016 financial statements in respect of intercompany:

(i) FY2016 profit and loss account: reduction of profit by £1.6 million.

(ii) FY2016 balance sheet: reduction of net assets by £3.7 million.

Inventory

Inventories amounted to more than a third of the Group's total assets at 31 December 2016. It had previously identified prior-period errors in relation to inventory that had been restated as at 31 December 2015. In the course of carrying out the audit, the Respondents raised a number of concerns as to the accuracy of the inventory costing process.

The restatement in the FY2017 financial statements resulted in a total reduction in the inventory balance of £3.1 million (approximately 4.3 times audit materiality) and consisted of four components, three of which relate to the breaches of Relevant Requirements identified.

(i) Adjustment for intercompany sales cut-off difference: £1.3 million.

In addition to the impact on intercompany balances identified above, this issue also had an impact on the value of stock shown on the Group's balance sheet at the year end.

(ii) Adjustment to the uplift applied to the cost of inventory manufactured by the Group's manufacturing subsidiary in China: £1.2 million.

Application of local accounting principles in China resulted in a lower calculated cost than when applying the IFRS. Therefore, the cost of inventory held by Group companies and manufactured by the Chinese manufacturing entity required an uplift. Prior years' accounts had needed adjustments to ensure stock purchased from that entity was recorded at the correct cost.

Despite being aware of the prior year errors and the need to ensure that the correct methodology, developed in 2015, was followed in 2016, and treating the cost of inventory as an 'other area of audit focus' during the course of the audit, the Respondents did not carry out any tests to confirm whether the correct methodology had been used.

The audit documentation failed to explain that such work was not carried out and the reasons why.

(iii) Overhead allocation £0.4 million.

At the FY2016 year end, inventory held by the Group in the UK purchased from China included, but was not limited to, items manufactured by the Group's Chinese manufacturing entity. In 2017, the Group's management identified that the uplift referred to above had been incorrectly applied to all items purchased from China, not just those manufactured by that entity. This error was not identified during the course of the audit.[59]

59 The uplift was only applied to the stock held in the UK. It was not clear why the uplift was not applied to the same stock located in China (valued at £11.2 million).

A number of the issues identified in relation to intercompany transactions and the accuracy of the cost of inventory were due to the Respondents failing to apply sufficient professional scepticism during the course of their work. At no point did they stand back and critically assess the audit evidence obtained during the audit as to the accuracy of intercompany transactions and year-end intercompany balances.

Breaches of Relevant Requirements

There were breaches of the following standards:

- ISA (UK) 200 (Overall Objectives of the Independent Auditor and the Conduct of an Audit);
- ISA (UK) 230 (Audit Documentation);
- ISA (UK) 330 (Auditor's Responses to Assessed Risks); and
- ISA (UK) 500 (Audit Evidence).

The breaches were not intentional, dishonest, deliberate or reckless.

Outcome

The following sanctions were imposed on KPMG:

- A financial sanction of £1.25 million (adjusted for admissions and early disposal to £875,000).
- A published statement in the form of a Severe Reprimand.
- A declaration that the audit report signed on behalf of KPMG in respect of the FY2016 audit did not satisfy the Relevant Requirements, as set out in the FSDN.
- An order pursuant to Rule 136(c) of the AEP, requiring KPMG to take the following remedial action to prevent a recurrence of the breaches:
  - Provide the FRC's Executive Counsel and Executive Director for Supervision with a report that identifies why it considers that the breaches occurred, why the firm's processes and controls did not prevent the breaches, and whether the firm's current processes would lead to a different outcome, and any further remedial action proposed.
  - Implement remedial action proposed by Executive Counsel and the Executive Director for Supervision in light of the report, by a date to be agreed between KPMG and the FRC. If Executive Counsel or the Executive Director for Supervision consider that an additional report is required to address further issues, it should be provided within three months of the FRC's request.

The following sanctions were imposed on the Responsible Individual:

- A financial sanction of £50,000 (adjusted for admissions and early disposal to £35,000).
- A published statement in the form of a Severe Reprimand.
- A declaration that the audit report signed on behalf of KPMG in respect of the FY2016 audit did not satisfy the Relevant Requirements, as set out in the FSDN.

KPMG also paid Executive Counsel's costs of the investigation.

KPMG/TheWorks.co.uk plc/AEP[60]

In February 2023, a FSDN was issued following admissions of breaches of Relevant Requirements by KPMG and the Audit Engagement Partner (a former Partner of KPMG) in relation to the Statutory Audit of the FY2020 consolidated financial statements of TheWorks.co.uk plc (the Group) for the financial year ended 26 April 2020.

