

IN THE MATTER OF:

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

-and-

MR PAUL NEWSHAM

- 1 This is the unanimous ruling of the Disciplinary Tribunal in respect of the allegations brought against Mr Paul Newsham by Executive Counsel to the Financial Reporting Council, the formal complaint being dated 31st May 2013. The complaints set out in that document run to 51 separate allegations of misconduct made against Mr Newsham. In summary form the allegations arise out of three separate audits of the Worthington Nicholls Group or its predecessor company (hereafter collectively WNG) for the years ended 30th September 2004, 2005 and 2006. There is in addition a series of allegations relating to a non-statutory audit carried out for the purposes of the listing of WNG on the Alternative Investment Market (AIM), for the 6 month interim period ending 31st March 2006.

- 2 At the hearing, Executive Counsel was represented by Mr. Browne-Wilkinson QC and Mr. Kinnear QC, and Mr. Newsham was represented by Mr. Hubble QC and Mr. Liddell. The hearing before us occupied eight days. There were three live witnesses, and we were referred to a large number of documents contained within some 26 bundles. We had the benefit of opening and closing submissions from both parties. We have reviewed all the evidence, both documentary and from live witnesses, and have considered in detail all the submissions (both oral

and written) which have been made to us. We are grateful to all counsel and to their solicitors for their assistance to the Tribunal in this complex case. In this ruling we refer only to those matters which we consider to be essential for our decisions.

- 3 Mr Newsham qualified as a Chartered Accountant in 1989 and became a member of the ICAEW in 1990. Originally he had been a partner of a firm called Demack & Co which subsequently became part of the Haines Watts Network in 2002 when Mr Demack retired. WNG had been clients of Demack & Co from 1992/1993 and Mr Newsham took over responsibility for the client when Mr Demack retired. The audit team responsible for the audit of WNG was based in Preston. The 2004 audit was undertaken by Haines Watts Preston which was a partnership. Mr Newsham was a partner of that firm and he was the only Responsible Individual in that office. From 1st October 2005, the Preston office became part of HWCA Limited ("HWCA") of which Mr Newsham was both a director and a shareholder. The audits for 2005 and 2006 were carried out by Mr Newsham and HWCA, and the case against Mr Newsham for the purpose of these proceedings is that he was also responsible for the 2006 interim audit. When WNG listed it was the only one of the Preston office's clients that was publicly listed. It was accepted in evidence that Mr Newsham had no previous experience of auditing listed companies.
- 4 WNG was a business which had been set up in 1973. It developed into a company responsible for the design, installation and maintenance of air conditioning units, mostly for a number of significant hotel groups. The chief executive at the time with which we are concerned was Mr Mark Worthington. On 12th June 2006 WNG

was admitted to AIM and raised £20m in its initial share placing. There were subsequent share placings in November 2006 and May 2007, which raised £6m and £20m respectively. At the peak of its value in May 2007, WNG had a market capitalisation of some £146m. At the end of December 2007 this had fallen to just over £7m.

- 5 The Admission Document prepared to support the listing included figures from the 2004 and 2005 audited financial statements and from the 2006 interim financial statements. The latter had been prepared and, so it was said, audited, specifically to support the listing.

- 6 In June 2007 the share price suffered from a substantial collapse leading to the eventual falling in its value in December 2007. A large part of the thrust of the case which we have heard is that the true financial position of WNG had previously been materially misstated and as a result both the turnover and gross profit of WNG over a period of time had been substantially overstated. After the collapse of the share price of WNG, new directors were put in place and Deloitte were appointed to replace HWCA as WNG's auditors on 4th December 2007 and to audit the accounts for the year ended 30th September 2007. These accounts showed a dramatic change in the fortunes of WNG in that an operating loss for the year of over £42m was shown which included write-offs and provisions of £13.67m. Some £5.37m related to prior year adjustments to correct fundamental errors in the accounts which had been previously audited by Mr Newsham.

- 7 We turn below to the definition of “*misconduct*” in the Accountancy Scheme with which we are concerned. Before that, we consider the relevant fundamental principles in the Institute’s Guide to Professional Ethics. Because of the change which occurred in the definition of fundamental principles during the relevant period, for the purpose of these proceedings there were in fact two different sets of principles which we have to consider. There were in addition numerous Statements of Auditing and Accounting Standards which were deployed before us. These were not in fact a matter of controversy in the matters in respect of which we have to make decisions. We attach as Appendix A a list of the Auditing Standards, Accounting Standards and Ethical Standards to which reference was made (D1 p.222). To the extent that may be necessary we refer during the course of our consideration of the complaints to any relevant Standard.
- 8 For the period covering the year-end 2004, the year-end 2005 and the interim 2006 audit, the relevant principle is principle 4;

“A member should carry out his professional work with due skill, care, diligence and expedition and with proper regard to the technical and professional standards expected of him as a member”.

- 9 For the financial year 2006, there was an update of the Guide to Professional Ethics, the relevant parts of which are as follows:

“A professional accountant is required to comply with the following fundamental principles...

(c) Professional competence and due care.

A professional accountant has a continuing duty to maintain professional knowledge and skill at the level required to ensure that a client or employer acquires competent professional service based on current developments in practice, legislation and techniques. A professional accountant should act diligently and in accordance with applicable technical and professional standards when providing professional services.”

Further guidance is provided in Paragraph 130 of the same Guide as follows:

“Professional competence and due care;

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

(a) To maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service; and

(b) to act diligently in accordance with applicable technical and professional standards when providing professional services”

10 Paragraph 130.4 of the same Guidance provides as follows:

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

Paragraph 130.5 of the Guidance provides as follows:

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

11 These are the overarching fundamental principles of ethical standards which are of application to the work carried out by Mr Newsham, and in addition, as stated above there were a large number of Auditing Standards which were of application to his work. For the 2004 and 2005 audits the relevant Statements of Auditing Standards are those set out in Appendix A. For accounting periods commencing after 15th December 2004, the applicable standards were those of the International Standards on Auditing. Again the relevant standards are set out in the Appendix. There are in addition relevant Accounting Standards, in particular SSAP9, which is of particular importance for long-term contracts, a central feature of these proceedings.

12 We turn to the topic of “misconduct”. This is defined in the Accountancy Scheme, with effect from 1st June 2014, as follows:

“Misconduct means an act or omission or series of acts or omissions, by a Member or Member Firm in the course of his or its professional activities (including as a partner, member, director, consultant, agent, or employee in or

of any organisation or as an individual) or otherwise, which falls significantly short of the standards reasonably to be expected of a Member or Member Firm or has brought, or is likely to bring, discredit to the Member or the Member Firm or to the accountancy profession”.

- 13 An amendment to the Scheme which was effective as of the 1st July 2013, with retrospective effect, added to the definition of misconduct the adverb “*significantly*”. As we shall relate in due course, a large part of the hearing was concerned with the question of whether or not, in a number of the allegations which were made against Mr Newsham, where certain limited admissions were made, he had indeed fallen “*significantly*” short of the standards reasonably to be expected of him.
- 14 In assessing how we should address the question of misconduct, we have been assisted by the approach adopted by the Disciplinary Tribunal ruling in respect of the complaint brought by Executive Counsel against Deloitte & Touche and Mr Einollahi. This decision was concluded on the 2nd September 2013 and there are observations upon the appropriate test to be applied in respect of misconduct to be found in the course of that ruling. That ruling plainly preceded the amendment to the Scheme by the addition of the expression “*significant*”. However, in the light of the paragraphs we set out below, we do not consider that anything turns upon the difference in the definition of misconduct as considered by that Tribunal and that by ourselves.

15 We consider that the guidance set out in the paragraphs below describes the relevant test which we apply in the circumstances of this particular case:

“18. Before we can make a finding that the Respondents or either of them are guilty of misconduct and make a finding adverse to them we have to be satisfied not only that there has been a departure from the conduct reasonably to be expected of a member or a member firm but that that departure has been significant. Whether that departure is significant is a matter for our judgment. A trivial departure will not suffice. We have to be satisfied before we reach a conclusion that there has been such a departure, that the Executive Counsel has proved that no reasonable accountant would have acted in the way that the Respondents have acted.”

“24. We accept the Respondents’ contention that for the Respondents to be guilty of misconduct and to have acted in a way that no reasonable professional would have acted the conduct has to amount to more than merely carelessness or negligence and has to cross the threshold of real seriousness. It is not sufficient for the Executive Counsel to prove that the Respondents failed to act in accordance with good or best practice or that most or many members of the profession would have acted differently. The conduct has to be more serious than that.”

16 We are satisfied that the test set out in these paragraphs is equally of application after the amendment to the Scheme and it sets out the approach which we have

adopted in respect of each of the allegations which have been made against Mr Newsham.

17 In the Deloitte case the ruling continues as follows in paragraph 25:

“The meaning of misconduct has been considered frequently by the Courts and particularly cases involving the medical profession. In Calhaem v. General Medical Council (2007) EWHC 2606 (Admin) Jackson J said;

(a) Mere negligence does not constitute ‘misconduct’ within the meaning of Section 35C(2)(a) of the Medical Act 1983. Nevertheless, and depending on the circumstances, negligent acts or omissions which are particularly serious may amount to ‘misconduct’.

(b) A single negligent act or omission is less likely to cross the threshold of ‘misconduct’ than multiple acts or omissions. Nevertheless, and depending upon the circumstances, a single negligent act or omission, if particularly grave, could be characterised as ‘misconduct’.

It follows from the above that if a Complaint is made and a large number of allegations made and proved then the conduct proved is more likely to amount to misconduct than if, for example, only one allegation is proved.”

1 These principles have not been the subject of dispute in the proceedings before us, and we have applied them. While we have examined with care each of the allegations made against Mr Newsham, and viewed each allegation separately, we

have necessarily had to consider each of those allegations in the context of all the allegations made against him. It is for Executive Counsel to prove its case on the balance of probabilities. It is common ground between the parties that whether or not Mr Newsham fell significantly short of the standards reasonably to be expected of him is a matter for the Tribunal to decide. Expert evidence was led before us in which views were advanced both for Executive Counsel and for Mr Newsham as to whether or not such a significant failure had taken place. We have, however, reached our own conclusions in respect of the appropriate standard to apply. In so doing we have had regard, of course, to the Fundamental Principles and to the relevant Standards which are of general application. We have been careful to apply the relevant standards which would have been of application at the time of the alleged misconduct, which occurred over five years ago. We have considered the contents of bundle J which has a selection of public reports issued by the Audit Inspection Unit of the FRC. We bear in mind in our approach to this case that the Audit Inspection Unit 2007/2008 report followed investigations at a number of substantial firms and raised various criticisms. These related to:

- (i) The quality of audit strategy and sufficiency of audit evidence in key areas; and
- (ii) The consideration of the acceptability of accounting treatment.

We do not accept that these Reports are to be read in such a way as to make us conclude that the identified shortcomings of Mr. Newsham cannot amount to

misconduct. We also have regard to the fact that conduct has to be judged in its context at the time it was committed and not with hindsight.

18 Of the 51 complaints made against Mr Newsham, 7 relate to the year-end 2004, 14 to the year-end 2005, 12 to the interim audit 2006, and 18 to the year ending 30th September 2006. Of the 39 complaints arising in respect of 2004, 2005 and 2006, Mr Newsham admits in 32 instances that his conduct fell short of the standards reasonably to be expected of him. He denies that there was any misconduct on his part because, he says, his conduct did not fall significantly short of the standards required, although they fell short of the standards reasonably to be expected of him.

19 Mr Newsham makes no admissions at all, however, in respect of the interim 2006 audit. His position is that there was no audit and that he was not the Responsible Individual in respect of any such audit. Accordingly he denies any shortcomings, let alone misconduct, in respect of the interim 2006 audit. The expert who gave evidence for and on behalf of Mr Newsham, Mr Wilkinson, concluded that in respect of the 12 allegations relating to the interim 2006 audit, if the Tribunal were to find that there was an audit and that Mr Newsham was responsible therefor, then there were shortcomings in respect of 11 of those 12 allegations.

20 This Tribunal therefore has to consider in respect of 32 of the allegations whether or not the admitted shortcomings fell significantly short of the standards

reasonably to be expected of Mr Newsham. In respect of the interim audit 2006 the Tribunal has to decide whether or not there was an audit at all, and if so, whether Mr Newsham was responsible for that audit. If we do so decide, then we need to consider whether or not in respect of the 11 admissions of shortcomings identified by both experts (in the case of Mr Wilkinson without prejudice to the main contention that there was no audit or that Mr Newsham was responsible therefor), Mr. Newsham fell significantly short of the standards reasonably to be expected of him. In respect of the remaining 8 complaints, we have to decide whether or not there have been shortcomings at all and, if so, whether or not those shortcomings fell significantly short of the standards reasonably to be expected.

21 In the Skeleton Argument served by Executive Counsel, for the first time during the course of these proceedings it was contended that Mr Newsham had acted recklessly. Objection was taken to this allegation and we made a ruling after hearing argument allowing such an allegation to proceed. The approach we have adopted in respect of recklessness (see para 51 of the FRC's Sanctions Guidance) is whether, in respect of each allegation, Mr Newsham knew that the proposed course of action might involve a breach of the applicable professional standards, and he proceeded nevertheless.

22 Until April 2003, WNG in various guises had acted as a sub-contractor rather than as principal contractor. Mark Worthington rejoined as Chief Executive in April 2003 and effected a change whereby WNG commenced acting as principal contractor with prospective increases in group revenue and an uplift in gross

profit margin. The change in the business model meant that WNG would be able to provide in its role as principal contractor air conditioning system refurbishment works to its main customers who tended to be substantial hotel chains. This change in the business model called for a fundamental shift in the accounting and auditing requirements which would be necessary for WNG. Long-term contracts posed particular problems for the accounting and auditing functions. Mr. Meredith, the expert witness called by Executive Counsel, told us, and we accept, that it is essential that there should be in place an accounting system which could capture contract revenue and costs on a contract by contract basis. Only if there is such a system which can collect all the costs and assess the final cost to complete and take into account accrued revenue and any other billings to which any contract might be entitled, can the underlying profitability be assessed. Absent such a system then it would be impossible to produce proper financial statements at the end of the year unless there had been some manual accounting equivalent process which had been put in place. This is a fundamental area where there were evident WNG weaknesses and consequent shortcomings on the part of Mr Newsham and his team which are repeated in general terms over a period of time as we shall subsequently relate.

23 Three live witnesses were called before us. They were Mr Meredith; Mr Newsham; and Mr Wilkinson, the expert called for and on behalf of Mr Newsham. We were very impressed by Mr Meredith's expert evidence to us. He gave his evidence in a careful and measured way, and in our view demonstrated a clear and full understanding of the issues which arise when accounting for long-term

contracts and the auditing of such long-term contracts. It was suggested that at times he was unfair in some of his conclusions. We reject such a contention as we consider he was dispassionately fair in the evidence he gave and in the conclusions which he drew. Some criticism was made of the fact that Mr Meredith had had a team working for him in his collation of the materials necessary for the production of his report and indeed in the production of the report itself. We see no problem whatsoever in his having a team to work for him as we are satisfied that the end result was a voluminous and detailed report, which was adopted by him and which represented in totality his own views. The same observation applies to subsequent reports made by Mr. Meredith.

