Edited for publication

IN THE MATTER OF:

THE EXECUTIVE COUNSEL TO THE FINANCIAL REPORTING COUNCIL

- and -

(1) PRICEWATERHOUSECOOPERS LLP

(2) NICHOLAS CAMPBELL LAMBERT

(3) HEATHER ANCIENT

FINAL SETTLEMENT DECISION NOTICE

Pursuant to Rule 108 of the Audit Enforcement Procedure

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

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1. INTRODUCTION

1.1. The Financial Reporting Council (the '**FRC**') is the competent authority for *Statutory Audit* in the UK and operates the Audit Enforcement Procedure (the '**AEP**'), effective 5 January 2022. The AEP sets out the rules and procedures for the investigation, prosecution and sanctioning of breaches of *Relevant Requirements*.

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

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

1.3.1. '**Audits**' means, collectively, the FY2017 Group Audit, the FY2018 Group Audit and the FY2018 DRDL Audit;

1.3.2. '**Babcock**' or '**Group**' means Babcock International Group plc;

1.3.3. '**DRDL**' means Devonport Royal Dockyard Limited;

1.3.4. '**DRDL Respondents**' means:

1.3.4.1. PricewaterhouseCoopers LLP ('**PwC**'), the *Statutory Audit Firm* for the

Audits; and

1.3.4.2. Heather Ancient, a former Partner of PwC. She was *Statutory Auditor* of DRDL for the FY2018 DRDL Audit and signed off the FY2018 DRDL audit report on behalf of PwC ('**DRDL Partner**').

1.3.5. '**EGA**' means Evidence Gathering Activity, the term used by PwC for a workpaper evidencing audit work;

1.3.6. '**FY2017**' means the financial year ended 31 March 2017 and that same formulation is applied *mutatis mutandis* for other financial years ending on 31 March;

1.3.7. '**FY2017 Group Audit**' means the *Statutory Audit* of the FY2017 Group financial statements;

1.3.8. '**FY2017 Group financial statements**' means the consolidated financial statements of the Group for that period;

1.3.9. '**FY2018 DRDL Audit**' means the *Statutory Audit* of the FY2018 DRDL financial statements;

1.3.10. '**FY2018 DRDL financial statements**' means the financial statements for DRDL for that period;

1.3.11. '**FY2018 Group Audit**' means the *Statutory Audit* of the FY2018 Group financial statements;

1.3.12. '**FY2018 Group financial statements**' means the consolidated financial statements for the Group for that period; and

1.3.13. '**Group Respondents**' means:

1.3.13.1. PricewaterhouseCoopers LLP ('**PwC**'), the *Statutory Audit Firm* for the Audits; and

1.3.13.2. Nicholas Campbell Lambert, former Partner of PwC. He was *Statutory Auditor* of the Group for the FY2017 Group Audit and the FY2018 Group Audit and signed off the FY2017 and FY2018 Group audit reports on behalf of PwC ('**Group Partner**').

1.3.14. '**Respondents**' means the DRDL Respondents and the Group Respondents collectively.

1.4. In accordance with Rule 102 of the AEP, *Executive Counsel* entered into settlement discussions with the Respondents. A *Proposed Settlement Decision Notice* was issued

by *Executive Counsel* on 14 December 2022 pursuant to Rule 103 of the AEP, in relation to the conduct of the Respondents in respect of the Audits.

1.5. On 15 December 2022, the Respondents provided their written agreement to the *Proposed Settlement Decision Notice* pursuant to Rule 105 of the AEP. The *Convener* subsequently appointed an *Independent Reviewer,* pursuant to Rule 106 of the AEP, to consider the *Proposed Settlement Decision Notice*. On 23 December 2022, the *Independent Reviewer* approved the issuance of a *Final Settlement Decision Notice* pursuant to Rule 107(a) of the AEP.

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

1.6.1. the breaches of *Relevant Requirements*, with reasons;

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

1.6.3. the amount payable by the Respondents in respect of *Executive Counsel*'s Costs.

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

1.7.1. Section 2: Executive Summary of the breaches of *Relevant Requirements* and *Sanctions*;

1.7.2. Section 3: General background;

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

1.7.4. Section 5: Background to, and detail of, the breaches of *Relevant Requirements* in respect of the FY2017 Group Audit (PwC and Mr Campbell Lambert);

1.7.5. Section 6: Background to, and detail of, the breaches of *Relevant Requirements* in respect of the FY2018 Group Audit (PwC and Mr Campbell Lambert);

1.7.6. Section 7: Background to, and detail of, the breaches of *Relevant Requirements* in respect of the FY2018 DRDL Audit (PwC and Ms Ancient);

1.7.7. Sections 8, 9 and 10: *Sanctions*;

1.7.8. Section 11: Costs.

2. EXECUTIVE SUMMARY

The audited entity

2.1. 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**'). A number of its contracts are highly sensitive UK government contracts and its work therefore attracts significant public interest in the UK.

2.2. 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 the *Statutory Audit* thereof.

2.3. DRDL is, and was at all material times, a subsidiary of Babcock. It was a significant company in its own right, with revenue of over £700m and c.5,550 employees as at 31 March 2018.

The Respondents' roles

2.4. The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the *Statutory Auditor* on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

2.5. Accordingly, the Group Respondents'[1] and DRDL Respondents'[2] responsibilities were to form an opinion as to whether the financial statements to which the Audits relate showed a true and fair view and had been properly prepared in accordance with the Companies Act 2006 and International Financial Reporting Standards as adopted by the EU ('**IFRS**'). The *Relevant Requirements* applicable to *Statutory Audits* include (among other things) the International Standards on Auditing ('**ISAs**'), the ACCA Rulebook (2018) (in respect of the DRDL Partner) and, the FRC Ethical Standard (2016) (in respect of PwC and Group Partner).

2.6. It is of particular importance that a *Statutory Auditor* obtains audit evidence and critically assesses that evidence with a sceptical mind:

2.6.1. **ISA 500.** An audit requires the auditor to obtain sufficient appropriate audit evidence about the amounts and disclosures in the financial statements in order to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. Audit evidence is defined in ISA 500 as "*information used by the auditor in arriving at the*

[1] In respect of the FY2017 Group Audit and FY2018 Group Audit.

[2] In respect of the FY2018 DRDL Audit.

conclusions on which the auditor's opinion is based". Audit evidence is primarily obtained from audit procedures performed by the auditor during the course of the audit.

2.6.2. **ISA 200.** The auditor is also required by ISA 200.15 to "*plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated…the auditor shall maintain professional skepticism throughout the audit, recognising the possibility of a material misstatement due to facts or behaviour indicating irregularities, including fraud, or error, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and of those charged with governance.*" Furthermore, ISA 200.A22 explains that, "*[p]rofessional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance.*"

2.7. As the *Statutory Auditor* responsible for the FY2017 and FY2018 Group Audits, the Group Partner was responsible for the overall quality of the audits (ISA 220.8) and for the direction, supervision and performance of the audits in compliance with professional standards and applicable legal and regulatory requirements (ISA 220.15(a)).

2.8. The Group Partner was also required to comply with any *Relevant Requirements* that were applicable to any work for which he was or ought to have been personally responsible.

2.9. As the *Statutory Auditor* responsible for the FY2018 DRDL Audit, the DRDL Partner was responsible for the overall quality of the audit (ISA 220.8) and for the direction, supervision and performance of the audits in compliance with professional standards and applicable legal and regulatory requirements (ISA 220.15(a)).

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

<u>The breaches</u>

2.11. Sections 5 to 7 (inclusive) set out details of breaches of *Relevant Requirements* in respect of the Audits. These relate predominantly to the FY2018 Group Audit, for which the Group Partner was the *Statutory Auditor.*

2.12. *Executive Counsel* investigated the audit of a wide range of matters, including seven

long-term contracts accounting for approximately 25% of the FY2018 Group revenue[3]. Breaches have been identified in respect of every area of audit which has been investigated by *Executive Counsel*, including areas which were or should have been identified as significant risk areas.

2.13. The breaches were not isolated incidents nor the result of one-off oversights, but relate to significant matters in respect of the areas identified in this *Final Settlement Decision Notice*.

2.14. There are a number of examples where basic audit requirements were not followed, evidencing a lack of care or diligence and / or lack of challenge in conducting the audit work. For example, there is no evidence that the audit team had, whether in FY2018 or before, obtained and read the Holdfast Contract[4] (a 30 year Public Private Partnership ("**PPP**") contract with FY2018 revenue of c.£77m and lifetime revenue of £3bn). Further, although Contract A[5] (a contract with a value of c.€640m) was written in French, the audit team neither possessed French language skills nor obtained a translation of the contract.

2.15. The failings relate to the work of both the Group audit team and separate component teams, working across different PwC offices. The 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 across these parts of the Audits.

2.16. In particular, the breaches include the following:

2.16.1. 12 breaches of ISA 200.15 – the requirement for the *Statutory Auditor* to exercise professional scepticism;

2.16.2. a breach of the Overarching Principle of Independence[6] in respect of the inappropriate provision of accounting advice to the audit client on one issue;

2.16.3. in respect of the FY2018 DRDL Audit, the 'pre-population[7]' of an audit workpaper, where the resulting inaccuracy was not identified when reviewed.

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[3] c.£1.1 billion out of c.£4.6 billion.

[4] As addressed in paragraphs 6.32 to 6.39 below.

[5] Where the FRC considers appropriate, the names and counterparties to contracts have been anonymised. This contract is addressed further in paragraphs 6.20 to 6.22 below.

[6] FRC Ethical Standard (2016).

[7] A term used by *Executive Counsel*, to describe the documenting of audit evidence prior to receipt of such evidence. See paragraphs 7.1 – 7.5 below.

The review was therefore not performed with appropriate due care. As a result that audit workpaper is a false record of the evidence obtained and the audit work undertaken;

2.16.4. 8 breaches of ISA 700 – the requirement to evaluate whether the financial statements were prepared in accordance with the financial reporting framework;

2.16.5. 11 breaches of ISA 500 – the requirement to obtain sufficient appropriate audit evidence; and

2.16.6. 6 breaches of ISA 540 relating to the auditing of accounting estimates and related disclosures.

2.17. The FY2017 and FY2018 Group financial statements have not been restated. However, the audit teams' repeated lack of challenge and failures to obtain audit evidence in respect of the areas where breaches have been identified may have created a risk that a material misstatement went undetected, and accordingly may have influenced the economic decisions of users of the financial statements.

2.18. During this investigation PwC conducted effective self-reviews into four of the areas giving rise to breaches, and in this respect PwC exhibited exceptional cooperation. However, this was countered by some important examples of errors, omissions and delays in providing material subject to our investigation notices and the provision of unclear, or inaccurate responses (although it is not alleged that such instances were intentional). These matters are dealt with in more detail at paragraphs 8.20 – 8.23 below.

Sanctions against PwC in respect of the Audits

2.19. A **financial sanction of £7,500,000** discounted by 25% for admissions and early disposal, resulting in a financial sanction to be paid of **£5,625,000**;

2.20. a **declaration** that the audit reports, in respect of each of the Audits, did not satisfy the *Audit Reporting Requirements*;

2.21. a published statement, in the form of a **severe reprimand**;

2.22. **An Order that PwC shall** undertake the reviews and training programmes set out at paragraph 8.18.4 below.

Sanctions against Nicholas Campbell Lambert

2.23. **a financial sanction of £200,000**, discounted by 25% for admissions and early disposal so that a financial *sanction* of **£150,000** is payable.

2.24. a published statement, in the form of a **severe reprimand**.

2.25. **a declaration** that the FY2017 Group Audit and FY2018 Group Audit reports did not satisfy the *Audit Reporting Requirements*.

Sanctions against Heather Ancient

2.26. **a financial sanction of £65,000**, discounted by 25% for admissions and early disposal so that a financial *sanction* of **£48,750** is payable.

2.27. a published statement, in the form of a **severe reprimand**.

2.28. **a declaration** that the FY2018 DRDL Audit report did not satisfy the *Audit Reporting Requirements*.

3. BACKGROUND

The Respondents

3.1. PwC is one of the largest accounting and audit firms in the UK. It is a member firm of the Institute of Chartered Accountants in England and Wales. PwC was appointed as the *Statutory Audit Firm* for Babcock for FY2003, and has remained as the *Statutory Audit Firm* up to (and including) FY2021 (having been reappointed on 25 May 2016). A different *Statutory Audit Firm* has been appointed for the FY2022 audit.

3.2. The Group Partner was admitted as a member of the Institute of Chartered Accountants in England and Wales in 1998. By FY2018, he was a partner of PwC with over 20 years' auditing experience. He signed the FY2017 and FY2018 Group Audit reports, on behalf of PwC, in respect of the FY2017 and FY2018 Group financial statements.

3.3. The DRDL Partner was admitted as a member of the Association of Chartered Certified Accountants ('**ACCA**') in 1998. By FY2018, she was a partner of PwC with over 20 years' auditing experience. She was Senior Partner for the PwC Plymouth office between 2016 and March 2018. She signed the FY2018 DRDL Audit report, on behalf of PwC, in respect of the FY2018 DRDL financial statements.

Babcock

3.4. Babcock is (and was at the time of the Audits) a major multinational corporation based in the UK providing engineering services (in the UK and internationally) in relation to maintaining, upgrading, operating and managing significant infrastructure and essential equipment. A number of its contracts are highly sensitive UK government contracts, such as the re-fueling and refit of the UK nuclear submarine HMS Vanguard, and its work therefore attracts significant public interest in the UK.

3.5. Babcock's shares are listed on the Main Market of the London Stock Exchange, and

during FY2017 and FY2018, it was a constituent of the FTSE 100 Index. There was and is an evident public and market interest in the truth and fairness of the Group's financial statements and the *Statutory Audit* thereof.

3.6. For FY2017, Babcock's revenue was £4,547m and its operating profit was c.£360m. On 31 March 2017, the Babcock share price was 882p, reflecting a market capitalisation of c.£4.459 billion.

3.7. For FY2018, Babcock's revenue was £4,659m and operating profit was c.£371m. The share price was 668.8p on 29 March 2018 (the last trading day before Babcock's financial year-end), reflecting a market capitalisation of c.£3.3 billion.

3.8. The subsequent half year results, announced on 21 November 2018, reported that the Group recorded an exceptional charge of £120 million, which included £80 million related to the Oil and Gas Business (part of the Aviation division). £37m of this charge was in respect of EC225 helicopters (to which the breaches at paragraphs A[8] and C[9] of Section 5 and Paragraph E[10] of Section 6 relate).