Points to note

- The breaches of Relevant Requirements related to the audit of inventory existence in one audit year and took place in the context of the challenges posed by COVID-19.
- The breaches concerned a number of basic and fundamental audit concepts, including the requirements to plan and perform an audit with professional scepticism, prepare sufficient audit documentation and design and perform audit procedures to obtain sufficient appropriate audit evidence.
- In particular, the Respondents repeatedly failed to respond appropriately to variances in stock counts identified during controls testing, including not investigating explanations for the variances and omitting the test results from the audit file. As a result, the audit file documentation provided a false degree of assurance. Also, substantive testing, undertaken after the controls testing had failed, was based on a population of the same stock count results from which the counts with variances had been removed.

Facts

The Group is a high street retailer of value gifts, arts, crafts, toys, books and stationery. As at the FY2020 year end, it had 534 stores across the UK and Ireland, employing nearly 4,000 people. Its shares are listed on the Main Market of the London Stock Exchange.

60 Press notice: Sanctions against KPMG and an Audit Engagement Partner

The Group's financial year end fell approximately six weeks after the first national lockdown that followed the onset of the COVID-19 pandemic. These circumstances, including the requirement for remote working, created additional, significant challenges for those involved in the FY2020 audit.

Issues

The Respondents initially tested management's controls of inventory held across the Group's stores with the intention of reverting to substantive testing in the event that testing of those controls failed. However, the audit team's approach was critically undermined by a succession of basic but serious failings, including:

- A sustained failure to respond appropriately to variances identified in the controls testing of management's stock counts, including not investigating management's explanations for those variances (no criticism is intended of management).
- The adoption of a substantive testing approach based on a subset of the full stock count population of 1,000 stock keeping units (SKUs) used in the controls testing, without further consideration or consultation, and despite variances having been identified in nearly one third of those counts.
- The removal of all counts with variances from the stock count population prior to the selection of the substantive testing sample as part of a selection process described on the audit file as 'random'.
- The omission from the audit file of the results of the controls testing, such that the audit file documentation provided a false degree of assurance.
- Not performing a roll-forward of all stock balances counted from the date of the store counts to the period end date.

The Respondents' testing of inventory existence at two warehouse locations, one of which was operated by a third party, was also seriously flawed. The audit team failed to undertake any roll-back procedure to reconcile the warehouse stock count despite planning to do so, and failed to prepare sufficient audit documentation in respect of discrepancies identified during the count. In addition, the audit team accepted third party confirmation of inventory via the Group's management, rather than directly from the third party itself.

The FY2020 audit therefore failed in its principal objective of providing reasonable assurance that the FY2020 financial statements were free from material misstatement.

These failures represent breaches of the following Relevant Requirements:

- ISA (UK) 200 (Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing);

- ISA (UK) 230 (Audit Documentation);
- ISA (UK) 501 (Audit Evidence – Specific Considerations for Selected Items);
- ISA (UK) 505 (External Confirmations); and
- ISA (UK) 530 (Audit Sampling).

Outcome

The following sanctions were imposed on KPMG:

- A financial sanction of £1.75 million, adjusted for mitigation, admissions and early disposal to £1,023,750.
- A published statement in the form of a Severe Reprimand.
- A declaration that the audit report signed on behalf of the firm did not satisfy the Relevant Requirements.
- An order requiring the firm to take action to mitigate the effect or prevent the recurrence of breaches of the Relevant Requirements, comprising , (i) additional supervision and monitoring of the future audit work of two members of the audit team for a period of one year, and (ii) a programme of work to review the effectiveness of its second line of defence function, including trialling changes intended to improve KPMG's ability to satisfactorily resolve issues identified during second line of defence reviews.

The following sanctions were imposed on the Audit Engagement Partner:

- A financial sanction of £75,000, adjusted for mitigation, admissions and early disposal to £43,875.
- A published statement in the form of a Severe Reprimand.
- A declaration that the audit report did not satisfy the Relevant Requirements.

KPMG/Eddie Stobart Logistics plc/AEP[61]

In March 2023, a FSDN was issued following admissions of breaches of Relevant Requirements by KPMG and the relevant Audit Engagement Partner in relation to the Statutory Audit of the financial statements of Eddie Stobart Logistics plc ('ESL') for FY2017.