24 Mr Newsham was giving evidence in respect of matters which occurred 7-10 years ago, and we have very much that fact in mind when assessing his evidence. To that should be added, obviously, the stress involved in giving evidence when he is the subject of disciplinary proceedings. While in some respects Mr Newsham, in our view, was doing his best to recall the events which had taken place some years ago, in other respects, as we shall hereafter relate, we are not satisfied that he was so doing. We have been careful to assess his evidence by reference to contemporaneous documents whenever it has been possible to do so, as this is, in our view, a fair way of approaching the evidence and assessing what he was doing at the relevant time. The area of Mr Newsham's evidence where we have been most concerned is in respect of the interim audit 2006. We shall deal with this in more detail below, but we were greatly troubled by some of the evidence he gave to us in seeking to explain contemporaneous documents. We were all left with a

clear impression that in certain respects Mr Newsham was being less than truthful to us in his description of what happened in the period April to May 2006. He has had ample time to reflect upon his actions and to review the documents, and while it may be that he has persuaded himself that he was not responsible for the interim audit 2006, as we set out below, we reject his evidence on this issue which we find deeply unsatisfactory.

25 In general terms, our conclusion, having considered Mr Newsham's live evidence and the relevant materials, is that he had great difficulty in getting to grips with the change in WNG's business model, with the ramifications of that change, and in dealing with the pressure that was placed upon him as audit partner from a number of different quarters by the impending listing in 2006. The pressure imposed as auditor of a listed company for the period ending 30th September 2006 in turn placed substantial responsibilities upon him. In our estimation a large measure of the admitted shortcomings were the product of these factors and as time went by he demonstrated an inability to identify and to resolve the difficult issues which were his responsibility.

26 Mr Wilkinson gave expert evidence on behalf of Mr Newsham. In his full written evidence, which was extremely detailed and which we found most helpful in its analysis of the shortcomings which had been identified by Mr Meredith and which were in turn reviewed by Mr Wilkinson, he displayed a thoroughness and objectivity which we found most helpful. While Mr Meredith had categorised the identified shortcomings in his report on the part of Mr Newsham as each being "*significant*", Mr Wilkinson did not do so. He certainly identified numerous

shortcomings as stated above. But Mr Wilkinson's evidence was that none of these shortcomings fell significantly below the standards reasonably to be expected of Mr Newsham. Although Mr Wilkinson had been referred to the Deloitte decision, extracts of which appear in this ruling, he applied a somewhat different test in assessing whether or not the conduct fell significantly short of the standards reasonably to be expected. In cross examination, which we consider to have been in no way unfair, and indeed in response to questions raised by members of this Tribunal, Mr Wilkinson stated that what he had done was to consider whether or not there was evidence of carelessness or negligence, and then in addition to those requirements whether or not there was evidence to demonstrate that what Mr Newsham had done was "*wilful*". We found such a high standard to be unhelpful and indeed contrary to the requirements of the elements of misconduct required by the Scheme. That said, Mr Wilkinson in his written evidence, where shortcomings were admitted, was in our view rightly critical of the actions of Mr Newsham. Indeed there was a large measure of agreement in respect of the "*admitted*" items as between Mr Meredith and Mr Wilkinson. We now turn to the separate allegations made against Mr Newsham. We attach as Appendix B to this Ruling the form of the complaint which sets out in detail the allegations which are made and which it is unnecessary for us to repeat in full detail.

27 We deal first of all with those allegations where shortcomings have been admitted.

28 Allegation 1. Allegations 1-7 relate to the audit for year-end 30th September 2004.

Allegation 1 is that Mr Newsham's audit planning did not achieve the objectives of the planning process in that he (a) failed to identify that WNG did not have an appropriate long-term contract accounting system; and (b) failed to use his experience and knowledge of WNG's systems, which hindered his ability to perform the audit in an effective manner. It is accepted that there was a shortcoming but Mr Newsham maintains his acts or omissions did not fall significantly short of the required standards.

29 There is no dispute that potential audit issues in the planning process are governed by SAS 200. Mr Newsham had been the auditor of WNG since 2002. WNG had a SAGE accounting system. The SAGE Line 50 is a job costing programme that can, if set up properly and operated properly, allocate costs by contract. We accept Mr Meredith's evidence that it was vital that such a system be used in an appropriate manner so that for each long-term contract the cost incurred to date could be identified, the level of completion on each contract could be identified, and the estimation of the cost to completion in order to determine that the contracts were indeed profitable. We accept long-term contracting is a difficult area for an audit and that an auditor would have to ensure that such a system was operating and was being properly used in order to express a valid audit opinion. Absent that, there is a real risk of material misstatement in the accounts and a consequent much increased need to plan for and obtain additional audit evidence. In our view Mr Newsham was aware that the system at WNG was not being used to capture revenue and costs on a

contract by contract basis. Accordingly, at the planning stage, this was an essential element for identification and for a plan and process to be stated. Mr Newsham accepted that the question of long term contracts is indeed a risky area for the purpose of audit and accepted that to comply with SSAP9 proper accounts had to be prepared in relation to long-term contracts. Mr Newsham accepted Mr Meredith's evidence in terms of the need to plan properly and to take account of the fact that the SAGE system was not being used to record costs and revenues on a contract by contract basis.

30 In paragraph 41 of his witness statement, Mr Newsham accepted that the planning of the audit in respect of long term accounting fell below the standards to be expected. He accepts that he should have identified that the contract accounting system was not being used appropriately by WNG as it did not record revenue and costs on a contract by contract or site by site basis. He also accepted that there was a failure to use his experience of WNG's systems as he should have done to identify specifically the lack of such a system as a key audit issue. Mr Newsham made reference in his evidence to the fact that at the stage of the 2004 year-end audit, WNG was effectively a small, family-run business. Our impression was that his approach to that audit was heavily influenced by that perception.

31 Mr Wilkinson's evidence to us was that the planning undertaken, recorded and supervised by Mr Newsham failed to consider or record whether WNG's long-term contract accounting system was appropriate and also failed to use prior experience of WNG's systems when performing and recording the planning work. He was satisfied that the planning of the audit, supervised by Mr Newsham in

respect of long-term contract accounting, fell below the standards expected of a reasonably competent auditor. To that extent he agreed with Mr Meredith. Our view is that this was plainly negligent and careless, and our assessment is that Mr. Newsham failed to carry out his planning obligations adequately. We view this as a serious matter which set the scene for the audit. It was no excuse that this was, in Mr. Newsham's view, a small family-run business. However, applying the principles we have quoted from the Deloitte decision, our unanimous view is that while the shortcomings were undoubtedly serious, on balance we do not consider that the threshold into significance was crossed.

Allegation 2

32 Allegation 2 relates to late invoiced work. Late invoiced work within the WNG financial statements related to work which was said to have been completed at year end, 30th September 2004, but which had not yet been invoiced by that date. Those amounts represented accrued income on individual contracts. Allegation 2 in detail alleges that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to determine with reasonable confidence that the late invoiced work was correctly categorised in the financial statements or that those statements had been prepared in accordance with Accounting Standards, as required by SAS 100. In the financial statements for the 2004 year end, there was a balance for late invoiced work of £711,318. This was incorrectly posted to WIP within stocks on WNG's balance sheet. That sum should have been identified as accrued income, and, on the basis it represented the value of work carried out up to 30th September 2004, should have been properly recorded as sales and

recorded within debtors. Because of the failure to categorise this amount properly, sales turnover was understated and gross profit margin was overstated. Mr Newsham in his witness statement accepted this shortcoming. He accepted that he had failed to identify from the audit evidence that late invoiced work included a profit element and so should not have been included within WIP. However, he also observed that the WIP in question was restated in the prospectus (for WNG's admission) as a debtor balance and also the impact on the balance sheet and reported profit was nil/neutral.

Mr Wilkinson accepted that in this misclassification the audit work had not been performed to the standards reasonably to be expected, but drew short of describing it as significant. Our conclusion is that the action was indeed careless and should not have happened, but in our judgment we do not conclude it was so serious as to amount to misconduct.

Allegation 3

33 The allegation is that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to draw reasonable conclusions in relation to the amounts included within work in progress relating to late invoiced work. Mr Newsham, it is said, failed to satisfy himself that a contractual relationship existed between WNG and its customers for the work said to have been performed and failed to obtain suitable evidence to demonstrate the value of the late invoiced work amount prior to 30th September 2004. Although the terms and conditions of WNG's contracts could well be material to some of the allegations which have been made

against Mr Newsham, and indeed there are occasions which we shall deal with below where it would have been appropriate to review those terms and ensure there was a signed contract, we accept that in the context of WNG's performance of its business, it was highly probable that contracts had been agreed with its customers and that it was not always necessary to ensure that the contract had indeed been reviewed by the auditing team. This can be said to be a counsel of perfection. That said it was plainly incumbent upon Mr Newsham to carry out suitable checks to value the late invoiced work to the balance sheet date. It was apparent from the evidence before us that some work had indeed been carried out to check the late invoiced work to contracts, to final account invoices and to after date cash.

34 Mr Meredith was critical about the failure to review the contract and failure to apply sufficient professional scepticism in respect of the audit conclusion validly to be drawn from the date of cash receipts. Mr Meredith was adamant that his criticisms amounted to more than failure to have clear evidence on the file of contracts or other failures to retain evidence. He asserted that it was necessary for an auditor to carry out a proper review of the contracts, understand their terms, check their key terms, check that they are signed and the nature of the terms in each agreement. He asserted that there was no evidence that that had been carried out or that there was a proper approach to the late cash receipt. Mr Wilkinson was broadly in agreement with Mr Meredith, and was satisfied that the documents did not confirm the level of work completed by WNG at the year-end or that WNG was contractually entitled to the late invoiced work balances. He

concluded that the audit testing undertaken and supervised by Mr Newsham as recorded on the audit files was not sufficient and appropriate to support Mr Newsham's audit conclusions in respect of the late invoiced work balance in the financial statements. He therefore concluded that the work fell short of the standards expected of a reasonably competent auditor. His conclusion was that this was no more than mere carelessness or negligence, and after careful consideration we agree with that assertion. We are not satisfied that these acts or omissions were sufficiently serious to amount to misconduct. We accordingly dismiss allegation 3.

Allegation 4 and Allegation 5

35 These allegations relate to retentions. Allegation 4 alleges that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to determine with reasonable confidence that retentions were properly accounted for by WNG in the financial statements in accordance with Accounting Standards as required by SAS 100. This is accepted by Mr Newsham as amounting to a shortcoming but he maintains his acts did not fall significantly short of the required standards.

36 In the financial statements for the 2004 year end, there was a balance for retentions of £474,653. The full amount of retention on completion of the contract was included in the sales revenue. At the time the audit work had been undertaken, none of the retention amounts had been paid. Mr Meredith told us

that he would expect WNG to make provision for any remedial work which would be necessary in respect of the retentions either because of known issues on contracts or on a general basis. WNG should know that in completing any contract there would be a level of work to be completed and provision for such cost should have been made. We accept his evidence that there was no provision for any such costs. In his view, which we accept, the retentions balance was material and it was unclear what, if any, audit work had been done to prove that the balance was correctly stated at the end year, that the contracts were complete, or that any costs that were to be incurred in the next 12 months had been provided for. Part of the difficulties related to a change in ownership of a significant customer, which contributed to non-payment of the retentions.

37 Mr Wilkinson's review of the underlying materials led him to agree that provision should have been made for expected claims by customers and for evidence relating to the recoverability of retention payments due within 12 months. He concluded, and we agree, that the audit work supervised by Mr Newsham in respect of retentions fell below the standards expected of a reasonably competent auditor. Again, our conclusion is that this was plainly negligent or careless, but we are not satisfied overall that it was so serious as to amount to misconduct for the purpose of the Scheme. Accordingly we dismiss this allegation.

38 Allegation 5 is that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to draw a reasonable conclusion in relation to the amounts included within debtors relating to retentions, as required by SAS 400.

There is a large measure of overlap between allegations 4 and 5. We accept the evidence of both Mr Meredith and Mr Wilkinson that insufficient appropriate evidence had been obtained and was documented in the file in respect of retentions. There was no evidence in respect of the calculation of retentions or their being agreed to a signed contract; there was no evidence of the review as to whether or not a contract had been signed by a customer or evidence obtained from an independent surveyor; and there was no evidence considering whether or not there was any history of retentions not being recovered. Allegation 6 also relates to retentions. It is alleged that the audit evidence retained on the file for retentions failed to ensure that an experienced auditor unconnected with the audit could discover easily and to understand the reasons for reaching the stated conclusions in respect of retentions. Mr. Wilkinson's evidence to us, which we accept, was that this was indeed the case.

39 We agree with him that the audit work performed and documented by the audit team in respect of retentions and supervised by Mr Newsham fell below the standards expected of a reasonably competent auditor. In our view while these shortcomings undoubtedly amounted to carelessness or negligence, they did not amount to sufficiently serious shortcomings so as to constitute misconduct, and we accordingly dismiss the Allegations 5 and 6.

Allegation 7

40 Allegation 7 relates to failures in the partner review. Mr Newsham's audit engagement partner review, it is asserted, failed to ensure that review procedures

were appropriately carried out and failed to identify that the audit evidence obtained was not sufficient appropriate to support the conclusions reached, and that the balances were not materially misstated, as required by paragraphs 49 and 59 of SAS 240. The thrust of this allegation is that in the audit engagement review Mr Newsham failed to identify the deficiencies in the evidence obtained and the conclusions drawn from the evidence in relation to both late invoiced work and retentions. Mr Newsham plainly did carry out a review on the 15th August 2005, a document to which we were taken. But while the review was undoubtedly carried out, it in our view demonstrably failed to identify the shortcomings in the audit evidence and any shortcomings in the review procedures. Mr Wilkinson agrees that given the failings in the audit work which he has already dealt with in his evidence, it was likely that the partner review of the audit areas performed by Mr Newsham would also be ineffective. *“Had Mr Newsham performed a comprehensive review of these audit areas I would have expected the deficiencies in the audit work to have been identified and corrected”*. We are quite satisfied that the evidence demonstrates a failure to perform the partner review adequately in respect of retentions and late invoiced work. We conclude that this failure was negligent or careless but was not so serious in the circumstances that it amounted to misconduct, and we dismiss the allegation.

- 41 We turn to allegations 8-22 inclusive which all relate to the 2005 audit. The audit report in respect of this financial year was signed on 3rd May 2006 by Mr Newsham. It was known to the audit team in respect of the 2005 audit that the financial statements were being prepared prior to the listing and share placement

of WNG. This was moving on very far from auditing a small family business. It was accordingly essential to ensure that sufficient appropriate work was done on the audit having regard to the purpose for which the financial statements were to be used. The work carried out in respect of the 2006 interim audit, a separate set of allegations, was performed latterly at the same time as the as the work for the 2005 audit, and highlights the importance of the financial statements.

Allegation 8

42 Allegations 8, 9 and 10 all relate to the 2005 year-end planning process, and we deal with them all together after describing each of the allegations. In respect of the financial year ending 30th September 2005 Allegation 8 is that Mr Newsham's audit planning did not achieve the objectives of the planning process in that he:

- (1) failed to identify that WNG did not have an appropriate long-term contract accounting system; and
- (2) failed to use his experience and knowledge of WNG's systems which hindered his ability to perform the audit in an effective manner.