3.9. The narrative surrounding the reporting of the Group's financial results in FY2017 and FY2018 is important to the failings identified in this *Final Settlement Decision Notice*. ISA 320.2 provides (and IAS 1 is to a similar effect):

> "*Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements*".

3.10. Accordingly, the reporting of line items in the accounts which are valued lower than the level of audit materiality can be material in a qualitative sense, if they could reasonably be expected to influence the economic decisions of users.

3.11. The first substantive page of the Babcock FY2017 Annual Report was titled "*a year of progress*" and contained a snapshot of financial performance measures for the year. It contained a variety of graphs presenting increases in revenue and profit since 2013.

3.12. The Group's press announcement on 24 May 2017 accompanying the FY2017 results stated, "*Babcock continued to deliver in 2016/17, with sustained growth of 6.5% in underlying operating profit...*"[11].

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[8] Paragraph 5.1 below.
[9] Paragraph 5.12 below.
[10] Paragraph 6.24 below.
[11] https://www.babcockinternational.com/wp-content/uploads/pdf/Babcock%20Preliminary%20Results%20Statement%20240517.pdf, page 3

3.13. The increase in operating profit between FY2016 and FY2017 was £7.1m. As described in Section 5 below, this is relevant to the recognition, in FY2017, of a receivable worth £22m from a supplier (‘**Supplier X**’), contrary to IAS 37.

3.14. Similarly, the first substantive page of the Babcock FY2018 Annual Report was titled "*A year of progress*" and contained a snapshot of financial performance measures for the year, in comparison with prior financial years.

3.15. The Group’s press announcement on 23 May 2018 accompanying the FY2018 results stated, “*Babcock enjoyed another successful year in 2017/18, with underlying revenue, operating profit and profit before tax at record levels.”*

3.16. The increase in operating profit between FY2017 and FY2018 was £11m. As explained in paragraph J of Section 6 below, this is relevant to the disclosures which were omitted from the FY2018 Group Financial Statements.

DRDL

3.17. DRDL is a subsidiary of Babcock and a substantial undertaking in its own right. Its principal activity is the maintenance and refit of Royal Navy warships and submarines and the provision of support services to the MoD in relation to the operation of the Devonport Naval base.

3.18. In FY2018, DRDL had a revenue of £734m and c.5,550 employees. DRDL was identified by PwC as a significant component of Babcock and the financial results of DRDL were consolidated into the FY2018 Group financial statements. The DRDL component included the financial results of two significant long-term contracts: (i) the BM Maritime Support Delivery Framework Agreement (the ‘**MSDF Contract**’) and (ii) the HMS Vanguard contract (the ‘**Vanguard Contract’**).

3.19. The following paragraphs describe the background to the audit matters where breaches of *Relevant Requirements* have been identified.

The Audits

3.20. For the FY2017 Group Audit, audit materiality was £24m, performance materiality was £18m and the *de minimis* threshold was £1.2m. For the FY2018 Group Audit, audit materiality was £26m, performance materiality was £19.5m and the *de minimis* threshold was £1m. In each audit year, the Babcock Audit Committee required PwC to identify on a Summary of Unadjusted Misstatements (‘**SUM**’) all identified misstatements above the *de minimis* level.

3.21. For the FY2017 and FY2018 Group Audits, PwC’s audit team identified the following

matters as significant risks: (i) contract accounting and revenue / profit recognition (including the risk of fraud in revenue recognition); (ii) valuation of defined pension liabilities; (iii) fraud and management override of controls. Impairment of Goodwill was identified as an elevated audit risk.

3.22. For the FY2017 Group Audit, the audit team conducted a fraud risk assessment and identified fraud risk areas including: (i) deliberate manipulation of results; and (ii) improper revenue recognition as fraud risk areas. For the FY2018 Group Audit, the audit team's assessment identified fraud risk areas including: (i) deliberate manipulation of results; (ii) improper revenue recognition; (iii) misappropriation of assets; (iv) payroll and expenses manipulation; and (v) management override of controls.

3.23. On 7 May 2019, the FRC's Audit Quality Review team ("**AQR**") issued their 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.*"

Audit of contract accounting

3.24. A significant part of Babcock's business involved it entering into long-term contracts with its customers. Accounting for long-term contracts can be complex because they usually span several accounting periods, involve a significant degree of estimation and judgement as to the revenue and costs arising over the course of the contract and because multiple variations, claims or incentive payments can arise. Furthermore, Babcock recognised revenue from its long-term contracts by reference to the stage of completion of the contract. The stage of completion can be calculated in a variety of ways, including by calculating what percentage of estimated total costs to complete the contract had been incurred.

3.25. The FY2018 Group Audit plan listed "*Contract accounting and revenue / profit recognition*" as a significant risk. The FY18 auditors' report in the FY18 Group financial statements states that "*the Group's business involves entering into contractual relationships with customers to provide a range of services with a significant proportion of the Group's revenues and profits derived from long term contracts.*" The auditors should have therefore conducted their audit work in these areas with particular care.

3.26. The contracts audited by the Group Respondents or DRDL Respondents, and which are relevant to the breaches of *Relevant Requirements* in this *Final Settlement Decision Notice,* set out immediately below. It is identified in brackets below to which statutory audit the breaches relate:

3.26.1. the **Vanguard Contract** (FY2018 Group Audit and FY2018 DRDL Audit).

3.26.2. ‘**Contract A**’[12] (FY2018 Group Audit).

3.26.3. a contract entered into by a Babcock joint venture (the ‘**Holdfast Contract’**) (FY2018 Group Audit).

3.26.4. the **MSDF** Contract (the Audits).

3.26.5. a contract entered into between Babcock and a branch of the MoD (the ‘**Phoenix II Contract**’) (FY2018 Group Audit).

3.26.6. a contract entered into between Babcock’s Defence Support Group (‘**DSG**’) division and the MoD (the ‘**DSG Contract’**) (FY2018 Group Audit).

3.26.7. a settlement agreement entered into between Babcock and the MoD (the ‘**RD57 Settlement Agreement**’) (FY2018 Group Audit).

<u>Other areas of investigation</u>

3.27. Section 5 also details breaches in respect of the following important audit matters:

3.27.1. aviation assets:

3.27.1.1. impairment (FY2017 and FY2018 Group Audits);

3.27.1.2. accounting for the Supplier X Receivable (FY2017 Group Audit only); and

3.27.1.3. onerous lease assessment (FY2017 and FY2018 Group Audits).

3.27.2. audit of the assessment of Goodwill impairment and related disclosures (FY2018 Group Audit).

4. RELEVANT REQUIREMENTS

4.1. Rule 1 of the AEP states that *Relevant Requirements* has the meaning set out in regulation 5(11) of the Statutory Auditors and Third Country Auditors Regulations 2016 (‘**SATCAR**’). The *Relevant Requirements* include, but are not limited to, the ISAs, issued by the International Auditing and Assurance Standards Board.

4.2. The ISAs relevant to this *Final Settlement Decision Notice* are those effective for audits of financial statements for periods ending on or after 17 June 2016.

4.3. The *Relevant Requirements* referred to in this *Final Settlement Decision Notice* are the following:

[12] Where the FRC considers it appropriate, the names of contracts or counterparties have been anonymised.

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

4.3.2. ISA 230 (Audit documentation);

4.3.3. ISA 220 (Quality Control for an Audit of Financial Statements);

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

4.3.5. ISA 315 (Identifying and Assessing the Risks of Material Misstatement);

4.3.6. ISA 330 (the Auditor's Responses to Assessed Risks);

4.3.7. ISA 500 (Audit evidence);

4.3.8. ISA 540 (Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures);

4.3.9. ISA 600 (Special considerations – audits of group financial statements (including the work of component auditors));

4.3.10. ISA 700 (Forming an Opinion and Reporting on Financial Statements);

4.3.11. Principle 2.1D of the FRC Revised Ethical Standard 2016; and

4.3.12. Section 130 of the ACCA Rulebook (the '**ACCA Code**') (Professional Competence and Due Care).

4.4. Extracts from the ISAs, and ACCA Code setting out those parts which are of particular relevance to the breaches of the *Relevant Requirements* addressed in this *Final Settlement Decision Notice* are set out in the Appendix 1 hereto.

5. BREACHES OF RELEVANT REQUIREMENTS – FY2017 GROUP AUDIT (PwC and Mr Campbell Lambert)

A. Audit risk assessment in relation to the EC225 helicopters ('EC225s')

Background

5.1. Within its Aviation segment, Babcock owned 8 EC225s and held operating leases for a further 5 EC225s. The EC225s were mainly used for transportation in the Oil and Gas sector.

5.2. In April 2016, an EC225 helicopter (not operated by Babcock) crashed in Norway. Following this, the UK Civil Aviation Authority ('**CAA**') issued a flight ban on EC225s. A similar ban was issued in Europe. Accordingly, Babcock's fleet of EC225s was grounded

and unable to fly.

5.3. In October 2016, the European flight ban was lifted and in July 2017 the CAA also lifted its flight ban, but in both cases the lifting of the ban was subject to certain conditions being met. One of Babcock's competitors did not write down the value of similar aircraft, whereas another recognised a substantial impairment charge against their fleet of EC225s, valuing each EC225 at a lower value than Babcock.

5.4. None of Babcock's EC225s were in operation at the date of the FY2017 auditor's report and only one was operational at the date of the FY2018 auditor's report.

5.5. In both FY2017 and FY2018, the audit risk in relation to the EC225s was classified as 'normal'.

Breaches

5.6. The audit planning and risk assessment in relation to the EC225 Matter in FY2017 breached paragraphs 27 and 28 of ISA 315 and paragraphs 10 and 11 of ISA 540 in the following ways:

5.6.1. the risk was classified as 'normal' despite having characteristics of a 'significant' risk[13]: the grounding of the EC225s was outside the normal course of business; none of Babcock's EC225s were in operation at the date of the FY2017 auditor's report; and accounting estimates were required which involved both subjective and complex judgements as well as assumptions about the effects of future events which were subject to a high degree of estimation uncertainty, which were all matters of which the Group Respondents were, or should have been, aware.

5.6.2. notwithstanding the foregoing, the Group Respondents did not adequately consider whether the risk of material misstatement arising from the grounding of the EC225s should have been classified as a significant risk.

5.6.3. there is no evidence that the Group Respondents considered the degree of estimation uncertainty in management's calculations in their risk assessment, either at the planning stage or during the audit.

B. Accounting for the Supplier X Receivable

Background

5.7. In FY2017, Babcock considered it had a claim against Supplier X in relation to the

[13] As defined in paragraph 4(e) of ISA 315.

grounding of the EC225s, albeit was not clear that the supplier would accept liability. Babcock entered into negotiations with Supplier X regarding Babcock's claim for compensation.

5.8. On 30 March 2017 (i.e. one day before the FY2017 year-end), negotiations with Supplier X had reached the stage of Supplier X proposing (in an email to Babcock stated to be "*subject to a settlement agreement*" and said to offer compensation "*essentially based on costs claimed for FY17 and H225 lease costs for FY18*") the following:

5.8.1. Supplier X would pay €8m in cash, with €6m to be paid within 30 days of signing the settlement agreement and €2m to be paid on receipt of supporting evidence of costs incurred by Babcock;

5.8.2. Supplier X would issue €12m in credit notes to be used by 31 March 2018;

5.8.3. Supplier X would issue €3m in credit notes per quarter in FY2018 on receipt of evidence of payment of lease invoices for the five EC225s, to be used by 31 March 2018.

5.9. The recognition of the Supplier X Receivable as an asset was only permissible if, pursuant to IAS 37[14], its realisation was "*virtually certain*". In fact: (i) recognition of the receivable was based on an "*in principle*" proposal from Supplier X which had a number of conditions, including the conclusion of a settlement agreement; (ii) the settlement agreement was not signed until 2 June 2017 (i.e. after the approval of the FY2017 Group financial statements) and a copy was not received by the audit team until 2 July 2017; (iii) a comparison of differences between the text of the "*in principle*" proposal and the final settlement agreement indicated that negotiations around the proposal continued after the financial year end; and (iv) given (i), (ii) and (iii) above, Babcock did not have an enforceable right to receive economic benefits from Supplier X at 31 March 2017. Realisation of the receivable was therefore not "*virtually certain*" at 31 March 2017.

5.10. In the FY2017 Group financial statements, Babcock recognised in its income statement the Supplier X Receivable as a reimbursement of costs incurred. The effect on the income statement was to increase operating profit by c.£22m[15].

Breaches

5.11. The audit work in relation to the Supplier X Receivable for FY2017 breached paragraphs 8, 9 and 11 of ISA 700, paragraphs 32(b) and (c) of ISA 240, paragraphs 6, 7, 9 and 11

[14] The accounting standard relating to: Provisions, Contingent Liabilities and Contingent Assets.

[15] An approximate figure based on a conversion from Euros at the relevant date.

of ISA 500 and paragraph 15 of ISA 200 in the following ways:

5.11.1. the Group Respondents failed to challenge sufficiently or exercise sufficient professional scepticism in relation to management's recognition of the Supplier X Receivable in circumstances in which Babcock did not have an enforceable right to receive economic benefits from Supplier X at 31 March 2017, the realisation of compensation income from Supplier X was not virtually certain and, accordingly, it should not have been recognised as an asset[16].

5.11.2. despite the wording of Supplier X's proposal expressly stating, and management confirming, that the proposal included compensation for future costs, the transaction was recorded as a reimbursement of costs already incurred. Although the audit working papers confirmed that the audit team was aware of the inconsistency between the proposal and the accounting treatment, the audit team did not challenge the treatment as a reimbursement of costs in FY2017.

5.11.3. given the express reference in the Supplier X proposal to the compensation including '*H225 lease costs for FY18*', the Group Respondents should have considered whether it was appropriate to record an onerous lease provision in respect of the leased helicopters (as addressed in paragraph 5.12 below) which effectively provided for the FY2018 lease costs. There is no evidence on the audit file that the Group Respondents considered this issue.

5.11.4. in PwC's fraud risk assessment, '[*d]eliberate manipulation of results*' was identified as a fraud risk, and the audit response was stated to be '[*r]eview areas of significant management judgement and unusual transactions'*. Management's decision to recognise the Supplier X Receivable in FY2017 despite the indicators that this was not appropriate, and in circumstances where it was outside the normal course of business, should have led to the Group Respondents exercising professional scepticism and, in accordance with ISA 240, to consider whether management was seeking to manage earnings that could lead to fraudulent financial reporting. However, there is no evidence that the Group Respondents considered the possibility of earnings management in relation to this transaction.