Points to note

- The Audit Engagement Partner had been the subject of other adverse FRC Enforcement and Audit Quality Review decisions, had ceased performing Statutory Audits in 2020, and no longer held a practising certificate. They provided an

61 Press notice: Sanctions against KPMG and former audit partner

undertaking that they would not carry out Statutory Audits or sign Statutory Audit Reports in the future. In view of these points, Executive Counsel did not impose a prohibition on the Audit Engagement Partner from carrying out audit work for a specified period.

- One of the non-financial sanctions imposed was for KPMG to report on its policies and procedures and any enhancements required to those procedures to manage potential risks to audit quality as regards Responsible Individuals who have received adverse Audit Quality Review or Enforcement findings.
- A separate FSDN was issued in respect of the audit for ESL's subsequent financial year, which was carried out by PwC (see case summary at page 79).

Facts

ESL operated in the supply chain, transport and logistics business and was listed on the Alternative Investment Market. ESL had entered into certain property transactions, which had a significant effect on its financial performance. In July 2019, ESL announced that a review had been conducted into its prior year financial statements. Following this review, in FY2020, ESL disclosed significant prior year accounting adjustments to FY2017. KPMG and the Audit Engagement Partner breached Relevant Requirements in some of the areas which were subject to prior year adjustments.

The FSDN covers audit work carried out in respect of four areas:

- Property transactions entered into by ESL.
- The disclosure in the financial statements regarding those transactions.
- Dilapidations.
- Accounting for a subsidiary company.

Issues

The Respondents failed to obtain sufficient appropriate audit evidence of services provided by ESL in respect of property transactions in order for revenue to be ascribed to the provision of those services and recognised up front in the relevant financial year.

Without the profit from the property transactions, ESL would have made a loss before tax. The disclosures relating to the property transactions did not adequately explain the impact of the transactions on ESL's financial performance. There was a failure to properly evaluate whether the disclosures about the property transactions were adequate to enable users of the financial statements to understand the impact of the transactions on profit.

The Respondents failed to design and perform audit procedures that were appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence to support management's view that dilapidations provisions were not required across the property lease portfolio.

There were also failures in the audit work relating to an issue of whether a company in which ESL had a shareholding should be accounted for as a subsidiary (with its results consolidated within the accounts), or as an associate (with only ESL's share of profit or loss being recognised within the accounts).

The standards found to have been breached were:

- ISA (UK) 200 (Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing).
- ISA (UK) 500 (Audit Evidence).
- ISA (UK) 700 (Forming an Opinion and Reporting on Financial Statements).

Outcome

The following sanctions were imposed on KPMG:

- A financial sanction of £1.35 million, adjusted for admissions and early disposal to £877,500. KPMG's poor disciplinary record was noted as an aggravating factor.
- Non-financial sanctions, comprising:
  - Provide the FRC's Executive Counsel and Executive Director for Supervision with a report that identifies why it considers that the breaches occurred, a Severe Reprimand.
  - Provide the FRC's Executive Counsel and Executive Director for Supervision with a report that identifies why it considers that the breaches occurred, a declaration that the FY2017 Audit Report did not satisfy the Relevant Requirements.
  - Provide the FRC's Executive Counsel and Executive Director for Supervision with a report that identifies why it considers that the breaches occurred, an order requiring KPMG to take specified actions to prevent the occurrence of the contravention, by (i) reporting to its FRC supervisor as to whether advice provided in accounting and disclosure technical consultations carried out by audit teams has been implemented properly and effectively; and (ii) reporting to and consulting with its FRC supervisor on its policies and procedures and any enhancements required to those procedures to manage potential risks to audit quality as regards (a) audit responsibilities for partners practising audit who have firm managerial and non-client responsibilities within KPMG; and (b) Responsible Individuals who have received adverse Audit Quality Review or Enforcement findings.

The following sanctions were imposed on the Audit Engagement Partner:

- A financial sanction of £70,000 adjusted for admissions and early disposal to £45,500. Notable aggravating factors were the Audit Engagement Partner's seniority at the point of signing the audit report and past disciplinary record.
- Non-financial sanctions, comprising:
  - Provide the FRC's Executive Counsel and Executive Director for Supervision with a report that identifies why it considers that the breaches occurred, a Severe Reprimand.
  - Provide the FRC's Executive Counsel and Executive Director for Supervision with a report that identifies why it considers that the breaches occurred, a declaration that the FY2017 Audit Report did not satisfy the Relevant Requirements.

PwC/Eddie Stobart Logistics plc/AEP[62]

In March 2023, a FSDN was issued following admissions of breaches of Relevant Requirements by PwC and the relevant Audit Engagement Partner in relation to the Statutory Audit of the financial statements of Eddie Stobart Logistics plc ('ESL') for FY2018.