This was the first year in which WNG adopted a long-term contract accounting policy in its financial statements. The WNG accounting system was not capable of recording and allocating revenues and costs against specific contracts or on a site by site basis. This could give rise to the risk of material misstatements. In the light of the history known to Mr Newsham and his team as to the shortcomings of the SAGE accounting system and its use by WNG to capture costs and revenues against specific contracts, it

was incumbent upon Mr Newsham to ensure that there was appropriate planning in respect of long-term contract related balances.

Allegation 9

43 This separate planning allegation relates to the failure to achieve the objectives of the planning process in that it failed to identify the risk based on prior experience that difficulties would be encountered in obtaining sufficient appropriate audit evidence and Mr. Newsham's failure to use his experience and knowledge of WNG hindered his ability to perform the audit in an effective manner as required by paragraphs 2 and 5 of SAS 200. This relates back to the difficulties in obtaining sufficient appropriate evidence in the previous year, year ending 2004, for both late invoiced work and retentions.

Allegation 10

44 This relates to a failure to achieve the objectives of the planning process as Mr Newsham failed to identify key audit areas, matched/pre-contract costs (PCC) and Amounts Recoverable on Contracts (AMROC) and this failure hindered his ability to perform the audit in an effective manner as required by paragraphs 2 and 5 of SAS 200.

45 Our findings in respect of these three allegations are as follows. First, WNG's ability to account for long-term contracts. Mr Meredith's evidence was that it was in this financial year that a long-term contract accounting policy was adopted by WNG. Such a policy therefore became central to the recognition of revenue and

costs in the financial statements. We have reviewed the Audit Planning Memorandum for the year ending 30th September 2005 (B1-2, C2 p.350). We note the following statements which appear in that Memorandum.

- (1) *"...on this assignment the focus is on the systems that the company has in place as well as the standard balance sheet approach that is adopted by HW.";*
- (2) *"Key audit test to be performed – testing WIP and stock to supporting docs, after date cash testing on debtors, cut off testing on creditors and debtors."*

In the same memorandum the risk assessment (C2 p.351) was as follows:

"The company has good controls in place that are overseen by the directors and management of the company along with additional controls that have to be met in order to satisfy their customers. There has been no problems in the past with obtaining audit evidence and no problems have been anticipated this year."

46 According to Mr Meredith, no attempt was made in the planning documentation to identify any potential audit issues relating to WNG's accounting system and this gave rise to a real risk that the company's accounting systems could not appropriately account for long-term contract revenue and costs which would have a material impact on the audit engagement and/or the financial statements.

Given the state of knowledge of Mr Newsham arising out of the previous financial

year's accounting and auditing problems, it is asserted that he should have been aware of and identified the lack of an appropriate system at that early stage. Had he done so, then the team would have been alerted to the need to design audit tests and seek alternative audit evidence to enable them to perform the audit of revenue and costs accrued on individual long-term contracts. Mr Newsham was aware of the difficulties as we have indicated above and as is set out in paragraph 41 of his witness statement.

47 In terms of Allegation 9 relating to difficulties which may be encountered in obtaining sufficient appropriate audit evidence, it seems to us that the Audit Planning Memorandum is completely incorrect when it stated there had been no problems in the past with obtaining audit evidence and no problems were anticipated. In addition, Mr Newsham gave evidence to us, which we accept, that there were persistent difficulties in obtaining accounting information from the management of WNG. He told us it was often very difficult to get hold of Mark Worthington for information on contracts and sales as he was often out and about all over the country. Indeed he told us that this was a *"very messy and difficult client to audit"*. In particular in respect of the year ending 2005 he told us that *"the audit proved to be a very difficult audit to undertake, particularly due to delays in information being supplied by the accounting function of WNL"*. In those circumstances we do find it extraordinary that there was no specific reference in the planning memorandum to alert the audit team to the difficulties on prior engagements. We accept Mr Meredith's evidence that an auditor should have tailored the timing and nature of his audit procedures according to past

experience which was an indication of the risk that difficulties might be experienced during the current year's audit. In terms of the failure to identify key audit areas, Mr Meredith told us, and we accept, that given the new long-term contract accounting policy, asset balances representing revenue recognised but, at the balance sheet date, not yet billed to customers, and long-term contract WIP could reasonably be anticipated to have been key audit areas. Despite this neither matched costs/pre-contract costs nor AMROC which were included in the 2005 financial statements at a value of over £1.7m were identified as key audit areas within the audit planning documentation.

48 Mr Wilkinson agrees with the allegation that the planning recorded did not make use of Mr Newsham's experience and knowledge of WNG's systems. Given that the financial year 2005 was the first year of the adoption of a long-term contract accounting policy, then Mr Newsham should have considered and recorded the effect of this policy change and whether the systems in place were still appropriate given this change. Mr Wilkinson agrees that there was a failure to recognise problems which had been faced in obtaining documentation from WNG although he observes that a number of the members of the team remained the same as those in respect of the 2004 audit. However he agrees that Mr Newsham should have made it plain to members of the audit team as a whole that there had been problems with obtaining documentation at an early stage in the audit. He agrees, therefore that there was a failure to plan the audit and accordingly having regard to his prior year's knowledge Mr Newsham fell below the standards expected of a reasonably competent auditor. In terms of the allegation in respect

of the identification of key audit areas, Mr Wilkinson agrees that there is no specific reference to PCC or AMROC although there is reference to the audit team considering revenue cut off and the work completed on contracts at the year-end being significant audit areas. Mr Wilkinson accepts that the failure to identify and document PCC and AMROC as key audit areas had the consequence that tailored tests were not considered and planned for these audit areas and reduced the ability of the audit team to perform effective testing. In addition there was no updating and recording within the audit planning once any awareness emerged of a need to perform further procedures:

49 We are quite satisfied that in view of the knowledge which Mr Newsham had acquired in respect of the accounting systems of WNG and the manner of their operation, in view of the impending listing, and in view of the adoption of the new accounting policy, it was an essential part of his planning to ensure that the issues raised above were properly and adequately addressed. Although it is right to say some effort was made to carry out planning, in our judgment the failures were substantial and were likely to have a significant impact upon the manner in which the audit would be undertaken.

50 Indeed Mr Newsham accepts that the level of planning fell below the standards to be expected, in that the job costing system or its operation was unreliable; there should have been a recorded risk, based on prior experience, that difficulties would be encountered in obtaining sufficient appropriate audit evidence, and the new policy of PCC/AMROC should have been identified as a key audit area. While we accept there was a tight knit team carrying out the audit it seems to us, as

stated above, that these were significant failures to carry out a basic function in respect of the planning of the audit. In our unanimous view, in the context of the 2005 financial statements, these acts or omissions were careless and negligent, and they fell significantly short of the standards reasonably to be expected of Mr. Newsham. We therefore find misconduct proved in respect of Allegations 8, 9 and 10.

The accounting treatment of pre-contract costs

Allegation 11

51 It is asserted that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to determine with reasonable confidence that WNG was entitled to recover pre-contract costs under a contract, that the pre-contract cost balance was correctly recognised in the financial statements or that the financial statements had been prepared in accordance with Accounting Standards, as required by SAS 100.

Allegation 12

52 The allegation here is that Mr Newsham failed to obtain sufficient appropriate audit evidence on which to draw a reasonable conclusion in relation to the asset recognised in respect of pre-contract costs.

53 In the 2005 year-end financial statements, matched/pre-contract costs were first recognised. The amounts described as pre-contract or matched costs were in fact

amounts of revenue. They were derived by extracting from a breakdown of the total contract price per room elements relating to site visits, design work and planning. WNG accounted for those elements as revenue in advance of commencing actual installation work, and in advance of billing the customer, on the basis that, as from the date of the contract, in the event of any subsequent cancellation, WNG would be entitled to bill the customer for recovery of costs incurred to the date of cancellation. Such recovery would have a revenue value to WNG which could be appropriately calculated by reference to the elements of the contract price referred to above. Accordingly matched/pre-contract costs amounts were recorded as an increase in revenue and debtors. The financial statements for the 2005 year-end contained a balance of £747,520 for pre-contract costs.

54 The documentary evidence to which we were taken shows that on the 22nd March 2006 (C2 p.325) Mr Tomlinson, a member of the audit team, prepared a document headed "Points for Responsible Individual". This made reference to "*matched costs*". The observation was made that further evidence was required, particularly in respect of meeting notes, e-mails and other materials to show that costs were in fact incurred prior to the year-end on a sample of the contracts. Mr Newsham then carried out on 13th April 2006 a review of the pre-contract roll-out costs (H21, C2 p.300). The attached Schedule at H21-1 contains an analysis giving rise to the total figure of £747,520. Mr Meredith's evidence to us was that there had been a complete failure to review the relevant contracts, ensure they were signed, and to ensure that the terms of those contracts provided for payment of

pre-contract costs. In addition, Mr Meredith's view was that there was a failure to identify the extent of any preliminary work which had been completed. The extent of that completed work needed to be clearly identified and evidenced.

55 Mr Newsham accepts that he should have carried out further work to consider the recognition of an element of profit and compared selling price to the cost. He appeared to rely upon the SAGE job costing system as capturing all costs to enable him to match those costs in total against the income recognised for pre-contract costs. Mr Wilkinson, in his evidence, stated that he would have expected Mr Newsham and the audit team to review the expected profitability of the hotel contracts at the year-end and to consider whether or not WNG should have recognised an element of profit on these contracts. He found no evidence on the audit file that this was considered by the audit team. No documentation was retained on the audit file to support any assertion that contracts had started and that money was being received, and accordingly, the document prepared by Mr Newsham on 13th April 2006 (H21) was incomplete. Mr Wilkinson asserts that the work undertaken by Mr Newsham as recorded on the audit files in relation to pre-contract costs was not sufficient or appropriate to support the conclusion within the audit file. He also confirms the audit work documented did not confirm the recoverability of pre-contract costs, that pre-contract costs were recognised in the correct period or that they were correctly accounted for. He therefore concluded that Mr Newsham's conduct in that respect fell below the standards expected of a reasonably competent auditor.

56 It is plain to us that the PCC balance was material. It was essential to review contractual conditions to ensure pre-contract costs were indeed recoverable and to carry out appropriate work on the extent of work done, to value it, and to document the result. It was essential to engage with WNG on this new process at an appropriate stage. While some work was plainly done, it was, in our collective view, seriously inadequate and fell significantly below the standards reasonably to be expected of Mr Newsham. Accordingly we find misconduct in respect of these allegations.

Allegation 14

57 It is alleged that Mr Newsham failed to obtain appropriate audit evidence to enable him to draw a reasonable conclusion in relation to late invoiced work amounts for the QMH Hotels.

58 The summary of late invoiced work dated 23rd February 2006 (05 appears in error) (H6.3 (C2 p.217)) shows a total of £736,750 by way of late invoiced work in relation to a number of hotels. The total included four QMH contracts showing a balance of £177,644. Mr Meredith's evidence was that tests should have been carried out to prove when the work was completed to ensure that the work was completed by the period end and to verify the status of contracts. In addition there was a need to confirm work done to the original contracts in terms of what was the total value and the extent of completion. No quantity surveyor valuation statements were retained on the file and there was a lack of retained evidence in respect of the status of the contracts at year end. Mr Tomlinson on 23rd February

2006 (see H19.1.2 (C2 p.263)) was concerned to ensure that appropriate tests had been carried out or evidence obtained to validate the date by which the work was carried out. He put a note on the file *"Despite requesting for information of rooms handed back for these hotels nothing has been received from the client. A note to this effect has been made on A24 for RI consideration."* That was a note directed to Mr Newsham, flagging up the fact that there were concerns about the validity of the financial information relating to the QMH contracts. On 24th April 2006 (A24.1 C2 p.325) the Points for Responsible Individual included specific reference to the QMH invoices and the fact that there may need to be a qualification in the audit report relating to the same, Mr Newsham responded in writing *"To be covered by LOR (Letter of Representation) as enough evidence gained on other items to suggest not materially incorrect"*. No further evidence was obtained and the subject was not covered in the Letter of Representation.

59 The upshot was that £177,000, a material amount, appeared as an asset in the financial statements albeit there was no evidence regarding the correct period or the correct amount. There should have been further auditing of this balance. Mr Wilkinson agreed that the audit work performed did not evidence that work had been carried out prior to the year-end or that WNG were entitled to recognise that revenue in respect of late invoiced work at the year end. There was no evidence that signed contracts were reviewed in relation to these accrued income balances. In summary, after reviewing the audit files, Mr Wilkinson confirmed that the audit work supervised by Mr Newsham in respect of late invoiced work

for QMH Hotels fell below the standards expected of a reasonably competent auditor.

60 After reviewing the expert evidence, the evidence of Mr Newsham and the contemporaneous documentation, we are satisfied that the audit work carried out under Mr Newsham's supervision fell significantly short of the standards reasonably to be expected of him, and we find that there was misconduct in respect of this allegation. Points which were flagged up for his attention were reviewed by him and not dealt with by him in any satisfactory fashion. There was negligence and carelessness and in our view there were serious and significant shortcomings in respect of a material balance.

Allegations 16 and 17

61 These allegations are in respect of alleged shortcomings in respect of retentions. First it is alleged that Mr Newsham failed to obtain sufficient appropriate audit evidence to allow him to determine with reasonable confidence that the retentions were accounted for by WNG in accordance with Accounting Standards as required by SAS 100. Secondly a similar allegation is made in respect of the amounts included within debtors relating to retentions, as required by SAS 400.

62 WNG's accounting policy in 2005 was to recognise the full value of the retention amounts on completion of the contract. A sum of £229,360 was included as sales revenue in respect of retentions in the 2005 year-end financial statement. (see H10-1 reviewed by Mr Newsham on 20th April 2006 (C2 p.242)). Mr Meredith

made particular criticism of the failure to consider the terms and conditions attached to the retentions, the period of the retention and whether any remedial costs had been incurred. It would appear from the evidence that no consideration was given to whether or not some form of provision should be made indeed for future remediation costs. Certainly no reference to the same appears in the audit papers. Another aspect to this allegation is that some retentions had been recognised in the 2004 year-end, and it was difficult to assess whether or not retentions included in the 2005 year-end retentions had indeed been recognised in the previous year. By way of example, in respect of the Holiday Inn Southampton, an invoiced amount (see H20.5 (C2 p.288)) of £32,690.92 dated 30th June 2005 had apparently also appeared in the 2004 accounts.

63 In respect of the retentions for the Coventry and Dublin Holiday Inns, there was a failure by Mr Newsham, according to Mr Meredith, to carry out appropriate work to assess whether or not there had been subsequent recovery of any retention amounts or to assess whether or not remediation costs had been provided for. It is apparent also that no work was done on the maintenance allowance which formed more than 50% of the retentions balance.

64 On document A24.1 dated 22nd March 2006 (C2 p.325), reviewed by Mr Newsham on 20th April 2006, being the Points for Responsible Individual, it is stated that in respect of retentions "*Insufficient audit evidence to gain assurance that retention amounts are complete, valued correctly or recoverable*". Notwithstanding this reservation and the incomplete work which had been carried out, on 24th April

2006 Mr Newsham simply wrote the word "*Done*" in respect of this and other outstanding queries.

65 Mr Wilkinson observes that certainly some work was performed in respect of the analysis of retentions, but he agreed that there was no documentation on the audit files as to the terms and conditions of the retentions; no consideration had been given by Mr Newsham to the recoverability of the retentions or whether provision was required for future remedial work on the contracts. Mr Newsham seemed to think that because claims and retentions could be recovered by WNG from the subcontractor and/or the manufacturer, retentions could be recognised in full. This overlooked the fact that there would notwithstanding be the potential claim by a customer giving rise to a liability which would then have to be reclaimed from the subcontractor or manufacturer.