5.11.5. in light of the foregoing, the Group Respondents did not obtain sufficient appropriate evidence to support the conclusion that it was appropriate for

[16] As defined in the Conceptual Framework for Financial Reporting (2010) at paragraph 4.4 *et seq*.

management to recognise the Supplier X Receivable in FY2017.

C. **Onerous lease assessment in relation to the EC225 Matter**

Background

5.12. In the FY2017 Group financial statements, an onerous lease provision of £10m was included in respect of the EC225s, notwithstanding that Supplier X's proposal referred to "*compensation*" for "*lease costs for FY2018*".

Breaches

5.13. The audit work in relation to the onerous lease assessment for FY2017 breached paragraphs 12, 13(b), 15 to 21, and 23 of ISA 540, paragraphs 8, 9 and 11 of ISA 700, paragraph 15 of ISA 200, paragraph 26 of ISA 330 and paragraphs 6, 7, 9 and 11 of ISA 500 and paragraphs 8 to 11 of ISA 230 in the following ways:

5.13.1. the Group Respondents failed to challenge, or exercise professional scepticism in relation to, whether management's conclusion that an onerous lease provision was required complied with IAS 37:

5.13.1.1. IAS 37 required an assessment to be made at the individual contract level and over the whole term of the individual contract. Therefore, a separate assessment should have been made for each helicopter because each helicopter was subject to a separate contract. Instead, management's calculation incorrectly aggregated all leased helicopters;

5.13.1.2. the audit team recorded on the audit file that, '[a]*s the period from FY19 onwards is not relevant to the calculation (as the aircraft are assumed to be operational again), we have not considered the discount rate used, or the length of the contracts (as each lasts beyond FY19)*'. Accordingly, although management had prepared calculations covering several years, the audit team limited their testing to agreeing annual costs to invoices and confirming the arithmetical accuracy of the model. Based on management's assumption that the aircraft would be operational from FY2019 onwards, other elements of the calculation, including future revenue and the discount rate were not subject to any detailed consideration. There is no explanation of, or justification for, this approach recorded on the audit file, despite it indicating that the calculation did not comply with IAS 37.

5.13.2. the audit team accepted, without sufficient challenge or audit evidence, two assumptions by management. Firstly, that the EC225s would be fully operational from the start of FY2019. Secondly, that the revenues from leased helicopters would equal the lease costs with the result that there would be zero net cash flows in future years. The latter assumption was inconsistent with the assumed position in relation to the helicopters owned by Babcock where positive gross profits of 20% of revenues were projected. There is no evidence that this contradiction was identified and challenged by the audit team. Had the onerous lease calculations included appropriate revenue and profits from FY2019 onwards, these positive future net cash flows, appropriately discounted, would have reduced the £10.1m provision which effectively covered net costs in FY2018.

5.13.3. in respect of the forecast cash flows for FY2018, the audit team did not consider whether management should have included the compensation proposed by Supplier X for future lease costs. Given the clear linkage between the lease costs and the compensation offered, and management's confidence in agreement with Supplier X being reached, this should have been challenged by the Group Respondents.

D. MSDF Contract

Background

5.14. The MSDF Contract was a long-term contract with the MoD, providing for the repair, maintenance and support of vessels and enabling services at naval bases. The initial contract value was c.£2.6 billion. It was selected for testing by PwC in both FY2017 and FY2018 and the audit was undertaken by the DRDL component audit team, under the DRDL Partner's supervision. Its results were consolidated into the Group financial statements. It was Babcock's largest contract by revenue, delivering FY2018 revenue of c.£400m; as well as profit of £56m.

5.15. The MSDF Contract incorporated proposed cost savings of c.£250m which were to be delivered by Babcock. Under the terms of the contract, any overspend was then to be borne by Babcock whereas the benefit of any additional contract underspend was to be shared equally between Babcock and the MoD. Accordingly, the financial impact of a contract underspend was to increase the profitability of the MSDF Contract.

5.16. In FY2017, key areas of judgement affecting the recognition of revenue and margin in relation to the MSDF Contract included the following:

5.16.1. the estimate of future cost savings; and

5.16.2. the estimation of MSDF pension cost savings.

5.17. In relation to future costs savings, at 31 January 2017, management had forecast cost savings under the MSDF Contract of £8.5m with a traded position of £1m. At a meeting in February 2017, the audit team noted that: '…*saving(s) delivered are flatlining…they are now expecting to meet the contracted savings and no more'.*

5.18. Between 31 January 2017 and 31 March 2017, the value of the forecast underspend was increased by management from £8.5m to £15.7m and the traded position was increased from £1m to £8.3m. The audit team recorded management's explanation for this revised level of estimated savings which was based on targets and objectives to be achieved in the future.

5.19. In relation to pension costs, under the MSDF Contract, it was agreed that Babcock would bear all the risks and rewards[17] in relation to the costs of pensions as an incentive to modernise the defined benefit pension provision. Accordingly, Babcock undertook a programme to save pension costs (referred to as 'modernisation'). The savings that resulted from modernisation were estimated by management and recognised over the period of the contract based on the percentage of completion of the contract at period-end. The estimate of savings was reviewed periodically (including at year-end) and adjusted accordingly.

5.20. In FY2017, the audit work on the impact of pension modernisation was largely carried out based on figures at 31 January 2017. As at this date, the audit team noted that the estimated pension savings from modernisation amounted to £19.3m, which was a fall from a figure of £23m estimated at the end of FY2016. The audit team stated that the key driver for this was an increase in the assumption of future service costs, which had risen from 0% in FY2017 to 8.8% in FY2018.

5.21. At 31 March 2017, the audit team noted that the estimated cost savings had increased to £20.6m, reflecting a reduction in the assumed rate of future service costs in FY2018 from 8.8% to 6.8%. It was further noted that it was assumed that future service costs would fall in the subsequent two years but that this assumption depended on the outcome of negotiations with a trade union.

Breaches

5.22. The audit work in relation to the MSDF Contract breached paragraph 15 of ISA 200 and

[17] i.e. Babcock was liable for future cost increases and would profit from any future savings.

paragraph 9 of ISA 500 in the following ways:

Future cost savings

5.22.1. the Group Respondents failed to challenge management on the achievability of forecast cost savings which had increased from a traded position of £1m at 31 January 2017 to £8.3m at 31 March 2017 in circumstances in which the audit team was aware that the MSDF Contract was facing challenges on the ground, the audit team had noted in February 2017 that '*saving(s) delivered are flatlining*', that management were '*expecting to meet the contracted savings and no more*' and the increase in forecast cost savings was based on uncertain targets and objectives, including:

5.22.1.1. savings from a claim to reduce the site's rateable value which depended on the outcome of a valuation appeal process which was uncertain;

5.22.1.2. a savings '*challenge*' which had been set by Babcock's management which had not been analysed or evidenced; and

5.22.1.3. a reversal of a planned increase in the procurement team headcount, when no consideration had been given to the potential adverse implications for future costs savings of a smaller procurement team than previously planned.

5.22.2. Accordingly,

5.22.2.1. the Group Respondents did not adequately assess whether the £8.3m of costs savings reflected in management's traded position was appropriate;

5.22.2.2. instead, the Group Respondents demonstrated a willingness to accept managements' forecasts with limited enquiry and no professional scepticism was applied; and

5.22.2.3. the Group Respondents did not obtain sufficient appropriate evidence to support their conclusion that management's judgements regarding the achievable future costs savings were appropriate.

Pensions

5.22.3. Save as regards the "future service cost" assumption, in respect of which supporting evidence was obtained, the Group Respondents failed adequately

to agree the key assumptions and inputs underlying the calculation of forecast pension savings (of c.£21m at 31 March 2017) to supporting documentation and evidence.

6. BREACHES OF RELEVANT REQUIREMENTS – FY2018 GROUP AUDIT (PwC and Mr Campbell Lambert)

A. Compliance with accounting standards in relation to the assessment of Goodwill impairment

Background

6.1. Goodwill with a value of c.£2.6 billion was recorded on the FY2018 Group balance sheet. This amount represented future benefits that were expected to arise for Babcock from acquisitions that it had made, principally in 2010 and 2015.

6.2. IAS 36 required that Babcock perform an annual impairment assessment to assess whether the carrying value of goodwill was recoverable at the year end. To perform this assessment, Babcock allocated the goodwill balances between their cash generating units ("**CGU**") within the business. Subsequently, Babcock compared:

6.2.1. the reported value (or "carrying value") of the net assets of each CGU, including its allocated goodwill; with

6.2.2. the CGU's "recoverable amount". The recoverable amount of a cash-generating unit is the higher of the cash-generating unit's fair value less costs of disposal and its value in use[18].

6.3. Provided that the recoverable amount exceeded the carrying value, no impairment was required. A positive difference between the recoverable amount and the carrying value is known as 'headroom'.

6.4. In FY2017, Babcock had identified five CGUs[19] for goodwill impairment testing. However, in FY2018, Babcock identified four CGUs[20] for that purpose with the four CGUs corresponding to the four operating segments identified for performance reporting. As part of this reorganisation, the "Africa" CGU was included within the "Land"

[18] IAS 36, paragraph 74.

[19] (i) Marine & Technology, (ii) Support Services, (iii) Defence & Security, (iv) Africa and (v) Mission Critical Services ("**MCS**").

[20] (i) Aviation, (ii) Land, (iii) Marine and (iv) Nuclear.

CGU for impairment testing in FY2018.

6.5. No impairment charge was recorded by Babcock in FY2018[21].

6.6. PwC identified the carrying value of the Group's goodwill as an 'Elevated' audit risk in FY2018. There is no evidence that the audit team carried out any procedures to assess whether the identification of CGUs by management was in compliance with IAS 36.

6.7. In FY2021, as part of management's "*Contract Profitability and Balance Sheet*" review, Babcock identified that the inclusion of the Africa CGU in the Land CGU was an error which, ultimately required a £122.6m prior year restatement in the FY2021 Group financial statements. The Africa CGU was also included in the Land CGU in FY2018. No restatement of the FY2018 Group financial statements has been made.

Breaches

6.8. The audit work in relation to the assessment of goodwill impairment in FY2018 breached paragraphs 12, 13(b) and (c) of ISA 700, paragraph 15 of ISA 200, and paragraph 12 of ISA 240[22] in the following ways:

6.8.1. Contrary to IAS 36, management included the "Africa" CGU in the "Land" CGU for the purpose of goodwill impairment testing in FY2018.

6.8.2. During the FY2018 Audit, the Group Respondents failed to assess and identify that it was inappropriate for Babcock to aggregate its CGUs to align them with operating segments in this manner. Moreover, there is no evidence that the audit team carried out any procedures to assess whether the identification of CGUs by management was in compliance with IAS 36. Accordingly:

6.8.2.1. the Group Respondents failed to evaluate whether the FY2018 Group financial statements were prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework, specifically IAS 36;

6.8.2.2. the Group Respondents failed to evaluate whether the accounting policies selected and applied by Babcock were consistent with the applicable financial reporting framework and were appropriate.

6.8.3. As a result, the Group Respondents failed to identify that Babcock omitted to carry out (as it should have done) goodwill impairment testing at the level of the

[21] *Executive Counsel* has not been able to re-calculate whether an impairment charge should have been recorded in FY2018.

[22] Read in accordance with paragraphs A2 and A11 of ISA 240.

individual Africa CGU in FY2018.

6.8.4. The Group Respondents failed to challenge management, to exercise professional scepticism or to consider whether there was any risk of fraud in relation to the aggregation of the Africa CGU into a larger CGU corresponding to the Land segment, and the aggregation of the MCS CGU into a larger CGU corresponding to the Aviation segment. In this respect:

6.8.4.1. the Group Respondents failed to make any enquiries as to the implications of the change in CGUs for goodwill impairment testing, in particular the impact on headroom in the goodwill impairment test of aggregating the CGUs in the manner set out immediately above;

6.8.4.2. it was evident from the FY2018 audit workpapers that the audit team was aware that in FY2017 the goodwill impairment test for the MCS CGU was sensitive (in that it had the lowest level of headroom), and that aggregating the MCS CGU into a larger CGU in FY2018 reduced the risk of impairment. Despite this, the audit team did not exercise professional scepticism, challenge management on the appropriateness of aggregating CGUs and the reasons for doing so, or assess the effect of testing goodwill at the MCS CGU level.

6.8.4.3. further, given that the audit team understood that the effect of aggregating CGUs was to reduce the risk of goodwill impairment in the MCS CGU, the Group Respondents should have considered whether management was biased towards easing the goodwill impairment test. Despite this, the Group Respondents failed to maintain professional scepticism and failed to consider whether there was any fraud risk associated with the aggregation of CGUs.

B. Auditing of Disclosures in relation to the assessment of Goodwill impairment

Background

6.9. The audit team also assessed that the Aviation CGU was most sensitive (i.e. it had the lowest 'headroom') but did not consider this warranted disclosure in the FY2018 Group financial statements.

Breaches

6.10. The audit work in respect of disclosures in relation to the goodwill impairment assessment in FY2018 breached paragraph 8 of ISA 230, and paragraphs 6, 7, 9 and 11 of ISA 500 in the following ways:

6.10.1. The Group Respondents concluded that the headroom applicable to the Aviation CGU was not sufficiently sensitive to warrant disclosure in the FY2018 Annual Report. In this regard:

6.10.1.1. the Group Respondents failed to obtain sufficient appropriate audit evidence regarding how management had considered alternative assumptions or outcomes, and why it had rejected them, or how management had otherwise addressed estimation uncertainty in making the related disclosures; and

6.10.1.2. the Group Respondents failed to prepare sufficient audit documentation recording the content of their evaluation of whether the disclosures related to goodwill impairment assessment in the financial statements were either reasonable in the context of the applicable financial reporting framework, or were misstated.

C. Vanguard Contract

Background

6.11. The Vanguard Contract was a long-term contract entered into between Babcock and the MoD in 2015 for the re-fuelling and re-fit of the HMS Vanguard nuclear submarine with anticipated completion in 2019. The contract originally stipulated a target price of £173m (increased in FY2017 to £197m). As at FY2018, the forecast revenue was £257m, the in-year revenue was £63m and the in-year profit was £7m.

6.12. The contract was selected for testing by PwC in FY2018 and the audit work was undertaken by the DRDL component audit team, under the DRDL Partner's supervision. Its results were consolidated into Babcock's financial statements.

6.13. Babcock experienced significant delays in relation to the Vanguard Contract. In August 2017, the MoD triggered a contract review date clause (**'the Contract Review Date clause**') for the renegotiation of the contract terms and by the end of FY2018, the Vanguard Contract was over 300 days behind schedule.