Points to note

- A separate FSDN was issued in respect of the audit of ESL's FY2017 financial statements, carried out by KPMG (please see summary of that case at page 76).
- The Respondents demonstrated an exceptional level of cooperation during the investigation, including by providing full admissions of breaches of Relevant Requirements at a relatively early stage (including admissions relating to matters which were not in the communicated scope of the investigation).

Facts

ESL operated in the supply chain, transport and logistics business and was listed on the Alternative Investment Market. ESL had entered into certain property transactions, which had a significant effect on its financial performance. KPMG performed the audit of the FY2017 financial statements. KPMG resigned as auditor to ESL thereafter, explaining in a letter of resignation that there had been a breakdown in their relationship with management following difficulties in obtaining sufficient appropriate audit evidence during the audit. PwC were subsequently appointed as auditor to ESL and carried out the FY2018 audit. In July 2019, ESL announced that a review had been conducted into its prior year financial statements. Following this review, in FY2020, ESL disclosed significant prior year accounting adjustments to FY2018.

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PwC and the Audit Engagement Partner breached Relevant Requirements in some of the areas which were subject to prior year adjustments.

The FSDN covers failings in audit work carried out in respect of six areas of the audit:

- First year audit procedures.
- Property transactions entered into by ESL.
- The disclosure in the financial statements regarding those transactions.
- Property lease accruals.
- Dilapidations.
- Accounting for a subsidiary company.

Issues

As the FY2018 audit was an initial audit engagement, PwC were required to consider how to address the reasons given by their predecessor, KPMG, for their resignation, given that they gave rise to potentially difficult or contentious matters. This should have resulted in a formal consultation. However, the Audit Engagement Partner failed to initiate any such formal consultation.

In relation to the audit work on the property transactions, there were serious professional scepticism, professional judgment and audit evidence failings. The Respondents failed to (among other things) obtain sufficient understanding of the transactions and to challenge management's policy to recognise the revenue from the transactions up front in the financial year relevant to the audit.

Without the profit from the property transactions, ESL would have been in a loss-making position. The disclosures relating to the property transactions did not adequately explain the impact of those transactions on ESL's financial performance. There was a failure to properly evaluate whether the disclosures about the property transactions were adequate to enable users of the financial statements to understand the impact of the transactions on profit.

The Respondents did not design or perform any audit procedures to test the completeness of the property lease accrual. Further, the Respondents failed to design and perform audit procedures that were appropriate for the purpose of obtaining sufficient appropriate audit evidence to support management's view that dilapidations provisions were not required across the property lease portfolio.

There were also failures in the audit work relating to an issue of whether a company in which ESL had a shareholding should be accounted for as a subsidiary (with its results consolidated within the accounts), or as an associate (with only ESL's share of profit or loss being recognised within the accounts).

The standards found to have been breached across the audit year covered by the FSDN were:

- ISA (UK) 200 (Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing).
- ISA (UK) 220 (Quality Control for an Audit of Financial Statements.
- ISA (UK) 260 (Communication with those Charged with Governance).
- ISA (UK) 300 (Planning an Audit of Financial Statements).
- ISA (UK) 315 (Identifying and Assessing the Risks of Material Misstatement through Understanding of the Entity and its Environment.
- ISA (UK) 330 (The Auditor's Responses to Assessed Risks).
- ISA (UK) 500 (Audit Evidence).
- ISA (UK) 700 (Forming an Opinion and Reporting on Financial Statements).
- ISA (UK) 701 (Communicating Key Audit Matters in the Independent Auditor's Report).

Outcome

The following sanctions were imposed on PwC:

- A financial sanction of £3.5 million adjusted for exceptional cooperation, admissions and early disposal to £1,990,625.
- Non-financial sanctions, comprising:
  - A Severe Reprimand.
  - A declaration that the FY2018 Audit Report did not satisfy the Relevant Requirements.
  - An order requiring PwC to take specified actions to prevent the occurrence of the contravention: to report to its supervisor at the FRC on its (i) monitoring of its audit teams' compliance with its policies regarding consultations; and (ii) training in this area of new audit partners.

The following sanctions were imposed on the Audit Engagement Partner:

- A financial sanction of £90,000 adjusted for exceptional cooperation, admissions and early disposal to £51,187.50.
- Non-financial sanctions, comprising:
  - A Severe Reprimand.
  - A declaration that the FY2018 Audit Report did not satisfy the Relevant Requirements.

The Respondents paid Executive Counsel's costs of the investigation.

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