66 Mr Wilkinson also concluded that no consideration had been given by the audit team or Mr Newsham as to whether the revenue recognised on retentions balances in 2005 had already been recognised in the 2004 year-end and could therefore be double counted. The potential duplicated amount was £165,871 which would be material to the 2005 year end audit.

67 Mr Wilkinson concluded that the evidence recorded on audit files in respect of retentions was not sufficient appropriate to conclude that retentions should have been recognised by the year end, that no provisions were required for these retentions or that retentions had not been previously recognised in the 2004 year end. He therefore was of the view that this audit work fell below the standards

expected of a reasonably competent auditor. We have reviewed all the materials and without hesitation conclude that this work was negligent, it was careless and it was so serious that it amounted to misconduct in that the work performed fell significantly short of the standards reasonably to be expected of Mr Newsham.

We therefore find misconduct in respect of each of these two allegations proved.

Allegation 18

68 This allegation is in respect of AMROC (Amounts Recoverable on Contracts). It is alleged that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to draw a reasonable conclusion in relation to amounts included in AMROC. This applied to contracts started before 30th September 2005 but which had not been completed at the year-end. The relevant accounting standards were set out in UK GAAP under FRS 5 (Application Note G) and under SSAP9 which provide for the accounting in respect of long-term contracts. Mr Newsham applied the calculation for the purposes of AMROC whereby the proportion of total contract value to be brought to account was assessed by reference to the number of rooms handed back under a hotel-related contract as a proportion of the total number of rooms contracted for. There was no dispute that this is the proper measure for calculation of AMROC. Mr Meredith was highly critical of the failure of the audit team to record the relevant contracts and to have sufficient evidence on file of those contracts. It seems to us highly likely that work would have been performed either under a signed contract or indeed under an oral agreement. What was critical to assess was when and how much work was done.

This would give rise to the correct assessment of the related balances which was the necessary requirement.

69 Mr Tomlinson tackled this topic on the 23rd March 2006 (H19.1.1 (C2 p.262)). In that document he summarised the approach he adopted in respect of work which had been started prior to the balance sheet date according to Mark Worthington. Although his approach as set out in that document was accepted by Mr Meredith as being a sensible one, there was a significant defect in that costs were to be checked back to WNG's job costing system. Mr Meredith observed that there had been real problems in the previous year and in respect of the ability of the job costing system properly to allocate costs by contract. In addition, there was no evidence on the file of any planned work or actual work to prove that the costs accumulated by the job costing system were accurate. The consequence of course was that it would be very difficult to be sure what amount could properly be posted as AMROC. There were other deficiencies in the retaining of evidence, including a failure to retain the rollout schedule (see H19.2 C2 p.265)) and the work in respect of the calculation of the percentage of gross profit which could properly be applied was not always carried out with proper care. For example, a retention sum in respect of the Holiday Inn Lancaster was added to the initial contract value rather than being included within it (see H19.3.2 (C2 p.267), a document prepared by Mr Newsham and Mr Tomlinson on the 3rd March 2006), which could give rise to a misstatement.

70 Mr Wilkinson reviewed the audit working papers relating to AMROC and agreed overall with the deficiencies in the audit testing as noted in the Complaint and in

Mr Meredith's report. It is plain that some work was indeed carried out upon this area as is not disputed, but it fell well short of what should have been done as Mr Wilkinson accepts. Yet again it is apparent that Mr Newsham's team was concerned about shortcomings in the information which had been made available. On audit schedule A24 (C2 p.325), Mr Newsham on 20th April 2006 simply noted "*Cleared and now resolved*" in respect of issues raised in respect of matched costs, understood by Mr Wilkinson also to apply to AMROC. No evidence was put on the file to show what extra work had been done to ensure the documentation issues were resolved. Mr Wilkinson concluded that the work supervised by Mr Newsham fell below the standards expected of a reasonably competent auditor. We agree with this assessment and are satisfied that the shortcomings in Mr Newsham's work in this area, involving a material and substantial balance, fell significantly below the standard which was reasonably to be required of him, and we are satisfied amounted to misconduct.

Allegation 19

71 This allegation relates to stock and work in progress. The allegation is that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to draw a reasonable conclusion in relation to the work in progress balance, as required by SAS 400. The audit file (G1 (C2 p.167)) showed a final balance for work in progress of £110,977. This was a material balance and the agreed evidence is that there was no work whatsoever done in respect of auditing this balance. Mr Newsham apparently took the view that the first draft balance had

been properly audited and the final balance could be carried through to the representation letter from the directors of WNG.

72 Mr Meredith's evidence to us, which we accept, was that none of the balance had been audited; audit evidence should be obtained where possible and it is not appropriate to rely on representations; and this was a material balance which should not have been ignored. Mr Wilkinson agrees that the final balance of WIP was not audited. In addition there was no evidence on file to show that the audit team considered whether the WIP balances were stocks or long-term contract balances such as PCC, AMROC or late invoiced work. Mr Wilkinson agreed that it was not appropriate to rely upon a letter of representation in respect of the work in progress figure. Mr Wilkinson concludes, and we agree, that the audit testing undertaken by Mr Newsham in respect of WIP failed to ensure that sufficient appropriate audit work was undertaken to support the audit conclusion for this material balance. In our judgment this was a material balance and there was a complete failure to carry out what should have been done. We consider this was negligent, careless and serious such that it fell significantly short of the standards reasonably to be expected of a member. Accordingly we find misconduct in respect of allegation 19.

Allegation 20

73 This allegation arises in respect of the Curzon Debt. The allegation is that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to draw a reasonable conclusion in relation to the inclusion of £670,000 of un-

invoiced revenue relating to Curzon Interiors, as required by SAS 400. This related to amounts said to be owed by a contractor, Curzon Interiors, for work performed on a project at the Intercontinental Hotel at Hyde Park Corner. There is a worksheet dated 3rd March 2006 in the audit file (H20.2 (C2 p.283)) relating to the amount of the Curzon debt. This records month by month amounts invoiced up to 19th July 2005 on what appears to be a monthly valuation basis., followed by a round-sum amount of £417,000 shown as dated 24th May 2005 (but considered by us to be mis-dated for 24th August 2005), giving a sub-total of £892,730 being the total invoiced up to 30th September 2005. To this has been added £670,000 (described as "work in progress adj") and giving a total of £1,562,730. This total is then compared with £1,579,958, described as being "Valuation No 7 Final Account". This audit worksheet does not record anything further relevant to assessing whether work to this value had been completed by WNG prior to 30th September, and thus that £670,000 (or indeed any other amount) could properly be included in revenue, and thus gross profit, for the year ended on that date. In his audit schedule A26-4 (C2 p.336) dated 25th March 2006, Mr. Hale correctly identified that there was no documentation on file to support the £670,000 figure. A clearance comment (reviewed on 20th April 2006 by Mr. Newsham) stated "This is work completed prior to 30/09/05 but no invoice has been raised. Therefore treat as trade debtors in final accounts." Mr Wilkinson agrees with Mr Meredith that the audit working papers do not show the value of work performed or the stage of completion of the work at 30th September 2005. Mr. Wilkinson agrees that the effect of the inclusion of the £670,000 was to increase gross profit

(although as the whole Curzon debt was written off, there was no net profit or balance sheet impact).

74 Mr Wilkinson is of the view that the work undertaken and supervised by Mr Newsham failed to obtain sufficient appropriate audit evidence to be able to draw a reasonable conclusion in respect of the un-invoiced Curzon Debt balance. He concluded that his work fell below the standards expected of a reasonably competent auditor. Mr Newsham in his witness statement stated that he felt it correct to recognise the income as it had been completed and valued within sales and it was proper to write it off as a bad debt as normal below the gross profit line. We have great difficulty in seeing how he could properly come to that conclusion. It is right to say that the bad debt was highlighted as an exceptional item within the accounts, and indeed it appears that by reason of Mr Newsham's insistence on the bad debt being included over the wishes of the directors of WNG, the initial float timed for March 2006 was aborted and rescheduled for June 2006. The fact remains that a significant un-invoiced amount was shown by way of revenue and gross profit without sufficient appropriate evidence. Particularly given the timing of this, and the use to be made of the 2005 accounts for the purpose of listing on AIM, we are quite satisfied that this was negligent, careless and serious and as such the acts or omissions fell significantly short of the standards reasonably to be expected. We accordingly find misconduct proven in respect of allegation 20.

Allegation 21

75 This allegation relates to failures in the partner review. It is alleged that Mr Newsham, as the audit engagement partner, failed to ensure in his review that procedures were properly carried out and failed to identify that audit evidence obtained was sufficient appropriate to support the conclusions reached and that the balances were not materially misstated as required by paragraphs 49 and 55 of SAS 240. The review carried out by Mr Newsham should have identified deficiencies in the quantity and quality of the audit evidence obtained and in particular in relation to the accounting treatment applied by WNG regarding pre-contract costs and retentions; and to assertions in relation to pre-contract costs, late invoiced amounts AMROC, stock, WIP and the Curzon Interiors Debt. It is right to say that Mr Hale carried out a substantial review (see A26 running through to A26-6 (C2 p.333 and following) but there appears to have been, and this is the evidence of Mr Meredith which we accept, a number of deficiencies which Mr Newsham himself did not identify. These include lack of evidence to support WIP and the Curzon Interiors un-invoiced debt balances; particular problems which had been raised by members of the audit team (A24-1 (C2 p.325)); a lack of evidence supplied by third parties to support the existence of contracts between WNG and its customers and, more importantly in our view, the amount of work completed before year-end; and finally, the resolution of discrepancies between the apparent start dates of customer contracts and the amount of work said to have been completed at year-end. In summary, with certain exceptions which are not relevant for present purposes, Mr Wilkinson agreed that the partner review undertaken by Mr Newsham failed to identify the deficiencies in quantity and quality of audit work undertaken by his audit team. He therefore concluded that

in respect of those deficiencies Mr Newsham fell below the standards expected of a reasonably competent auditor.

76 Mr Newsham accepts that there were some deficiencies in the audit evidence obtained for the period and also that he should have identified this in his review as engagement partner. He refers to the review which was carried out by Mr Hale to give himself some comfort, and we consider the review was indeed thorough. But Mr Newsham failed to follow up on any deficiencies and that was his sole responsibility. These were wide ranging and important issues which should have been reviewed by Mr. Newsham with care. We are satisfied that his conduct fell significantly short of the standards reasonably to be expected, and accordingly in respect of allegation 21 we make a finding of misconduct.

Interim 2006 audit

77 The issues we here have to decide are first, whether or not there was an interim audit at all, and, if so, whether or not Mr Newsham was responsible for it. We have to determine both these issues and only if we decide that there was an audit and Mr Newsham was responsible therefor, go on to consider the allegations of misconduct in respect of such audit.

78 Our starting point is the documentation for admission of WNG shares to trading on AIM on 12th June 2006. As part of that on 6th June 2006 the Manchester office of HWCA Limited, the Member Firm of which Mr Newsham was a director and shareholder, signed the Short Form Accountants Report. This was a document

upon which in our view HWCA Limited knew that investors were entitled to rely and would rely; accordingly it was a document that HWCA Limited will have prepared with care and with regard to the accuracy of statements made therein, particularly statements as to what audits HWCA Limited had itself carried out. The report says in terms that the financial information set out and attached to it has been "*prepared in accordance with applicable United Kingdom generally accepted accounting principles*" and is based on the audited financial statements of WNG for the years ending 2003, 2004, 2005 and the "*audited non-statutory accounts for the period ended 31st March 2006.*" The report confirms the Financial Information, which in turn confirms that it is HWCA Limited that has audited the interim financial information of WNG for the period ended 31st March 2006 and has given an unqualified opinion thereon to the directors.

79 Thus the admissions process plainly proceeded on the basis that there were non-statutory accounts for the period ended 31st March 2006, that these had been audited and that they had been audited by HWCA Limited. We have also seen a signed (albeit undated) Letter of Representation from WNG addressed to the Preston office of HWCA Limited and confirming that the representations given by WNG to HWCA Limited were made in connection with "*your audit of the financial statements for the period ended 31st March 2006*". Accordingly it is plain that WNG and its directors were of the view that an audit had been performed and had been performed by the Preston office of HWCA Limited. Indeed payment was made in respect of the audit which they understood to have been performed.

80 Mr Newsham, however, is adamant that he did not give an audit report, and that he was not responsible for any form of audit. Given the matters set out in the preceding paragraph, we have found this stance very troubling. For reasons set out below we reject it.

81 Before setting out the detail of those reasons we consider the Audit Regulations and Guidance dated December 1995 issued by the ICAEW. An audit for the purpose of these Regulations is one which either has to be discharged by or under UK legislation or is in respect of a company included on the official list.

82 The Regulations also define a 'Responsible Individual' as a person who is designated as being qualified to give an audit and to sign an audit report. Such a person has to accept responsibility for an audit. Mr Newsham was the only Responsible Individual in the Preston office. Accordingly he was the only person in that office who could, in terms of the Regulations, be responsible for an audit and sign an audit report. It was submitted on his behalf that, given the provisions of the Regulations, the absence of a signed audit report is conclusive proof of his not being exposed to responsibility as Responsible Individual. But in our view the Regulations were inapplicable to this interim audit, and the status of Mr Newsham as Responsible Individual was not relevant. Neither of the conditions that would trigger the applicability of the Regulations were present in respect of the accounts for the period ended 31st March 2006. These were not statutory accounts and WNG was not a company included on the official list. In our view the correct approach is to consider the matter, as is done in the Formal Complaint, in terms of his being simply the individual responsible, not the Responsible Individual.

Responsibility for a non-statutory audit of non-statutory accounts can carry with it the full burden and consequences of professional obligations and standards; it certainly does do so when the context of that non-statutory audit is a set of financial statements prepared specifically for purposes of an admission to AIM. We should add that, even if we are wrong on this point (i.e if the correct approach is that the Regulations did apply), it would not change our view that an audit opinion on the 31st March 2006 financial statements was given by Mr Newsham, albeit not in the form of a signed audit report. We say this, because we have no doubt that, even under the regime governed by the Regulations, a Responsible Individual can, without there being a signature on an audit report, commit and engage his, and his firm's, responsibility by an act or communication intended to indicate that an audit has been completed and has resulted in an unqualified opinion.

83 Mr Newsham's evidence in his witness statement was that any work carried out by the Preston Office was to "*carry out some work and testing of the 31st March 2006 accounts. We were instructed to help prepare these accounts and carry out tests on the same to give the reporting accountant some comfort. However we did not at any time carry out an audit as this was not a statutory audit, but we prepared a file similar to that that would be put together for a normal audit, hence why a lot of schedules were prepared as per our normal audit file.*" He went on to say that the directors of WNG did not sign the accounts for this period, and he did not sign an audit report or give an audit opinion, concluding that there was no audit of the financial statements for this period. Similarly, in the course of cross

examination Mr Newsham sought to tell us that he was merely *“pulling numbers together (for a short form report) and carrying out audit procedures on them and we were doing the equivalent of audit work on them”*.

84 We have great difficulty in accepting this evidence. It is seriously different from what Mr Newsham said in each of two earlier formal interviews. It is also in our view completely inconsistent with the contemporaneous documentation and indeed inconsistent with other answers which were given to us while he was being cross examined. The overwhelming weight of the documentation supports the conclusion that an audit was carried out. True it is that there is no evidence that a signed report existed or that it was signed by Mr Newsham. Also no copy was produced to us of any actual financial statements which went forward for inclusion in the placing document. But the information in that document for the period to 31 March was stated to have come from such financial statements and plainly did so. In addition documentary evidence produced to us shows that on 23rd April 2006 Mr Hale had before him for purposes of his review a draft set of accounts and notes for the 6 month period. The placing documentation says also that the 6 month information has been audited and, in the light of that and of other evidence referred to below, we are quite satisfied that on 9th May or at a date close thereto Mr Newsham one way or another led the directors of WNG and Mr Fort and the staff at HWCA Limited in Manchester to conclude that, in relation to financial statements for the 6 months to 31st March 2006, information from which was to be used for the purposes of the placing, he was giving an unqualified audit opinion even if he did not produce an actual audit report saying so.

85 In his first interview Mr Newsham spoke of doing the audit and signing off once others were happy, with no mention of there not being any actual audit report. In the second interview he did speak of the absence of a signed report, but not in terms of thereby denying any responsibility; “not that I actually signed off an audit because there was no statutory audit” (p 4369) and “I was happy if somebody had asked me to sign but they didn’t”. (p 4378). Subsequently Mr Newsham has sought to distance himself from answers given in these interviews, saying that he was under pressure of an oppressive interrogation; we have read the interview transcripts with care and do not accept that they show any cause for us to doubt the truthfulness of the statements quoted above. Likewise, in his evidence to us Mr Newsham confirmed that he was happy that the numbers that went across to Manchester were reliable and accurate as he had done “*debtors circularisations, creditors, attended a stock take, etc*”.

86 The contemporaneous documentation to which we refer above included the planning documentation, daily plan, audit team discussions, and points for the letter of representation. We have reviewed all those materials which point in our view in only one direction, namely that an audit was indeed being carried out as was understood by Mr Newsham and all his team, and by his Manchester colleagues, by HWCF and by his client WNG. In cross examination, Mr Newsham accepted that right up until 12th April 2006 he understood that an audit was being carried out and that he was the person doing this audit. We therefore do not consider it necessary to describe in detail all the documentation leading up to 12th April (C3, pp 535, 533, 526, 523, 521 and 515). The document dated 12th April

2006 (G14.1 (C2 p. 404)) upon which Mr Newsham was cross examined, was a stock valuation test carried out by him in respect of the period ending 31st March 2006. His conclusion was that *"Based on the work carried out the audit objective has been achieved"*. Mr Newsham accepted that he must have thought on 12th April 2006 that an audit was indeed being carried out. After the 12th April and at a date before 23rd April the file was made available to Mr Hale for review.

87 He carried out that review on the 23rd April 2006 (C3, p 492 to 494). He wrote down his review points and queries and that document is on the Preston office audit file. It is this document that evidences that at this stage there was a full set of accounts and notes to the accounts. It is also in this document that Mr Hale asks what is to be the form of the audit report, given that this is a non-statutory audit. Plainly Mr Hale understood this review to form part of an audit as opposed to being a review simply for purposes of the Manchester office work on the Short Form report.

88 On 2nd May 2006 Mr Newsham completed a *"Hot audit file review checklist"*. This document (C3, p 575) contains a number of specific declarations and confirmations. The purpose of the hot review is to *"minimise the firm's exposure to risk by seeking the opinion of an audit partner unconnected with the client and, in some cases, unconnected with the office"*. Five declarations are set out and against each of those five declarations Mr Newsham has placed his initials confirming as Audit Partner prior to the hot review each of the declarations had been properly complied with. In an additional clearance statement, by the Audit Partner, Mr Newsham confirmed on 2nd May 2006 that he had cleared all points

to the satisfaction of the Review Partner. This document was signed off by Mr Fort on 3rd May 2006. Again, the involvement of the Manchester office person (Mr Fort) was plainly understood by both parties to be an involvement in a Preston office audit for which Mr Newsham was responsible.

89 In his evidence to us about the hot review, Mr Newsham confirmed that on the date that he signed the hot review document, he believed that he was the audit partner on the audit and that all the various steps which he had confirmed had been taken had indeed been taken. This evidence flies in the face of what he sought to say in his witness statement and of other, earlier, evidence given by him to the effect that he did not carry out an audit. We reject such earlier evidence and the witness statement.

90 Supporting evidence - were it necessary, which we do not consider it is - for our conclusion (that Mr Newsham carried out an audit, committed himself to its resulting in his having an unqualified audit opinion and communicated such an opinion to others), is to be found in a number of documents signed or initialled by Mr Newsham on 9th May 2006. In particular is a document entitled "*Responsible Individual Review and Conclusion*". (A21-1 and A 20 (C3 pp. 488 to 490)). The purpose is to ensure that all necessary procedures have been followed to form the audit opinion. Fourteen separate initials are placed by Mr Newsham on that document and he confirms that he is "*able to issue my audit opinion subject to the satisfactory completion of the procedures below*". He confirms that the director's report and balance sheet have been signed, approved and dated; that subsequent events have been considered up to the date of the audit report; and

that the audit report has been signed and dated. He confirms that he can give an unqualified opinion in respect of the audit. In his overall review of the financial statements a further 12 signatures appear and the overwhelming evidence is that Mr Newsham accepted that an audit had been carried out. His final words are *"The audit objective above has been achieved and in my opinion the conclusions a reader might draw from these financial statements are justified"*. That statement is signed and dated 9th May 2006.

91 Also on that date Mr Newsham entered a number of other signatures or initials on the papers in the front section of the audit file, all of a kind to indicate that he was content to 'close' the audit. One of these was his response to Mr Hale's query of 23rd April asking about the form of the audit report; Mr Newsham's response on 9th May was "part of reporting accountant's role". It was submitted to us on behalf of Mr Newsham – and advanced also by Mr Newsham himself – that this response shows that Mr Newsham did not carry out an audit or give an audit opinion. We disagree with that interpretation. The strong evidence of all the other documentation is that in this response Mr Newsham understood Mr Hale to be addressing the 'form' of the audit report, not the responsibility as to whether or not to sign a report at all. The 'form' of report was a natural subject for Mr Hale to address and for Mr Newsham to deal with in his response, given that the public visibility of the audit opinion would not be by way of publication of statutory accounts to all shareholders with a standard-wording audit report included in that publication, but by way of the inclusion of the audited figures in the short form report and publication in that report not of an audit report itself, but of a

statement by the reporting accountants that the figures had been audited and the auditor had given an unqualified opinion.

92 Mr Newsham told us that all of those statements, appearing to demonstrate his having completed an audit, were signed in error. He could not explain why he did sign off at the time although he told us that it was “ *a very difficult period of time, and it was just, I don’t know, force of habit, tired, just to get the thing off the desk and away*”. We reject that evidence.

93 It seems to us that somehow or other, in circumstances that there is no signed audit report on file, Mr Newsham has persuaded himself that despite the overwhelming evidence to the contrary, he did not carry out an audit and did not give an audit opinion. While his opinion may not have been recorded in an audit report, it is absolutely plain to us that an audit process was carried out and that one way or another he did give that opinion to enable the financial statements for the period to 31st March 2006 to be relied upon by WNG, HWCA Limited, Manchester and indeed others. We reject his evidence to us denying that there had been an interim 2006 audit or that he was responsible therefor, and we are regrettably forced to the conclusion that this evidence was less than truthful, and that he failed to accept responsibility for the interim audit carried out by him and others under his supervision.

94 In the light of these findings, we proceed to deal with the allegations of misconduct arising out of the interim 2006 accounts. We note that there was a large overlap with the end process of signing of the year-end 2005 accounts

(signed on 3rd May 2006 by Mr Newsham) and we also, of course, have very much in mind that not only the 2005 accounts but also the interim 2006 accounts were being prepared for inclusion in the placing document. This was indeed recorded in the planning documentation (C3 p.515) where it is stated *“The company is looking to float on AIM. These accounts form an integral part of this process and as a result there is a high level of reliance to be placed upon them”*.

Allegation 23

95 Mr Newsham’s audit planning did not achieve, so it is said, the objective of the planning process in that he

- (i) failed to identify that WNG did not have an appropriate long term contract accounting system, and
- (ii) failed to use his experience and knowledge of WNG’s systems, which hindered his ability to perform his audit in an effective manner.

This is effectively a repetition of the allegation in respect of 2005. When this audit was being planned, there was, so it is alleged, no specific reference to the WNG contract accounting system and whether or not costs on each contract could be properly captured. No reference was made to testing for AMROC, pre-contract costs or other contract related balances. It should have been known, certainly by this stage, that the WNG accounting system as used was not capable of accurately

recording and allocating revenues and costs against specific contracts. For that reason there would be a real risk of material misstatements.

96 Mr Newsham did not deal with any of these shortcomings in respect of the interim 2006 accounts in his witness statement, but they were addressed by Mr Wilkinson in his report and his evidence in this regard was accepted by Mr Newsham. It is apparent that Mr Newsham's team identified that contract sales were a major audit risk area (C2, p.428). However they completely failed to identify what steps should be taken in order to resolve likely problems. On 7th April 2006 Mr Tomlinson repeated that the area of long term contracts was one of key importance in the carrying out of the audit (C3, p.515). Given our acceptance of Mr Meredith's evidence to us that absent a fully operational and properly operated job costing system, planning was essential to ensure that each contract was examined separately on a revenue and cost basis, the complete absence of planning related to this area and creation of any form of testing procedures is a very serious shortcoming. Mr Wilkinson confirms that there were shortcomings in this area including a failure to document the long term contract accounting system or an assessment of its effectiveness. No control weaknesses following any assessment of the systems appear in the audit papers. The audit team also failed to plan and record any specific tests for AMROC, pre-contract costs or any other related contract balances. Mr Wilkinson observes, and we accept, that it is not at all clear that the long-term contract accounting system of WNG would not operate, but it appears that it was not effectively utilised to report accurately costs and revenues associated with each individual contract. This was a signal

failure which should have been clearly identified and steps taken as to how this should be dealt with.

97 Mr Wilkinson confirms that in his planning of the 2006 interim audit, Mr Newsham failed to consider or record whether WNG's long-term contract accounting system was appropriate and also failed to use his prior experience of WNG's systems when performing and recording the planning work and that there were accordingly shortcomings in that Mr Newsham fell below the standards expected of a reasonably competent auditor. We agree with this assessment, and given the knowledge which had already been obtained of these systems, their critical importance to ensuring the financial statements were accurate, and the impending listing of WNG, these were acts or omissions which in our view fell significantly short of the standards reasonably to be expected, and accordingly we find misconduct has been proved.

Allegation 24

98 It is alleged that Mr Newsham failed to achieve the objectives of the planning process in that he failed to identify the risk, based on prior experience, that difficulties would be encountered in obtaining sufficient appropriate audit evidence and failed to use his experience and knowledge of WNG which hindered his ability to perform the audit in an effective manner. It is obvious that there had been many problems in obtaining sufficient appropriate audit evidence for late invoiced work and retentions in respect of the 2004 year-end audit and in relation to pre-contract costs, late invoiced work, retentions, AMROC, stock and WIP in

respect of the 2005 year-end. Mr Wilkinson accepted, after reviewing the audit materials, that there was a failure to communicate the problems which had been encountered in obtaining appropriate audit evidence for the balances associated with long-term contract accounting in 2005. No appropriate procedures appear to have been designed to deal with this and while there is a reference in the materials to WNG's "*struggle to produce the management accounts and supporting information on time*" the response was to set up a meeting with Mark Worthington to resolve as many problems as could be achieved.

99 But this fell well short of designing alternative testing procedures for AMROC, late invoiced work or retentions. Mr Wilkinson therefore concluded that there had been a failure by Mr Newsham to identify that his team would encounter issues in obtaining sufficient appropriate audit evidence from WNG in relation to AMROC, late invoiced work and retentions. We consider that again, given the importance and timing combined with prior knowledge and experience of these issues, the failure amounted to a significant falling short of the standards reasonably to be expected, and we find misconduct proved.

Allegation 25 and Allegation 26

100 These allegations are in respect of pre-contract costs. First, the allegation is that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to draw a reasonable conclusion that WNG had obtained a right to consideration and that the pre-contract cost balance was correctly recognised in

the financial statements or that the financial statements had been prepared in accordance with Accounting Standards as required by ISA 200.

101 Allegation 26 is made in respect of the obtaining of sufficient appropriate audit evidence from which to draw a reasonable conclusion in relation to the asset recognised in respect of pre-contract costs. The allegation relates to a balance of £628,240 included in the interim financial statements as pre-contract costs. Mr Newsham had carried out work on this balance (C2 p.425). The pre-rollout costs were summarised by site, number of bedrooms per contract and start date and £150 per room was identified by Mr Newsham as the amount of revenue to be recognised. The shortcoming identified by Mr Meredith is that there was inadequate audit evidence on the file to confirm or to record that Mr Newsham had indeed carried out what he said he had done. In addition Mr Meredith in his evidence stated that there was no evidence retained to demonstrate that the contracts which had been reviewed were awarded before year-end and that accordingly there was a right to recover pre-contract costs. This was a similar issue which had been raised in previous years. It would have been good practice to ensure that the balance had been agreed to a signed contract and that the signed contract allowed the recovery of the element of the per room cost that had been deemed to be pre-contract expenses. The failure in this regard includes Allegation 27 which relates to the failure to retain audit evidence in respect of pre-contract costs. In his review of the audit files, Mr Wilkinson concluded that there was no evidence to demonstrate that Mr Newsham or his team considered

whether or not pre-contract costs were reasonable and whether or not they should have been recognised at the year end. Because the pre-contract costs related to accrued income, Mr Wilkinson would have expected a review of the expected profitability of the hotel contracts at the year end and an assessment of whether or not WNG should have recognised an element of profit on these contracts. There was no evidence on the file that this was considered by the audit team. Accordingly, Mr Wilkinson concluded that the allegations in respect of pre-contract costs were indeed made out. We agree. Again, having regard to the importance of these balances, and the prior knowledge and experience of WNG together with the critical period of timing, we are satisfied that these were acts or omissions which fell significantly short of the standards reasonably to be expected and we find misconduct proved in respect of each of these three allegations.

We turn to the allegations in respect of retentions.

Allegation 28

102 It is alleged that Mr Newsham failed to obtain sufficient appropriate audit evidence to allow him to conclude that retentions were accounted for by WNG in accordance with the relevant Accounting Standards. In addition, Allegation 29 alleges that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to draw a reasonable conclusion in relation to the amounts included within debtors relating to retention.

103 The policy of WNG was to recognise the full value of the retention. The financial statements for the 2006 interim period show a balance for retentions of £221,061. It appears that reliance was placed on the work performed in respect of the 2005 financial year retentions, and there is no indication that this was reviewed. The 2005 year-end audit was deficient in respect of retentions and this balance should not have been relied upon. As before, there was no assessment of possible future rectification costs and no explanation was given as to what work was performed on retentions. Mr Wilkinson agrees that there is no explanation on the file, and it does not appear that the audit team considered the status of the balances at the 2006 interim period other than to copy the audit schedules from the 2005 audit file. The document headed "*Outstanding Audit Evidence*" dated 9th May 2006 (C3 p.491), (see above for the importance of that date), makes reference to "*Retentions Re LRG commitment to pay*". There is then a reference to a Monday meeting with Mark which is a reference to Mr Worthington. This related to the delay in payment of some of the retentions but whether or not this was actually discussed with Mr Worthington is not known since no reference appears on the audit file as to the outcome of the meeting. Mr Wilkinson concludes, and we agree, that Mr Newsham's work in this area relating to retentions as recorded on the audit files fell below the standards reasonably to be expected, and in our judgment again, given the critical importance at this period of ensuring proper audit evidence was obtained and clear process applied to the materials, misconduct is proved since we consider that Mr Newsham's conduct fell significantly short of the standards reasonably to be expected.

Allegation 30

104 We now deal with two allegations in respect of AMROC relating to the interim period 2006. It is alleged that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to draw a reasonable conclusion in relation to the amounts included in AMROC, as required by ISA 500. The final balance of AMROC was £1,629,709, derived from a calculation which had been performed by WNG. This related to the number of rooms which had been completed as a percentage of the whole contract. No audit procedures were recorded by Mr Newsham in relation to this balance. An alternative calculation was carried out by Mr Tomlinson on 26th April 2006 (C2 p.418) for a sample of 10 contracts which were then compared to the original WNG schedule. That document sets out the number of rooms handed back as a proportion of the total number of rooms covered by the contract, but no evidence was available or recorded on the audit file in respect of the source of information in respect of the number of rooms handed back.

105 The audit evidence did not demonstrate whether WNG had indeed performed work on a contract that had not been billed prior to 31st March 2006 or that WNG was entitled to receive consideration from its customer for the work it had done. Mr Wilkinson reviewed the audit files and concluded that the audit team had indeed carried out some procedures on the AMROC balance (C2 p.419); but that documentation seen by the audit team was not retained and there was no documentation to indicate where the information in respect of the number of rooms handed back (C2 p.418) had been derived from as it was not on the audit

file. In addition, Mr Wilkinson could find no justification for the sample size of 10 tested sites covering some £400,000 when the total AMROC balance was £1,629,709. Overall, Mr Wilkinson was satisfied that there was a failure to obtain and record sufficient appropriate audit evidence to be able to draw a reasonable conclusion in respect of AMROC balances and that this failure caused the work to fall below the standards expected of a reasonably competent auditor. We agree with this assessment and in the light of the material balance and the previous difficulties encountered in this regard together with the importance of these accounts we conclude that Mr Newsham fell significantly short of the standards reasonably to be expected and we find misconduct proved. We should add that Mr Hale in his review on the 23rd April 2006 (C3 p.493) highlight the need to obtain audit work to complete and evidence these balances and to confirm that the contracts were complete as at the 31st March 2006. Mr Newsham simply wrote “Done” in the margin against this point for review.

Allegation 31

106 It is alleged that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to draw a reasonable conclusion that long-term contract amounts had not been double counted, as required by ISA 500. It originally appeared that some deductions were made when assessing the AMROC calculation in respect of amounts previously taken to revenue in the 2005 financial year relating to 6 Holiday Inn contracts. This was to prevent double counting. It was asserted that no deductions had been made for amounts recognised as pre-contract revenue in the 2005 financial year. In respect of some of the contracts

100% of the contract revenue was recognised in the 2006 interim audit although a proportion had already been accounted for in the 2005 financial year. The effect of this was to give rise, so it was alleged, to double counting of £458,115 which would have an equal effect on net profits.

107 After Mr. Meredith's original report was produced, new materials emerged which were reviewed by him. He accepted that in fact there was no double counting. There remained shortcomings in terms of the failure to obtain appropriate evidence and indeed there was a signal failure to demonstrate in the audit working papers that any issue had been identified. The outcome was that revenue and profits were not in fact overstated. Mr Wilkinson also concluded that there had been a failure to obtain and place on the audit file sufficient appropriate audit evidence to ensure that the balances had not been double counted, but in the circumstances, we conclude that this was not so serious as to amount to misconduct. The work undoubtedly fell below the standards to be expected of a reasonably competent auditor, but in our judgment in this instance the work was not so serious as to amount to misconduct. We accordingly dismiss this allegation.

Allegation 32

108 This allegation relates to stock and work in progress. The allegation is that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to draw a reasonable conclusion in relation to the long term contracts and stock balances. For the period ended 31st March 2006, an adjusted balance showing stock and WIP of £411,932 was made up of two separate amounts. First,

£227,967 in respect of long-term contract balances, representing stock held at 16 sites; secondly, £183,965 relating to stock items held at Hyde Park Corner. In respect of the first allegation, audit procedures were carried out and a stock take attendance was performed at 2 of the 16 sites. No explanation was given as to the reason for choosing those two sites or indeed the exact procedures undertaken for the stock take or the conclusions drawn therefrom. The supplier price lists in respect of the items checked on the stock sheets were not retained on file.

109 Mr Meredith sought to say that there should have been a wider investigation and analysis as to whether or not stock should be reflected in the balance sheet or whether it was a cost that had already been incurred for an individual site so that it should be counted and included separately from long-term contract work in progress. This broader criticism was no part of the pleaded allegation and effectively we are left with the main thrust in respect of long-term contract balances relating to failure to retain price lists on the audit files. Mr Wilkinson on his review of the audit materials agreed that the supplier lists had not been retained on the audit file. He considered the valuation tests performed by the audit team had not fully covered the valuation of stock. In addition he would have expected the audit team of Mr Newsham to document on file why these balances were shown as stock and that they had gained comfort that these balances were not double counted with pre-contract costs, AMROC or late invoiced work accrued income balances within debtors. No such documentation was contained. Again these criticisms seem to us to go wider than the actual terms of the allegation and

we conclude that although there are shortcomings in respect of this aspect of the allegation, they do not amount to misconduct as they are not items which fall significantly short of the standards reasonably to be expected of a member.

110 Allegation 32 also relates to stock items held at Hyde Park Corner. There was a balance of £183,695 supposedly verified by an invoice from ECG Group. However Mr Meredith told us, and we accept, that the stock in the work papers was confirmed at July 2005, so the same balance appears in the September 2005 accounts as in the March 2006 accounts. No investigation appears to have been carried out as to why the stock balance has not changed. Secondly, this balance represented stock relating to the Curzon contract and of course Curzon was in some form of insolvency process. A question therefore arose as to whether or not the stock, if it was specific to that contract, was or was not recoverable. No audit evidence was obtained in respect of this amount. Mr Wilkinson in his report confirms that the ECG invoice did not show that stock was still present at the 2006 interim period end and no site visits had been made by the audit team to confirm that the stock still exists. In respect of this part of the allegation we are satisfied that sufficient and appropriate audit work was not carried out in respect of the conclusion for these material balances. In respect of the stocks, in our view the actions taken by Mr Newsham fell significantly short of the standards reasonably to be expected of him and we find misconduct proved.

Allegation 33

111 This allegation relates to failures in the partner review. It is stated that Mr Newsham, as audit engagement partner, in his review failed to identify that the audit evidence obtained was not sufficient appropriate to support the conclusions reached, and that the balances were not materially misstated as required by paragraph 26 of ISA 220. We have referred to the review carried out by Mr Newsham on 9th May 2006. He was satisfied there was sufficient evidence to support the audit opinion and that the financial statements were free from material misstatement. The allegation is that Mr Newsham failed to identify the deficiencies in the evidence obtained and the conclusions in respect of

- (i) pre contract costs;
- (ii) retentions;
- (iii) AMROC and
- (iv) stock and WIP.

In our view it is plain that there were a number of deficiencies in the audit evidence obtained to support these balances and these were not identified by Mr Newsham during his partner review, and we accept Mr. Meredith's evidence on this topic. These include the following:

- (i) A failure to obtain contractual evidence to confirm that WNG were entitled to revenues on long-term contracts;
- (ii) A lot of the audit evidence was in draft form and not signed by the relevant third party;

- (iii) Very little audit evidence was retained on file;
- (iv) There was a lack of evidence in respect of the financial statement assertions which a reasonably competent auditor would have identified as being relevant to these balances;
- (v) The evidence obtained did not provide adequate material from which to draw a conclusion that the relevant balances were not materially misstated.

112 Mr Wilkinson, other than in respect of the double counting of revenues in relation to AMROC, concludes that the review undertaken by Mr Newsham failed to identify the deficiencies in the quantity and quality of audit work undertaken by his audit team and that his standards fell below the standards expected of a reasonably competent auditor. We agree that there was no failure to identify double counting in respect of AMROC that had been previously recognised in the 2005 year-end audit. However, we are satisfied that his conduct fell significantly below the standards reasonably to be expected of him and we find misconduct proven. We return below to whether or not we conclude that Mr. Newsham was reckless in his performance of the 2006 interim audit.

The 2006 Audit

113 It will be apparent that a number of the allegations made against Mr Newsham fall into a similar pattern. We continue to consider each of them on their merits, and the seriousness of them does not of course diminish. We also

have much in mind that by the time of the 2006 accounts, WNG had achieved its listing and this was an element of which Mr Newsham, as audit engagement partner, should have been only too well aware in terms of the type and level of responsibility it laid upon him.

114 There are three allegations in respect of the failure to identify potential audit issues in the planning process. These are repeated shortcomings in the light of previous history.

Allegation 35

115 This allegation asserts that the audit planning did not achieve the objectives of the planning process in that:

- (i) it failed to identify that WNG did not have an appropriate long-term contract accounting system; and
- (ii) Mr. Newsham failed to use his experience and knowledge of WNG's systems which hindered his ability to perform the audit in an effective manner. It is alleged that the planning documentation failed to address the ability of WNG's accounting system to account appropriately for long-term contracts.

At this stage there were still problems in recording and allocating revenues and costs to specific contracts, with consequential risk as to material misstatement. There is no dispute that the contemporaneous documentation does not address directly

these issues. Mr Hale on 29th September 2006 (C4 p.1233) stated that *“Historically the accounting for pre roll out contract costs, amounts recoverable on contracts and associated WIP has been poor. P Newsham is to review the workings provided”*.

116 In our view this fell well short of what should have happened at the planning stage. Mr Meredith’s evidence to us, which we accept, and which we refer to above, is that if the SAGE accounting system was not fully operational or was not being operated properly, then it was essential for WNG to go back and reconstitute on a contract by contract basis to understand the position on a contract by contract basis. In his view absent such an exercise, it would not be possible to express an opinion on the accounts. Yet again, there was a signal failure to address this important issue at a vital stage of the company’s progress. Mr Wilkinson agrees that the planning did not achieve the appropriate objectives and asserts that this meant that the conduct fell below the standards reasonably to be expected of an auditor. Our view is that the planning was totally inadequate in respect of its shortcomings and in terms of the implications of it. It was a bad failure of the planning stage which should have been capable of rectification during the course of the audit. As we shall hereafter relate, this simply did not happen. We are satisfied that this failure, repeated yet again, amounted to a significant shortcoming and amounted to misconduct.

Allegation 36

117 The allegation here is that Mr. Newsham failed to identify the risk, based on prior experience, of difficulties being encountered in obtaining sufficient

appropriate audit evidence and his failure to use his experience and knowledge of WNG hindered his ability to perform the audit in an effective manner. There had undoubtedly been difficulties in respect of previous audits in obtaining sufficient appropriate audit evidence in particular for late invoiced work and for retentions. Despite Mr Hale's attempt to flag up the previous difficulties, it is clear that no real effort was made to address the particular problem. Mr Wilkinson agreed that from his review of the audit files the audit team in prior years had "*struggled to obtain sufficient appropriate audit evidence for the balances associated with long term contract accounting over a number of years*".

118 In his view there should have been identified during the 2006 audit the previous problems and a review of how appropriate audit procedures could be designed to meet them. None of this appears to have been reviewed or recorded in any document. Symptomatic of the approach that was adopted was the statement in an Audit Planning Memorandum (C4 p.1204) that "*There has been no problems in the past with obtaining audit evidence and no problems have been anticipated this year*". This was plainly a quotation carried forward from previous memoranda that indicates in our view the lack of rigour which was applied in the planning process. Mr Wilkinson considered that the planning undertaken and recorded by Mr Newsham failed to identify and document the risk based upon prior experience of the difficulties that would be encountered in obtaining sufficient appropriate audit evidence and the failure fell below the standard expected of a reasonably competent auditor. Again, we conclude that this was a very serious failure in the light of previous history and the position of WNG at the

time and we consider that his actions fell significantly short of the standards reasonably to be expected of him and accordingly we find misconduct proved.

Allegation 37

119 This allegation relates to the failure to identify at a planning stage key audit areas, as required by paragraph 4 of ISA 300. It is alleged that because of the previous difficulties in respect of the accounting of AMROC and WIP, these risks should have led to the consideration of the actual procedures to be performed and there is no evidence that they did. Mr Wilkinson confirms that the planning section of the audit file makes no specific reference to a tailored testing plan to mitigate the risk identified over pre-contract costs and AMROC. He makes the point that it appears that some procedures were performed on the relevant balances despite that lack of tailored testing which was not designed and recorded at the planning stage of the audit. Again, Mr Wilkinson concludes that there was a failure to design and document testing to mitigate against key risks identified during planning and that this failure meant that the actions of Mr Newsham fell below the standards expected of a reasonably competent auditor. We agree and we find these shortcomings were sufficiently serious as to amount to misconduct in that his actions fell significantly short of the standards reasonably to be expected of him.

Allegation 41

120 This allegation asserts that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to determine with reasonable confidence that WNG had obtained a right to consideration, that the pre-contract costs balance was correctly recognised in the financial statements or that the financial statements had been prepared in accordance with Accounting Standards as required by ISA 200. In addition, Allegation 42 alleges that Mr Newsham failed to obtain sufficient appropriate audit evidence on which to draw a reasonable conclusion in relation to the asset recognised in respect of pre-contract costs.

121 The 2006 year end financial statements show a balance for pre-contract costs of £2,406,939. This was a significant increase on the balance shown in the 2006 interim audit. Mr Newsham himself carried out audit work on some of the contracts. He made no explanation on the file as to the different rates which he applied to different sites. It is alleged that there were no signed contracts obtained, reviewed or retained by him and no audit procedures conducted to ensure that WNG had actually incurred costs in undertaking pre-installation work and that such costs could be billed at the per room rates used in the calculation.

122 In our view it was imperative that it should be ascertained that there were contracts in place, that they gave a right to recovery of costs of pre-installation work, that costs had actually been incurred, (although a standard value per room was appropriate), and we accept Mr. Meredith's evidence in this regard. We reviewed the audit file at C3 p.760. There were significant shortcomings in demonstrating that the appropriate amount of work had been carried out in respect of this material balance. Mr Wilkinson agreed that there was no

explanation for the use of different room rates and number of rooms compared to those used in previous periods. He also agreed that there was no explanation as to the large increase in the pre-contract costs balance when compared to the 2006 interim balance. He also would have expected Mr Newsham and the audit team to review the expected profitability of the hotel contracts at the year end and to consider whether or not WNG should have recognised an element of profit on those contracts. There was no evidence that he had done so on the audit files.

123 Mr Wilkinson concludes that, yet again, the audit work documented did not confirm the recoverability of pre-contract costs, that pre-contract costs were recognised in the correct period (and should be recognised) or that pre-contract costs were correctly accounted for. He concluded that the audit work supervised by Mr Newsham fell below the standards expected of a reasonably competent auditor. Again, we agree with this conclusion, save that we think it goes further. In our view the failings fell significantly short of the standards reasonably to be expected and misconduct is proved in respect of each of these two allegations. This was a significant balance for a listed company and the issue was not a new one and required careful and detailed consideration. Mr Newsham himself accepts that, on reflection, he should have obtained further audit evidence in relation to this balance overall.

Allegation 43

124 This allegation is made in respect of the failure to obtain sufficient appropriate audit evidence to enable a conclusion to be drawn that the retentions were

accounted for by WNG in accordance with Accounting Standards. Linked to this is Allegation 44 whereby it is stated that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable a reasonable conclusion to be drawn in relation to amounts included within debtors relating to retentions. These allegations relate to two amounts making up the retention balance of £259,588. First, £44,000 relates to Debenhams Maintenance; secondly £215,588 is described as "2004 Holiday Inn". Very little evidence could be found on the audit file relating to the Holiday Inn balance, and no audit procedures were carried out on the Debenhams balance. Effectively, so it was said, the retentions balance of £259,588 remained unaudited. Mr Wilkinson accepts that that balance was untested and was a material balance to the 2006 year-end audit. In his view there were failures to consider whether provisions were required for the retentions recognised, that work had been completed by the year-end and indeed that retentions were recoverable. Mr Wilkinson's view was that the audit work as recorded on the audit files in respect of retentions was not sufficient appropriate to conclude that retentions should have been recognised by the year-end or that no provisions were required for these retentions. Accordingly he concluded that the work supervised by Mr Newsham in respect of retentions fell below the standards expected of a reasonably competent auditor. We agree with this conclusion so far as it goes. This was a material balance, and the whole way in which Mr Newsham approached the audit fell seriously short of the professional standards to be expected. This goes beyond his negligence or carelessness and in our view is sufficiently serious as to amount to misconduct in that he fell significantly short of the standards reasonably to be expected of him. We

accordingly find misconduct proved in respect of the allegations relating to retentions.

Allegation 45

125 This allegation relates to AMROC and is in respect of the failure to obtain sufficient appropriate audit evidence to enable Mr Newsham to draw a reasonable conclusion in relation to the amounts included in AMROC. Related to this is Allegation 46 whereby it is alleged that Mr Newsham failed to retain audit evidence that was sufficient to enable an experienced auditor, unconnected with the audit, to understand what audit procedures had been carried out, why they had been carried out or the reasons for reaching the stated conclusions, as required by Paragraph 9 of ISA 230. The 2006 financial statements contained an AMROC balance of £2,066,092. Over 50 sites were involved, the maximum value being £162,408. WNG provided a spreadsheet giving information in relation to each contract, including the percentage completion at 30th September 2006 and the completion value and amount billed as at that date. Mr Tomlinson agreed the contract value for each customer back to the order; project managers from WNG were required to confirm the completeness of the work, but no formal documentation or third party verification was found in relation to this. The total amount billed was agreed to SAGE but the Holiday Inn sales were posted through a single SAGE account, and checks were made to ensure unbilled sales at 30th September 2006 were billed after the balance sheet date. No notes were retained in the audit documentation as to the sampling methodology.

126 It is plain that verification work was carried out by Mr Tomlinson (C3 p.748) although there are serious shortcomings with the retention of internal valuations upon the file. Not only that, but Mr Meredith told us that there were significant failures to agree some £400,000 worth of revenue to any contracts or purchase orders in respect of Stardon. Mr Meredith's view was that there was no evidence to demonstrate the percentage completion as being 100% in respect of these contracts and that the evidence furnished by Mr Ford of Stardon Management was lacking in precision for the purpose of being able to sign off the rooms at 30th September, the year end.

127 Mr Wilkinson agreed that the e-mail evidence obtained in respect of the Stardon balances, totalling £1.05m was insufficient, as it did not provide evidence of the work performed on those hotels by the year end. He also agreed that evidence for some balances was not obtained and that the total of those balances, £224,088, was a material balance to the 2006 year end audit. No consideration appeared to have been given, according to Mr Wilkinson, by the audit team to the question of whether or not contracts would be profitable or not, or to gain assurance that profits should be recognised on those contracts.

128 Mr Newsham himself accepts that in hindsight further audit evidence should have been obtained and retained on the audit file and in particular further audit evidence should have been obtained in respect of the balance of £224,088 and the Stardon contracts which were not available at the time of testing. In our view the failings were more significant than that, in particular in relation to the 5 entries of £80,000 each with no supporting evidence (C3 p.647). These were

material balances, and the whole approach seems to us to have been negligent and careless. Mr Wilkinson agrees with this. In our view though it goes beyond mere negligence and carelessness and crosses the line such that it becomes a significant shortcoming in the standards reasonably to be expected of a member and accordingly we find in misconduct respect of these allegations.

Allegation 47

129 It is alleged that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to draw a reasonable conclusion in relation to the general stock and work in progress balances or the right of WNG to receive revenue in respect of the costs it had incurred, as required by ISA 500.

130 The adjusted stock and balance was £335,706 in the 2006 financial statement.

This comprised:

- (i) £275,706 in respect of raw materials and consumables (including £183,964 relating to a site at Hyde Park Corner);
- (ii) £60,000 of WIP.

It is asserted that the WIP balance was merely supplied by Mark Worthington and was not verified by any audit evidence. In terms of the stock-take attendance at any of the 13 sites, only 4% of the total balance was subject to audit process. Mr Meredith's evidence to us was that in respect of the stock at Hyde Park Corner, there was no attempt to count it; the number remained the same as between interim 2006 and the

year end 2006; the stock related to the Curzon contract, and no consideration was given as to why the stock had not moved, why it had not changed and whether or not the insolvency process undergone by Curzon affected its value. In terms of the balance of the stocks, the work that was performed was only in respect of 4% of the stock, and Mr Meredith would have expected the coverage to be higher.

131 Mr Wilkinson agrees that the audit team could have visited more sites to gain coverage over a greater percentage of the stock balance at the year end in order to gain assurance over the assertion in respect of stock. No update was performed in respect of the Hyde Park Corner balance which had not been updated since the interim 2006 audit. Although this was raised by Mr Hale in his review comments, Mr Newsham, it was recorded, discussed the same with Mark Worthington who confirmed that the stock was still held. Mr Wilkinson considered that the audit team should have documented on the audit file why the balances are included in stock and that they have gained comfort that these balances were not double counted with pre-contract costs, AMROC and late invoiced work balances. No such documentation or explanation is present on the audit files.

132 Mr Wilkinson concludes that the audit work supervised by Mr Newsham in respect of stock and WIP fell below the standards expected of a reasonably competent auditor. We entirely agree. This was another example of extremely poor exercise of the auditing function. In our view, the acts or omissions of Mr

Newsham fell significantly short of the standards reasonably to be expected of him, and we find misconduct proven.

133 We turn to the allegations in respect of the accounting policy regarding goodwill.

Allegation 48

134 It is alleged that Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to draw a reasonable conclusion that goodwill was accounted for by WNG in accordance with the requirements of UK GAAP, as required by ISA200. In addition, it is alleged in Allegation 49 that Mr Newsham failed to recognise that conducting the goodwill impairment review had the potential to threaten the independence of HWCA Limited and their objectivity as auditors, as required by ISA 220.

135 By reason of the reorganisation of WNG, there was a very significant goodwill balance of £28.7m. This was the largest asset in the financial statement. It appears that a decision had been taken by the directors of WNG not to amortise the goodwill in the group accounts on the basis that it had an indefinite life. Although concerns were registered about this, a calculation was made by Mr Hale. The objective of the calculation was not recorded and no detail of any work carried out on the fair value of the assets or liabilities or record of any justification for the conclusion that was reached. In addition, Mr Hale carried out a goodwill impairment review.

136 According to Mr. Meredith, the work carried out by Mr Hale did not justify the conclusions reached. No real consideration appears to have been given nor evidence provided for the conclusion that the goodwill had an indefinite economic life. Mr Meredith was not cross examined about his evidence on these allegations. Mr Wilkinson agreed that the audit team had failed to obtain sufficient appropriate audit evidence in relation to goodwill. In his oral evidence to us, he was very clear that no impairment review should have been carried out at all by members of the audit team, and that this could well have undermined their independence. Mr Wilkinson's conclusions are that Mr Newsham failed to obtain sufficient appropriate audit evidence to ensure goodwill was accounted for in accordance with UK GAAP; and failed to identify and consider the independence threat posed by preparing the goodwill impairment review on WNG's behalf.

137 Given the size and materiality of this balance, these failings were serious. They demonstrate to us a failure to exercise properly an important auditing function which could have very serious consequences. We have no hesitation in finding that the work in this regard fell significantly short of the standards reasonably to be expected and that in respect of both allegations misconduct is proved.

Allegation 50

138 The allegation is that Mr Newsham, as audit engagement partner, failed in his review to identify that the audit evidence obtained was not sufficient appropriate

to support the conclusions reached, and that the balances were not materially misstated as required by paragraph 26 of ISA 220. The allegations related to Mr Newsham's review carried out on 17th January 2007, (see, for example, C4 p.1180) in which he concluded that there was sufficient evidence to support the audit opinion and that the financial statements were free from material misstatement. The deficiencies related to pre contract costs; retentions; AMROC, stock and WIP, and goodwill. The alleged deficiencies are in similar form to those in respect of previous periods. These include the following;

- (i) Lack of contractual evidence to confirm that WNG were entitled to revenues on long term contracts;
- (ii) Audit evidence being in draft form and not signed by third parties;
- (iii) Large parts of the evidence, if obtained at all, not being retained on audit file;
- (iv) The evidence did not address the financial statement assertions, which should have been addressed by a reasonably competent auditor who would have identified them as being relevant to these balances;
- (v) Recognition that the evidence obtained did not provide sufficient coverage upon which to draw a conclusion that the balances were not materially misstated;

- (vi) Material balances such as in relation to retentions remaining unaudited.

We accept Mr. Meredith's evidence (not the subject of challenge) that there were deficiencies as alleged, and these failings reflect on the poor quality of the audit and were not reviewed as they should have been. In large measure Mr Wilkinson agrees with these allegations. He concludes that the partner review undertaken by Mr Newsham failed to identify the deficiencies and the quantity and quality of audit work undertaken by his team. We agree with this assessment and are quite satisfied that the acts or omissions of Mr Newsham in this regard fell significantly short of the standards reasonably to be expected of a Member. We accordingly find misconduct has been proved.

We now turn to 8 separate allegations which were made against Mr Newsham, in respect of which there was a denial as to whether or not there was any shortcoming at all. This is obviously quite different to the position in respect of each of the allegations with which we have already dealt where there were admissions as to shortcomings, but obviously no concession that any of those shortcomings amounted to misconduct.

Allegation 13

139 It is alleged that for the purpose of the 2005 audit Mr Newsham relied on a report prepared by Unity Accountants to support his audit work and conclusions in relation to pre-contract costs, when a copy of that report had neither been

obtained nor considered, nor was such reliance in accordance with the requirements of SAS 520.

140 In May 2005, Unity Accountants were instructed by Royal Bank of Scotland to conduct a review of the financial condition of WNG. They produced a report. That report was for the benefit of the bank, and a copy of it was never seen by Mr Newsham. No copy of it, obviously, was included in the HWCA audit files. It is alleged that Mr Newsham relied upon this report as evidence that contracts with customers actually existed.

141 In his evidence to us, Mr Newsham confirmed that he had found some degree of comfort from the existence of the Unity report and the resultant facility letter emanating from Bank of Scotland, in support of his conclusions for the year end 2004 audit as to whether or not WNG was a going concern. Although in interview as a result of the FRC investigation Mr Newsham made reference to this Unity report, we accept that this was something of a throwaway remark, and we are quite satisfied that he made no inappropriate reliance upon the contents of this report, unseen by him, in respect of pre-contract costs for the 2005 year end. We accordingly dismiss this allegation.

Allegation 15

142 This is an allegation in respect of alleged double counting for the year end 2005.

Mr Newsham is said to have failed to obtain sufficient appropriate audit evidence to enable him to draw a reasonable conclusion that pre-contract costs and late-

invoiced work were not double counted. In the 2005 year-end financial statements it is said that there was double counting of un-invoiced amounts. £71,165 related to four QMH sites, and, so it was said, this sum was included within both "*late invoiced work*" and "*pre contract costs*". Mr Wilkinson examined the schedule at C2 p.265 and his view was that looking at columns I, J and K, they added together to make column L. Mr Meredith in his supplemental report agreed that on the face of that schedule, there was no double counting of these uninvoiced amounts but he could not exclude the possibility that there was still double counting, though we are satisfied it could not be proved. On a balance of probabilities, having regard to Mr Wilkinson's evidence, we therefore conclude that we should dismiss this allegation.

143 We turn to allegations in respect of the hot review. It is said that in respect of the 2005 year-end (Allegation 22), the 2006 interim (Allegation 34) and 2006 year-end (Allegation 51) there was an inappropriate reliance placed by Mr Newsham on the hot review process and in so doing he failed fully to comply with his responsibilities as the audit engagement partner. The hot review was not intended to review the detailed working papers, but rather to focus on the planning and completion sections of the engagement. It seems to us that the purpose of having a hot review was to provide an independent assessment of the quality of the audit, and that does not make it improper for the audit partner to gain some comfort. As Mr Wilkinson said in his evidence, there would be little point in having a hot review were one not able to draw some degree of comfort from it.

144 Our conclusion is that Mr Newsham did indeed draw some comfort from each of the hot reviews that were performed in respect of his work, but that as a matter of fact he did not place inappropriate reliance on the hot review process. We accordingly dismiss each of the three allegations, 22, 34 and 51 made against him.

145 In Allegation 38 it is alleged in respect of the year end 2006 audit that Mr Newsham failed to carry out adequate planning in that he failed to identify a potential problem, that being the audit team's lack of experience in auditing listed clients, as required by paragraph 4 of ISA 300 and paragraph 19 of ISA 220.

146 By 2006 WNG was a listed company and there would be an increased risk of an incentive for WNG to overstate revenue and/or profits because of market pressure to meet expectations. The HWCA engagement team, and indeed Mr Newsham himself, had little or no experience of working with listed companies. It is right to say that the planning documentation contains no reference to the experience of the engagement team in auditing listed clients. Mr Newsham told us, and we accept, that Mr Hale had experience of working with listed companies, and that he had that in mind when he was brought onto the team. Mr Newsham accepts with hindsight that this should have been documented and plainly it was an important aspect of the planning process. However, taken in isolation and as pleaded, we are not satisfied that this failure amounted to misconduct. It may

have been careless, but it was not so serious as to fall significantly short of the relevant standards.

Allegation 39

147 It is asserted in relation to the same year that Mr Newsham failed to achieve the objectives of the planning process in that he failed to identify and take into account Mr Thompson's lack of experience in the auditing of AMROC and as a result the audit in respect of AMROC was not appropriately assigned to engagement team members as required by paragraph 4 of ISA 300.

148 Mr Thompson was a new member of the engagement team for the 2006 year-end audit. He had no professional accounting qualification. The AMROC balance amounted to £2,066,092. The allegation asserts that there would be real concern that the calculation and audit of AMROC might give rise to material misstatement.