6.14. There was significant uncertainty regarding the financial outcome of the Vanguard Contract, as a result, principally, of the significant delay. The audit workpapers record that as at April 2018, negotiations with the client were in the "*early stage of agreeing a revised scope of works*", that *''[o]verall, there is significant uncertainty on the outcome of the final contract negotiation''*, and commercial negotiations as to the financial implications of this delay were yet to take place.

6.15. Against this background, management made two key accounting judgements:

6.15.1. that the Vanguard Contract had in effect become a 'cost-plus' contract, such that all costs incurred and to be incurred by Babcock (including future contract growth) were reimbursable.

6.15.2. that Babcock would earn a margin of […]% of revenue through to contract completion including a […]% incentive fee.

6.16. There was no justification for either of these judgements:

6.16.1. Pursuant to the contract, following the triggering of the Contract Review Date clause, and as the audit team was aware, Babcock had no legally enforceable right to reimbursement of costs incurred pending re-negotiation. The contract merely provided for the parties to negotiate in "*good faith*" regarding the future of the contract.

6.16.2. The margin and incentive fee assumed by Babcock had not been agreed with the MoD and was therefore uncertain.

6.17. Further, at the time of the FY2018 Group Audit, total forecast costs of the Vanguard Contract were £233m. This figure included the costs of forecasted "contract growth" for which the MoD had not, at that stage, agreed to pay. The amount of revenue agreed to be paid to Babcock under the contract was at that stage only £198m.

6.18. The FY2018 Group audit team reviewed a Babcock internal audit report, prepared by a different accountancy firm, which identified that "[t]*he value of work undertaken either at risk or against agreed changes / letters of authority is not routinely monitored"*. This indicated that at a given point in time, Babcock management would not know the extent to which work carried out had been approved by the MoD and whether the related cost and margin would be recovered under the Vanguard Contract. The internal audit report noted that there was a "*risk to contract fee/margin if the final costs associated with change are not accepted in full by the customer*". The Group audit team was therefore also aware of the weakness around the process for approval of contract growth, and the need for improvement to ensure that work carried out by Babcock was properly accounted for. The audit team relied on an assumption that contract growth work would not be performed by Babcock without MoD approval and that the work performed continued to attract fees (profit) at rates in line with the Vanguard Contract, which would be billed and paid by the MoD.

Breaches

6.19. The audit work in relation to the Vanguard Contract breached paragraph 15 of ISA 200, paragraph 6 7, 9 and 11 of ISA 500, paragraphs 12 to 13(b) and (c) of ISA 700,

paragraphs 10, 12, 13(b), 15 to 21 and 21D-1 of ISA 540 in the following ways:

6.19.1. following extensive delay to the contract, the Group Respondents did not adequately challenge or exercise professional scepticism in relation to management's judgement that the Vanguard Contract should be treated as in effect, '*cost-plus*' following the triggering of the Contract Review Date clause. The Group Respondents were aware that the contract merely provided for the parties to negotiate in 'good faith' regarding the future of the contract; i.e. the contract provided no legal basis for recovery of costs after the triggering of the Contract Review Date clause. Accordingly, management's judgement and the Group Respondents' consideration of that judgement regarding '*cost-plus*' was not supported by the terms of the Vanguard Contract or by evidence that the contracting parties had agreed to the Vanguard Contract being treated in this way.

6.19.2. the Group Respondents applied limited professional scepticism as regards management's recognition of margin at an uplifted trading rate (of 10.85%) despite the significant uncertainties surrounding the contract outcome and, in particular, the lack of agreement between the contracting parties (both in terms of quantum and conditions to be met) that an incentive fee (included in the uplifted trading rate at 1%) should be paid.

6.19.3. despite the significance of the costs of forecasted "contract growth", the Group Respondents did not assess whether the revenue recognised by management in the FY2018 Group financial statements complied with the requirements of IAS 11.

6.19.4. further, despite management assuming that all contract growth would be approved and reflected in significant changes to the contract price, the Group Respondents did not obtain any documentary evidence[23] to confirm that payment for any contract growth was in fact approved.

6.19.5. given that the Vanguard Contract was unclear about the responsibility for costs after the Contract Review Date clause and commercial negotiations between the contracting parties were yet to commence, there was insufficient appropriate audit evidence to support the Group Respondents' conclusion that management's judgements were appropriate.

6.19.6. as a result of incorrectly accepting management's conclusion that the Vanguard

[23] Such as "*Alterations and Amendments*", "*Variation Orders*" or "*Limits of Authority*."

Contract should be accounted for on a cost-plus basis, the Group Respondents did not perform substantive testing of the estimated costs to complete the contract. Notwithstanding the clear uncertainty about the financial outcome of the contract, the Group Respondents failed to evaluate whether, and if so how, management had considered alternative assumptions or outcomes to the contract, (if alternatives had been considered) why management had rejected them, or how management had otherwise addressed estimation uncertainty in accounting for the contract. Had the Group Respondents determined that management had not adequately addressed the effects of estimation uncertainty, the Group Respondents should have developed a range (with respect to forecast revenue or forecast costs to complete) with which to evaluate the reasonableness of the accounting estimates. They failed to do so.

D. Contract A

Background

6.20. Contract A was a 10-year contract with a foreign government agency for the provision of specialist training facilities for […] and the supply of personnel, support services and infrastructure work. The initial contract value was €640m. In FY2018, which was the first year in which revenue was recognised under the contract, Babcock recognised revenue of £96m with profit of £5m.

6.21. Contract A was a substantial and complex contract. It was critical for the audit team to gain a sound understanding of how the contract worked and of Babcock's rights and obligations under it. The audit team obtained a signed copy of Contract A, written in French, but did not possess the French language skills to understand it. Instead, the audit team's understanding of Contract A was based solely on explanations received from management. The audit team did not therefore independently analyse the meaning of the contract terms or their impact on management's accounting judgments.

6.22. Contract A gave rise to three key areas of accounting judgement:

The timing of revenue recognition

6.22.1. Babcock accounted for Contract A under IAS 11, with revenue recognised over time based on stage of completion. Babcock recognised the revenue on the aircraft (which they procured for their customer) over time on a percentage basis (50%, 80% and 100%), based on three stages of certification and delivery. Whilst the workpapers evidence that the audit team checked that revenue was calculated according to these stages and percentages, there is

no evidence within the audit file to substantiate why the audit team concluded that the specific percentages were appropriate.

Whether Babcock was acting as principal or agent under the contract

6.22.2. Babcock accounted for Contract A as principal (as opposed to an agent for a third party seller), recognising all revenue and related costs through the income statement[24]. The audit team identified this as a matter of judgement and noted:

> '*Babcock are the principal in this arrangement. This is primarily determined by control during transfer of bundled goods and services and their influence in the design and engineering of the aircraft…*'.

6.22.3. The audit workpapers contained no specific evidence regarding the level of influence Babcock had in the design and engineering of the aircraft which they procured. Although the audit workpapers referred to the criteria in IFRS 15[25] and asserted that accounting as principal was in accordance with IFRS 15, there was no analysis in the workpapers of the features of Contract A against the guidance in IFRS 15.

How to account for the supply chain financing

6.22.4. The audit team noted that there was supply chain finance (by way of a reverse factoring arrangement) in place for Contract A involving Babcock, the aircraft supplier and Babcock's relationship bank. The audit workpapers explained that under this arrangement:

> '*(supplier)…supplies goods to Babcock whilst the bank offers to facilitate payments of the trade payables arising between the buyer and supplier*'.

6.22.5. The audit team noted that the arrangement was collateralised (i.e. guaranteed) by Babcock (as the parent company) which it '*considered* [unusual] *for trade creditors*', and raised concerns as to whether the liability should be classified as bank debt. Accordingly, the audit team consulted PwC's internal accounting specialists. The audit file does not indicate what information was provided to

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[24] Had Babcock, alternatively, accounted for the contract as agent then the revenue and costs would not have been recognised in the income statement. Only the profit (if any) would have been so recognised.

[25] As aforementioned, Contract A was accounted for under IAS 11, not IFRS 15. The latter was not adopted by Babcock in FY2018. It was not therefore appropriate for the audit team to seek to use provisions of IFRS 15 to justify an accounting treatment to which IAS 11 applied.

the specialists for this consultation. However, the conclusion of the consultation was recorded in the audit file as follows:

> '*The outcome was the recognition of the €46m as trade creditors was acceptable given Babcock discloses a policy for supply chain finance and have a sentence in the payable note detailing the arrangement*'.

6.22.6. Following the PwC internal accounting specialists' recommendation, the audit team proposed that Babcock add an additional disclosure to their accounting policies and trade creditors note in the FY2018 Group financial statements regarding the reverse factoring arrangement. At the time, disclosure in relation to the use of supply chain finance was a topical issue of concern within the engineering industry. On 29 January 2018, the FRC had written to the boards of listed companies to remind them of their reporting obligations in the light of the recent collapse of Carillion plc. The FRC drew boards' attention to the amendments to IAS 7 (Statements of Cash Flows) and stated:

> '*The new requirements provide an opportunity for companies to improve clarity of their disclosures, particularly in those areas where investors have voiced disappointment; for example, on the disclosure of financing facilities such as invoice discounting and reverse factoring arrangements*'.

6.22.7. The workpapers record that the proposed further disclosure was discussed during the Group audit committee meeting on 17 May 2018 and management decided that no disclosure would be necessary for FY2018.

Breaches

6.23. The audit work in relation to Contract A breached paragraphs 15 and 16 of ISA 200, paragraphs 6, 7, 9 and 11 of ISA 500, paragraphs 12, 13 (b) and 13 (c) of ISA 700 and paragraphs 8 and 9 of ISA 230 in the following ways:

Contract review

6.23.1. despite Contract A being written in French, the audit team neither obtained an English translation nor possessed the French language skills (and the audit file contains no evidence that they obtained the assistance of a person with such skills) enabling the audit team to understand the contractual terms directly.

6.23.2. Consequently, the Group Respondents failed to obtain an adequate understanding of Contract A and instead relied on management's explanations as to the content of the contractual terms. Particularly in light of the complex

accounting judgements which arose from the contract, it was inappropriate for the Group Respondents to rely solely on management's representations as to the interpretation of the contract.

Revenue recognition - timing

6.23.3. the Group Respondents failed to sufficiently consider and challenge management's decision to account for Contract A under IAS 11 and recognise revenue over time. This was despite a number of contrary indicators[26] to management's position. The audit file did not record that the Group Respondents had challenged management regarding the contrary indicators or adequately explain why IAS 11 was the appropriate accounting standard for revenue recognition given the nature of Babcock's obligations under Contract A.

Revenue recognition – principal / agent

6.23.4. although Babcock accounted for Contract A as the principal on the contract, recognising all revenue and related costs through the income statement, the Group Respondents failed sufficiently to analyse the level of influence Babcock had in the design and engineering of the aircraft, and other relevant contract-related factors, and failed sufficiently to challenge management's position.

Revenue recognition – stage of completion

6.23.5. revenue on the aircraft relevant to the contract was recognised over time on a percentage basis based on three stages of aircraft certification and delivery. There is no evidence on the audit file to substantiate why the Group Respondents concluded that the specific percentages were appropriate. Insufficient audit work was performed on these percentages and the Group Respondents accepted the percentages as being appropriate without further enquiry or challenge. Accordingly, there was insufficient appropriate audit evidence to support the conclusion that the revenue recognised was appropriate.

Supply chain financing – trade creditors

6.23.6. there was insufficient appropriate audit evidence to support the Group Respondents' conclusion that management's creditor classification was

[26] For example, Babcock was described in the audit workpapers as acting as project manager to buy aircraft according to a specification set by the customer. This does not suggest that Contract A was a contract for the construction of an asset to which IAS 11 applied.

appropriate. The supply chain finance for the contract (arranged by the contracting Babcock subsidiary) was collateralised (i.e. guaranteed) by Babcock, which the auditor team '*considered unusal* (sic) *for trade creditors*'. The audit team also noted concerns as to whether the liability should be classified as bank debt, and provided weak challenge to management on this point. Although the audit team consulted PwC's internal technical accounting specialists and documented the conclusion of this consultation, it is not clear what information was provided to the specialists for this consultation. Apart from noting the outcome of this consultation, the audit workpapers do not document the considerations which led the Group Respondents to conclude that management's creditor classification was appropriate.

E. EC225s impairment and onerous lease assessment

Background

6.24. In FY2018, Babcock decided not to recognise an onerous lease provision in relation to the leased EC225s. Prior to a meeting with management on 1 May 2018, the audit team was considering whether an onerous lease provision of between £4m and £8m should either be recorded in the financial statements or be recorded on the auditor's SUM.

6.25. At the meeting on 1 May 2018, management stated that they did not wish to raise a provision and agreed to provide a paper setting out their reasoning. At management's request, a member of the audit team then sent to management on 2 May 2018 a two-page word document relating to IAS 37 (the "**IAS 37 Document**"), in which sentences applicable to conditions where an onerous lease would not be required to be recognised were highlighted by the auditor. The primary source of the text of the IAS 37 Document appears to have been a technical accounting paper, produced in 2010 by a different accountancy firm, based in Australia (not PwC internal guidance). Following receipt of the IAS 37 Document, management produced a paper which included management's cash flow analysis. This paper was intended for the audit team's consideration and reflected the sentences highlighted in the IAS 37 Document, while ignoring relevant contradictory arguments. Management's desired outcome (for no onerous lease provision) was then accepted by the audit team without further challenge.

6.26. In FY2018, management's estimates of future revenue were underpinned by an assumption that the EC225s would be redeployed to lines of service other than the line in which they had previously been deployed (Oil and Gas). However, there were no contracts in place with customers or other adequate evidence to support revenues from these alternative uses and the audit team instead relied on an unsupported

representation from management that '*no provision for impairment is required at year end on the grounds that the carrying value of the owned fleet is recoverable through alternative use of the fleet outside of the Oil and Gas market'*.

6.27. Babcock's FY2018 half year results (for the six months ended 30 September 2018), announced on 21 November 2018, reported that Babcock recorded an exceptional charge of £120m. This included £80m related to the reshaping of the Oil and Gas business, notably the EC225s, comprising:

6.27.1. an asset impairment charge of £38m to reduce Oil and Gas assets to their market value; and

6.27.2. an onerous lease provision of £42m against leased Oil and Gas assets to reflect the costs of these commitments versus current market rates.

6.28. £23.1m of the asset impairment charge of £38m related to Babcock's 8 owned EC225s, and amounted to a write-off of approximately 37% of the net book value of the assets at 31 March 2018. £13.9m of the onerous lease provision of £42m related to 4 of the 5 EC225s.

