

IN THE MATTER OF:

THE EXECUTIVE COUNSEL TO THE FINANCIAL REPORTING
COUNCIL

Complainant

-and-

1. SIXONETHREEONE LIMITED
(FORMERLY KNOWN AS HWCA LIMITED)

2. PAUL NEWSHAM

Respondents

FORMAL COMPLAINT

A summary of the allegations is contained in Appendix A "Schedule of Allegations of Misconduct", appended to this document.

Introduction

1. The Financial Reporting Council (the "FRC") is the independent, investigative and disciplinary body for the accountancy and actuarial professions in the UK. The FRC's rules and procedures relating to accountants are set out in the Accountancy Scheme as amended with effect from 1st July 2013 (the "Accountancy Scheme").
2. This is the Executive Counsel's paragraph 7(11) Formal Complaint in respect of:-
 - i. Sixonethreone Limited, formerly known as HWCA Limited ("HWCA"), a Former Member Firm of the Institute of Chartered Accountants in England and Wales ("ICAEW") (HWCA changed its name to Sixonethreone Limited on 28th October 2009. For convenience it is referred to throughout this Formal Complaint as HWCA);
 - ii. Mr Paul Newsham ("Mr Newsham"), a Member of the ICAEW;

in connection with their conduct in relation to the preparation, approval and audit of the financial statements of Worthington Nicholls Group plc ("WNG"), and its predecessor businesses. The allegations in respect of the financial year ended 30th September 2004 relate to Mr Newsham alone¹. The allegations in respect of the financial years ended 30th September 2005 and 2006, and the preparation, approval and audit of the interim financial statements for the six months ended 31st March 2006, relate to both Mr Newsham and HWCA (together the "Respondents").

3. HWCA was, at the time of the misconduct alleged against it in this Formal Complaint, a Member Firm of the ICAEW. It is a Former Member Firm for the purposes of the Accountancy Scheme.
4. Mr Newsham is and was, at all material times, a Member of the ICAEW and thus a Member for the purposes of the Accountancy Scheme. He was a director and shareholder of HWCA.
5. The 2004 financial statements of WNG were audited by Haines Watts Preston ("Haines Watts") a partnership. Its business was later taken over by HWCA, which was instructed to audit the financial statements of WNG between 2005-2007, until its replacement by Deloitte and Touche LLP ("Deloitte") in December 2007. During each of the audits to which this Formal Complaint relates Mr Newsham, initially with Haines Watts and latterly with HWCA, was the engagement partner and responsible individual with overall conduct and oversight of the audits.

¹ The 2004 audit report was signed by the Haines Watts Preston partnership on 15th September 2005 and its business was not transferred to HWCA until 1st October 2005.

6. This Formal Complaint sets out the allegations against the Respondents and provides an overview of the facts supporting them. In support of the Formal Complaint, Executive Counsel relies in particular upon²:-
 - i. The Investigation Report of FTI Consulting dated 23rd May 2013, which collates the facts underlying the Formal Complaint;
 - ii. The Expert Report of Nigel Meredith dated 30th May 2013.

Worthington Nicholls Group

7. The business that developed into WNG was set up in 1973. It grew into a company that was responsible for the design, installation and management of air conditioning units, primarily for a number of major hotel groups. At the material times WNG's Chairman was the founder Peter Worthington, the Chief Executive was his son Mark Worthington and the Corporate Director was David Levis. There were two non-executive Directors, Alastair Stoddart and Stephen Mulligan.
8. On 12th June 2006 WNG was admitted to the Alternative Investment Market ("AIM"). This initial share placing raised £20 million. There were two subsequent share placings in November 2006 and May 2007, which raised £6 million and £20 million respectively. At its peak in May 2007 WNG had a market capitalisation of about £146 million. By the close of business on 31st December 2007 this had fallen to just under £7 million.
9. The successful listing of WNG on AIM was founded on the reliability of the figures contained in WNG's financial statements as audited and approved by the Respondents. The figures from the 2004 and 2005 audited financial statements were provided in the short form report

² This is not intended to be an exhaustive list and other evidence may be served and relied upon.

prepared for the purpose of supporting the listing, as were the figures from the 2006 interim financial statements, which were prepared and audited specifically to support the listing.

10. The misconduct by the Respondents, as detailed below, led to a misstatement of the true financial position of WNG and resulted in both the turnover and gross profit being substantially overstated. These inflated figures would have had a significant impact on the decision of investors to invest at the time of the initial listing and at the subsequent share placings, when there was a significant demand for shares. The audited accounts would also have played a significant part in generating market confidence and the very large increase in the market capitalisation of WNG.
11. When the true financial position of WNG began to be revealed from June 2007 onwards, this caused a spectacular collapse in the share price (from 199p on 16th April 2007 to 7.75p on 31st December 2007) and very substantial losses to those who had invested in WNG. The misconduct of the Respondents contributed significantly to the misrepresentation of WNG's true financial position, which led to this chain of events.

HWCA and the Audits of WNG Financial Statements

12. WNG's audited financial results for the years ended 30th September 2003-2007 are summarised in the following table:-

Year ended 30 Sept	2003 £,000	2004 £,000	2005 £,000	2006 £,000	2007 £,000
Turnover	7,904	11,255	12,878	24,841	25,900
Gross Profit	1,749	2,088	3,389	7,298	2,997
Operating Profit/(Loss)	104	145	(562)	2,181	(42,068)
Net Assets (exc. Goodwill)	99	1,347	773	33,040	13,571

13. 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 an operating loss for the year of over £42 million and included write-offs and provisions of £13.67 million. Of these, almost £5.37 million related to prior year adjustments to correct fundamental errors in accounts previously audited by the Respondents.
14. The fundamental errors in the 2006 financial statements of WNG, totaling £5.367 million, had a 100% impact on profits. They were not detected during the 2006 year-end audit by the Respondents. They were made up as follows:-
- i. Matched/pre-contract costs - £2,407,000;
 - ii. Trade debtors and retentions - £260,000;
 - iii. Specific contract issue - £699,000;
 - iv. Unallocated accrued income - £1,367,000³;
 - v. Stock - £184,000;
 - vi. Work in Progress - £150,000;
 - vii. Debt notes not received - £300,000.

Each of these areas is the subject of allegations of misconduct against the Respondents. The significance and effect of these fundamental errors of £5.367 million is best demonstrated by considering that WNG's operating profit at the 2006 year-end was £2.181 million and its cumulative operating profit for the 2004-06 year ends was just £1.764 million.

The Relevant Auditing Framework

The 2004 and 2005 year-end audits

³ Items iii and iv together make up the Amounts Recoverable on Contracts (AMROC) balance.

15. In relation to the conduct of the 2004 and 2005 year-end audits the applicable UK auditing standards were those issued by the Auditing Practices Board ("APB") in the form of Statements of Auditing Standards ("SAS"). These contain the basic principles and procedures with which auditors were required to comply in the conduct of any audit of financial statements. The applicable SASs are appended to the Expert Report at Appendix D.

The 2006 interim audit and 2006 year-end audit

16. In relation to the conduct of the 2006 interim audit and the 2006 year-end audit the relevant auditing framework was that of the International Auditing Standards ("ISAs"). These were introduced on 22nd December 2004 and apply to all audits of financial statements for periods commencing on or after 15th December 2004. The purpose of the ISAs, also issued by the APB, is to establish standards and general principles with which auditors are required to comply in the conduct of any audit. The applicable ISAs are appended to the Expert Report at Appendix D.

The Relevant Standards of Conduct

The 2004 and 2005 year-end audits and the 2006 interim audit

17. In relation to the conduct of the 2004 and 2005 year-end audits and the 2006 interim audit, the standards of conduct reasonably to be expected of the Respondents included those set out in the Fundamental Principles and Statements contained in the 2004/05 and 2006 ICAEW Guides to Professional Ethics (the "2004/05/06 Guides") stated to be revised with effect from 1st August 2001. The Fundamental Principles and Statements contained in the 2004/05/06 Guides are designed to maintain a high standard of efficiency and professional conduct by all members of the ICAEW. The applicable Fundamental Principles and Statements are appended to the Expert Report at Appendix E.

18. Fundamental Principle 4 'Performance' of the Fundamental Principles, set out in section 1.200 of the 2004/05/06 Guides, provides that:-
A member should carry out his professional work with due skill, care, diligence and expedition and with proper regard for the technical and professional standards expected of him as a member.

The 2006 year-end audit

19. In relation to the conduct of the 2006 year-end audit, the standards of conduct reasonably to be expected of the Respondents included those set out in the Fundamental Principles and Statements contained in the 2007 ICAEW Code of Ethics (the "2007 Code") stated to be revised with effect from 1st September 2006. The Fundamental Principles and Statements contained in the 2007 Code are designed to maintain a high standard of efficiency and professional conduct by all members of the ICAEW.
20. Fundamental Principle (c) 'Professional Competence and Due Care' of the Fundamental Principles, set out in section 100.4 of the 2007 Code, provides that:-
A professional accountant has a continuing duty to maintain professional knowledge and skill at the level required to ensure that a client or employer receives 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.
21. In addition Fundamental Principle 100.4(c) is supplemented by the guidance in section 130 of the 2007 Code, of which relevant extracts state:-

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

...

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

130.2 *Competent professional service requires the exercise of sound judgement in applying professional knowledge and skill in the performance of such service.*

...

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

130.5 *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.*

The Accountancy Scheme

22. Under paragraph 2(1) of the Accountancy Scheme '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 Member Firm or to the accountancy profession."
23. Each of the specific allegations of misconduct detailed below in respect of the 2004 year-end, 2005 year-end, 2006 interim and 2006 year-end audits involved a breach of the relevant Fundamental Principles and amount to misconduct as defined by paragraph 2(1) of the Accountancy Scheme in that the conduct of Mr Newsham in 2004, and of the Respondents in the other periods, fell significantly short of the standards reasonably to be expected of them.

24. The report in respect of the 2004 audit was signed in the name of the Haines Watts Preston partnership. Each of the allegations in relation to that period is made against Mr Newsham as the engagement partner and responsible individual with overall conduct and oversight of that audit. The reports in respect of the 2005 and 2006 audits were signed in the name of HWCA and therefore each of the allegations in relation to those periods is made against Mr Newsham and HWCA. No signed set of financial statements for the 2006 interim audit was retained on the audit file, but this audit was also carried out by Mr Newsham, acting on behalf of HWCA, and accordingly each of the allegations in relation to it are made against Mr Newsham and HWCA.

The 2004 Audit

25. The Haines Watts audit team members for the audit of the financial statements for the year ended 30th September 2004 were Mr Newsham (Responsible Individual), Lee Tomlinson (Manager) and Tim Fox (Senior). Materiality was calculated as £91,000 (1% of turnover). The audit report was signed on 15th September 2005 and the accounts were filed late with Companies House.

A. The identification of potential audit issues in the planning process

WNG's Ability to Account for Long Term contracts

Allegation 1

26. Mr Newsham's audit planning did not achieve the objectives of the planning process in that he:-
- i. Failed to identify that WNG did not have an appropriate long term contract accounting system;
 - ii. Failed to use his experience and knowledge of WNG's systems, which hindered his ability to perform the audit in an effective manner,
- as required by paragraphs 2 and 5 of SAS 200.

PARTICULARS

27. The identification of potential audit issues in the planning process is governed by SAS 200.
28. In 2003 WNG changed its business model from one where it acted as a subcontractor to one where it acted as principal contractor. An implication of this change was that WNG was more likely to have higher value and longer running contracts that were in progress at the end of the financial year. The financial position of these contracts

needed to be assessed so that appropriate amounts of turnover, costs and profits could be included in the financial statements.

29. The Client Knowledge Summary, a document prepared as part of the audit planning and contained within the audit working papers, states: *"The accounting standards regarding long term contracts may also need careful consideration in light of recent revenue recognition changes"*. Work in Progress ("WIP") was also identified, in the Audit Planning Memorandum ("APM") contained within the audit working papers, as a *"key audit area"*.

30. WNG did not appear to adopt a long term contract accounting policy in 2004. Revenue was recognised on an invoiced basis and work not yet invoiced was accounted for within WIP, described as "late invoiced amounts" and accounted for as closing stock and deducted from cost of sales in the profit and loss account, rather than being included in sales turnover.

31. The WNG accounting system⁴ did not record, and was not capable of recording and allocating, revenues and costs on a contract-by-contract or site-by-site basis. Furthermore, cost to complete forecasts were not prepared for individual contracts to determine the expected profit or loss on those contracts. This should have called into question WNG's ability to account for revenues, costs, assets and liabilities relating to long term contracts and the way that Mr Newsham would be able to undertake audit testing on them. There is no evidence that Mr Newsham identified and recorded the lack of an appropriate long term contract accounting system or included any strategy to address this issue. The lack of an appropriate long term contracting system meant

⁴ "Accounting system" refers to the accountancy methodology and processes adopted by WNG, rather than the SAGE accountancy software package WNG had.

there was a risk that WNG could not appropriately account for contract revenue and costs in its accounting systems and a consequent risk that the information provided by WNG's accounting system could not be relied upon in the audit of contract revenues and costs. Mr Newsham had been the audit partner for WNG since 2002 and he should have been aware of and identified the lack of a system for monitoring revenues and costs on individual contracts as a key audit issue.

B. Accounting policies adopted by WNG and audit evidence obtained

Late Invoiced Work

32. The objective and general principles covering the audit of financial statements are governed by SAS 100.
33. The obtaining of audit evidence is governed by SAS 400. Where auditors are unable to obtain sufficient appropriate audit evidence through their audit procedures their opinion may be based on representations made to them by the management of the entity being audited.
34. The retention of audit evidence is dealt with by SAS 230.
35. Within the WNG financial statements late invoiced work related to work that was said to have been completed at year-end, 30th September 2004, which had yet to be invoiced by that date. The amounts represented accrued income on individual contracts.

The Accounting Treatment of Late Invoiced Work

Allegation 2

36. 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 the financial statements had been prepared in accordance with Accounting Standards, as required by SAS 100.

PARTICULARS

37. Given the change to principal contractor status WNG was more likely to have contracts that were in progress at year-end. WNG did not appear to adopt a long term contract accounting policy as the late invoiced amounts refer to work completed prior to 30th September 2004 (in any event WNG's accounting system was incapable of properly accounting for such contracts). Mr Newsham did not raise as an issue the fact that there did not appear to be any contracts in progress at 30th September 2004, which could only have occurred in the unusual circumstance that all material contracts had been completed at year-end.

38. The financial statements for the 2004 year-end contain a balance for late invoiced work of £711,318. This was classified as WIP within stocks on WNG's balance sheet. These amounts actually related to accrued income and, to the extent they represented the value of work carried out up to 30th September 2004, should have been recorded as sales and recorded within debtors. Consistent with their classification as stocks the accounting entry for late invoiced work amounts was to add the balance to WIP in the balance sheet and deduct the amounts from cost of sales. The impact of this accounting treatment was that sales turnover was understated and gross profit margin overstated.

39. The audit evidence obtained by Mr Newsham for the late invoiced work represented the sales invoice value of the work performed rather than the value of the costs incurred. The sales invoice would have included an element of profit earned on the contracts to the extent that

they were profitable. Late invoiced work therefore represented accrued income that should have been accounted for as turnover in the profit and loss account and as a debtor on the balance sheet. During the audit Mr Newsham failed to identify from the audit evidence that late invoiced work included a profit element and so were not stated at cost. They should have been included within debtors and not within WIP.

40. WNG prepared its financial statements in accordance with UK Generally Accepted Accounting Practice ("UK GAAP"). SSAP 9 "Stocks and long term contracts" sets out the standard accounting practice in relation to stocks. It states:-

The amount at which stocks are stated in periodic financial statements should be the total of the lower of cost and net realisable value of the separate items of stock or of groups of similar items.

41. Classifying the late invoiced amounts within WIP is therefore contrary to the provisions of UK GAAP") as the value of stocks should not include any profit element and the audit evidence obtained did not alert Mr Newsham to this.
42. Mr Newsham should have considered whether the accounting treatment of the long term contract balances was in line with Accounting Standards, in that revenue and profit were recognised appropriately. He should also have sought to establish the nature of the late invoiced work amounts through his audit testing. From the audit evidence obtained it should have been apparent that the late invoiced work amounts actually represented the sales value rather than the costs incurred by WNG in undertaking the work.

43. Mr Newsham should have sought audit evidence regarding the costs incurred by WNG. If he had done so then he would have been able to identify that a profit element existed which meant that balances should have been treated as revenue and debtors rather than cost of sales and stocks.
44. During the audit Mr Newsham failed to properly consider whether, given the change in status to principal contractor, it was realistic for all WNG's contracts to be complete at year-end. If they were complete Mr Newsham failed to identify from the audit evidence that the late invoiced work amounts included a profit element and were incorrectly shown as WIP rather than as accrued income, included within turnover and debtors resulting in gross profit being overstated.

Audit Evidence for Late Invoiced Work

Allegation 3

45. Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to draw a reasonable conclusion in relation to the amounts included within work in progress relating to late invoiced work, as required by SAS 400.

PARTICULARS

46. The stocks and work in progress lead schedule in the audit file shows a first draft balance of £1,399,250. However, WNG was unable to provide any supporting evidence for this balance, eventually producing a schedule supporting a total of £711,318. The accounts were therefore adjusted to show the lower amount. The audit file contains no indication of the reasons for, or the nature of, the adjustments.

47. A judgmental sample of the amounts making up the £711,318 was tested to after date cash receipts and supporting final accounts, but no rationale is set out in the audit working papers for the sample selected.
48. The audit evidence obtained consisted of:-
- i. An unsigned statement of final account (dated 30th March 2005), an undated roll-out schedule for Holiday Inn Dublin, and an unsigned final account for Holiday Inn Windsor (prepared 6th October 2004). Together these balances represent 49% of the total late invoiced work;
 - ii. Evidence of cash received from customers or credit notes issued to customers in the period following 30th September 2004. A cash receipt said to be in respect of the balance outstanding at 30th September 2004 for one site, Balmoral Hotel, was not received until September 2005. Cash received in relation to Holiday Inn Dublin and Debenhams Sheffield, was greater than the WIP amount and the surplus was not explained.
49. Mr Newsham's conclusion was that WIP was not overstated.
50. The audit evidence obtained by Mr Newsham for late invoiced work was insufficient in that:-
- i. It does not substantiate that a contractual relationship existed between WNG and its customers for the work said to have been performed;
 - ii. It does not confirm that WNG had performed work to the value of the late invoiced work amount prior to 30th September 2004. There is no evidence on the audit file to suggest that Mr Newsham sought confirmation as to when the work was completed.

51. Mr Newsham failed:-

- i. To obtain sufficient appropriate audit evidence that satisfied the requirements of paragraph 4 of SAS 400, in relation to whether the work had been undertaken, its value and whether WNG was entitled to invoice the amount to its customers in accordance with the terms of the contract;
- ii. To obtain confirmation from third parties of the amounts owed to WNG at the balance sheet date, as required by paragraph 16 of SAS 400;
- iii. In the absence of sufficient appropriate evidence, to consider the implications for his audit report, as required by paragraph 7, SAS 400.

Retentions

Assessment of the Accounting Treatment of Retentions

Allegation 4

52. Mr Newsham failed to obtain sufficient appropriate audit evidence to enable him to determine with reasonable confidence that the retentions were properly accounted for by WNG in the financial statements, in accordance with Accounting Standards, as required by SAS 100.

PARTICULARS

53. Certain of the contracts entered into by WNG had retention clauses attached. These retentions represented amounts withheld by the customer to cover any faults.
54. The financial statements for the 2004 year-end contained a balance for retentions of £474,653. WNG's accounting policy was to recognise the full retention amount on completion of the contract and it was therefore included in sales revenue.

55. None of the retention amounts had been paid when the audit work was undertaken. However, the audit papers recorded that "*no correspondence re problems on the jobs therefore the retentions should be recovered in full*". It is unclear how this conclusion was reached. There is no other audit evidence on the file to show that Mr Newsham had considered whether, having recognised 100% of the retentions amounts as turnover, there was a need to make a provision in relation to future rectification costs.

Audit Evidence Obtained for Retentions

Allegation 5

56. 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.

PARTICULARS

57. A sample of retentions, covering 84% of the balance, was selected on a judgmental basis and verified to final accounts from details supplied by Quantity Surveyors. The judgment used to select the sample was not documented. The material making up the evidence and retained on the audit file had not been signed by either the Quantity Surveyor or on behalf of WNG. Several of the final accounts were marked as being in draft.
58. There is no indication on the final accounts as to the period to which the retentions related or what the conditions for the release of the retentions were. No explanation is given as to why five of the final accounts sampled are dated after 30th September 2004.
59. The audit evidence obtained by Mr Newsham in relation to retentions was deficient in that:-

- i. Unsigned or draft documents did not provide confirmation that the retention amounts were an agreed part of the contract and that the amounts were due to WNG at the accounting year-end;
- ii. The audit evidence does not confirm the period to which the retention relates;
- iii. In relation to three of the amounts selected in the audit sample the documentation does not identify the amount as a retention amount.

Allegation 6

60. Mr Newsham failed to retain audit evidence that was sufficient to enable an experienced auditor unconnected with the audit to discover easily, and to understand, what work had been done and why, and the reasons for reaching the stated conclusions, as required by paragraph 7 of SAS 230.

PARTICULARS

61. In relation to the retention amounts the audit file contains a schedule listing the balances comprising the total of £474,653 and copies of the unsigned, and in some cases draft, final accounts. Proper evidence was not retained to confirm that the contracts existed, that the work had been completed or that the terms and conditions in relation to the recovery of the retentions had been understood, that it was likely that they would be recoverable and that any rectification costs were properly provided. 2004 was the first year that retentions were included in the financial statements, increasing the importance of obtaining and retaining audit evidence.

C. Quality control and closure of the audit

62. The relevant standards in relation to the quality control procedures that an audit firm should have in place, the responsibilities of the audit

engagement partner, independent review and monitoring processes are contained in SAS 240.

Failures in the partner review

Allegation 7

63. Mr Newsham's audit engagement partner review failed to ensure that the review procedures were appropriately carried out and failed to identify that the audit evidence obtained was not sufficient appropriate to support the conclusions reached, that the balances were not materially misstated, as required by paragraphs 49 and 55 of SAS 240.

PARTICULARS

64. At all material times Mr Newsham was the partner responsible for the audit of the WNG financial statements. In accordance with paragraph 49, SAS 240 the responsibility for ensuring that the review procedures were appropriately carried out lay with him.
65. The audit engagement review carried out by Mr Newsham failed to identify the deficiencies in the evidence obtained, particularised in allegations 2-6 above, and the conclusions drawn from it in relation to both late invoiced work and retentions.

The 2005 Audit

66. The HWCA audit team members for the audit of the financial statements for the year ended 30th September 2005 were Mr Newsham (Responsible Individual), Peter Hale (Reviewer/Manager), Lee Tomlinson (Manager/Audit Senior) and David Fort (Hot Review Partner). Materiality was calculated as £101,000 (1% of turnover). The audit report was signed on 3rd May 2006. This audit was carried out in close succession with the 2006 interim audit in the lead up to the AIM listing of WNG (see below in relation to the 2006 interim audit). As the last full set of financial statements prepared prior to the listing and share placement, the Respondents, knowing of WNG's intention to list, would have been aware of their central importance to that process.

A. The identification of potential audit issues in the planning process

67. The identification of potential audit issues in the planning process is governed by SAS 200.

WNG's Ability to Account for Long Term contracts

Allegation 8

68. The Respondents' audit planning did not achieve the objectives of the planning process in that they:-
- i. Failed to identify that WNG did not have an appropriate long term contract accounting system;
 - ii. Failed to use their experience and knowledge of WNG's systems, which hindered their ability to perform the audit in an effective manner,
- as required by paragraphs 2 and 5 of SAS 200.

PARTICULARS

69. In the 2005 financial year WNG altered its policy and adopted a long term contract accounting policy for the first time. Long term contract accounting became central to the recognition of costs in the 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. The lack of an appropriate long term contracting system meant there was a risk that WNG could not appropriately account for contract revenue and costs in its accounting systems and a consequent risk that the information provided by WNG's accounting system could not be relied upon in the audit of contract revenues and costs.

70. The 2005 APM makes no reference to long term contract related balances as being an area of particular consideration. The APM states that the assignment would focus on the systems that WNG had in place. The Risk Assessment, a heading within the APM, recorded that the company had good controls in place. The audit planning documentation does not comment on the appropriateness of the WNG accounting system for monitoring progress on long term contracts and does not state the approach that was to be undertaken to audit the long term contract balance.

Issues Regarding Obtaining Sufficient Appropriate Audit Evidence

Allegation 9

71. The Respondents failed 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 their failure to use their experience and knowledge of WNG hindered their ability to perform the audit in an effective manner as required by paragraphs 2 and 5 of SAS 200.

PARTICULARS

72. In performing the 2004 year-end audit the Respondents experienced issues in obtaining sufficient appropriate evidence for both late invoiced work and retentions. SAS 200 states that one of the objectives of planning is to ensure that potential problems are identified.
73. The APM for the 2005 year-end audit states that there had been no problem in the past with obtaining audit evidence and no problems were anticipated. This was wrong and inconsistent with the Respondents' past experience of their ability to obtain sufficient appropriate evidence from WNG.

Identification of Key Audit Areas

Allegation 10

74. The Respondents did not achieve the objectives of the planning process as they failed to identify key audit areas, matched/pre-contract costs and Amounts Recoverable on Contracts, and this failure hindered their ability to perform the audit in an effective manner, as required by paragraphs 2 and 5 of SAS 200.

PARTICULARS

75. The 2005 year-end audit was the first year that WNG had adopted a long term contract accounting policy. This was a key audit area that was likely to have a material impact on the financial statements. Neither matched/pre-contract costs nor Amounts Recoverable on Contracts were identified as key audit areas within the planning documentation. These were key audit areas that should have been identified at the planning stage. These items were recorded in the 2005

year-end audit with a value of over £1.7 million, representing very significant balances.

B. Accounting policies adopted by WNG and audit evidence obtained

76. The objective and general principles governing an audit of financial statements are governed by SAS 100.
77. The obtaining of audit evidence is governed by SAS 400.
78. Using the work of an expert is governed by SAS 520.
79. The relevant standards in relation to the quality control procedures that an audit firm should have in place, the responsibilities of the audit engagement partner, independent review and monitoring processes are contained in SAS 240.

The Accounting Treatment of Pre-Contract Costs

Allegation 11

80. The Respondents failed to obtain sufficient appropriate audit evidence to enable them 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

81. The Respondents 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, as required by SAS 400.

PARTICULARS

82. The principle of including matched/pre-contract costs was first applied in WNG's 2005 year-end financial statements. It appears that the balance represented accrued revenue - i.e. revenue recognised in advance of billing the customer, to which WNG claimed it was entitled, on contracts where some work, such as site visits, design work and planning, was said to have been performed but actual installation work had yet to commence. Matched/pre-contract cost amounts were recorded as an increase in revenue and debtors.
83. The financial statements for the 2005 year-end contained a balance for pre-contract costs of £747,520. This had the effect of increasing WNG's gross and net profits by an identical amount.
84. The balance of £747,520 was derived from a schedule of contract related balances retained in the audit file. It is unclear if this schedule was created by WNG or by the Respondents. Initial audit work was carried out by Mr Tomlinson, but was superseded by alternative audit procedures undertaken by Mr Newsham.
85. The audit evidence obtained did not support the balance of £747,520 that was included in the accounts. The information obtained by Mr Newsham consisted of a series of schedules showing a breakdown of the per room contract price for 10 hotels. He also obtained information which he intended would show that the contracts had been awarded and visits had taken place before 30th September 2005, but this work referred to only 6 hotels, comprising less than 20% of the balance. Further, the evidence obtained provided no confirmation that the work recognised had been carried out.

86. The audit evidence obtained by the Respondents had five major shortcomings:-
- i. It is not clear that the schedules retained in the audit file were extracts of signed customer contracts, since it is not documented that the full contracts had been reviewed;
 - ii. It is not clear that the amounts identified relate to pre-installation work;
 - iii. There is no evidence that pre-installation work had actually taken place;
 - iv. There is no evidence retained on file of any work being undertaken to assess profitability on each of the contracts;
 - v. None of the amounts are consistent with those initially set out by WNG.

Reliance on the Work of an Expert

Allegation 13

87. The Respondents reliance on a report prepared by Unity Accountants, to support their audit work and conclusions in relation to pre-contact costs, when a copy of that report had neither been obtained nor considered, was not in accordance with the requirements of SAS 520.

PARTICULARS

88. In May 2005 Unity Accountants ("Unity") were instructed by the Royal Bank of Scotland to conduct a review of the financial condition of WNG. In interview, Mr Newsham stated that in relation to the work carried out on pre-contract costs he had obtained some comfort that the WNG contracts with customers had actually existed based on the fact that Unity had verified a number of contracts and performed site visits.
89. The report prepared by Unity was not included in the HWCA audit file and in interview Mr Newsham confirmed that he had never actually

seen a copy of it. The report did not constitute appropriate audit evidence to confirm the existence of WNG customer contracts.

Late Invoiced Work

Allegation 14

90. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to draw a reasonable conclusion in relation to late invoiced work amounts for the QMH hotels, as required by SAS 400.

PARTICULARS

91. A summary of late invoiced work on the audit working paper showed a balance of £736,750, in relation to a number of hotels. For each hotel the amount of late invoiced work was calculated by multiplying the number of rooms by a "*project management*" charge of £250. There is no evidence of audit work having been undertaken on the schedule and the basis for the late invoiced work calculation is not explained in the audit papers.
92. A revised late invoiced work schedule was included in the audit file with a balance of £685,935. The difference of £50,815 is recorded in the audit papers as being an overstatement and was recorded as being an audit difference and was included on the summary of errors and deviations.
93. The amended balance of £685,935 included four QMH contracts totaling £177,644. A contract schedule contained in the audit file gives the earliest start date for these QMH contracts as being 7th November 2005, after the balance sheet date.

94. Concerns with the audit evidence that had been obtained were raised by Mr Tomlinson, a member of the audit engagement team, on the audit working paper. He noted that invoices raised and cash received after the balance sheet date did not prove the work had been carried out prior to year-end, and that further information had been requested from WNG in relation to the number of "rooms handed back" at year-end but nothing had been received.

95. These comments were included on the points for partner consideration document with an additional comment that it may require qualification in the audit report. The matter was raised by Mr Hale, another member of the audit engagement team, for Mr Newsham's attention. Mr Newsham replied with the comment: "*Sufficient evidence gained on other items to suggest not materially incorrect therefore cover via LOR*". No reference was made to the balance in the Letter of Representation ("LOR") from WNG.

96. The audit evidence obtained by the Respondents in relation to the QMH contracts was insufficient in that:-

- i. It did not substantiate that a contractual relationship existed between WNG and its customer for the work said to have been performed;
- ii. It did not confirm that WNG had performed work to the value of the late invoiced work amount prior to 30th September 2005. The available evidence suggests the contrary.

The Respondents should have ensured that appropriate testing was performed on these balances.

97. HWCA and, in particular, Mr Newsham failed:-

- i. To obtain audit evidence that satisfied the requirements of paragraph 4 of SAS 400;
- ii. To obtain confirmation from third parties of the amounts owed to WNG at the balance sheet date, in breach of paragraph 16 of SAS 400;
- iii. To consider the implications for their report of the failure to obtain sufficient appropriate audit evidence in accordance with paragraph 7, SAS 400.

As such they did not obtain sufficient appropriate audit evidence on which to draw a reasonable conclusion in relation to late invoiced work amounts for the QMH hotels, in breach of SAS 400.

Double Counting of Amounts Included Within Pre-Contract Costs

Allegation 15

98. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to draw a reasonable conclusion that pre-contract costs and late invoiced work were not double counted, as required by SAS 400.

PARTICULARS

99. In the 2005 year-end financial statements there was double counting of un-invoiced amounts. £71,165, relating to the four QMH sites, was included within both the "late invoiced work" and "pre-contract costs".
100. This double counting was not identified during the audit or HWCA's review process (including the "hot review" conducted by Mr Fort). The double counting was not identified due to the lack of sufficient appropriate audit evidence regarding both amounts, and this indicates a lack of knowledge and investigation as to what these balances were intended to represent. There was a failure properly to consider the

overall contract position in relation to the sites included within these balances.

Retentions

Allegation 16

101. The Respondents failed to obtain sufficient appropriate audit evidence to allow them to determine with reasonable confidence that the retentions were accounted for by WNG in accordance with Accounting Standards, as required by SAS 100.

Allegation 17

102. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to draw a reasonable conclusion in relation to the amounts included within debtors relating to retentions, as required by SAS 400.

PARTICULARS

103. In 2005 WNG's accounting policy was to recognise the full value of the retention amounts on completion of the contract. A total of £229,360 was included as sales revenue in respect of retentions in the 2005 year-end financial statements. In the first draft of the financial statements no balance was recognised for retentions. However, an adjustment was made to include this amount under the trade debtors heading. The adjustment resulted in an increase in gross profit of £229,360.
104. In relation to the retentions for the Coventry and Dublin Holiday Inns, the Respondents compared the value of sales invoices and the retention amounts to the final contract value specified by the Quantity Surveyor. No audit work was undertaken by the Respondents with regard to the subsequent recovery of any retention amounts or to

assess if WNG had incurred any remediation costs which had been provided.

105. The amounts relating to the two Holiday Inn hotels were tested by agreeing total contract value to final accounts certified by the Quantity Surveyor and comparing this to the total amounts recognised by WNG as income plus the value of retentions. These final accounts were not retained in the audit working papers and no reference is made to any terms and conditions attached to the retentions, the period of the retention or whether any remedial costs had been incurred.
106. The Respondents' testing achieved coverage of the total balance of retentions of less than 40% of un-invoiced retentions.
107. The assessment of the accounting treatment and the audit evidence obtained by the Respondents in relation to retentions was deficient in that:-
 - i. They did not consider whether there was a need for a provision to be made in relation to future remediation costs. There was no comment on this in the audit papers;
 - ii. The audit procedures were not sufficient to establish that work had been completed on a contract prior to 30th September 2005;
 - iii. No consideration was given as to the turnaround effect of the reduction of the un-invoiced retentions amount from the 2004 year-end to the 2005 year-end. It is unclear if amounts invoiced in the 2005 year-end relating to retentions at the 2004 year-end were excluded from sales revenue as they had been recognised in the 2004 year-end. It is possible that retentions amounts invoiced in the 2005 year-end were double counted.

AMROC (Amounts Recoverable on Contracts)

Allegation 18

108. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to draw a reasonable conclusion in relation to the amounts included in Amounts Recoverable on Contracts, as required by SAS 400.

PARTICULARS

109. The principle of including Amounts Recoverable on Contracts was first introduced in WNG's financial statements for the 2005 financial year. Amounts Recoverable on Contracts related to contracts that had started before 30th September 2005, but had not yet been completed at year-end.

110. Under UK GAAP the provisions of FRS 5 (Application Note G) are applicable to the accounting for long term contracts. This states:-

(G4) A seller recognises revenue under an exchange transaction with a customer, when, and to the extent that, it obtains the right to consideration in exchange for its performance. At the same time, it typically recognises a new asset, usually a debtor.

...

(G18) A seller should recognise turnover in respect of its performance under a long term contract when, and to the extent that, it obtains the right to consideration. This should be derived from an assessment of the fair value of the goods and services provided to its reporting date as a proportion of the total fair value of the contract.

111. SSAP 9 "Stocks and long term contracts" sets out specific guidance with regard to accounting for long term contracts, as follows (the full text is included at Appendix D):

(8) *Companies should ascertain turnover in a manner appropriate to the stage of completion of the contracts, the businesses and the industries in which they operate.*

(9) *Where the business carries out long term contracts and it is considered that their outcome can be assessed with reasonable certainty before their conclusion, the attributable profit should be calculated on a prudent basis and included in the accounts for the period under review. The profit taken up needs to reflect the proportion of the work carried out at the accounting date...*

...

(28) *Long term contracts should be assessed on a contract by contract basis and reflected in the profit and loss account by recording turnover and related costs as contract activity progresses. Turnover is ascertained in a manner appropriate to the stage of completion of the contract, the business and the industry in which it operates.*

112. The first draft of the WNG accounts did not include any amount relating to Amounts Recoverable on Contracts. Following completion of the audit the financial statements for the 2005 year-end contained a balance of £968,419, relating to six Holiday Inn hotels. This amount was made up of two parts:

- i. £89,590 – included on a schedule retained on HWCA’s audit file;
- ii. £878,829 – calculated as a result of audit work carried out by the Respondents.

These balances represented the proportion of revenue that the Respondents thought could be recognised on the contracts as at 30th September 2005. This was measured by comparing the number of rooms handed back to the customer as a proportion of the total number of rooms covered by the contract. This was said to have been agreed to documentation provided by the Quantity Surveyor.

113. The figures are based on the number of rooms completed and handed back as being between 75-85% across the six hotels as at 30th September 2005. However, the earliest commencement date of any of the six contracts was 13th September 2005 with a minimum length of 68 days. In relation to the Colchester site the contract did not start until 29th September 2005, yet 89 of 109 rooms are recorded as having been handed back by 30th September 2005. The monthly profile of costs shows that for each of these hotels the majority of costs were incurred after 30th September 2005.
114. The evidence retained on the audit file is not sufficient appropriate to be able to draw reasonable conclusions that the revenue recognised on the six Holiday Inn contracts was in the correct accounting period. Every indication is that it was not.
115. The assessment of the accounting treatment and the audit evidence obtained by the Respondents in relation to Amounts Recoverable on Contracts was deficient in that they:-
- i. failed to establish the contractual terms of the contracts or that the status of the contracts was part complete as at 30th September 2005;
 - ii. failed to obtain or retain evidence from third parties providing confirmation that contractual obligations existed and that the work had been completed;
 - iii. failed to carry out detailed audit testing regarding contract costs;
 - iv. failed to obtain evidence that a profitable outcome could be assessed with reasonable certainty on a contract-by-contract basis.
- As such they did not obtain sufficient appropriate audit evidence on which to draw a reasonable conclusion in relation to the amounts included in Amounts Recoverable on Contracts, in breach of SAS 400.

Stock and Work in Progress

Allegation 19

116. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to draw a reasonable conclusion in relation to the work in progress balance, as required by SAS 400.

PARTICULARS

117. The financial statements for the 2005 year-end contained a balance of £110,978 for stock and work in progress. This was a material balance and was an area that was noted as high risk in the audit work programme. No audit work was carried out in relation to this balance.

The Curzon Debt

Allegation 20

118. The Respondents failed to obtain sufficient appropriate audit evidence to enable them 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.

PARTICULARS

119. The financial statements for the 2005 year-end included a debt of £1,108,810 relating to amounts said to be owed by a contractor, Curzon Interiors, in relation to work performed on a project at the Intercontinental Hotel, Hyde Park Corner.
120. The debtors balance comprised an invoiced amount of £438,810 and an un-invoiced amount of £670,000. The first draft of the financial statements had not included the £670,000, but an adjustment was later

made to include it. An exceptional item adjustment was then included to write off the entire amount. The effect of including this un-invoiced work in the exceptional bad debts was to increase revenue and gross profit by £670,000. Sufficient appropriate audit evidence should have been obtained to support this balance.

121. The amounts owed were reviewed within the Respondents' bad debt work as there were doubts over Curzon Interiors' ability to pay. The issue was raised in the points for the responsible individual and the comment "*now bad, Curzon went into receivership*" was included and later initialed by Mr Newsham. Despite this, and the fact that the work had not even been invoiced, the £670,000 was included in turnover and debtors and no further audit work was undertaken by the Respondents in relation to the £670,000 adjustment.

C. Quality control and closure of the audit

122. The relevant standards in relation to the quality control procedures that an audit firm should have in place, the responsibilities of the audit engagement partner, independent review and monitoring processes are contained in SAS 240.

Failures in the partner review

Allegation 21

123. The Respondents' audit engagement partner review 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, that the balances were not materially misstated, as required by paragraphs 49 and 55 of SAS 240.

PARTICULARS

124. The key audit working papers, including the lead schedules and the completion and conclusion forms at the end of each section were signed by Mr Newsham in his role as audit engagement partner. Mr Newsham also signed a number of documents prepared by other members of the audit team that raised a number of issues for him to consider. Mr Newsham had also undertaken much of the detailed audit work in relation to pre-contract costs and Amounts Recoverable on Contracts himself.
125. The audit engagement review carried out by Mr Newsham failed to identify deficiencies in the quantity and quality of the audit evidence obtained, as particularised in allegations 11-20 above, and the conclusions drawn from it in relation to:-
- i. The accounting treatment applied by WNG in relation to pre-contract costs and retentions;
 - ii. The relevant assertions in relation to pre-contract costs, late invoiced amounts, Amounts Recoverable on Contracts, stock and WIP and the Curzon Interiors' debt.
126. The Respondents failed to:-
- i. Identify that no audit evidence had been obtained to support the WIP (£110,977) and the Curzon Interiors' un-invoiced debt balances;
 - ii. Identify that there was a double counting of assets, with amounts being included in both pre-contract costs and late invoiced work;
 - iii. Properly address the issues raised by other members of the audit team in documents that they had specifically prepared for Mr Newsham's consideration;
 - iv. Have Mr Newsham's own audit work reviewed by someone with appropriate seniority and experience;

- v. Identify that there was a lack of evidence supplied by third parties to support the existence of contracts between WNG and its customers, and the amount of work completed before year-end;
- vi. Identify discrepancies between the apparent start dates of customer contracts and the amount of work that was said to have been completed at year-end.

Reliance on the Hot Review

Allegation 22

127. The Respondents inappropriately placed reliance on the hot review process and in doing so failed to fully comply with the responsibilities of the engagement partner, as required by SAS 240.

PARTICULARS

128. In relation to the 2005 year-end audit an independent or "hot review" was carried out, in order to address potential threats to HWCA's independence that had been identified in the audit planning documents.
129. The hot review was conducted by David Fort, who, along with Mr Newsham, initialed a "Hot Audit File Review Checklist". Mr Fort signed the document on 3rd May 2006. The objective of the hot review performed by Mr Fort was not to review the detailed working papers, but to focus on the planning and completion sections of the engagement. Mr Fort signed a declaration that, based on the discussions with the audit partner (Mr Newsham) and a review of some of the papers, he concurred that the audit file supported the audit opinion.

130. In interview, Mr Newsham stated that he believed the hot review's purpose was *"to ensure that we've gained all the audit evidence that we've needed to give an audit opinion"*. He also stated that he believed it to include a consideration of double counting within long term contract asset balances and evidence regarding pre-contract costs. In fact the purpose and scope of the hot review was much narrower. Mr Newsham relied on the hot review to support his opinion that sufficient appropriate evidence had been obtained.

131. Paragraph 62 of SAS 240 states that the purpose of the independent review is to provide an independent assessment of the quality of the audit and does not affect the responsibilities of the audit engagement partner.

The 2006 Interim Audit

132. The 2006 interim audit was conducted for the 6 month period ending 31st March 2006. Its main purpose was to assist with the flotation of WNG on AIM. It, along with the 2004 and 2005 audited accounts, formed the basis of the Accountant's Report that was a requirement of the AIM listing process. As a result the 2006 interim audit was of the utmost importance and it must have been clear that it would be relied on in persuading potential investors to invest.
133. Audit fieldwork began in April 2006 and the completion documentation was signed on 8th May 2006. The key members of the audit team were Mr Newsham (Responsible Individual), Peter Hale (Manager), Lee Tomlinson (Senior) and David Fort (Hot Review Partner). Materiality was calculated as £80,000, based on 1% of turnover.

A. The identification of potential audit issues in the planning process

134. The 2006 interim audit was conducted in accordance with the requirements of the ISAs. ISA 300 "Planning an audit of financial statements" sets out overall guidance and considerations for the auditor in planning the audit.

WNG's Ability to Account for Long Term contracts

Allegation 23

135. The Respondents' audit planning did not achieve the objectives of the planning process in that they:-
- i. Failed to identify that WNG did not have an appropriate long term contract accounting system;

ii. Failed to use their experience and knowledge of WNG's systems, which hindered their ability to perform the audit in an effective manner,

as required by paragraphs 2 and 4 of ISA 300.

PARTICULARS

136. As stated above, WNG first adopted a long term contract accounting policy during 2005. It was central to the recognition of revenue and costs.
137. The APM for the 2006 interim audit identified that there were weaknesses in WNG's purchases system and that these needed to be discussed with the company before undertaking substantive testing of the purchase ledger day book. The issue of revenue from long term contracts was recognised as an area of key importance.
138. The planning documentation makes no specific reference to WNG's contract accounting system and whether the costs on each contract were appropriately captured within it. It does not identify any specific testing required in relation to Amounts Recoverable on Contracts, pre-contract costs or other contract related balances. In fact, WNG's accounting system was not capable of accurately recording and allocating revenues and costs against specific contracts. This was a key issue in terms of the overall audit. The lack of an appropriate long term contracting system meant there was a risk that WNG could not appropriately account for contract revenue and costs in its accounting systems and a consequent risk that the information provided by WNG's accounting system could not be relied upon in the audit of contract revenues and costs

Issues Regarding Obtaining Sufficient Appropriate Audit Evidence

Allegation 24

139. The Respondents failed 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 their failure to use their experience and knowledge of WNG hindered their ability to perform the audit in an effective manner, as required by paragraphs 2, 4 and 9 of ISA 300.

PARTICULARS

140. The Respondents had experienced issues in obtaining sufficient appropriate audit evidence for late invoiced work and retentions when performing the 2004 year-end audit and in relation to pre-contract costs, late invoiced work, retentions, Amounts Recoverable on Contracts and stock and WIP, in respect of the 2005 year-end.
141. The Plan of Action for the interim audit recognised the need to meet with Mark Worthington and to thoroughly investigate the level of WIP and gain as much audit evidence as possible. Despite this there are no notes or comments in the planning documentation relating to the difficulties experienced in the previous audits that the Respondents were aware of.

B. Accounting policies adopted by WNG and audit evidence obtained

142. ISA 500 "Audit Evidence" sets out guidance in relation to the quantity and quality of evidence to be obtained by the auditors. The evidence must allow the auditors to conclude that the financial statements are free from material misstatement. In addition to obtaining sufficient appropriate audit evidence, paragraph (2) of ISA 200 requires that

auditors must also satisfy themselves that the financial statements have been prepared in accordance with the relevant Accounting Standards.

143. Guidance in relation to the retention of audit evidence is provided by ISA 230 "Audit Documentation".

144. ISA 501 "Audit Evidence" provides specific guidance in relation to stock.

The Accounting Treatment of Pre-Contract Costs

Allegation 25

145. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to draw a reasonable conclusion that WNG had obtained a right to consideration, 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.

Allegation 26

146. The Respondents 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, as required by ISA 200 and ISA 500.

PARTICULARS

147. A balance of £628,240 was included in the interim financial statements as pre-contract costs. This figure was derived from a calculation performed on the HWCA audit working papers. The amount represented an upward adjustment of £185,509, from the £442,731 as initially calculated by WNG. The WNG balance was calculated by multiplying the number of rooms on 17 contracts by a per room rate

that varied between £155-£175 depending on the site. There is no explanation in the audit papers as to how these different room rates were derived, or why different rates applied to different sites.

148. Mr Newsham used different, higher, room rates to those used by WNG, in the range £175-£350 and it was this that led to the £185,509 increase in the balance and therefore revenue and profits.
149. No documentation was retained on the audit file to support the audit work performed by Mr Newsham. No customer contracts or schedules to contracts were retained on the file, and there is no evidence that signed contracts were ever seen by Mr Newsham. There was no review of the costs incurred on these supposed contracts and no Quantity Surveyor was asked to provide third party confirmation. The 2006 interim audit was carried out alongside the 2005 year-end audit. Mr Newsham placed inappropriate reliance on the 2005 audit evidence for the 2006 interim audit, because the work conducted for the 2005 year-end audit was deficient and therefore should not have been relied upon.
150. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to draw a reasonable conclusion in relation to whether:-
- i. WNG had performed any pre-installation work prior to 31 March 2006;
 - ii. WNG had earned a right to any consideration through the performance of its contractual obligations;
 - iii. The pre-contract cost balance was correctly recognised in the financial statements.

Retention of Audit Evidence regarding Pre-Contract Costs

Allegation 27

151. The Respondents failed to retain audit evidence that was sufficient to enable an experienced auditor, unconnected with the audit, to discover easily, and 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 paragraph 9 of ISA 230.

PARTICULARS

152. No audit evidence was retained on the audit file in relation to pre-contract costs. As such there is no third party confirmation that:-
- i. WNG were entitled to these revenues;
 - ii. That they had undertaken pre-installation work prior to 31st March 2006;
 - iii. The value of the work was fairly stated.

Retentions

Allegation 28

153. The Respondents failed to obtain sufficient appropriate audit evidence to allow them to conclude that the retentions were accounted for by WNG in accordance with Accounting Standards, as required by ISA 200.

Allegation 29

154. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to draw a reasonable conclusion in relation to the amounts included within debtors relating to retentions, as required by ISA 500.

PARTICULARS

155. WNG's policy was to recognise the full value of the retentions. The financial statements for the 2006 interim period contain a balance for retentions of £221,061. In the first draft a balance of £139,360 was

included, however an adjustment to increase the balance by £81,701 was made during the course of the audit (relating to balances for the Coventry and Dublin Airport Holiday Inns being brought forward from the 2004/05 financial year).

156. The Respondents' approach to the audit of retentions is not set out in the audit working papers. Reliance was placed on the work completed in respect of the 2005 financial year retentions. This was inappropriate because the work conducted for the 2005 year-end audit was deficient and therefore should not have been relied on.

157. The assessment of the accounting treatment and the audit evidence obtained by the Respondents in relation to retentions was deficient in that:-

- i. No consideration was given as to whether there was a need for a provision to be made in relation to future rectification costs;
- ii. No audit procedures were carried out on the Debenhams or first year maintenance balances, leaving a material balance of £139,360 un-audited (representing over 60% of the total balance);
- iii. The audit evidence obtained was not sufficient appropriate to conclude that the retentions were accounted for in accordance with UK GAAP.

AMROC (Amounts Recoverable on Contracts)

Allegation 30

158. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to draw a reasonable conclusion in relation to the amounts included in Amounts Recoverable on Contracts, as required by ISA 500.

PARTICULARS

159. The first draft of the financial statements for the period ending 31st March 2006 did not contain any balance for Amounts Recoverable on Contracts. The final balance of £1,629,709 was derived from a calculation performed by WNG. This figure was based on the number of rooms said to have been completed as a percentage of the whole contract. If any audit procedures were completed by the Respondents in relation to this balance, they have not been recorded on the audit file.
160. The audit procedures carried out by the Respondents amounted to an alternative calculation for the Amounts Recoverable on Contracts balances for a sample of 10 contracts, which was then compared to the original WNG schedule. The stage of completion of each contract was based on the number of rooms said to have been handed back as a proportion of the total number of rooms covered by the contract. The source of the information in respect the number of rooms handed back is not recorded on the audit file.
161. The audit evidence obtained by the Respondents was insufficient to determine whether:-
- i. WNG had performed work on a contract that had not been billed prior to 31st March 2006;
 - ii. The value of Amounts Recoverable on Contracts was calculated to reflect the proportion of work carried out prior to 31st March 2006;
 - iii. WNG was entitled to receive consideration from its customer for the work it had done.

Double Counting regarding AMROC

Allegation 31

162. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to draw a reasonable conclusion that long term contract amounts had not been double counted, as required by ISA 500.

PARTICULARS

163. As part of the interim Amounts Recoverable on Contracts calculation, deductions were made for amounts previously taken to revenue in the 2005 financial year in relation to the six Holiday Inn contracts (see paragraphs 108-115 above) in order to prevent double-counting. However, within the calculations, no deductions were made for amounts recognised as pre-contract revenue in the 2005 financial year. For some contracts 100% of the contract revenue was recognised in the 2006 interim audit despite a proportion having already been accounted for in the 2005 financial year. This amounted to double counting of £458,115 that would have had an equal effect on net profits. Revenue and therefore profits were materially overstated.

Stock and Work in Progress

Allegation 32

164. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to draw a reasonable conclusion in relation to the long term contracts and stock balances, as required by ISA 500.

PARTICULARS

165. The first draft of the financial statements for the period ending 31st March 2006 did not include an amount for stock and WIP. Following the audit this balance was adjusted to £411,932, made up of two amounts:
- i. £227,967 referred to as long term contract balances, representing stock held at 16 sites;
 - ii. £183,965 relating to stock items held at Hyde Park Corner.

166. In relation to the stock balance the Respondents conducted audit procedures consisting of three tests:-
- i. Analytical review of the overall stock balance;
 - ii. A valuation test;
 - iii. Stock take attendance at two of the 16 sites, equating to just 12.5% of the total long term contract costs balance.
167. The audit papers note that the stock and WIP balance was to be confirmed through third party evidence.
168. No explanation is given on the audit papers as to the purpose of the analytical review and no conclusions are drawn from it.
169. The stock valuation test consisted of collecting stock sheets from all sites and checking the additions and calculations. The value of items was checked against supplier price lists. None of these supplier price lists were retained on the audit file.
170. There is no explanation retained on the audit file as to how the two sites were chosen, the exact procedures undertaken for the stock take attendances or the conclusions drawn from them.
171. The Hyde Corner balance of £183,965 was verified by what was said to be an invoice from ECG Group, to which a 12% mark-up was added. The stock was also referred to in a management representation letter. No physical verification of the existence of this stock was carried out. Paperwork indicated that the stock had been on site in July 2005, but nothing was done by the Respondents to satisfy themselves that it still existed as at 31st March 2006, despite the fact they were aware that the main contractor had gone into administration and of the write off of

balances owed in connection with the site in the 2005 year end accounts.

C. Quality control and closure of the audit

172. Guidance in relation to quality control procedures is provided by ISA 220 "Quality Control".

Failures in the partner review

Allegation 33

173. The Respondents' audit engagement partner review failed to identify that the audit evidence obtained was not sufficient appropriate to support the conclusions reached, that the balances were not materially misstated, as required by paragraph 26 of ISA 220.

PARTICULARS

174. Mr Newsham conducted the responsible individual review of the 2006 interim audit files on 9th May 2006. He concluded that there was sufficient evidence to support the audit opinion and that the financial statements were free from material misstatement.
175. The audit engagement review carried out by Mr Newsham failed to identify the deficiencies in the evidence obtained and the conclusions drawn from it in relation to:-
- i. Pre-contract costs;
 - ii. Retentions;
 - iii. Amounts Recoverable on Contracts; and
 - iv. Stock and WIP.

176. There were a number of serious deficiencies in the audit evidence obtained by the Respondents to support key balances that were not identified by Mr Newsham during the partner review. These deficiencies include:-

- i. The lack of contractual evidence to confirm that WNG were entitled to revenues on long term contracts;
- ii. Much of the audit evidence was in draft form and not signed by the relevant third party;
- iii. Much of the audit evidence, if obtained at all, was not retained on file;
- iv. A failure to identify the double counting of revenues recognised in relation to Amounts Recoverable on Contracts that had been previously recognised in the 2005 year-end audit;
- v. The evidence obtained did not address the financial statement assertions which a reasonably competent auditor would have identified as being relevant to these balances;
- vi. The evidence obtained did not provide sufficient coverage on which to draw a conclusion that the relevant balances were not materially misstated.

Reliance on the Hot Review

Allegation 34

177. The Respondents inappropriately placed reliance on the hot review process and in doing so failed to fully comply with the responsibilities of the engagement partner, as required by ISA 220.

PARTICULARS

178. As in the 2005 year-end audit a hot review process was undertaken by Mr Fort. The audit files contain a "Hot Audit File Review Checklist", initialed by Mr Fort and Mr Newsham and signed by Mr Fort on 3rd

May 2006. The checklist makes it clear that the purpose of the review was not to duplicate the review function of the audit partner.

179. In interview Mr Newsham stated that he considered that the hot review would have picked up any issues relating to double counting and any issues relating to the evidence obtained regarding pre-contract costs. This was not the function of the hot review.

The 2006 Audit

180. The HWCA audit team members for audit of the financial statements for the year ended 30 September 2006 were Mr Newsham (Responsible Individual), Peter Hale (Manager), Mark Croasdale (Senior), Nigel Thompson (Staff) and David Fort (Hot Review Partner). Materiality was calculated as £200,000 (1% of turnover). The audit report was signed on 17th January 2007. This was the first audit following the AIM listing on 6th June 2006. An additional £20 million was raised by way of a share placing in May 2007. Potential investors would have relied on the audited accounts when considering the financial well-being of WNG and in making their decision whether or not to invest in it. There was a high demand for shares at this additional placing.

181. The relevant auditing standards were the ISAs.

A. The identification of potential audit issues in the planning process

182. The objective and general principles governing an audit of financial statements are contained in ISA 200.

183. Planning an audit of financial statements is governed by ISA 300.

WNG's Ability to Account for Long Term Contracts

Allegation 35

184. The Respondents' audit planning did not achieve the objectives of the planning process in that they:-

- i. Failed to identify that WNG did not have an appropriate long term contract accounting system;
- ii. Failed to use their experience and knowledge of WNG's systems, which hindered their ability to perform the audit in an effective manner,

as required by paragraphs 2 and 4 of ISA 300.

PARTICULARS

185. The APM highlights the difficulties experienced in the previous audits in relation to accounting for long term contracts. However, there is no reference within the planning documentation regarding the ability of WNG's accounting system to appropriately account for long term contracts and no reference was made as to whether costs on each contract were accurately captured. The WNG accounting system was still not capable of recording and allocating revenues and costs to specific contracts. The lack of an appropriate long term contracting system meant there was a risk that WNG could not appropriately account for contract revenue and costs in its accounting systems and a consequent risk that the information provided by WNG's accounting system could not be relied upon in the audit of contract revenues and costs. These deficiencies were not identified at the planning stage.

Issues Regarding Obtaining Sufficient Appropriate Audit Evidence

Allegation 36

186. The Respondents failed to achieve the objectives of the planning process in that they failed to identify the risk, based on prior experience, that difficulties would be encountered in obtaining sufficient appropriate audit evidence and their failure to use their experience and knowledge of WNG hindered their ability to perform the audit in an effective manner, as required by paragraphs 2, 4 and 9 of, ISA 300.

PARTICULARS

187. The Respondents had experienced issues in obtaining sufficient appropriate audit evidence for late invoiced work (when performing

the 2004 and 2005 year-end audits) and retentions (when performing the 2004 and 2005 year-end audits, and the 2006 interim audit).

188. The APM records that historically the accounting for both matched/pre-contract costs and the Amounts Recoverable on Contracts had been poor. There is no indication of what actual or additional audit procedures were to be undertaken to address this. A second APM records that there had been no problem in the past with obtaining audit evidence.

189. There is no reference in the planning documentation to how the issues with obtaining evidence were to be addressed.

Identification of Key Audit Areas

Allegation 37

190. The Respondents failed to carry out adequate planning in that they failed to identify key audit areas, as required by paragraph 4 of ISA 300.

PARTICULARS

191. Planning documentation for the 2006 year-end audit identified that historically accounting for Amounts Recoverable on Contracts and WIP had been poor. A further planning document identified "*completeness of income*" as a crucial audit assessment. The identification of these risks did not lead to further comment being made on the actual procedures to be performed and it is unclear what, if any, action was taken by the Respondents in relation to the identified risks.

Listed Client Experience

Allegation 38

192. The Respondents failed to carry out adequate planning in that they failed to identify a potential problem, that being the engagement team's lack of experience in auditing listed clients, as required by paragraph 4 of, ISA 300 and paragraph 19 of ISA 220.

PARTICULARS

193. By the 2006 financial year WNG was a listed company. As a result, there was an increased risk that there was an incentive to overstate revenue and/or profits due to pressure to meet market expectations. This risk was exacerbated by the fact that WNG was planning, and ultimately conducted, additional share placings, which would be substantially based on the 2006 year-end audit. The HWCA engagement team had very little experience of working with listed companies.
194. The planning documentation contains no reference to the experience of the engagement team in auditing listed clients. No specific audit procedures were planned to mitigate the impact of this lack of experience.

Assignment of Staff to Key Audit Areas

Allegation 39

195. The Respondents failed to achieve the objectives of the planning process in that they failed to identify and take into account Mr Thompson's lack of experience in the auditing of Amounts Recoverable on Contracts and as a result the audit in respect of the Amounts Recoverable on Contracts was not appropriately assigned to engagement team members as required by paragraph 4 of ISA 300.

PARTICULARS

196. Mr Thompson was a new member of the engagement team for the 2006 year-end audit. He had no professional accounting qualifications. He was allocated to audit the Amounts Recoverable on Contracts balance, which amounted to £2,066,092. As a key driver of revenue on contracts, the calculation and audit of the Amounts Recoverable on Contracts was of real importance in ensuring that the financial statements were free from material misstatement.

Experience of Auditing Goodwill

Allegation 40

197. The Respondents failed to achieve the objectives of the planning process in that they failed to identify a potential problem, that being the engagement team's lack of experience of auditing goodwill, as required by paragraph 4 of ISA 300.

PARTICULARS

198. Following the re-organisation of WNG prior to the AIM listing in 2006 an amount of goodwill arose in relation to the trade and assets of WNL (a predecessor company) being transferred to WNG. The goodwill balance was stated in the 2006 financial statements as £28.7 million (made up of £24.4 million on the pre-listing transfer of the predecessor companies and £4.3 million on the Project Air acquisition). It was by far the largest asset in the accounts.

199. In the 2006 year-end audit engagement Mr Hale was allocated to audit goodwill. He had no experience of undertaking a goodwill impairment review. The engagement team in general had very little experience of auditing goodwill.

200. The lack of experience of the engagement team was not identified during the planning procedures. As detailed elsewhere, the

deficiencies in the work undertaken are reflective of the team's inexperience in this area.

B. Accounting policies adopted by WNG and audit evidence obtained

201. The objective and general principles governing an audit of financial statements are contained in ISA 200.
202. Guidance in relation to quality control procedures is provided by ISA 220 "Quality Control".
203. Guidance in relation to the retention of audit evidence is provided by ISA 230 "Audit Documentation".
204. ISA 500 "Audit Evidence" sets out guidance in relation to the quality of evidence to be obtained by the auditors. The evidence must allow the auditors to conclude that the financial statements are free from material misstatement.

The Accounting Treatment of Pre-Contract Costs

Allegation 41

205. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to determine with reasonable confidence that WNG had obtained a right to consideration, 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.

Allegation 42

206. The Respondents 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, as required by ISA 500.

PARTICULARS

207. The 2006 year-end financial statements contain a balance for pre-contract costs of £2,406,939. This balance was derived from a calculation carried out on HWCA's working papers. The amount was almost 4 times the balance included in the 2006 interim audit. Mr Newsham carried out the audit work in relation to this balance.

208. As in previous periods the balance was calculated by WNG multiplying the number of rooms on each site, where a pre-contract visit was said to have taken place, by a per room rate. Different rates were applied to different sites and these were different from the rates used in previous years. No explanation was given for this.

209. It does not appear that any signed contracts were obtained, reviewed or retained by the Respondents. No audit procedures were performed by the Respondents to evidence that WNG had actually incurred costs in undertaking pre-installation work, that any such costs could be billed at the per room rates used in the calculations or in fact that any such work had actually taken place.

210. The audit evidence obtained by the Respondents had four major deficiencies:-

- i. Copies of final customer contracts or schedules to contracts were not retained on the audit file;

- ii. It is not clear if the amounts identified related to pre-installation work that had been performed and that these amounts were recoverable given the stage of the contract;
- iii. The audit evidence does not confirm that all contracts were awarded to WNG; and
- iv. There is no evidence retained on file of any work being undertaken to assess the profitability or stage of completion on each of the contracts.

Retentions

Allegation 43

211. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to conclude that the retentions were accounted for by WNG in accordance with Accounting Standards, as required by ISA 200.

Allegation 44

212. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to draw a reasonable conclusion in relation to the amounts included within debtors relating to retentions, as required by ISA 500.

PARTICULARS

213. The 2006 financial statements contained a retention balance of £259,588. This balance was made up of two amounts:-
- i. £44,000 relating to Debenhams maintenance;
 - ii. £215,588 described as "2004 Holiday Inn".
214. As in previous periods it was WNG's policy to recognise the full value of the retentions as revenue and a debtor on completion of the contract.

215. The only audit evidence obtained in relation to the Holiday Inn balance was a printout from the WNG SAGE system showing customer activity between WNG and LRG Hotels (between 1st June 2005 and 31st July 2005). Next to a debit posting of £215,588 is a handwritten note: "Retention". It does not mention which hotel or hotels it relates to and, in any event, the same document shows the posting being reversed on the same day. Both entries are dated 30th June 2005 and do not support the existence of this balance at the 2006 year-end.
216. No audit procedures were carried out on the Debenhams balance.
217. A letter of representation stated that the policy of "*carrying forward 100 per cent of monies due to the company...is considered prudent*". No reference is made in the letter to the value of the balance considered recoverable.
218. The retentions balance of £259,588 remained unaudited.
219. The treatment of retentions by the Respondents was deficient in that they failed to obtain sufficient appropriate audit evidence to establish that:-
- i. WNG had completed work on contracts prior to year end and that the retention amount was recoverable;
 - ii. The value of the retention was as stated in the audit working papers;
 - iii. Appropriate provision had been made for remedial costs;
 - iv. WNG was entitled to receive the retention amount from its customer.

AMROC (Amounts Recoverable on Contracts)

Allegation 45

220. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to draw a reasonable conclusion in relation to the amounts included in Amounts Recoverable on Contracts, as required by ISA 500.

Allegation 46

221. The Respondents 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.

PARTICULARS

222. The 2006 financial statements contained an Amounts Recoverable on Contracts balance of £2,066,092. The balance related to over 50 sites with a maximum site value of £162,408. The audit procedures in relation to this balance were undertaken by Mr Thompson.

223. The value of the Amounts Recoverable on Contracts balance was provided by WNG in a spreadsheet which provided information in relation to each contract, including the percentage completion at 30th September 2006 and the completion value and the amount billed as at that date.

224. The audit procedures undertaken by Mr Thompson were:-

- i. The contract value for each customer was agreed back to the order;
- ii. WNG project managers confirmed the completeness of the work, but there was no formal documentation or third party verification in relation to this;

- iii. The total amount of sales billed in the year was agreed to SAGE, but this could not be done on a contract by contract basis as all Holiday Inn sales were posted through a single SAGE account;
- iv. Checks were made to ensure that unbilled sales as at 30th September 2006 were billed after the balance sheet date.

225. There are no notes in the audit documentation made as to the sampling methodology. No evidence was obtained in relation to five balances totaling £224,088.

226. £1.045 million of the balance was made up in relation to the customer Chardon at 10 different sites (5 named, 5 unnamed). The evidence obtained in relation to this balance consisted of an email from a Chardon employee that stated: "*all Final Account applications are now with Jenni for approval and have been signed off by me*". There was no indication in the email of the hotels referred to or the value of the unbilled work as at year-end.

227. The audit evidence obtained by the Respondents was insufficient to determine whether:-

- i. Contracts were actually in place which entitled WNG to revenues;
- ii. The work had been completed prior to year-end;
- iii. The valuation of the Amounts Recoverable on Contracts balance was fairly stated.

Stock and Work in Progress

Allegation 47

228. The Respondents failed to obtain sufficient appropriate audit evidence to enable them 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.

PARTICULARS

229. The first draft of the 2006 financial statements included a stock and WIP balance of £591,931. Following audit this was adjusted to £335,706 consisting of:-
- i. £275,706 relating to raw materials and consumables (including £183,965 relating to a site at Hyde Park Corner);
 - ii. £60,000 of WIP.
230. In relation to the stock balance the Respondents conducted audit procedures consisting of three tests:-
- i. Analytical review of the overall stock balance;
 - ii. A valuation test;
 - iii. Stock-take attendance at one of 13 sites, equating to just 4% of the total balance.
231. The audit papers contain notes which indicate that the Hyde Park Corner balance had not been verified and that the £60,000 WIP balance had been supplied by Mark Worthington and was still to be confirmed. No further audit evidence was obtained.
232. The stock valuation test was carried out at all sites except Hyde Park Corner.
233. The method/judgment of selecting the single site, making up just 4% of the total balance, at which a physical check took place, is not documented.

234. No physical verification was performed on the balance relating to Hyde Park Corner. The evidence relied on in the 2006 interim audit was relied on again, it stated "*material on site 7th July 2005*". As was the case with the Respondents' work in relation to this balance when conducting the 2006 interim audit, no steps were taken by the Respondents to satisfy themselves that this stock still existed as at 30th September 2006, despite the write off in relation to the site that occurred in the 2005 year-end audit.

Accounting Policy regarding Goodwill

Allegation 48

235. The Respondents failed to obtain sufficient appropriate audit evidence to enable them to draw a reasonable conclusion that the goodwill was accounted for by WNG in accordance with the requirements of UK GAAP, as required by ISA 200.

Allegation 49

236. The Respondents failed to recognise that conducting the goodwill impairment review had the potential to threaten their independence and objectivity as auditors, as required by ISA 220.

PARTICULARS

237. The reorganisation of WNG in preparation for the AIM listing created a goodwill balance of £28.7 million (made up of £24.4 million on the pre-listing transfer of the predecessor companies and £4.3 million on the Project Air acquisition). This was by far the largest asset in the financial statements.

238. A decision was taken by the directors of WNG not to amortise the goodwill in the group accounts, on the basis that it had an indefinite life. HWCA noted concerns in relation to this decision and whether it

was appropriate, under UK GAAP and in particular FRS 10, to adopt this policy. HWCA took advice from the ICAEW helpline.

239. As a result Mr Hale carried out a goodwill impairment review. This was an accounting function that should not have been carried out by HWCA, but by WNG. No explanation was given in the documentation for the assumptions used in this calculation and the information does not justify the assumptions applied by Mr Hale to the impairment calculation. There is insufficient support for the conclusion that the goodwill had an indefinite useful economic life, which was required if there was to be no amortisation.
240. FRS 7 states that, in order to calculate the amount of goodwill arising from an acquisition, the assets and liabilities should be measured at fair value.
241. In the 2006 year-end audit the fair value work undertaken by the Respondents amounted to a calculation of the goodwill balance prepared by Mr Hale. The objective of the calculation is not recorded and it did not detail any work carried out on the fair value of the assets and liabilities or record any justification for the conclusion reached.
242. If the goodwill had been amortised over the usual 20-year period, a charge of £352,156 would have been recorded in the profit and loss account. This would have had a direct and equal effect on net profit after tax.

C. Quality control and closure of the audit

Failures in the partner review

Allegation 50

243. The Respondents' audit engagement partner review failed to identify that the audit evidence obtained was not sufficient appropriate to support the conclusions reached, that the balances were not materially misstated, as required by paragraph 26 of ISA 220.

PARTICULARS

244. Mr Newsham conducted the responsible individual review of the 2006 year-end audit files on 17th January 2007. He concluded that there was sufficient evidence to support the audit opinion and that the financial statements were free from material misstatement.

245. The audit engagement review carried out by Mr Newsham failed to identify the deficiencies in the evidence obtained (as particularised in allegations 41-49 above) and the conclusions drawn from it in relation to:-

- i. Pre-contract costs;
- ii. Retentions;
- iii. Amounts Recoverable on Contracts;
- iv. Stock and WIP;
- v. Goodwill.

246. There were a number of serious deficiencies in the audit evidence obtained by the Respondents to support key balances. These deficiencies include:-

- i. The lack of contractual evidence to confirm that WNG were entitled to revenues on long term contracts;
- ii. Much of the audit evidence was in draft form and not signed by third parties;
- iii. Much of the audit evidence, if obtained at all, was not retained on file;

- iv. The evidence obtained did not address 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 sufficient coverage upon which to draw a conclusion that the balances were not materially misstated;
- vi. Material balances, such as in relation to retentions, remained unaudited.

Reliance on the Hot Review

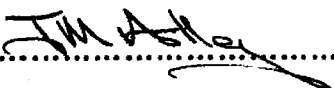
Allegation 51

247. The Respondents inappropriately placed reliance on the hot review process and in doing so failed to fully comply with the responsibilities of the engagement partner, as required by ISA 220.

PARTICULARS

248. A hot review process was again undertaken by Mr Fort. The audit files contain a "Hot Audit File Review Checklist", initialed by Mr Fort and Mr Newsham and signed by Mr Fort on 16th January 2007. The purpose of the review was not to review the detailed working papers but to focus on the planning and completion sections of the audit.

249. In interview Mr Newsham stated that he considered that the hot review would have picked up any issues relating to double counting and any issues relating to the evidence obtained regarding pre-contract costs.

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Alternate Executive Counsel

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31st May 2013
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Date