149 Mr Newsham told us, and we accept, that Mr Thompson had had more than 25 years' experience of dealing in accounts and he was familiar with WNG. Mr Thompson had no understanding of SSAP9 as he accepted in interview. However Mr Newsham informed us, and we accept, that Mr Thompson was not being asked to carry out anything other than a test to confirm the amount of unbilled work, the actual debtor balance (see E p.169) and that he was not asked to look at any profit or losses on the contracts. Any work he carried out would then be subject to review by Mr Newsham. We conclude that so far as it goes any

planning involving Mr Thompson was adequate in the circumstances, and we dismiss this allegation.

Allegation 40

150 It is alleged that in the same year Mr Newsham failed to achieve the objectives of the planning process in that he failed to identify a potential problem, that being the engagement team's lack of experience of auditing goodwill.

151 The goodwill balance was stated to amount to some £28.7m. This was the largest asset in the accounts. Mr Hale, who was allocated to audit goodwill, had no experience of undertaking a goodwill impairment review and the team in general had very little experience of auditing goodwill. It seems to us that it was essential at a planning stage to focus on how and by whom goodwill was to be addressed. There was plainly a lack of experience in the team which needed careful management and planning. Mr Meredith considered that there was nothing wrong in principle with goodwill being allocated to Mr Hale, but that the fact he had not undertaken an impairment review before should have been noted in the planning memorandum, and some steps taken to mitigate the risk. Mr Wilkinson gave evidence to us that in the light of Mr Hale's seniority he would expect him to be able to deal with goodwill because he was senior enough to actually do his own research, speak to colleagues, and come back with a reasoned view. He was adamant however that no impairment review should have been carried out by him. But that was not a planning issue. It seems to us that although this planning was far from perfect, taking into account all the evidence

we have heard, it would not be appropriate to make a finding of misconduct in respect of the planning allegation relating to goodwill. We accordingly dismiss it.

Recklessness.

152 We gave permission to Executive Counsel to allege that there was recklessness on the part of Mr Newsham. We have carefully considered this allegation in respect of each of the complaints made against him. While we are quite satisfied that on numerous occasions Mr Newsham fell way below the standard reasonably to be expected of an auditor, we are satisfied that for the most part he did not act recklessly. Rather we consider that over time he became increasingly out of his depth. This was a complex audit to carry out, with significant pressures from WNG and elsewhere. Our impression is that Mr Newsham was simply incapable of coping either with the pressure or the increased complexities of dealing with the long-term contract basis under which WNG operated.

153 In our judgment, however, Mr. Newsham acted recklessly in respect of the interim 2006 audit. When he submitted his audit file to Mr. Fort on 2nd May 2006 declaring that his audit had been satisfactorily completed, he must have known there were serious deficiencies in the audit evidence and that they might involve a breach of the applicable professional standards. Nonetheless he proceeded to submit the audit file and he allowed the financial statements to go forward. In the same way, when carrying out his closing review on 9th May 2006, he proceeded to close the file with the same knowledge. We are accordingly satisfied that in respect of the following allegations he acted recklessly, all of them being

intrinsically relevant to his giving his audit opinion. These are Allegations 25, 26, 27, 28, 29, 30 and 32.

154 Adverse Findings. This Tribunal in the light of this ruling, makes a series of Adverse Findings in respect of the allegations of misconduct which we have found proven. We shall accordingly require a hearing for the consideration of sanctions. We should state that we have been troubled by the significant delay in this case. Investigations by the AADB started in 2008, and in April 2009 Mr Newsham was informed that he was being treated as a Member under investigation. It was another 4 years before the formal complaint was served and a further year has now elapsed culminating in the hearing held before the Tribunal.

SANCTIONS

155 Following the issue of our draft Report (which comprised Para 1-154 above), we conducted a hearing to consider what sanction we should impose upon Mr. Newsham. Prior to the hearing (on 5th September 2014) we received further materials from Executive Counsel and from Mr. Newsham. These included skeleton arguments and other documentation. We perused all those materials prior to the hearing, and we received oral submissions from both parties. We have considered all those materials, both written and oral, which we found to be very helpful. We do not refer to all of those materials, but they have all been subject to review by us. We have been referred to other sanctions decisions made by other Tribunals, but we consider each case to be fact sensitive and, obviously, to be decided on its own individual facts.

156 Our starting point is the Sanctions Guidance (SG) issued by the Financial Reporting Council on 1st June 2014, which we have considered in detail. Sanctions are imposed for a number of stated objectives. Para 9 sets them out, and they include the deterrence of the accountancy profession from committing misconduct; the protection of the public from Members whose conduct has fallen significantly short of the standards reasonably to be expected of them; the maintenance and promotion of public and market confidence in the accountancy profession and the quality of corporate reporting; and the declaration and upholding of proper standards of conduct amongst Members. The primary purpose of the imposition of a sanction is not punishment, but the protection of the public and the wider public interest. We should add that public confidence in the accountancy profession extends also to confidence in the effective and fair disciplinary process (*Fuglers LLP and others v SRA* [2014] EWHC 179 (Admin) at para 32). We have had this proposition very much in mind when considering the appropriate sanction.

157 Para 16 SG sets out the approach which we should adopt in reaching our conclusion upon which sanctions to impose. First, we address the nature and seriousness of the Misconduct. Para 18 SG sets out a number of non-exhaustive factors. We consider the following to be relevant:

(a) whether the Misconduct caused or risked the loss of significant sums of money.

We accept that the Misconduct did not directly lead to the collapse in the share price

of WNG in late 2007, as indeed was accepted in evidence by Mr Meredith, nor did it lead directly to all the investors' losses. That said, we are satisfied Mr Newsham knew that the accounts for the year end 2005 and interim 2006 accounts were to be relied upon in connection with the listing on AIM upon the basis they had been audited and a clean audit opinion given. £20m was invested on the initial listing and we consider investors would have relied upon the audited accounts, just as they would have done after WNG was listed. Indeed we consider that had Mr Newsham carried out a proper audit for the interim 2006 accounts, in respect of which we have found 10 allegations proved, 7 of them committed recklessly, the listing may well not have proceeded. Substantial sums were at least put at risk by the Misconduct.

(b) the nature, extent and importance of the standards breached. We consider the breaches (totalling 35) were themselves significant and had an inevitable impact upon the reliability of the financial statements over a three year period at a critical stage of WNG's history. The failure to come to grips with the proper auditing of long term contracts caused real problems over a significant amount of time (see Para 22 above). While it may well have been a complex process, and WNG was not the easiest client, nonetheless there was a signal failure over time to address the vitally important issue of these contracts.

(c) whether the Misconduct was dishonest, deliberate or reckless. Our finding of recklessness is set out above at Para 153, and is in respect of 7 proven complaints in respect of the interim 2006 audit, a critical audit from the perspective of investors.

(d) whether the Misconduct adversely affected, or potentially adversely affected, a significant number of people in the United Kingdom, including investors, other market users and others. We conclude that a significant number of people were adversely affected when they invested in WNG upon its listing or in subsequent placings.

(e) whether the Misconduct could undermine confidence in the standards of conduct in general of Members and/or in financial reporting and corporate governance in the United Kingdom and/or in the profession generally. The scale and extent of the Misconduct which we have found established could, in our view, undermine confidence in the profession especially in financial reporting.

(f) whether the Member held a senior position and/or supervisory responsibilities. Mr Newsham was the audit partner and Responsible Individual for the 2005 and 2006 audits, and in our judgment was responsible for the interim 2006 audit.

(g) whether the Member was solely responsible for the Misconduct. While it is correct to say that Mr Newsham was subject to hot reviews by Mr Fort, and that some elements of his work were reviewed by Mr Hale and that he had a team of staff working for him, in our view he was solely responsible for the Misconduct.

(h) we also were, as set out above, especially concerned by the failure on the part of Mr Newsham to acknowledge his responsibility for the interim 2006 audit, and the manner in which he did so before us. Such failure could in our view undermine confidence in the profession.

158 Having reviewed our findings and the factors set out above, we unhesitatingly conclude that the Misconduct was serious, a conclusion with which Mr Newsham agrees. The 35 findings of Misconduct relate to work carried out over a period of time, and there was a degree of repetition. Public confidence on the part of investors and others in the profession will have been affected.

159 We next turn to the sanction or combination of sanctions which we consider potentially appropriate in the light of the Misconduct. These include Reprimands or Severe Reprimands, a Direction, Fines, Repayment of client fees, Preclusion and Exclusion.

160 We first set out the position of each party, which of course is in no way binding upon us. Executive Counsel has submitted that the circumstances are such that we should make an order of exclusion for a period of four years. Mr Newsham by contrast submits that we should order a Severe Reprimand, give Directions for further education or training, impose restrictions upon his ability to conduct any audit function, and order payment of a sum of £50,000 by way of fine and/or costs.

161 We have to ensure that any sanction is proportionate. This requires us (Para 12 SG) to consider whether any particular sanction is proportionate with the circumstances of the case, including our findings as to seriousness of the Misconduct and the circumstances of Mr Newsham.

162 A Reprimand or Severe Reprimand signals our disapproval of the Mr Newsham's conduct, and of course it is communicated to the public and would appear on his disciplinary record. Either form of reprimand may be issued in conjunction with a fine. A Reprimand (including a Severe Reprimand) may be appropriate (para 24 SG) where the Misconduct is "not so damaging to public and market confidence in the standards of conduct of Members ... and in the accountancy profession and the quality of corporate reporting in the United Kingdom that, in order to protect the public and the wider public interest, ineligibility for a licence, withdrawal of a licence or exclusion would be the more appropriate sanction".

163 The mirror of that is to be found in Para 44 SG: the ability to exclude a Member exists because "certain Misconduct is so damaging to the wider public and market confidence in the standards of conduct of Members and in the accountancy profession and the quality of corporate reporting in the United Kingdom that removal of the Member's professional status is the appropriate outcome in order to protect the public or otherwise safeguard the public interest" (Para 44 SG).

164 Before imposing such an order, all other available sanctions have to be considered by us to ensure that exclusion is the most appropriate sanction and is proportionate taking into account all the circumstances of the case. (Para 45 SG)

165 At this stage, we are minded to consider exclusion as a more appropriate sanction than a Severe Reprimand. This is because of the nature of the Misconduct, our views as to its seriousness, our findings of recklessness, the risks to investors which were caused by the Misconduct, the damage to public and market confidence in the standards of conduct of Members and in the profession, and the damage to the quality of corporate reporting in the United Kingdom. At this stage, we provisionally consider exclusion to be the correct sanction.

166 We do not consider Repayment of client fees to be an appropriate sanction. Nor in the circumstances do we accept the making of any Direction in terms of education or function to be adequate. The evidence from Mr Newsham (consistent with our having decided that his costs should be borne by the FRC) is that he would be unable to pay a fine of any real significance. In any event, we are unpersuaded that a fine is proportionate to the Misconduct and to all the circumstances of the case, would act as an effective deterrent, and would promote public confidence in the regulation of the profession and in the way that Misconduct is addressed. (Para 31 SG)

167 Accordingly, we go on to consider Para 43 SG to assess whether indeed exclusion is appropriate (see Para 47 SG). Of the factors there set out, we consider the following to be of relevance:

- a. The Misconduct calls into question the competence of Mr Newsham;
- b. Some (7) of the acts of Misconduct were carried out recklessly;

- c. The Misconduct was significant, and the nature and importance of the standards breached were important from the perspective of public interest and confidence in the profession;
- d. The Misconduct continued over a period of time over three separate audits of WNG's financial statements;
- e. A significant number of people in the United Kingdom, including investors in particular, were adversely affected;
- f. Significant sums of money were put at risk if not actually lost by reason of the Misconduct;
- g. The Misconduct could undoubtedly undermine confidence in the standards of conduct of Members and Member Firms, and/or in financial reporting and/or corporate governance in the United Kingdom.

168 Accordingly, subject to the steps we must now follow, our provisional view is that having regard to all the relevant circumstances and to the seriousness of the Misconduct the appropriate sanction is one of exclusion. Given our view of the matter, Mr Newsham's Misconduct is fundamentally incompatible with continued membership of the ICAEW. (Para 46 SG). We consider a four year exclusion to be the correct sanction at this stage.

169 We now consider the aggravating and mitigating circumstances (Para 16 iii SG) and how those circumstances affect the level of sanction under consideration.

170 The aggravating features are as follows:

- a. The Misconduct was repeated and occurred over an extended period of time;
- b. Mr. Newsham held a senior position and had supervisory responsibility;
- c. We found that Mr Newsham was less than truthful to us in his explanation of his role in the interim 2006 audit;
- d. The failure by Mr Newsham to accept his responsibility for that audit.

171 The mitigating features are as follows;

- a. Mr Newsham co-operated fully with the investigation by the AADB and the FRC;
- b. He did not stand to gain personally any profit or benefit from the Misconduct;
- c. He has a clean disciplinary record;
- d. He has substantial personal mitigation, which includes the impact upon his mental health and wellbeing of the investigation and proceedings;
- e. The investigation and proceedings have been hanging over Mr Newsham for a long time.

172 We are not persuaded that any sanction should be reduced by reason of any admission of some or all the facts of the case (Para 57 SG). Although Mr Newsham accepted that he had on various occasions acted below the standards reasonably to be expected of a Member, he emphatically refused to accept he was guilty of Misconduct, and all allegations had to be investigated and dealt with fully by Executive Counsel and considered by the Tribunal.

173 We have considered with care Mr Newsham's witness statement made to assist the Tribunal with the Sanctions hearing. We accept that an exclusion order would have grave ramifications for Mr Newsham and his family. In addition, it would impact upon the Preston office of Haines Watts. It may be that there would be other financial consequences in terms of the relationship with the bank, and dire consequences for Mr Newsham personally. We have taken account of all the matters set out in that witness statement and indeed those of Mr Fairclough, Mr Lucey and Mr Holmes.

174 We were referred to Bolton v Law Society [1994] 1 WLR 512. The Court of Appeal observed at p.519 that because disciplinary tribunals are not primarily punitive, factors which may ordinarily be relied on in mitigation have less effect than they may have in criminal cases. Even if a respondent has overwhelming personal mitigation, this does not impact on the need to maintain public confidence. "The reputation of the profession (the solicitor's profession in that case) is more important than the fortunes of any individual member. Membership of a profession brings many benefits, but that is part of the price." We respectfully apply those principles.

175 Taking into account all the factors set out above, we consider that the period of exclusion of four years should be discounted by 25%.

176 We next consider whether any further adjustment is necessary to achieve the appropriate deterrent effect. On the basis that there is an exclusion, we consider

the deterrent effect would be attained. We do not consider the same would apply if we were to accede to the proposal from Mr Newsham:

177 We next consider any discount for admissions or settlement, and in our view there is none.

178 We conclude that the appropriate sanction is one of exclusion for a period of three years, at the end of which Mr Newsham may make application to the Re-admission Sub Committee of the ICAEW. The period of three years will commence 29 days after this Report is notified to Mr Newsham (Para 9 (12)(i) of the Scheme). We are satisfied that this sanction is commensurate with the circumstances of the case, including the seriousness of the Misconduct and the circumstances of Mr Newsham. In the light of his personal financial circumstances, we make no order for costs.



RICHARD JONES QC

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IAN ABRAMS

5th September 2014