<u>Breaches</u>

6.29. The audit planning and risk assessment in relation to the EC225 matter in FY2018 breached paragraphs 27 and 28 of ISA 315, and paragraphs 10 to 11 of ISA 540 in the following ways:

6.29.1. the risk of material misstatement arising from the grounding of the EC225s was classified as 'normal' despite having characteristics of a 'significant' risk[27] :the grounding of the EC225s was outside the normal course of business; only one of Babcock's EC225 helicopters was in operation at the date of the FY2018 auditor's report and accounting estimates were required which involved both subjective and complex judgements as well as assumptions about the effects of future events.

6.29.2. notwithstanding the characteristics identified above, it is not apparent from the audit file that any or adequate consideration was given to whether the risk of material misstatement arising from the grounding of the EC225s should have been classified as a significant risk.

6.29.3. management's calculations in the impairment model and in the onerous lease calculation contained estimates of future EC225 activity and revenues which

[27] As defined in paragraph 4(e) of ISA 315

were uncertain and the presence of high estimation uncertainty should have been clear, in the circumstances, to the Group Respondents. Notwithstanding this, there is no evidence that the Group Respondents considered the degree of estimation uncertainty in management's calculations, in their risk assessment, either at the planning stage or during the audit.

6.30. The audit work in relation to the onerous lease assessment for FY2018 failed to comply with principle 2.1D of the FRC Revised Ethical Standard 2016 (Independence), and breached paragraphs 12, 13(b), 15 to 21, 21D-1 and 23 of ISA 540, paragraphs 12 and 13(b) and (c) of ISA 700, paragraph 15 of ISA 200, paragraph 26 of ISA 330 and paragraphs 6, 7, 9 and 11 of ISA 500 in the following ways:

6.30.1. the Group Respondents failed to challenge, or exercise professional scepticism in relation to, whether management's conclusion that an onerous lease provision was not required, complied with IAS 37:

6.30.1.1. IAS 37 required an assessment to be made at the individual contract level (because each EC225 was subject to a separate contract), and therefore a separate assessment should have been made for each EC225. Instead, management's calculation incorrectly aggregated all leased EC225s;

6.30.1.2. IAS 37 required that where the effect is material, future cash flows should be discounted. Management applied a discount rate of 4% whereas the Group Respondents' valuation specialist advised that the appropriate discount rate, being a risk-free rate, was 1.7%. Despite this discrepancy, the audit team failed to assess the impact of the lower discount rate on management's calculations or challenge management on the appropriateness of their chosen discount;

6.30.1.3. in a paper prepared by management (in the circumstances further addressed in paragraph 6.25 above) to justify the lack of an onerous lease provision, whilst the judgement was supported by cash flow forecasts, management also included contentions that: (i) it was normal to have aircraft that were not fully utilised at all times and any surplus assets were necessary operational overheads; and (ii) an individual lease should not be considered onerous if at any time the cash inflows to be derived from the leased aircraft could not be determined with reasonable certainty. Neither of these

contentions was supported by the requirements of IAS 37 in these circumstances. In respect of (i), the assessment of future revenues would allow for periods of underutilisation; and in respect of (ii), paragraph 25 of IAS 37 explains that it is '*extremely rare*' for an entity to be unable to produce a reliable estimate and contrary to management's paper, estimates were made by them for future revenues for EC225s for the leased helicopters and these did allow for periods of underutilisation. Despite these obvious errors, these contentions in management's paper were accepted by the Group Respondents, without challenge.

6.30.1.4. further, management's paper contained clear indications of management bias, given that it contended for no provision without taking account of factors supporting the opposite conclusion, yet it was not challenged by the Group Respondents.

6.30.2. management's conclusion in FY2018 that the EC225 leases were not onerous differed from the conclusion reached in FY2017 that a provision of £10m was required. Despite this, the differing accounting conclusions were not reconciled or challenged as part of the FY2018 Group Audit.

6.30.3. as a result of the above, the Group Respondents did not obtain sufficient appropriate audit evidence to support the conclusion that no onerous lease provision was required in FY2018.

6.30.4. Whilst it may be permissible for an auditor to provide their client with relevant generic accounting advice, the circumstances set out in paragraph 6.25 above indicate that management may have been guided by the Group Respondents towards accounting arguments that supported management's desired outcome (i.e. no onerous lease provision), and such accounting arguments were not challenged by the Group Respondents. Accordingly, in the provision of the IAS 37 Document with highlighted text and the subsequent lack of challenge of management's paper, the Group Respondents breached principle 2.1D of the FRC Revised Ethical Standard 2016 (Independence).

6.31. The audit work in relation to aviation asset impairment for FY2018 breached paragraph 6, 7, 9 and 11 of ISA 500, paragraphs 9, 10, 11, 15 to 17 and 21D-1 of ISA 540, and paragraph 15 of ISA 200 in the following ways:

6.31.1. the Group Respondents identified four key areas of judgement in assumptions and estimates used in management's impairment calculation but the audit

procedures carried out to evaluate those assumptions and estimates, and the audit evidence obtained, were inadequate in that sufficient appropriate audit evidence was not obtained, management was not challenged and professional scepticism was not exercised:

6.31.1.1. management assumed a phased return to service of the helicopters over FY2019, FY2020 and FY2021, however, there is very limited evidence that the Group Respondents challenged the validity of this assumption or considered the impact on the impairment calculation of alternative scenarios arising from a delay in return to service;

6.31.1.2. management's assumptions in relation to profitability[28], contained in their impairment model, were accepted with very limited challenge and professional scepticism or consideration of alternative scenarios;

6.31.1.3. management's estimates for residual values were taken from a 2016 valuation report and accepted by the Group Respondents without any update to 2018 or support for management's assumption that residual values would remain the same over a 10 year period (notwithstanding the intrinsic unlikelihood of this assumption given the relevant assets). There was no consideration by the Group Respondents of the impact on the impairment model of different residual value assumptions;

6.31.1.4. management's estimates of future revenue were underpinned by an assumption that the EC225s would be redeployed to lines of service other than the line in which they had previously been deployed (Oil and Gas). In fact, there was very limited supporting evidence to justify the assumed demand for the helicopters in novel lines of service, and consequently very limited supporting evidence for the assumed revenues. There was significant uncertainty attached to such revenues.

6.31.1.5. the Group Respondents failed, when auditing estimates relevant to the impairment exercise, to carry out additional substantive procedures in response to significant risks (as required by paragraphs 15 to 17 of ISA 540) given that the audit team had not

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[28] Such as margin expectation.

determined that this was an area of significant risk.

F. Holdfast Contract

Background

6.32. Holdfast Training Services Limited ('**Holdfast**') was a joint venture special purpose vehicle in which Babcock had a 74% interest (with the joint venture partner holding the remaining 26%), which related to a 30 year PPP[29] contract for military engineer training, with lifetime revenue of £3 billion. FY2018 revenue was £77.4m.

6.33. Holdfast was brought into scope for the Group audit for the first time in FY2018. The audit work was conducted by a component audit team.

6.34. Although the audit team needed to have a thorough understanding of the key terms of the contract, there is no evidence that the audit team had, whether in FY2018 or before, obtained a copy of the contract or read or considered its terms. The audit team did not therefore independently analyse the meaning of the contract terms or their impact on management's accounting judgments.

6.35. When the Holdfast Contract was signed, Holdfast commissioned a financial model prepared by an external expert which was approved by the joint venture partners. The model included forecast revenue, forecast costs relating to lifecycle funding,[30] cash flows over the contract term and an initial contract margin. The original model had been rolled forward from prior year audit files and was also relied on during the FY2018 Group Audit. In addition, in FY2018 the audit team was provided with an updated contract model which Holdfast had engaged an external expert to prepare.

6.36. Revenue earned by Babcock on the Holdfast Contract was recognised based on the long-term Estimate at Completion ('**EAC**') margin over the life of the contract. The audit team documented that management had determined a profit margin range of 6% to 7%, and concluded that the actual profit margin of 5% recognised in FY2018 was acceptable, as it was conservative. The calculation of the margin involved a number of judgements and estimates, including in relation to future costs and revenue.

6.37. In order to estimate future costs to complete the contract, Holdfast management commissioned an expert to perform a full lifecycle spend review. Based on costs savings indicated by the review, a credit to the income statement of £14.8m (representing Babcock's 74% share of £20m) was recognised in respect of savings from the lifecycle

[29] Public Private Partnership

[30] From the contract inception a 'lifecycle fund' was created to determine the future spend required over the contract term.

fund spend to date. The audit team obtained a draft of an executive summary of the report prepared by the expert.

6.38. Despite the fact that no management fees had been paid since the inception of the contract in 2008, and in circumstances in which such fees had not been approved by both shareholders (which was understood by the Group Respondents to be a mandatory requirement for payment), management recognised a £5m fee in FY2018.

6.39. No specific disclosures were included in the FY2018 Group financial statements in relation to the significant judgements applied by management in relation to accounting for the Holdfast Contract.

<u>Breaches</u>

6.40. The audit work in relation to the Holdfast Contract breached paragraphs 15 and 17 of ISA 200, paragraphs 6, 7, 8, 9 and 11 of ISA 500, paragraphs 9, 12, 13(b), 15 to 18, 21, 21D-1 and 23 of ISA 540, paragraphs 12 and 13(b) and (c) of ISA 700 paragraphs 8 to 11 of ISA 230 and paragraph 42 of ISA 600 in the following ways:

6.40.1. there was no evidence on the audit file of the key terms of the Holdfast Contract which were relevant to the FY2018 Group financial statements (whether by way of a copy of the contract or summary of all the key contract terms), or that the Group Respondents had, whether in FY2018 or before, read or considered the contract. Furthermore, there was no evidence of how these terms were taken into account by the Group Respondents in planning and executing audit procedures.

6.40.2. the audit documentation does not evidence that the Group Respondents reviewed the original and updated FY2018 contract models used to calculate the EAC margin commissioned by Holdfast, the work performed to validate the relevant inputs within the models or the Group Respondents' conclusions as to the appropriateness of the models and the overall contract profit margin. The audit documentation also does not record whether or how the Group Respondents had considered that the inputs and assumptions within the original contract model had been updated appropriately in the preparation of the FY2018 EAC margin. Consequently, the Group Respondents did not obtain sufficient appropriate audit evidence in relation to the appropriateness of management's judgements and estimates of future revenue and costs.

6.40.3. the Group Respondents did not challenge management's adoption of a profit margin of 5% when management had determined a profit margin range of 6%

to 7%.

6.40.4. in purporting to conduct testing over costs to complete the contract, the Group Respondents only obtained a draft of an executive summary of a report commissioned by Holdfast's management to estimate the future lifecycle spend over the remaining contract term. Furthermore, the audit file does not record the outcome of the Group Respondents' review of this draft executive summary, or other evidence of work on costs to complete.

6.40.5. there was insufficient challenge of management and audit evidence obtained to support the appropriateness of a credit to the income statement of £14.8m in respect of savings from the lifecycle fund (created to determine the future spend required over the contract term).

6.40.6. the Group Respondents did not evaluate the competence, capabilities and objectivity of the experts[31] engaged by management or evaluate the appropriateness of the experts' work relied upon as audit evidence.

6.40.7. in their work on management's estimates, the Group Respondents did not consider the potential for management bias.

6.40.8. the Group Respondents did not challenge management on whether the £5m management fee should be recognised or assess whether the judgement by management to recognise management fees was in accordance with IAS 18. Further, the Group Respondents did not question the applicability of the original shareholder agreement on the audit file or obtain the latest shareholder agreement despite a change in shareholders since the inception of the contract.

6.40.9. the failure of the FY2018 Group audit team to identify in their review the issues referred to above demonstrates that the review was inadequate for the purposes of ISA 600.

G. MSDF Contract

Background

6.41. In FY2018, key areas of judgement affecting the recognition of revenue and margin in relation to the MSDF Contract included the following:

6.41.1. the estimate of future cost savings;

[31] In respect of the Report by management's experts, to which paragraph 6.37 refers and the updated FY2018 contract model.

6.41.2. forecast increased revenue (or 'contract growth'); and

6.41.3. the estimation of MSDF pension cost savings.

Future cost savings

6.42. The audit team were aware in FY2018 of (a) a cost overspend, (b) that cost saving targets had been missed and (c) that Babcock had experienced a "*difficult year*" on the MSDF contract.

6.43. At the end of FY2018, Babcock's management reports identified future cost savings of £35.9m over the remaining two years of the contract, and management informed the audit team that further savings of £5m had been identified which were not reflected in the management reports. Accordingly, forecast savings totalled £40.9m. An element of the forecast savings continued to be from planned redundancies. Babcock's traded position reflected an assumed underspend of £11.5m.

6.44. The audit team performed sensitivity analyses on the impact of two scenarios: (a) no savings achieved, and (b) a £5m overspend. These analyses showed that the impact was to reduce both revenue and profit by £1.6m in scenario (a), and £5.3m in scenario (b) (and both amounts were noted as immaterial).

Contract growth

6.45. The audit team noted that, in forecasting the contract outturn, management assumed '*contract growth*' consisting of "Agreed but not Contracted Variations'" and "Other Assumed Contract Variations". The net impact of this growth was to increase revenue by over £107m for the lifetime of the contract and the audit team calculated that in FY2018 contract growth of £72m had been assumed which resulted in an increase in revenue (and therefore profit) recognised in FY2018 of £8.9m

Pensions

6.46. Pursuant to the contract, Babcock was liable for future cost increases and would profit from any future savings. Babcock undertook a programme to save pension costs ('modernisation'). The savings that resulted from modernisation were estimated by management and recognised over the period of the contract based on the percentage of completion of the contract at period-end. The estimate of savings was reviewed periodically (including at year-end) and adjusted accordingly.

6.47. Between FY2017 and FY2018, the estimated total pension savings over the contract increased from c.£22m to £31m, with £17m of savings forecast in FY2019 and FY2020.

6.48. The audit team was also aware in FY2018 that reducing future costs required successful

negotiations with a trade union.

6.49. It was recorded that the audit team had as part of their procedures '[a]*greed the key assumptions to supporting documentation*' and '[a]*greed the actuarial assumptions to the [NAME REDACTED] report*'. The audit team calculated that the impact on income of the increase in pension savings in FY2018 was £2.2m and was therefore immaterial. The audit team concluded that '*the calculation made and the underlying assumptions are appropriate*'.

Breaches

6.50. The audit work in relation to the MSDF Contract breached paragraphs 15 of ISA 200, paragraphs 9, 12 and 15 of ISA 540, paragraphs 6, 7, 9 and 11 of ISA 500, and paragraph 8 of ISA 230 in the following ways:

Future cost savings

6.50.1. the Group Respondents did not challenge management on the achievability of cost savings of £40.9m over the life of the MSDF Contract, and to what extent it was appropriate to reflect forecast savings in its trading position. In addition, the Group Respondents did not challenge management on why the forecast savings over the life of the contract at the end of FY2018 had increased to £40.9m from the equivalent forecast at the end of FY2017 of £15.7m. In particular, the Group Respondents carried out no work to assess the likelihood of a programme of planned redundancies meeting the targeted savings.

6.50.2. accordingly, the Group Respondents did not adequately assess whether the £11.5m of cost savings over the life of the contract reflected in management's trading position was appropriate. Instead, the Group Respondents demonstrated a willingness to accept managements' forecasts with limited enquiry and no professional scepticism applied.

6.50.3. the Group Respondents did not document the basis for selecting sensitivity analyses based on (a) no savings achieved, and (b) a £5m overspend, for example by relating them to the risks in the elements of the savings (e.g. redundancies). Further, there were errors in the sensitivity calculations which, had they been corrected by the audit team, would have shown that the impact of scenarios (a) and (b) were to reduce both revenue and profit by £4.6m in scenario (a), and by £5.0m in scenario (b).

Contract growth

6.50.4. the Group Respondents did not perform audit procedures or obtain any audit

evidence to confirm that the contracting party had agreed to the contract growth assumed by management. The Group Respondents should have carried out further procedures to assess the basis for management's assumption of contract growth and challenged management to provide supporting evidence, but they failed to do so.

Accounting estimates relating to cost savings and contract growth

6.50.5. the Group Respondents failed to evaluate how management had considered all alternative assumptions or outcomes (for example, that a higher level of costs savings could be achieved, or that the assumed value of contract growth would not be accepted by the contracting counterparty) or to consider whether management had adequately addressed the effects of estimation uncertainty, reflecting both future cost savings and contract growth.

6.50.6. further, in relation to estimation uncertainty, it is not evident that the Group Respondents considered the accuracy of management's forecasting, for example, by comparing the forecast made at the FY2017 year-end for savings and contract growth in FY2018 against the savings and contract growth actually achieved in FY2018.

Reconciling costs and revenue to General Ledger

6.50.7. the audit team did not reconcile the MSDF Contract revenue and costs, for FY2018, as set out in the audit working papers, to the amounts recognised as costs and revenue in the general ledger, despite the need to ensure (particularly given the size and complexity of the MSDF Contract) that it could be demonstrated that the audit work was undertaken on the correct balances.

Pensions

6.50.8. the audit work on MSDF pension benefits was insufficient to support the auditor's conclusion that: '*the calculation made and the underlying assumptions are appropriate*':

6.50.8.1. although the audit team was aware of the contradiction between forecasted future service costs having increased in FY2018, and forecasted future pension savings increasing also, this was not challenged by the Group Respondents;

6.50.8.2. the Group Respondents failed to consider the impact on pension savings in FY2018 if Babcock did not achieve the savings forecasted in the future. The audit team was aware that reducing

future costs required successful negotiations with a trade union, but there is no evidence that the audit team enquired as to progress between FY2017 and FY2018 on trade union negotiations and the impact they may have on the achievability of the forecasted reduced pension costs;

6.50.8.3. Save as regards the "*future service cost*" assumption, in respect of which supporting evidence was obtained, the Group Respondents failed to adequately agree the key assumptions and inputs underlying the calculation of forecast pension savings to supporting documentation and evidence.

H. <u>Phoenix II Contract</u>

<u>Background</u>

6.51. The Phoenix II Contract was a 6 year contract (with the option for a further 4 year extension) entered into in 2016 between Babcock and a branch of the MoD, for Babcock to provide management of leased vehicle fleet and provision of rental bookings across the UK and Northern Europe.

6.52. Under the contract, Babcock was responsible for selecting and paying certain suppliers to the MoD, and recharging the revenue to the MoD at nil margin. The key judgement on this matter was whether Babcock was acting as the principal or agent in respect of this 'passthrough' arrangement. Babcock recorded the revenue and costs on a "principal" basis; had it been an "agent", both revenue and costs would be removed from its income statement. In FY2018, such contract revenue amounted to £96.7m.

6.53. The Phoenix II Contract was preceded by the original Phoenix contract which was entered into in 2012. From inception of the original Phoenix contract, the audit team concluded that recognition of revenue as principal was appropriate. Following the signing of the Phoenix II Contract, the audit team concluded that recognition as principal remained appropriate due to the similarity of the two contracts. The evidence to support this conclusion, including a comparison of the two contracts, does not appear on the FY2018 Group Audit file. However, the audit team recorded that the judgement as to whether Babcock should be treated as contract principal or agent was considered to be '*finely balanced*'.

6.54. This key judgement was not disclosed in the FY2018 Group financial statements. It is not clear from the audit file whether the audit team considered recommending disclosure of the judgement of treating Babcock as principal in the financial statements or

communicating the judgement to those charged with governance.

Breaches

6.55. The audit work in relation to the recognition of revenue as principal (rather than agent) in respect of the Phoenix II Contract for FY2018 breached paragraph 15 of ISA 200, paragraph 6 of ISA 500 and paragraph 8 of ISA 230 in the following ways:

6.55.1. the audit documentation does not clearly or adequately record why the audit team concluded (or the evidence on which such conclusion was based) that it was appropriate to recognise revenue as principal (rather than as agent) on account of the alleged similarity between the Phoenix II Contract and the original Phoenix Contract first audited in FY2012. Further, despite recording that the judgement was considered to be 'finely balanced', there is no evidence of the audit team's consideration whether this judgement should be disclosed in the FY2018 Group financial statements.

6.55.2. given the lack of evidence noted above, the documentation was insufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing and extent of the audit procedures, the results of the audit procedures performed, and the audit evidence obtained.

I. DSG Contract

Background

6.56. The DSG Contract was entered into in 2015 between the MoD and a subsidiary of Babcock, in the DSG division, for a 10 year term. The purpose of the contract was to provide military vehicle fleet management services including maintenance, repair, overhaul, and inventory management across several sites. In the FY2018 Group financial statements, the DSG Contract contributed £372m of revenue and £11.3m profit before tax.

6.57. The revenue under the DSG Contract consisted of two elements.

6.57.1. First, Babcock received revenue from the provision of spares and repairs on behalf of the MoD. These costs were billed to the MoD on a 'passthrough' basis at nil margin. In FY2018, this element of the revenue was £218m. As with the Phoenix II Contract (addressed in paragraphs 6.51 to 6.54 above), a key judgement in relation to the 'passthrough' revenue under the DSG Contract was whether Babcock was to be treated as contract principal or agent.

6.57.2. In FY2016, the audit team had consulted internally and concluded that whilst

this was a 'highly judgemental area', treating Babcock as principal under the DSG Contract was appropriate. In FY2018, the audit team again concluded that it was appropriate for Babcock to be treated as principal but that it was a fine judgement. This key judgement was not disclosed in the FY2018 Group financial statements. It is not clear from the audit file whether the audit team considered recommending disclosure of the judgement of treating Babcock as principal in the financial statements or communicating the judgement to those charged with governance.

6.57.3. Second, revenue was received for maintenance and repair of military vehicles and fleet management. Babcock used an EAC model to estimate the long-term margin that would be earned over the lifetime of the contract and therefore the revenue in the FY2018 Group financial statements. The audit team did not carry out detailed testing of the forecast revenues and costs to complete in Babcock's EAC model. In FY2018, this element of revenue was £154m with a profit margin of £11.3m.

Breaches

6.58. The audit work in relation to the forecast revenues and costs to complete in respect of the DSG Contract for FY2018 breached paragraphs 9 of ISA 500, paragraph 15 of ISA 200 and paragraphs 8 and 9(a) of ISA 230 in the following ways:

6.58.1. the Group Respondents did not carry out detailed testing of the forecast revenues and costs to complete in Babcock's EAC model. Further, there is no recorded evidence of challenge by the Group Respondents of management's assumptions and calculations in the EAC model.

6.58.2. given the lack of evidence noted above, the documentation was insufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing and extent of the audit procedures, the results of the audit procedures performed, and the audit evidence obtained.

J. Disclosure of key accounting judgements

Background

RD57 Settlement Agreement

6.59. The RD57 Settlement Agreement was a complex settlement agreement entered into between Babcock and the MoD in 2015 in relation to the Rosyth Royal Dockyard ('RRD'). The term 'RD 57' referred to a derelict area of land to the west of the main operational site at RRD.

6.60. The purpose of the RD57 Settlement Agreement was to settle certain and limit other future liabilities of the MoD, to transfer property to Babcock, to agree for Babcock to waive certain claims against the MoD and for Babcock to commit to deliver overhead savings in the period to 2030.

6.61. Under the RD 57 Settlement Agreement, the MoD agreed to pay Babcock £37m (including indexation). The cash was to be received over a three year period:

6.61.1. FY2016: £3m;

6.61.2. FY2017: £7m;

6.61.3. FY2018: £27m.

6.62. In FY2018, Babcock received cash of £27m. Of the £27m, £3m was deferred on the balance sheet as a liability to cover various remediation costs. The remaining £24m was recognised in revenue and profit but not disclosed in the income statement of the FY2018 Group financial statements despite it being a large one-off credit to profit which offset the impact of other contractual losses in the year.

Other disclosure issues

6.63. The background to Contract A and the Holdfast, Vanguard, MSDF, Phoenix II and DSG Contracts, relevant to the following breaches, is set out earlier in this section 6.

Breaches

6.64. The audit work in relation to the disclosure of key accounting judgements in the FY2018 Group financial statements breached paragraphs 13(e) and 14(b) of ISA 700, as the auditors did not consider adequately whether: (i) the financial statements provided adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements, and / or; (ii) the financial statements represented the underlying transactions in a manner that achieved fair presentation, as follows:

6.64.1. The £24m credit recognised under the RD57 Settlement Agreement was not disclosed in the income statement of the FY2018 financial statements, despite it being a large one-off credit to profit which offset the impact of other contractual losses in the year. The Group Respondents did not consider whether this one-off credit should be disclosed. Although the credit was below audit materiality (of £26m), it exceeded the £11m increase in reported FY2018 group operating profit (£370.6m) over the prior year (£359.6m) and so excluding this credit would have led to reporting a reduction in operating profit

from FY2017 to FY2018, rather than an increase, in circumstances where the summary picture on page 3 of the FY2018 Annual Report referred to the increase under the heading '*A year of progress'*;

6.64.2. in respect of the £19.8m credit recognised in respect of the Holdfast Contract lifecycle savings and management fees, the Group Respondents did not consider, or challenge management regarding, whether the significant judgements applied by management in estimating margin and the credit to income in connection with the lifecycle fund should have been disclosed in accordance with the applicable accounting framework or challenge management on the lack of such disclosure. This was notwithstanding that, as explained at paragraph 6.64.1 above, excluding this credit would have led to reporting a reduction in operating profit, rather than an increase, between FY2017 and FY2018;

6.64.3. in relation to the Contract A supply chain finance arrangement referred to at paragraph 6.20 above: (i) PwC's internal technical accounting specialists recommended to the audit team that the supply chain finance arrangement be disclosed in the FY2018 Group financial statements in the note on creditors and (ii) in January 2018, the FRC wrote to company Boards identifying that the clarity of the disclosure of reverse factoring arrangements could be improved. Despite this, no disclosure was made in the FY2018 Annual Report. The audit file records that the question of disclosure *"was discussed during the AC meeting on 17 May and the decision was made that a disclosure won't be necessary for FY18 given this is a best practice and not standard requirement."* The matter was not included as a disclosure matter in the PwC report to the Audit Committee, and the minutes of the meeting do not record any comment or challenge by PwC on this matter.

6.64.4. The Group Respondents did not adequately consider, or challenge management regarding, whether disclosure of significant contract judgements was required where a range of outcomes were possible in respect of: the Vanguard Contract; the MSDF Contract; the Phoenix II and DSG Contracts and specifically the estimation uncertainty in respect of the EC225 assets.

K. <u>Failure of overall direction and supervision</u>

<u>Breaches</u>

6.65. In light of the significant failings identified above in this section 6, paragraphs 8, 15(a) and 16 of ISA 220 were breached by the Group Partner in relation to the FY2018 Group

Audit given that the supervision and review he undertook did not identify areas of non-compliance with accounting standards, inaccuracies, lack of supporting evidence for accounting judgements and weaknesses in the audit team's professional scepticism and challenge of management. Specifically:

Aviation asset impairment and onerous lease assessment

6.65.1. there is no evidence that the grounding of the helicopters, which had the characteristics of a significant risk, was raised for further consideration by the audit team as a significant risk or whether this required the planned audit approach to be modified appropriately. Further, appropriate consultations (e.g. with the Engagement Quality Control Reviewer ('**EQCR**')) were not held.

6.65.2. errors in calculations and weaknesses in underlying assumptions in management's impairment and onerous lease calculations were not detected by the review of the work of the audit team, indicating that supervision and review of work was inadequate.

MSDF

6.65.3. the auditor's review process failed to identify and correct the errors in the sensitivity analyses and the error in quantifying the level of contract growth (as identified at Paragraph D of Section 5 and Paragraph G of Section 6 above).

Contract A, Holdfast, Phoenix II, DSG

6.65.4. the failures noted in Paragraphs D, F, H and I of Section 6 above, indicate that supervision and review by the Group audit team was not adequate; in that the supervision and review carried out did not identify areas of non-compliance with accounting standards, lack of supporting evidence, insufficient documentation and lack of challenge of management.

7. BREACHES OF RELEVANT REQUIREMENTS – FY2018 DRDL AUDIT (PwC and Ms Ancient)

A. <u>Pre-population of elements of the Vanguard EGA</u>

<u>Background</u>

7.1. At a meeting on 13 February 2018, the DRDL Partner asked DRDL management to provide substantive evidence to support key assumptions in relation to revenue recognition for the Vanguard Contract at Period 12 (i.e. the end) of FY2018. A paper directing the DRDL audit team to the relevant contractual clauses (the '**Commercial**

Paper') was promised by management. On 16 April 2018, the DRDL Partner attended a meeting during which the Commercial Paper was promised again. Further requests were made by the DRDL audit team for the Commercial Paper on 17, 23 and 24 April 2018.

7.2. As at 23 / 24 April 2018, the DRDL Partner did not consider that sufficient audit evidence had been obtained. On 26 April 2018, she signed off meeting minutes stating, "[Management] *will provide us with a commercial paper to support the updated trading position which is showing uplift from trading through the year* – [audit team member] *to chase this*."

7.3. Although management had agreed to provide a "Commercial Paper" and the audit team had chased management for its provision, in fact, a Commercial Paper was never received by the audit team, and as a result the audit team had sought alternative audit evidence which was recorded in the Vanguard EGA together with the audit conclusions thereon.

7.4. The DRDL Partner completed her final review and sign off of the Vanguard EGA on the same day as the memorandum of examination for the component audit was signed and the Marine sector clearance meeting for the component audit was held. Notwithstanding lack of receipt of the Commercial Paper, the relevant EGA referred in three places to a commercial paper in respect of the status of the HMS Vanguard Contract said to have been provided by management to the audit team. In each of these three places the EGA recorded that the audit team had either verified factual matters against the Commercial Paper or noted that it supported management's approach to the Vanguard Contract:

7.4.1. "*A commercial paper has been produced by [Management], which has been discussed as support for management's position on this within this EGA*."

7.4.2. *"Current negotiations to rebaseline the contract have suggested that […]% will be the base rate profit for the contract. This has been verified against a commercial paper created by [Management], - see linked tab below for review of this*[32]."

7.4.3. "*Each of these scope growths have been agreed with the MoD as their liability. This has been supported by [Management], commercial paper*."

7.5. Although, as noted in paragraph 7.3 above, the audit team sought alternative evidence, the Vanguard EGA therefore contained statements prepared in anticipation of receipt of the Commercial Paper, which was never received by the audit team, together with an

[32] There was in fact no "linked tab", in respect of the non-existent Commercial Paper.

assumption that its contents would support management's approach to the HMS Vanguard Contract. In this respect the Vanguard EGA created a false record of the audit evidence obtained.

Breaches

7.6. The audit work relating to the Vanguard EGA failed to comply with the fundamental principle of Competence and Due Care contained in paragraph 130 of the ACCA Rulebook, and breached paragraph 15 of ISA 200, paragraphs 15(a) and 16 of ISA 220, and paragraphs 8(a) - (b) and 11 of ISA 230 in the following ways:

7.6.1. preparing the Vanguard EGA in anticipation of receiving audit evidence was unacceptable and the references to the Commercial Paper in the Vanguard EGA demonstrated a lack of professional scepticism and a lack of an intention to exercise proper professional scepticism.

7.6.2. despite being aware that the Commercial Paper had not been received, the reviewers of the Vanguard EGA, including the DRDL Partner, failed to identify and correct the three inaccuracies in relation to the Commercial Paper in the Vanguard EGA. This displayed a lack of competence and due care by the DRDL Partner and also a lack of appropriate supervision and review.

7.6.3. in light of the above, to the extent that it referred to the Commercial Paper, the Vanguard EGA created a false record of the evidence obtained, and the audit work undertaken in relation to that aspect of the Vanguard Contract.

B. Vanguard Contract

7.7. The breaches set out in paragraph 6.11 to 6.17 and 6.19 above apply equally to the DRDL Partner and PwC in relation to the FY2018 DRDL Audit.

C. MSDF

7.8. The breaches set out in paragraph 6.41 to 6.50 above apply equally to the DRDL Partner and PwC in relation to the FY2018 DRDL Audit.

8. SANCTIONS – PwC

8.1. Paragraph 10 of the FRC's Sanctions Policy (Audit Enforcement Procedure) (January 2022 edition) (the "**Sanctions Policy**") provides that *Sanctions* are intended to be effective, proportionate and dissuasive. The reasons for imposing *Sanctions* are identified in paragraph 11 of the Sanctions Policy as the following:

8.1.1. to declare and uphold proper standards of conduct amongst *Statutory Auditors*

and *Statutory Audit Firms* and to maintain and enhance the quality and reliability of future audits;

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

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

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

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

8.3. In reaching her decision regarding *Sanctions*, *Executive Counsel* has, in summary, considered the following stages and taken account of the following factors in accordance with the Sanctions Policy.

<u>Factors in paragraph 24 of the Sanctions Policy, including nature, seriousness, gravity and duration of the breaches</u>

8.4. 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 about whether the financial statements as a whole were free from material misstatement.

8.5. Many of the matters to which the breaches relate were (individually or in aggregate) qualitatively material to users of the financial statements[33]. In particular:

8.5.1. The increase in operating profit between FY2016 and FY2017 was £7.1m. The Group Respondents failed to apply sufficient professional scepticism in respect of management's recognition of a receivable of £22m from Supplier X in circumstances which should have led the Group Respondents to consider whether management was seeking to manage earnings. If this receivable had been accounted for in the correct accounting period such that the £22m of revenue was not recognised in FY2017, operating profit in FY2017 would have been reduced by £22m, resulting in an operating profit level below FY2015 levels. In terms of operating profit, management's assertion in the FY2017

[33] Further discussed at paragraphs 3.10 to 3.17 above.

financial statements that FY2017 was "*A year of progress*" would have been contradicted, as the picture of financial performance would have been different. Furthermore, FY2018 operating profit would have been increased by £22m of revenue. The £22m amount was settled within 7 months after the FY2017 year-end by a combination of: (i) cash receipts and (ii) credit notes.

8.5.2. The increase in operating profit between FY2017 and FY2018 was £11m. In the financial statements, management asserted that FY2018 was "*A year of progress*". As explained in Section 6, the increase in operating profit reflected, among other things, significant one-off items with a value in excess of £11m[34]. 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.

8.6. The breaches of *Relevant Requirements*:

8.6.1. were serious, and in many cases displayed a lack of competence;

8.6.2. were numerous, spread across a number of contracts and transactions and occurred in all audit areas investigated by *Executive Counsel*. They were not isolated incidents, resulting from one-off oversights but relate to significant matters in respect of the areas to which this *Final Settlement Decision Notice* relates;

8.6.3. reflect an apparent reluctance to challenge the management of a major UK *Public Interest Entity* across parts of these Audits;

8.6.4. include a breach of the FRC Ethical Standard; and

8.6.5. include several breaches which relate to "*Contract accounting and revenue / profit recognition*", an audit area specifically identified by the Respondents as a significant risk.

8.7. A number of the ISAs breached, such as ISA 200 and ISA 500 are fundamental to the conduct of a *Statutory Audit*.

8.8. ISA 700 is a fundamental requirement of an auditor, to: "*form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework*" (paragraph 10)". There were 8 matters which involve breaches of ISA 700.

[34] For example a £24m credit recognised under the RD57 Settlement Agreement and of £19.8m credit recognised in respect of the Holdfast Contract.

8.9. This *Final Settlement Decision Notice* identifies repeated failures to exercise professional scepticism. As the FRC's "Developments in Audit" report (July 2017), stated, "...[a]*t the heart of an effective audit is the demonstration by the auditor of an independent and sceptical mind-set*...".

8.10. Babcock's shares are listed on the Main Market of the London Stock Exchange. In aggregate, the breaches ran the risk that a material misstatement in the FY2017 and / or FY2018 Group Financial Statements may have gone undetected, and accordingly had the potential to adversely affect a significant number of people in the United Kingdom (such as the public, investors or other market users).

8.11. In aggregate the breaches 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*. In particular, due to the lack of challenge of management and the "*pre-population*" of part of an audit workpaper.

8.12. 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 sought to take account of this guidance[35] but notwithstanding, lack of challenge in respect of the audit of long-term contract accounting remained in respect of the matters to which this *Final Settlement Decision Notice* relates.

8.13. As regards the "financial strength"[36] of the *Statutory Audit Firm*: PwC is one of the largest audit firms in the UK. In the year to 30 June 2021, revenue was approximately £3.5 billion, of which £790m was *Statutory Audit* fee income. It has 914 partners and average profit per partner was £868,000. In FY2017 and FY2018 combined, PwC earned c.£4.3m in fees from Babcock.

8.14. Certain deficiencies, similar to the breaches of *Relevant Requirements* in this case, were identified by the FRC's AQR team in the course of their 2015, 2016 and 2017 PwC inspections.

8.15. *Executive Counsel* does not allege that either the Group Partner or the DRDL Partner

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[35] By updating an EGA, by issuing an "In-Brief" training publication to staff and by adding Contract A and the Holdfast Contract to the FY2018 Group Audit scope.

[36] Paragraph 24 e) of the Sanctions Policy.

specifically caused or encouraged other individuals to breach the *Relevant Requirements.* However, there were failures to challenge the audit client, across the Group and component audit teams who conducted the relevant audit work in various offices.

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

8.17. The majority of the breaches relate to one audit year.

Identification of Sanction

8.18. Having assessed the nature, seriousness, gravity and duration of the breaches, *Executive Counsel* has identified the following combination of *Sanctions* as appropriate:

8.18.1. a **financial sanction of £7,500,000**;

8.18.2. a **declaration** that the Audit reports, in respect of each of the Audits, did not satisfy the *Audit Reporting Requirements*;

8.18.3. a published statement, in the form of a **severe reprimand**; and

8.18.4. **An Order that PwC shall:**

8.18.4.1. within two months of the date of the *Final Settlement Decision Notice*, review its current training programmes to Staff working on UK-based audits in respect of the Overarching Principle of Independence, and propose changes designed to guard against recurrence of the breach of Principle 2.1D of the FRC Revised Ethical Standard 2016 which occurred during the FY2018 Group Audit. Changes to the training programme shall be agreed with *Executive Counsel* and the Executive Director for Supervision.

8.18.4.2. within two months of the date of the *Final Settlement Decision Notice*, agree with *Executive Counsel* and the Executive Director for Supervision a training programme for Staff working on UK-based audits designed to guard against recurrence of the "pre-population" issue which arose in respect of the 2018 DRDL Audit.

8.18.4.3. Both of the training programmes referred to at paragraphs 8.18.4.1 and 8.18.4.2 shall include an assessment of understanding for those being trained and the programmes shall be completed within 12 months of the Final Settlement Decision Notice. Promptly thereafter, PwC shall provide to the Executive Director for Supervision data to identify the effectiveness of the training,

including the number of staff who undertook the training and the aggregate results of their assessments.

8.18.4.4. within two months of the date of the *Final Settlement Decision Notice*, PwC shall review the breaches of *Relevant Requirements* which relate to long-term contracts in the Audits and report to *Executive Counsel* and the Executive Director of Supervision on whether the non-financial sanctions previously imposed in relation to the audits of Kier Group plc[37] require augmentation to take account of the breaches of *Relevant Requirements* arising in the Audits. PwC shall incorporate into the Kier Group plc non-financial sanctions processes any additional requirements agreed with *Executive Counsel* and the Executive Director for Supervision arising from the Audits.

8.19. *Executive Counsel* has then taken into account aggravating and mitigating factors that exist (to the extent that they have not already been taken into account in relation to the seriousness of the breaches).

Cooperation

8.20. It is a requirement that audit firms cooperate fully with *Executive Counsel's* investigations.

8.21. In an important regard PwC has provided an exceptional level of cooperation during the investigation. The facts underlying the breaches of *Relevant Requirements* relating to the Holdfast, RD57, Phoenix II and DSG contracts were identified by PwC by way of a self-review (the "**Contracts Report**"). The Contracts Report was candid and self-critical, setting out numerous deficiencies in the audit work. It significantly assisted the resolution of *Executive Counsel's* investigation and the provision of the Contracts Report should rightly be recognised as an important mitigating factor.

8.22. However, this was countered by some important examples in which PwC did not provide the level of cooperation required by *Executive Counsel* during this investigation. Whilst it is not alleged that such failures were intentional, these matters were serious and did lead to delays in the investigation. There were some specific instances of:

8.22.1. errors in productions and delays in providing document disclosure. The failures

[37] *Executive Counsel's Final Decision Notice* dated 20 December 2021 in respect of PwC's statutory audit of the FY2017 Financial Statements of Kier Group plc (https://www.frc.org.uk/getattachment/95d7eff4-414f-4b53-989a-09e7113427e4/Final-Decision-Notice-Sanctions-against-PwC-in-relation-to-PwC%e2%80%99s-audit-of-Kier-07-06-22.pdf).

to respond in a timely and accurate manner to *Executive Counsel's* requests were unacceptable.

8.22.2. insufficient rigour being applied so as properly to answer specific questions raised by *Executive Counsel*, or the provision of unclear, non-specific or inaccurate responses.

8.23. *Executive Counsel* expects and reminds *Statutory Audit Firms* to respond to all information requests in a timely and accurate way.

Other mitigating factor

8.24. None of the Respondents stood to gain any profit or benefit from the breaches of the *Relevant Requirements* (beyond the audit and non-audit fees chargeable for the Audits).

Other aggravating factors

8.25. *Sanctions* have been imposed on PwC in relation to four other investigations since 2019:

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

8.25.2. **Galliford Try plc** (AEP – 30 June 2018 and 30 June 2019 year-ends, settled 31 March 2022): £5.5m fine (reduced to £3.038m for settlement and cooperation).

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

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

8.26. The Group Partner and the DRDL Partner each had c.20 years' audit experience by FY2018. The DRDL Partner also held supervisory responsibilities as the PwC Plymouth Office Senior Partner between 2016 and March 2018.

Conclusion regarding aggravating and mitigating factors

8.27. Absent the significant cooperation shortcomings described at paragraph 8.22 above, a reduction to the financial *Sanction* would have been appropriate to recognise the firm's exceptional cooperation (explained at paragraph 8.21). Whilst recognising that the aggravating and mitigating factors are significant in their own right, on balance, *Executive Counsel* considers that no adjustment to *Sanction* is required overall.

Other considerations

8.28. In accordance with paragraph 47(c) of the Sanctions Policy, *Executive Counsel* has taken into account the financial resources and financial strength of PwC, the effect of a financial *Sanction* on it, and whether it is insured (or otherwise indemnified) as to any financial *Sanction*.

Deterrence

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

Discount for Admissions and Settlement

8.30. Having taken into account the full admissions by the Respondents and the stage at which those admissions were made (during Stage 1 of the case in accordance with paragraph 84 of the Sanctions Policy), *Executive Counsel* determines that a reduction of 25% to the financial sanction is appropriate, such that a financial *Sanction* of **£5,625,000** is payable. The level of discount reflects, in part, that the current settlement process has taken longer than expected.

9. SANCTIONS – MR CAMPBELL LAMBERT

9.1. *Executive Counsel* imposes the following *Sanctions* against Mr Campbell Lambert, in respect of the FY2017 Group Audit and FY2018 Group Audit:

9.1.1. a **financial sanction of £200,000**, discounted by 25% for admissions and early disposal so that a financial *sanction* of **£150,000** is payable;

9.1.2. a published statement, in the form of a **severe reprimand**; and

9.1.3. a **declaration** that the FY2017 and FY2018 Group Audit reports did not satisfy the *Audit Reporting Requirements*.

9.2. In reaching this decision, *Executive Counsel* has, in summary, considered the following stages and taken account of the following factors in accordance with the Sanctions Policy.

Factors in paragraph 24 of the Sanctions Policy, including nature, seriousness, gravity and duration of the breaches

9.3. The factors set out above in paragraphs 8.4 to 8.10 and 8.14 to 8.16 (inclusive) are also relevant to Mr Campbell Lambert.

9.4. Mr Campbell Lambert has no previous adverse compliance or disciplinary record, save

in respect of the AQR review of the FY2018 Group Audit.

9.5. Mr Campbell Lambert had c.20 years' audit experience by FY2018.

Identification of *Sanction*

9.6. Having assessed the nature, seriousness, gravity and duration of the breaches, *Executive Counsel* has identified the combination of *Sanctions* set out in paragraph 9.1 above are appropriate.

9.7. *Executive Counsel* has then taken into account any aggravating and mitigating factors that exist (to the extent that they have not already been taken into account in relation to the seriousness of the breaches).

Aggravating and mitigating factors

9.8. There are no additional significant aggravating or mitigating factors specifically relating to the Group Partner, which have not already been taken into account and so no adjustment to the financial *Sanctions* is appropriate.

Other considerations

9.9. In accordance with paragraph 47(d) of the Sanctions Policy, *Executive Counsel* has taken into account factors including the financial resources and annual income of the Group Partner, and his future employment, and whether he is insured (or otherwise indemnified) as to any financial *sanction.*

Deterrence

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

Discount for admissions and settlement

9.11. The circumstances identified at paragraph 8.30 above apply equally to the Group Partner. Having taken into account the full admissions by the Group Partner and the stage at which those admissions were made (during Stage 1 of the case in accordance with paragraph 84 of the Sanctions Policy), *Executive Counsel* determined that a reduction of 25% to the financial sanction is appropriate, such that a financial sanction of **£150,000** is payable.

10. SANCTIONS – MS ANCIENT

10.1. *Executive Counsel* imposes the following Sanctions against Ms Ancient, in respect of the FY2018 DRDL Audit:

10.1.1. a **financial sanction of £65,000**, discounted by 25% for admissions and early disposal so that a financial *sanction* of **£48,750** is payable;

10.1.2. a published statement, in the form of a **severe reprimand**; and

10.1.3. a **declaration** that the FY2018 DRDL Audit report did not satisfy the *Audit Reporting Requirements*.

10.2. In reaching this decision, *Executive Counsel* has, in summary, considered the following stages and taken account of the following factors in accordance with the Sanctions Policy.

Factors in paragraph 24 of the Sanctions Policy, including nature, seriousness, gravity and duration of the breaches

10.3. The factors set out above in paragraphs 8.6.1, 8.6.5, 8.7, 8.9, 8.15 to 8.17 (inclusive) are also relevant to Ms Ancient.

10.4. Ms Ancient has no previous adverse compliance or disciplinary record.

10.5. Ms Ancient had c.20 years' audit experience by FY2018. She held supervisory responsibilities as the PwC Plymouth Office Senior Partner between 2016 and March 2018. She retired from PwC in June 2021.

Identification of *Sanction*

10.6. Having assessed the nature, seriousness, gravity and duration of the breaches, *Executive Counsel* has identified the combination of *Sanctions* set out in paragraph 10.1 above are appropriate.

10.7. *Executive Counsel* has then taken into account any aggravating and mitigating factors that exist (to the extent that they have not already been taken into account in relation to the seriousness of the breaches).

Aggravating and mitigating factors

10.8. There are no additional significant aggravating or mitigating factors specifically relating to the DRDL Partner, which have not already been taken into account and so no adjustment to the financial *Sanction* is appropriate.

Other considerations

10.9. In accordance with paragraph 47(d) of the Sanctions Policy, *Executive Counsel* has taken into account factors including the financial resources and annual income of the DRDL Partner, and her future employment, and whether she is insured (or otherwise indemnified) as to any financial S*anction*.

Deterrence

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

Discount for admissions and settlement

10.11. The circumstances identified at paragraph 8.30 above apply equally to the DRDL Partner. Having taken into account the full admissions by the DRDL Partner and the stage at which those admissions were made (during Stage 1 of the case in accordance with paragraph 84 of the Sanctions Policy), *Executive Counsel* determined that a reduction of 25% to the financial *sanction* is appropriate, such that a financial sanction of **£48,750** is payable.

11. COSTS

11.1. *Executive Counsel* requires that the Respondents pay her costs in full in this matter, being £733,236. Such costs shall be paid no later than 28 days after the date of the *Final Settlement Decision Notice.*

Signed:

Claudia Mortimore
DEPUTY EXECUTIVE COUNSEL

Date: 3 January 2023

APPENDIX 1 – EXTRACTS OF RELEVANT REQUIREMENTS

Extracts from ISAs

ISA	Paragraph	Text
ISA 200 (Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing)	15	*The auditor shall plan and perform an audit with professional scepticism recognising that circumstances may exist that cause the financial statements to be materially misstated.*
	16	*The auditor shall exercise professional judgment in planning and performing an audit of financial statements.*
	17	*To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.*
ISA 220	8	*The engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned.*
	15(a)	*The engagement partner shall take responsibility for: (a) The direction, supervision and performance of the audit engagement in compliance with professional standards and applicable legal and regulatory requirements.*

	16	*The engagement partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures.*
ISA 230 (Audit documentation)	8	*The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:* *(a) The nature, timing and extent of the audit procedures performed to comply with the ISAs (UK) and applicable legal and regulatory requirements;* *(b) The results of the audit procedures performed, and the audit evidence obtained; and* *(c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.*
	9	*In documenting the nature, timing and extent of audit procedures performed, the auditor shall record:* *(a) The identifying characteristics of the specific items or matters tested;* *(b) Who performed the audit work and the*

		date such work was completed; and *(c) Who reviewed the audit work performed and the date and extent of such review.*
	10	*The auditor shall document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.*
	11	*If the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency.*
ISA 240 (The auditor's responsibilities relating to fraud in an audit of financial statements)	12[38]	*In accordance with ISA (UK) 200 (Revised June 2016), the auditor shall maintain professional scepticism throughout the audit, recognising the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance.*
	32(b)	*Irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform audit*

[38] Read in accordance with paragraphs A2 and A11 of ISA 240

		procedures to: *Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, the auditor shall:* *(i) Evaluate whether the judgments and decisions made by management in making the accounting estimates included in the financial statements, even if they are individually reasonable, indicate a possible bias on the part of the entity's management that may represent a risk of material misstatement due to fraud. If so, the auditor shall re-evaluate the accounting estimates taken as a whole; and* *(ii) Perform a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year.*
	32(c)	*For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment and other information obtained during the audit, the auditor shall*

		evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.
ISA 315 (Identifying and Assessing the Risks of Material Misstatement)[39]	27	*As part of the risk assessment as described in paragraph 25, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.*
	28	*In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:* *(a) Whether the risk is a risk of fraud;* *(b) Whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention;* *(c) The complexity of transactions;* *(d) Whether the risk involves significant transactions with related parties;*

[39] Revised June 2016

		(e) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and *(f) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.*
ISA 330 (the Auditor's Responses to Assessed Risks)[40]	26	*The auditor shall conclude whether sufficient appropriate audit evidence has been obtained. In forming an opinion, the auditor shall consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements.*
ISA 500 (Audit evidence)	6	*The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.*
	7	*When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence.*
	8	*If information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the*

[40] Revised June 2016

		significance of that expert's work for the auditor's purposes: *(a) Evaluate the competence, capabilities and objectivity of that expert;* *(b) Obtain an understanding of the work of that expert; and* *(c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.*
	9	*When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including as necessary in the circumstances:* *(a) Obtaining audit evidence about the accuracy and completeness of the information; and* *(b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes.*
	11	*If:* *(a) audit evidence obtained from one source is inconsistent with that obtained from*

		another; or *(b) the auditor has doubts over the reliability of information to be used as audit evidence, the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit.*
ISA 540 (Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures)	9	*The auditor shall review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period. The nature and extent of the auditor's review takes account of the nature of the accounting estimates, and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements. However, the review is not intended to call into question the judgments made in the prior periods that were based on information available at the time.*
	10	*In identifying and assessing the risks of material misstatement, as required by ISA (UK) 315 (Revised June 2016), the auditor shall evaluate the degree of estimation uncertainty associated with an accounting estimate.*

	11	*The auditor shall determine whether, in the auditor's judgment, any of those accounting estimates that have been identified as having high estimation uncertainty give rise to significant risks.*
	12	*Based on the assessed risks of material misstatement, the auditor shall determine:* *(a) Whether management has appropriately applied the requirements of the applicable financial reporting framework relevant to the accounting estimate; and* *(b) Whether the methods for making the accounting estimates are appropriate and have been applied consistently, and whether changes, if any, in accounting estimates or in the method for making them from the prior period are appropriate in the circumstances.*
	13b	*In responding to the assessed risks of material misstatement, as required by ISA (UK) 330 (Revised July 2017), the auditor shall undertake one or more of the following, taking account of the nature of the accounting estimate:* *(a) [...]* *(b) Test how management made the accounting estimate and the data on which it is based. In doing so, the auditor shall evaluate whether:*

		(i) The method of measurement used is appropriate in the circumstances; and *(ii) The assumptions used by management are reasonable in light of the measurement objectives of the applicable financial reporting framework.*
	15	*For accounting estimates that give rise to significant risks, in addition to other substantive procedures performed to meet the requirements of ISA (UK) 330 (Revised July 2017), the auditor shall evaluate the following:* *(a) How management has considered alternative assumptions or outcomes, and why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate.* *(b) Whether the significant assumptions used by management are reasonable.* *(c) Where relevant to the reasonableness of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action and its ability to do so.*

	16	*If, in the auditor's judgment, management has not adequately addressed the effects of estimation uncertainty on the accounting estimates that give rise to significant risks, the auditor shall, if considered necessary, develop a range with which to evaluate the reasonableness of the accounting estimate.*
	17	*For accounting estimates that give rise to significant risks, the auditor shall obtain sufficient appropriate audit evidence about whether:* *(a) management's decision to recognise, or to not recognise, the accounting estimates in the financial statements; and* *(b) the selected measurement basis for the accounting estimates,* *are in accordance with the requirements of the applicable financial reporting framework.*
	18	*The auditor shall evaluate, based on the audit evidence, whether the accounting estimates in the financial statements are either reasonable in the context of the applicable financial reporting framework, or are misstated.*
	19	*The auditor shall obtain sufficient appropriate audit evidence about whether the disclosures in the financial statements related to accounting estimates are in accordance with the requirements of the applicable financial*

		reporting framework.
	20	*For accounting estimates that give rise to significant risks, the auditor shall also evaluate the adequacy of the disclosure of their estimation uncertainty in the financial statements in the context of the applicable financial reporting framework.*
	21	*The auditor shall review the judgments and decisions made by management in the making of accounting estimates to identify whether there are indicators of possible management bias. Indicators of possible management bias do not themselves constitute misstatements for the purposes of drawing conclusions on the reasonableness of individual accounting estimates.*
	21D-1	*In accordance with ISA (UK) 200 (Revised June 2016), the auditor shall maintain professional scepticism throughout the audit and in particular when reviewing management estimates relating to fair values, the impairment of assets and provisions.*
	23	*The auditor shall include in the audit documentation[41]:* *(a) The basis for the auditor's conclusions about the reasonableness of accounting estimates and their disclosure that give rise to*

[41] ISA (UK) 230 (Revised June 2016), Audit Documentation, paragraphs 8–11, and A6

		significant risks; and *(b) Indicators of possible management bias, if any.*
ISA 600 (Special considerations – audits of group financial statements (including the work of component auditors))	42	*The group engagement team shall evaluate the component auditor's communication (see paragraph 41). The group engagement team shall:* *(a) Discuss significant matters arising from that evaluation with the component auditor, component management or group management, as appropriate; and* *(b) Determine whether it is necessary to review other relevant parts of the component auditor's audit documentation.*
ISA 700 (Forming an Opinion and Reporting on Financial Statements)	8	*Reference to "financial statements" in this ISA (UK) means "a complete set of general purpose financial statements." The requirements of the applicable financial reporting framework determine the presentation, structure and content of the financial statements, and what constitutes a complete set of financial statements.*
	9	*Reference to "International Financial Reporting Standards" in this ISA (UK) means the International Financial Reporting Standards (IFRSs) issued by the International*

		Accounting Standards Board, and reference to "International Public Sector Accounting Standards" means the International Public Sector Accounting Standards (IPSASs) issued by the International Public Sector Accounting Standards Board.
	11	*In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account:* *(a) The auditor's conclusion, in accordance with ISA (UK) 330 (Revised July 2017), whether sufficient appropriate audit evidence has been obtained*[42]*;* *(b) The auditor's conclusion, in accordance with ISA (UK) 450 (Revised June 2016), whether uncorrected misstatements are material, individually or in aggregate*[43]*; and* *(c) The evaluations required by paragraphs 12–15.*
	12	*The auditor shall evaluate whether the financial statements are prepared, in all*

[42] ISA (UK) 330 (Revised July 2017), The Auditor's Responses to Assessed Risks, paragraph 26
[43] ISA (UK) 450 (Revised June 2016), Evaluation of Misstatements Identified during the Audit, paragraph 11.

		material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.
	13 13(b)	*In particular, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework:* *The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate...*
	13(c)	*The accounting estimates made by management are reasonable...*
	13(e)	*The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements...*
	14(b)	*When the financial statements are prepared in accordance with a fair presentation framework, the evaluation required by paragraphs 12–13 shall also include whether the financial statements achieve fair presentation. The auditor's evaluation as to whether the financial statements achieve fair presentation shall include consideration of:*

		(b) Whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation...
Principle 2.1D of the FRC Revised Ethical Standard 2016 (Independence).		*The firm and each covered person, shall ensure (in the case of a covered person, insofar as they are able to do so) that the independence of the firm and each covered person is not compromised with respect to each entity relevant to the engagement. This includes ensuring that the firm and each covered person is not involved in the decision taking of any such entity. The period during which independence shall not be compromised is:* *(a) In the case of an audit, at least throughout the period covered by the financial statements to be audited and throughout any subsequent period until the audit has been completed...*

Extracts from the ACCA Rulebook

130.1 The principle of professional competence and due care imposes the following obligations on all professional accountants:

> *(a) [...]*
>
> *(b) To act diligently in accordance with applicable technical and professional standards when providing professional services.*

130.4 Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis.