Edited for publication

**IN THE MATTER OF**

**THE EXECUTIVE COUNSEL OF THE FINANCIAL REPORTING COUNCIL**

**-and-**

**(1) OLIVER CLIVE & CO LIMITED**

**(2) EMMA BENJAMIN**

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# FINAL SETTLEMENT DECISION NOTICE

**Pursuant to Rule 108 of the Audit Enforcement Procedure**

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

## 1. INTRODUCTION

1.1. The Financial Reporting Council (the "**FRC**") is the competent authority for statutory audit in the UK and operates the Audit Enforcement Procedure (the "**AEP**"), revised in June 2023. The AEP sets out the rules and procedure for the investigation, prosecution and sanctioning of breaches of *Relevant Requirements*.

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

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

1.3.1. "**2015 Financial Statements**" means the financial statements of London Capital & Finance Ltd (**"LCF"**) for the one-month period ended 30 April 2015, and "**2015 Audit**" means the statutory audit of the 2015 Financial Statements.

1.3.2. **"Respondents"** means:

1.3.2.1. Oliver Clive & Co Limited (**"OCC"** or **"the firm"**), which was the *Statutory Audit Firm* for the 2015 Audit.

1.3.2.2. Emma Benjamin, who was the *Statutory Auditor* responsible for the 2015 Audit, and signed the 2015 Audit report on behalf of OCC.

1.4. In accordance with Rule 102 of the AEP, Executive Counsel entered into settlement discussions with the Respondents.

1.5. A *Proposed Settlement Decision Notice* was issued by Executive Counsel on 3 October 2023 pursuant to Rule 103 of the AEP in relation to the conduct of the Respondents in respect of the 2015 Audit. The Respondents provided written agreement to the *Proposed Settlement Decision Notice* on 11 October 2023, pursuant to Rule 105 of the AEP. The *Convener* subsequently appointed an *Independent Reviewer* to consider the *Proposed Settlement Decision Notice*, pursuant to Rule 106 of the AEP.

1.6. On 30 October 2023 the *Independent Reviewer* approved the issuance of a *Final Settlement Decision Notice* pursuant to Rule 107(a) of the AEP.

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

1.7.1. the breaches of *Relevant Requirement(s)*, with reasons;

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

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

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

1.8.1. Section 2: Executive Summary of the breaches of *Relevant Requirements*;

1.8.2. Section 3: Background;

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

1.8.4. Section 5: Detail of the breaches of *Relevant Requirements*;

1.8.5. Section 6: *Sanctions*;

1.8.6. Section 7: Costs.

## 2. EXECUTIVE SUMMARY OF THE BREACHES OF *RELEVANT REQUIREMENTS*

2.1. LCF's business involved issuing private bonds to retail investors and lending the proceeds to a small number of commercial clients. LCF went into administration just over three years after the 2015 audit was concluded. By that stage, LCF had issued bonds with a total value of about £237m, to 11,625 individual investors.

2.2. LCF's borrowers were unable to repay their loans, leaving bondholders with significant losses. These have been partly reimbursed by compensation schemes funded by the financial services industry and the taxpayer. The Serious Fraud Office (the **"SFO"**) has begun a criminal investigation on the basis of suspicion that LCF's bondholders may have been defrauded, but no finding to that effect has been made by any court.

2.3. Against that background, this *Final Settlement Decision Notice* sets out breaches of *Relevant Requirements* in relation to the following matters:

2.3.1. Compliance with Ethical Standards

2.3.1.1. The Respondents failed to identify and assess threats to their objectivity, namely the self-review threat arising from the fact that they had prepared the 2015 Financial Statements, and the management threat arising from the fact that they were in a position to take accounting and reporting decisions on behalf of LCF. The Respondents did not have adequate procedures in place for the identification and assessment of such threats to objectivity.

2.3.1.2. The Respondents failed to apply appropriate safeguards to reduce the self-review threat, and breached the prohibition on undertaking the role of management.

2.3.2. Planning

2.3.2.1. The Respondents failed to agree the terms of the 2015 Audit with the management of LCF, and failed to issue an audit engagement letter recording those terms.

2.3.2.2. The Respondents failed to establish and include in the audit documentation an adequate overall audit strategy and audit plan.

2.3.3. Identifying and assessing the risk of material misstatement

2.3.3.1. The Respondents failed adequately to identify, assess, discuss and record the risk of material misstatement in LCF's financial statements. Various features of LCF's structure and operations heightened the risk of misstatement due to fraud or the incorrect application of accounting standards.

2.3.3.2. The Respondents failed to apply appropriate professional skepticism in respect of the risk.

2.3.4. Loan debtor

2.3.4.1. The Respondents failed to design and perform audit procedures to obtain sufficient appropriate audit evidence in relation to the loan arrangement between LCF and its sole borrower at the time, with particular regard to the amount of the loan balance and the advances made under the loan, the recoverability of the loan, and the amount of commission charged by a third-party marketing company, which was added to the loan balance.

2.3.4.2. The Respondents also failed to apply appropriate professional skepticism in respect of those matters.

2.3.5. Related parties

2.3.5.1. LCF's sole borrower was a related party. The Respondents failed to identify, assess and discuss the risks of material misstatement associated with related party relationships and transactions, design and perform appropriate audit procedures in that regard, and evaluate whether identified related party relationships and transactions had been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

2.3.5.2. The Respondents failed to apply appropriate professional skepticism in respect of the identified related party relationship.

2.3.5.3. The Respondents failed adequately to document their work in respect of related parties.

2.3.6. Bond creditors

The Respondents failed to design and perform audit procedures to obtain sufficient appropriate audit evidence in relation to LCF's bondholders, and particularly in relation to whether the amounts recorded as owing to bondholders and as having been repaid to them were not materially misstated.

2.3.7. Opening balances

The Respondents failed to perform any procedures for the specific purpose of testing the opening balances for the 2015 Financial Statements, and did not evaluate whether procedures carried out for other purposes provided evidence in that regard.

2.3.8. Subsequent events

The 2015 Financial Statements disclosed as a subsequent event (in other words, an event occurring between the date of the financial statements and the date of the auditor's report) the fact that the debt owed by LCF's sole borrower had been passed on to a different entity after the balance sheet date. The Respondents failed to perform and document audit procedures designed to obtain sufficient appropriate audit evidence that all subsequent events that required adjustment of, or disclosure in, the financial statements had been identified.

2.3.9. Going concern

The Respondents failed adequately to consider and document the appropriateness of LCF's preparation of the financial statements on the assumption that the company was able to continue as a going concern, and in particular the impact on the use of the going concern assumption of issues affecting the company's liquidity.

2.3.10. Quality control

As *Statutory Auditor,* Ms Benjamin failed to comply with her personal responsibilities in respect of the engagement team's compliance with ethical standards, the acceptance and continuance of the engagement, the engagement team's competence and capabilities, the direction and supervision of the audit and the review of audit documentation. OCC is responsible for these failings on her part, as *Statutory Audit Firm*.

2.4. Section 5 of this *Final Settlement Decision Notice* sets out the detail of the breaches of *Relevant Requirements.*

2.5. This *Final Settlement Decision Notice* sets out the following *Sanctions* imposed on the Respondents.

Against OCC:

2.5.1. A financial penalty of £60,000, discounted for admissions and early disposal by 30% so that the financial penalty payable is £42,000;

2.5.2. a published statement in the form of a severe reprimand; and

2.5.3. a declaration that the 2015 Audit report did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*.

<u>Against Emma Benjamin:</u>

2.5.4. A financial penalty of £20,000, discounted for admissions and early disposal by 30% so that the financial penalty payable is £14,000;

2.5.5. a published statement in the form of a severe reprimand; and

2.5.6. a declaration that the 2015 Audit report did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*.

## 3. BACKGROUND

### The Respondents

3.1. In 2015 OCC was, and remains, a local accountancy firm based in central London. In 2021-22 the firm had an average of 16 employees and only one Responsible Individual (**"RI"**) qualified to sign audit opinions – Ms Benjamin. The firm usually has about ten statutory audit clients at any one time. In 2021-22 the firm's total fee income for all work was about £1.9m, and its total fee income for audit work was about £250,000. The latter figure was higher than usual, and a more representative figure for audit fee income in recent years would be about £150,000. The firm is a limited company wholly owned by the principal and an associated individual.

3.2. Ms Benjamin joined OCC in October 2014 and became an RI qualified to sign statutory audit opinions in the same year. She was, and remains, an employee of OCC with no equity stake in the firm.

### The 2015 Audit

3.3. OCC acted as LCF's accountants before the 2015 Audit, and prepared the 2015 Financial Statements. They had previously prepared financial statements for a three-month period ending 31 March 2014 and for the year ending 31 March 2015, but those financial statements had been exempt from the requirement for statutory audit. The need for the 2015 Financial Statements to be audited arose initially from an intention to list the company on the Maltese stock exchange, but by the time the audit was carried out the purpose was to allow LCF to re-register as a Public Limited Company (**"PLC"**) in the UK. The 2015 Financial Statements were, therefore, the first to be subject to statutory audit.

3.4. The 2015 Financial Statements reported that LCF's principal activities during the relevant period of April 2015 were "the raising and lending of funds". The financial statements reported current assets of around £1,250,000 (almost exclusively trade debtors), creditors of around £1,200,000 and net assets of around £40,000. Turnover of

around £14,000 was reported in the period, and net profits of less than £1,000. The financial statements were signed by one of two directors of the company in April 2015, who was the sole shareholder (**"LCF Director A"**).

3.5. The Respondents issued an unqualified audit opinion on the financial statements on 6 November 2015. The fee for carrying out the audit, as disclosed in the 2015 Financial Statements, was £3,000.

**Events after the 2015 Audit**

3.6. LCF re-registered as a PLC on 11 November 2015, in reliance on the Respondents' unqualified audit opinion and the balance sheet from the audited 2015 Financial Statements. OCC continued to act as LCF's accountants, preparing the company's financial statements for the years ended 30 April 2016 and 30 April 2017. Those financial statements were, however, audited by other firms – in each case a different one of the "Big Four" largest accountancy firms in the UK.

3.7. LCF's promotion of its bonds was regulated by the Financial Conduct Authority (the **"FCA"**). LCF went into administration on 30 January 2019, after the FCA imposed restrictions on LCF's ability to issue or approve further financial promotions, and subsequently called into question the viability of LCF's business. The FCA's intervention was prompted by serious concerns regarding LCF's conduct, including issues with the accuracy of the firm's financial promotions. This was just over three years after the 2015 Audit was concluded, in which time the company had grown very significantly (and, as set out above, during which time its financial statements were audited by other firms from the "Big Four"). By the time it entered administration, LCF had issued bonds with a total value of about £237m, to 11,625 individual investors.

3.8. LCF's administrators reported that the company had limited immediately realisable assets, and its borrowers were unable to repay their loans. The administrators' latest estimate is that the total return to secured creditors (including bondholders) will be in the range of 10% to 18%, and it is not anticipated that there will be a surplus to enable a dividend to be paid to unsecured creditors. Total compensation of about £172m has been paid to LCF bondholders by the Financial Services Compensation Scheme (the **"FSCS"**), either under the general statutory compensation scheme funded by the financial services industry or under a bespoke scheme set up by the Government specifically for LCF investors.

3.9. LCF's administrators also reported that large sums of bondholders' money ended up in the personal possession of a small group of individuals connected to each other and to LCF, as a result of a number of highly suspicious transactions. The administrators have

begun legal proceedings to try to recover this money. The SFO has also begun a criminal investigation, in conjunction with the FCA, into individuals associated with LCF. The conduct under investigation relates to LCF investments offered between 2013 and 2018. It is suspected that actions relating to the sale of LCF bonds may have been fraudulent, but this question has not been decided by any court to date.

## 4. *RELEVANT REQUIREMENTS*

4.1. Rule 1 of the AEP states that *Relevant Requirements* has the meaning set out in regulation 5(11) of the Statutory Auditors and Third Country Auditors Regulations 2016 ("**SATCAR**"). The *Relevant Requirements* applicable to the 2015 Audit include, but are not limited to, the Ethical Standards (**"ESs"**) issued by the Auditing Practice Board and the International Standards on Auditing (UK and Ireland) ("**ISAs**") issued by the FRC.

4.2. The ESs referred to in this *Final Settlement Decision Notice* are:

4.2.1. ES 1 (Integrity, objectivity and independence); and

4.2.2. ES 5 (Non-audit services provided to audited entities).

4.3. The relevant versions of the ESs are those revised in December 2010 and updated in December 2011.

4.4. The ISAs referred to in this *Final Settlement Decision Notice* are:

4.4.1. ISA 200 (Overall objectives of the independent auditor and the conduct of an audit in accordance with the International Standards on Auditing (UK and Ireland));

4.4.2. ISA 210 (Agreeing the terms of audit engagements);

4.4.3. ISA 220 (Quality control for an audit of financial statements);

4.4.4. ISA 230 (Audit documentation);

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

4.4.6. ISA 300 (Planning an audit of financial statements);

4.4.7. ISA 315 (Identifying and assessing the risks of material misstatement through understanding the entity and its environment);

4.4.8. ISA 500 (Audit evidence);

4.4.9. ISA 510 (Initial audit engagements – opening balances);

4.4.10. ISA 550 (Related parties);

4.4.11. ISA 560 (Identification of subsequent events); and

4.4.12. ISA 570 (Going concern).

4.5. The relevant versions of the ISAs are those effective for audits of financial statements for periods ending on or after 15 December 2010, except in the case of ISA 315, where the relevant version is that effective for audits for periods ending on or after 15 June 2014, and ISA 570, where the relevant version is that effective for audits of periods ending on or after 1 October 2014.

4.6. Those parts of the ESs and ISAs which are of particular relevance to the breaches of *Relevant Requirements* are set out as an **Appendix** to this *Final Settlement Decision Notice*.

4.7. As the *Statutory Auditor* responsible for the 2015 Audit, Ms Benjamin was responsible for the overall quality of the audit, and the direction, supervision, and performance of the audit in compliance with professional standards and applicable legal and regulatory requirements.

4.8. As the *Statutory Audit Firm* responsible for the 2015 Audit, OCC is responsible for any established breaches of *Relevant Requirements* on the part of its employees.

## 5. BREACHES OF *RELEVANT REQUIREMENTS*

### Breach 1 – Compliance with Ethical Standards

Requirements – objectivity and independence

5.1. Auditors must conduct audits of financial statements with objectivity and independence. The audit firm, individual partners and professional staff must all comply with the requirements of objectivity and independence.[1]

5.2. Objectivity is a state of mind that excludes bias, prejudice and compromise, and that gives fair and impartial consideration to all matters that are relevant to the task in hand, disregarding those that are not. Objectivity is a fundamental ethical principle, and requires that the auditor's judgment is not affected by conflicts of interest.[2]

5.3. Independence is freedom from situations and relationships which make it probable that a reasonable and informed third party would conclude that objectivity either is impaired, or could be impaired. Independence is related to and underpins objectivity.[3]

[1] ES1
[2] ES1, para 10
[3] ES1, para 13

5.4. However, whereas objectivity is a personal behavioural characteristic concerning the auditor's state of mind, independence relates to the circumstances surrounding the audit, including the financial, employment, business and personal relationships between the auditor and the audited entity and its connected parties.

5.5. Auditors are required to identify and assess the circumstances which could adversely affect their objectivity ('threats'), including any perceived loss of independence, and to apply safeguards which will either eliminate or reduce the threat to an acceptable level.[4]

5.6. In order to promptly identify and address those threats where they arise, audit firms are required to establish certain policies and procedures. Most relevant to this case, audit firms are required to establish policies and procedures:

5.6.1. requiring persons in a position to influence the conduct and outcome of the audit to be constantly alert to circumstances that might reasonably be considered threats to their objectivity or the perceived loss of independence and, where such circumstances are identified, to report them to the audit engagement partner or to the Ethics Partner, as appropriate;[5] and

5.6.2. requiring the audit engagement partner to identify and assess the significance of threats to the auditor's objectivity on an individual and cumulative basis, including any perceived loss of independence, when:

5.6.2.1. considering whether to accept or retain an audit engagement;

5.6.2.2. planning the audit;

5.6.2.3. forming an opinion on the financial statements;

5.6.2.4. considering whether to accept or retain an engagement to provide non-audit services to an audited entity; and

5.6.2.5. potential threats are reported to him or her.[6]

<u>Threats to objectivity</u>

5.7. In this case, there were two obvious threats. First, a "self-review" threat arose because OCC prepared the financial statements which were the subject of the audit. That threat was all the more acute because the same OCC employee (**"OCC Employee A"**) prepared the financial statements and conducted the audit work on them.

[4] ES1, para 30
[5] ES1, para 31
[6] ES1, para 38

5.8. Secondly, there was a "management threat", that is, a threat that partners and employees of OCC would take decisions on behalf of the management of LCF. In fact, that threat was realised. OCC Employee A drafted documents properly the preserve of the LCF board, such as the Strategic Report. Moreover, OCC effectively determined accounting treatments applied in the financial statements. That too should have been a decision for LCF, albeit a decision upon which OCC were entitled to advise.

5.9. The audit team failed to identify those threats, and there were inadequate procedures in place within OCC to assist the firm's partners and employees to identify threats to their objectivity and independence.

5.10. In the event, the only evidence that any thought was given to objectivity and independence is a client acceptance form. On that form, a box was ticked "no" in response to all questions regarding whether OCC had any concerns in respect of its independence or objectivity. No explanation was given as to why.

5.11. Consequently, the Respondents are in breach of the provisions requiring them to identify and assess the circumstances which could adversely affect their objectivity and to have adequate procedures in place in that regard, those being paragraphs 30, 31 and 38 of ES1.

Requirements – non-audit services

5.12. The Ethical Standards contain requirements and guidance on specific circumstances arising from the provision of non-audit services by auditors to entities audited by them which may create threats to the auditor's objectivity or a perceived loss of independence.[7]

5.13. In this case, the relevant requirements pertain to the provision of accounting services to LCF by OCC. "Accounting services" include the maintenance of accounting records and the preparation of financial statements that are then subject to audit.[8]

5.14. Auditors are prohibited from undertaking an engagement to provide accounting services to an audited entity where those accounting services would involve the audit firm undertaking part of the role of management.[9] The role of management includes taking responsibility for maintaining accounting records and preparing financial statements.[10] While auditors are permitted to advise on appropriate accounting treatments for the

[7] ES5
[8] ES5, para 156
[9] ES5, para 160 and para 165.
[10] ES5, para 166

entity being audited, the decision as to which accounting treatments are applied is for management.

5.15. If an auditor undertakes an engagement to provide accounting services, appropriate safeguards must be applied to reduce the self-review threat which arises as a result of providing both accounting and audit services.[11] For example, accounting services could be performed by partners and staff of the firm who are not involved in the audit, or the accounting services or audit could be reviewed by a suitably senior, skilled and independent individual within the firm.[12]

Provision of accounting services to LCF

5.16. As explained above, OCC Employee A both prepared LCF's financial statements and audited them. OCC did not apply appropriate safeguards to reduce the resulting self-review threat. Moreover, OCC took management decisions in that, (i) OCC determined accounting treatments of transactions and balances for LCF and in doing so went beyond advising and OCC took that decision itself, and (ii) OCC Employee A drafted the strategic report attached to the financial statements.

5.17. Consequently, the Respondents acted in breach of their obligations pertaining to the provision of both audit and accounting services as explained above and which are set out in ES5 at paragraphs 160 and 165.

5.18. In breach of paragraph 8 of ISA 230, the Respondents also failed to document (adequately or at all) any assessment of compliance with the ESs.

**Breach 2 – Planning**

Agreeing and recording the terms of the audit engagement

5.19. An auditor is to accept or continue an audit engagement only when the basis upon which the audit is to be performed has been agreed.[13] A number of requirements are aimed at achieving that objective. In this case, two are relevant.

5.20. First, auditors are required to agree the terms of the audit engagement with a company's management or those charged with governance of the company.[14] Secondly, once the terms are agreed, auditors are required to record the agreed terms in an audit engagement letter or other suitable form of written agreement.[15]

[11] ES5, para 165
[12] ES5, para 168
[13] ISA 210, para 3
[14] ISA 210, para 9
[15] ISA 210, para 10

5.21. The audit team failed to agree the terms of the 2015 Audit and failed to issue an audit engagement letter recording those terms. Consequently, the Respondents acted in breach of the obligations explained above and set out at paragraphs 9 and 10 of ISA 210.

Audit strategy and audit plan

5.22. Auditors are required to plan an audit so that it will be performed in an effective manner.[16] To that end, auditors are required to establish an overall audit strategy that sets the scope, timing and direction of the audit and guides the development of the audit plan.[17] The audit plan must contain a description of the nature, timing and extent of risk assessment and further audit procedures.[18]

5.23. The audit team addressed the scope of the audit in one tab within the single audit working paper, but not in sufficient detail to guide the development of an adequate audit plan. The working paper did not address the timing and direction of the audit at all. In breach of the requirements set out in paragraphs 7 and 9 of ISA 300, the Respondents failed to establish an overall audit strategy or an audit plan.

5.24. In breach of paragraph 12 of ISA 300, the Respondents failed to include in the audit documentation anything that could properly be described as an audit strategy and an audit plan.

**Breach 3 – Identifying and assessing risks of material misstatement**

Requirements

5.25. One objective of an audit is to identify and assess risks of material misstatement, whether due to fraud or error. Material misstatements may occur at a financial statement level (misstatements of the figures reported by an entity in its financial statements) or at the assertion level (misstatements made in the express and implied representations which the management of the entity makes through its financial statements).[19] Auditors must identify and assess the risks of material misstatement at both levels to provide a basis for designing further audit procedures.[20]

5.26. Two assertions are particularly relevant in this case. The completeness assertion is the implied assertion that all transactions and events that should have been recorded, have been recorded. The valuation assertion is the implied assertion that assets, liabilities

[16] ISA 300, para 4
[17] ISA 300, para 7
[18] ISA 300, para 9
[19] ISA 315, para 4(a)
[20] ISA 315, para 25

and equity interests are included in the financial statements at appropriate amounts and any resulting valuation adjustments are appropriately recorded.

5.27. Auditors identify and assess the risks of material misstatement through understanding the entity and its environment.[21] That process provides a basis for designing and implementing responses to the assessed risks of material misstatement.[22]

5.28. One important aspect of an entity that an auditor is required to understand is the entity's internal control. "Internal control" refers to the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. The term ''controls'' refers to any aspects of one or more of the components of internal control.[23]

5.29. An auditor must perform risk assessment procedures to obtain an understanding of an entity and its environment, including the entity's internal control. The procedures are to provide a basis for the identification and assessment of risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.[24]

5.30. Risk assessment procedures must include: inquiries of management and of others within the entity who, in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error; analytical procedures; and observation and inspection (of, e.g., the entity's operations, documents, records, manuals, reports prepared by management and the entities premises).[25]

5.31. Auditors must consider whether information obtained from their client acceptance or continuance process is relevant to identifying risks of material misstatement.[26]

5.32. The engagement partner and other key engagement team members must discuss the susceptibility of the entity's financial statements to material misstatement, with particular emphasis on misstatement due to fraud. They must also discuss the application of the applicable financial reporting framework to the entity's facts and circumstances.[27]

5.33. Auditors are required to obtain an understanding of a number of aspects of the entity and its environment. Those include: relevant industry and regulatory factors including the financial reporting framework; the nature of the entity including its operations,

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[21] ISA 315 para 3 and para 26(a)
[22] ISA 315, para 3 and para A124
[23] ISA 315, para 4(c)
[24] ISA 315, para 5, read with the definition of "risk assessment procedures" in para 4(d)
[25] ISA 315, para 6 and para A18
[26] ISA 315, para 7
[27] ISA 315, para 10 and ISA 240, para 15

ownership and governance structures, the types of investment the entity makes and plans to make, and how the entity is structured; the entity's selection and application of accounting policies; the entity's objectives and strategies as well as related business risks; and the measurement and review of the entity's financial performance.[28]

5.34. When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, auditors are required to perform specified procedures aimed particularly at obtaining information in relation to the risk of material misstatement due to fraud.[29]

5.35. Once risks have been identified, auditors must: assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions; relate the identified risks to what can go wrong at assertion level; and consider the likelihood of misstatement.[30]

5.36. The requirement that auditors must exercise professional skepticism is pertinent to their risk assessment work. Auditors must plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.[31]

5.37. Several aspects of the 2015 Audit did not meet the standards required in relation to identifying and assessing risks of material misstatement.

Identification of risks

5.38. The audit team failed to identify the most prominent risks associated with the audit. Perhaps the greatest risk was the risk of management override, i.e., the risk that LCF Director A could operate the business as he pleased, overriding any internal controls which were said to be in place. LCF's business model was also high risk in itself. In the absence of robust internal controls, there was a risk that some of LCF's liabilities would not be included in the figures presented in its financial statements.

5.39. That the funds were lent on, at rates which were not, on their face, commercial, to a single related party debtor (**"Company A"**) heightened the risk of material misstatement due to fraud. LCF's complex accounting policies heightened the risk of material misstatement due to incorrect application of the relevant accounting standards, in the absence of specialist expertise in the financial services field.

[28] ISA 315, para 11
[29] ISA 240 para 16; the procedures are specified procedures in paras 17-24
[30] ISA 315, para 26
[31] ISA 200, para 15

5.40. The audit team categorised the audit of LCF as low risk. That was inappropriate, in light of the risk factors which ought to have been apparent to any auditor. The audit team conducted the 2015 audit without the professional skepticism that would be expected in light of those factors.

Assessment and discussion of risks

5.41. There is little evidence that any adequate risk assessment was planned or performed. If the Respondents did carry out risk assessments, they were not documented save for being mentioned briefly in the working papers. The absence of any records pertaining specifically to risk assessment indicates that no risk assessments were carried out in the detail required by the Relevant Requirements. That inference is supported by the fact that the initial meetings apparently carried out by the Respondents with LCF were ineffective in directing the audit to the key areas of risk. It is further inferred that those meetings themselves did not adequately assess the risks inherent in the 2015 audit and that internal meetings did not include any adequate discussion of the susceptibility of LCF's financial statements to fraud.

5.42. There was no adequate assessment of risks at the assertion level. The audit documentation does not refer, in terms, to the assertions at all. The valuation assertion ought to have been carefully scrutinised. LCF had only one asset of any value: the loan made to Company A. Any significant impairment of that loan would have resulted in LCF being unable to repay its bondholders. Consequently, the valuation assertion pertaining to that asset ought to have been identified as high risk, and specific procedures designed to determine whether the valuation was accurate (a valuation which would have hinged on whether the monies loaned were recoverable were the debtor to default). The audit file does not contain any evidence to show that work was planned to assess the recoverability of the loan.

5.43. The completeness assertion also warranted more careful scrutiny. The audit team recognised the importance of ascertaining whether bond creditors were all captured within the financial statements. To that end, the audit team checked a sample of bonds against entries in LCF's bank statements and nominal ledgers. However, this could not detect any understatement of the bond creditor balance due to a failure to pay invested funds into LCF's bank account. Neither could it detect understatement due to interest or redemption payments being made to someone other than the bondholder in question. No audit procedures were planned to confirm that the bond creditor liabilities were not under-stated in either respect, and the audit team failed to gain an understanding of the

internal controls applied by the third parties responsible for bond issuance process, and whether they were sufficient to ensure that all liabilities were recorded.

5.44. The audit team placed too much reliance on the assertions of LCF Director A when assessing the risk of material misstatement and failed to make sufficient enquiries of management to assess his assertions.

Conclusions

5.45. In short, the audit team:

5.45.1. failed to identify the risk of material misstatements in LCF's financial statements through understanding the entity;

5.45.2. failed to conduct an adequate risk assessment;

5.45.3. failed to consider and document risks of material misstatement due to fraud;

5.45.4. failed to conduct a meeting at which the susceptibility of LCF's financial statements to material misstatement (due to fraud, or otherwise) was effectively discussed;

5.45.5. failed to make sufficient enquiries of management;

5.45.6. failed to apply appropriate professional skepticism;

5.46. For these reasons, the Respondents were in breach of the obligations explained above and set out in paragraphs 5, 6, 7, 10, 25 and 26 of ISA 315 and paragraphs 15 and 16 of ISA 240, as well as paragraph 15 of ISA 200.

5.47. In breach of paragraph 32 of ISA 315, the Respondents failed to include in the audit documentation a note of: any discussion among the engagement team; key elements of the audit team's understanding pertaining to LCF and its environment; identified and assessed risks of material misstatement at the financial statement level and at the assertion level; or the risks identified, and related controls about which the audit team had obtained an understanding.

5.48. In breach of paragraph 8 of ISA 230, the Respondents failed to document (adequately or at all) the procedures that were performed to identify and assess risks of material misstatement.

**Breach 4 – Loan Debtor**

Requirements

5.49. Auditors are required to design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.[32]

5.50. The audit team's audit procedures were inappropriate for that purpose so far as they pertained to LCF's loan to Company A, which was its sole material asset in the period under audit. The audit team's audit procedures were deficient in relation to:

5.50.1. confirming the balance of the loan;

5.50.2. advances made under the loan;

5.50.3. the recoverability of the loan (i.e., the ability of Company A to repay the loan, and LCF's ability to recoup from Company A any money that was not repaid); and

5.50.4. the amount of the marketing commission charged by the third-party marketing company added to the loan balance.

Confirmation of the loan balance

5.51. On 3 November 2015, the audit team sent a list of outstanding information by email to LCF Director A. One of the items on the list was a letter from Company A confirming the loan balance of £1,296,628.19 at 30 April 2015. Later that day, LCF Director A sent an email to the audit team attaching a confirmation letter date 1 November 2015 confirming that same loan balance and signed on behalf of a former corporate director of Company A. The next day, the audit team emailed LCF Director A noting that one figure had changed and asking for a similar confirmation in the amount of £1,251,395.86 as at 30 April 2015. LCF Director A's assistant (**"LCF Employee A"**) replied approximately an hour later attaching an updated letter date 4 November 2015, which was again signed on behalf of a former corporate director of Company A.

5.52. That process could not have served to confirm the loan balance. The figures were calculated by the audit team, and they made errors in their original calculation. Company A was apparently willing to confirm any figure provided, confirming both the originally mis-calculated amount and the revised amount. Moreover, the request for confirmation and the reply allegedly from Company A was made to LCF and not directly to Company A. For those reasons, the confirmation procedure was inappropriate and inadequate for

[32] ISA 500, para 6

the purpose of obtaining sufficient appropriate audit evidence in respect of the loan balance. It appears that the loan balance was, in fact, misstated.

Advances made under the loan

5.53. LCF's obligations under the loan were conditional upon Company A delivering to LCF "*the documents listed in Schedule 1*". Schedule 1 was not attached to the copy of the loan agreement seen by LCF. The audit team did not ask to see Schedule 1, or the documents referred to in relation to that schedule, and as a result they did not check that there had been compliance with the terms of the loan. No other evidence was obtained to verify that amounts recorded as advanced to Company A had in fact been paid to that company, either in the one-month period ended 30 April 2015 audited by OCC or in the previous financial periods.

Recoverability of the loan

5.54. The recoverability of the loan was central to LCF's viability as a business. The audit documentation indicates that the Respondents assured themselves of the recoverability of the loan on the basis that the liability had been "*passed over*" to another company (**"Company B"**) and a debenture had been issued.

5.55. That approach was deficient in that the audit team failed to consider:

5.55.1. whether Company B was able to service Company A's debt;

5.55.2. the validity of the debenture over Company B's assets, as a means of securing Company A's debt;

5.55.3. the value of the assets covered by the debenture;

5.55.4. whether Company B had legal title to the assets:

5.55.5. whether LCF (as opposed to Company A) would be able to recover the debt from Company B, in the event that Company B did not pay it; and

5.55.6. in the event that the debt was not paid by, and could not be recovered from, Company B, whether it would still be paid by, or could be recovered from, Company A.

5.56. In the circumstances, it appears that the audit team overestimated the value of the purported security, and that there was good reason to believe that the asset valued was not, in fact, owned by Company B.

Marketing commission added to loan balance

5.57. The company used to market LCF's bonds charged a commission, and the structure of LCF's business required the cost of that commission to be passed on to its loan debtor (i.e., Company A). The loan agreement stipulated that a costs of funds fee was payable when drawing down the loan and could be added to the loan. While the loan agreement did not specify the amount, it stipulated that the fee would be quantified on a "loan schedule".

5.58. The audit team audited the loan debtor figures on the basis that a fee of 33.33% was added to the loans made to Company A. However, the audit team never saw a loan schedule and never confirmed with Company A that it had agreed to such an exceptionally high fee. The fact that the quantum of the fee added was not specified in the loan agreement meant it is possible that a lower fee was in fact agreed with Company A. The inadequate confirmation process described above took matters no further.

Conclusions

5.59. For the reasons explained above, the Respondents breached their obligation to design and perform appropriate audit procedures (as set out in paragraphs 6, 7, and 9 of ISA 500) in several different ways.

5.60. Moreover, the Respondents failed to plan and perform audit work in respect of loan debtors with adequate professional skepticism as required by paragraph 15 of ISA 200.

**Breach 5 – Related Parties**

Requirements

5.61. The nature of related party relationships and transactions may give rise to higher risks of material misstatement of the financial statements, because related parties are not independent of each other and related party transactions may not be conducted under normal market terms and conditions.[33]

5.62. The audit team's planning discussion of the susceptibility of LCF's financial statements to material misstatement (due to fraud, or otherwise) was required to include specific consideration of susceptibility resulting from related party relationships and transactions[34]. The audit team were also required, as part of the risk assessment process, to identify and assess the risks of material misstatement associated with

[33] ISA 550, para 2
[34] ISA 550, para 12

related party relationships and transactions, and determine whether any of them were significant risks.[35]

5.63. Since LCF's financial statements asserted that the loan to Company A was a related party transaction conducted on terms equivalent to those prevailing in an arms' length transaction, the audit team were required to obtain sufficient appropriate audit evidence about this assertion.[36]

5.64. Further, in forming an opinion on the financial statements the audit team were required to evaluate whether the identified related party relationships and transactions had been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.[37]

Audit work on related party matters

5.65. The audit team's consideration of related party relationships and transactions was recorded in a tab on the single audit working paper. This does not demonstrate adequate discussion and assessment of the relevant risks. The only risk mentioned is that of the loan to Company A not being on commercial terms, and the conclusion that this risk was low because there was a signed loan agreement was clearly incorrect. The existence of a signed agreement is no evidence that the terms of that agreement were equivalent to those which would have prevailed in an arms' length transaction. Proper consideration of the detail of the loan terms was necessary, but does not appear to have taken place. On the face of it, the terms were not commercial – on the audit team's assessment, Company A was liable to pay back 133.33% of the value of the money it borrowed plus interest at 15% per annum. Further, as explained under Breach 4 above, the audit team's assessment was based on a mistaken understanding of the extent to which the lending was secured by debentures.

5.66. The audit team failed to identify and assess the risks of material misstatement of the loan debtor balance arising from the fact that LCF's only borrower was a related party. There is no indication that the audit work performed was designed to address these risks, and the work was not in fact adequate to do so. Neither was it adequate to provide sufficient appropriate audit evidence as to the validity of the assertion that the loan was made on terms equivalent to those in an arms' length transaction.

5.67. The analysis of related party matters in the working paper and the disclosures in the financial statements were ambiguous and inconsistent. In particular, the Note to the

[35] ISA 550, para 18
[36] ISA 550, para 24
[37] ISA 550, para 25

financial statements disclosing the loan to Company A as a related party transaction was incomplete, unclear and misleading. It did not clearly describe Company A's role and relationship to LCF, making confusing references to a different company (**"Company C"**) which appears to have drawn down the loan on Company A's behalf. It also failed to disclose the full terms of the loan, including the arrangement fees and cost of borrowing, the repayment terms, and whether the loan was secured.

Conclusions

5.68. Consequently, the Respondents breached their obligations to:

5.68.1. Discuss the particular susceptibility of LCF's financial statements to material misstatement as a result of related party relationships and transactions (as set out in paragraph 12 of ISA 550).

5.68.2. Identify and assess the risks of material misstatement associated with related party relationships and transactions, and determine whether any of them were significant risks (as set out in paragraph 18 of ISA 550).

5.68.3. Design and perform appropriate audit procedures to address related party transactions (as set out in paragraphs 6, 7, and 9 of ISA 500 and paragraph 24 of ISA 550).

5.68.4. Evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework (as set out in paragraph 25 of ISA 550).

5.69. The obligations pertaining to professional skepticism (explained above) also apply to an auditor's treatment of related parties. The Respondents failed to apply sufficient professional skepticism when reviewing the loan to Company A. The circumstances warranted the application of careful skepticism in light of the following factors:

5.69.1. The loan was a mechanism by which all monies raised from retail investors were immediately loaned to a related party.

5.69.2. The terms of that loan were, on the face of it, not commercial.

5.69.3. The figures in the confirmation letters provided in relation to the loan simply reflected OCC's calculations – the figures had not been independently arrived at by Company A. Those letters were received from LCF Director A and LCF Employee A, on the day they were requested without any query as to how the amount was calculated or, later, why it had changed. It was not explained who

the corporate signatories of the confirmation letters (in fact the former corporate director of Company A) were or in what capacity they had signed the letters.

5.70. Consequently, the Respondents failed to approach the loan to Company A with professional skepticism as required by paragraph 15 of ISA 200.

5.71. In breach of paragraph 8 of ISA 230, the Respondents failed adequately to document the procedures that were performed in relation to related parties.

**Breach 6 – Bond Creditors**

5.72. As already noted under Breach 3 above, LCF audited the bond creditor balance by checking a sample of bonds against bank statements and nominal ledger entries. These procedures were incapable of testing whether bond creditors were materially misstated, in that they could not confirm that:

5.72.1. All sums invested by bond holders had been paid into LCF's bank account.

5.72.2. Recorded payments to creditors were actually made to those creditors.

5.73. Had the Respondents gained an understanding of the controls operated by LCF and its third-party provider in relation to the bond process, they would have understood what records were created in respect of the receipt of funds from investors and the making of payments to them. They could then have designed and performed appropriate testing of those records, in order to confirm completeness of the bond creditor balance.

5.74. Consequently, the Respondents breached their obligation to design and perform appropriate audit procedures (as set out in paragraphs 6, 7, and 9 of ISA 500) in relation to bond creditors. It appears that the bond creditor balance was, in fact, materially misstated.

5.75. In breach of paragraph 8 of ISA 230, the Respondents failed adequately to document the audit procedures that were performed in relation to bond creditors, by failing to document their sampling methodology.

**Breach 7 – Opening Balances**

Requirements

5.76. Auditors have specific responsibilities to consider the opening balances in an audit engagement in which the financial statements for the prior period were not audited by them (including where the previous financial statements were not audited at all, as was

the case with LCF).[38] Opening balances are defined as those account balances that exist at the beginning of the period.

5.77. Where the previous financial statements have not been obtained, auditors must obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by, among other things, evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or performing specific audit procedures to obtain evidence regarding the opening balances.[39]

Audit work on opening balances

5.78. In this case, no procedures were performed in the 2015 Audit to obtain evidence regarding the opening balances, nor to evaluate whether other procedures performed in the audit provided sufficient appropriate audit evidence in relation to the opening balances. The procedures performed were relevant only to transactions in the period under audit, and not the opening balances.

Conclusions

5.79. By failing to perform audit procedures in relation to opening balances, the Respondents breached the requirements set out in paragraph 6(c) of ISA 510.

**Breach 8 – Subsequent events**

Requirements

5.80. "Subsequent events" are events occurring between the date of the financial statements and the date of the auditor's report. Auditors are required to perform audit procedures designed to obtain sufficient appropriate audit evidence that all subsequent events that require adjustment of, or disclosure in, the financial statements have been identified[40]. Auditors should take account of their assessment of risk in determining the nature and extent of these procedures.[41]

Audit work on subsequent events

5.81. The financial statements disclosed as a subsequent event the fact that the loan to Company A had been taken over by Company B (although the disclosure confusingly suggested that the loan was to Company C, not Company A).

[38] ISA 510
[39] ISA 510, para 6 (excluding 6(a), which only applies where there has been a previous audit)
[40] ISA 560, para 6
[41] ISA 560, para 7

5.82. However, there is no evidence that the audit team performed audit procedures designed to identify relevant subsequent events, or adequately considered the evidence obtained from procedures carried out for other purposes. The single audit working paper contains a brief section on subsequent events, which does not refer to the one matter actually disclosed in the financial statements. It does not explain how that the audit team identified that subsequent event, or confirmed that the disclosure was complete. As set out in paragraphs 5.54 to 5.56 above, the audit team failed to perform audit procedures to test the impact on the recoverability of the loan balance of the fact that Company B had taken over the loan.

Conclusions

5.83. As a result, the Respondents breached the requirements set out in paragraphs 6 and 7 of ISA 560 in respect of subsequent events, and in so far as they failed adequately to document their audit work in that regard, they also breached the requirement in paragraph 8 of ISA 230.

**Breach 9 – Going Concern**

Requirements

5.84. Most financial statements are prepared on the assumption that the entity is a "going concern", i.e., that the entity will continue in business for the foreseeable future. However, auditors are required to assess whether management's use of the going concern assumption is appropriate.

5.85. Auditors are required to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern.

5.86. As part of the risk assessment explained above under Breach 3 above, auditors are required to consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Auditors must also discuss that issue with management. If management has already performed a preliminary assessment of the entity's ability to continue as a going concern, that assessment will form the basis of the discussion between management and the auditor.[42]

5.87. Auditors must also remain alert throughout the audit for evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.[43]

[42] ISA 570, para 10
[43] ISA 570, para 11

Audit work on going concern

5.88. In this case, the audit team's consideration of the going concern assumption was inadequate. Only cursory attention was paid to the going concern assumption in discussions with management and a key issue was overlooked.

5.89. Liquidity is a central issue in relation to the going concern assumption. The audit team should have considered whether LCF would be able to pay its debts (i.e., to repay bondholders) when they became due (i.e., when bonds matured). The audit team had identified that LCF was reliant on only one borrower to be able to meet its obligations to pay capital and interest payments to bond holders. The audit team also identified that, post year end, Company B took over the loan to Company A. However, the Respondents did not consider the terms of the loan, and in particular whether the loan would provide sufficient funds to meet bond redemptions when they fell due. Moreover, LCF did not produce a cash flow forecast at the time of the 2015 audit. In the absence of such a forecast, it was not possible to assess the appropriateness of the going concern assumption.

5.90. The inadequate consideration of the appropriateness of LCF's use of the going concern assumption was not revisited during the course of the audit.

Conclusions

5.91. It follows that the Respondents acted in breach of their obligations (set out in paragraphs 10 and 11 of ISA 570) to obtain sufficient audit evidence about the going concern assumption and to remain alert for evidence which may have cast doubt on that assumption.

5.92. In breach of paragraph 8 of ISA 230, the Respondents failed to document (adequately or at all) the procedures that were performed in relation to the going concern assumption.

**Breach 10 – Quality control**

Requirements

5.93. Auditors are required to implement quality control procedures that provide the auditor with reasonable assurance that the audit complies with professional standards and applicable legal and regulatory requirements, and that the auditor's report is appropriate in the circumstances.[44]

[44] ISA 220, para 6

5.94. The responsibility for quality control at the engagement level falls largely upon the audit partner[45] and a number of specific obligations are aimed at ensuring that objective is met, including the following:

5.94.1. Throughout the audit engagement, the engagement partner must remain alert, through observation and making inquiries as necessary, for evidence of noncompliance with relevant ethical requirements by members of the engagement team.[46]

5.94.2. The engagement partner must satisfy herself that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed and must determine that conclusions reached in this regard are appropriate.[47]

5.94.3. The engagement partner must satisfy herself that the engagement team (with any experts who are not part of the team, where applicable) collectively have the appropriate competence and capabilities to perform the audit engagement in accordance with professional standards and applicable legal and regulatory requirements, and enable an auditor's report to be issued that is appropriate in the circumstances[48].

5.94.4. The engagement partner must take responsibility for the direction, supervision and performance of the audit engagement in compliance with professional standards and applicable legal and regulatory requirements, and for the auditor's report being appropriate in the circumstances.[49]

5.94.5. The engagement partner must satisfy herself that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. That must be done on or before the date of the auditor's report through a review of the audit documentation and discussion with the engagement team.[50]

Compliance with Ethical Standards

5.95. As explained above, the Respondents were in breach of ES1 and ES5. Moreover, OCC's consideration of its need to comply with Ethical Standards was not documented.

[45] However, the audit firm is vicariously liable for the acts and omissions of the engagement partner. So, the Respondents are jointly liable for breaches of requirements which mention the audit partner specifically.
[46] ISA 220, para 9; ISA 300, para 6 confirms that this and the following requirements are mandatory
[47] ISA 220, para 12
[48] ISA 220, para 14
[49] ISA 220, para 15
[50] ISA 220, para 17

It must therefore be inferred that Ms Benjamin failed to remain sufficiently alert for evidence of non-compliance with relevant ethical requirements (namely, ES1 and ES5) by members of the engagement team.

Acceptance and continuance

5.96. Ms Benjamin failed to satisfy herself that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements had been followed in relation to the 2015 Audit. OCC's New Client Form, dated 9 September 2015 in this case, was inadequate to draw attention to the procedures which ought to have been carried out in accepting the client relationship with LCF and recording the basis of the engagement. That form was not signed by the engagement partner, and it is not clear from the documentation what, if any, role she played in the client acceptance process. Moreover, the scope of the audit was unclear as late as 3 November 2015, when emails indicate that there was still ongoing discussion about the period under audit.

Engagement team competence and capabilities

5.97. Ms Benjamin did not satisfy herself that the engagement team (which consisted of her and OCC Employee A) collectively had the required competence and capabilities. There is no evidence that she turned her mind to this issue. She should have given particular consideration to the team's practical experience with audit engagements of a similar nature and complexity, technical expertise, and knowledge of the industry in which LCF operated[51]. In that regard, it was relevant that:

5.97.1. Ms Benjamin herself qualified as an auditor in 2006. However, she only had a little over a year's post-qualification experience of conducting audits as a Responsible Individual.

5.97.2. OCC Employee A had been fully qualified as an accountant for less than two years, and had no prior experience of auditing a financial services business.

5.97.3. Ms Benjamin and OCC Employee A struggled to understand LCF's business model and the applicable accounting requirements. This is clear from:

5.97.3.1. contemporaneous email correspondence;

5.97.3.2. the fact that they sought assistance from external advisors and, at one point, an accountant working as a tax consultant to OCC; and

[51] ISA 220, para A11

5.97.3.3. the fact that LCF's accounting policies were incorrectly applied and, as a result, there were material misstatements in the financial statements (which were prepared, as well as audited, by OCC Employee A).

5.98. These matters should have been considered with care by Ms Benjamin before she could satisfy herself that it was appropriate to continue the audit with the assigned engagement team, but there is no evidence that she did so.

Direction and supervision

5.99. Ms Benjamin did not take sufficient responsibility for the direction and supervision of the audit. Direction includes informing members of the engagement team of their responsibilities, the objectives of the work to be performed, the nature of the client's business, risk-related issues, problems that may arise, and the detailed approach to the performance of the engagement.[52] There is no documentary evidence that Ms Benjamin did so, and nor is there documentary evidence that she participated sufficiently in the planning of the audit (which would have been the appropriate time to raise these matters with OCC Employee A).

5.100. Supervision includes tracking the progress of the audit, considering whether the team have sufficient time to carry out their work, whether they understand their instructions and whether the work is being carried out in accordance with the planned approach, and addressing significant matters arising during the audit.[53] There is no documentary evidence that Ms Benjamin exercised this degree of oversight over the work of OCC Employee A. Her recorded participation in the audit appears to have been limited to her review of the single working paper, which was itself not adequate, as set out in the next paragraph.

Review

5.101. Ms Benjamin did not properly satisfy herself, through a review of audit documentation and discussion with the engagement team, that sufficient appropriate audit evidence had been obtained to support the conclusions reached and for the auditor's report to be issued. The documentary evidence in this case suggests that Ms Benjamin spent limited time reviewing the audit documentation. Moreover, the audit evidence was, in fact, inadequate, as explained in relation to the other breaches above. Such inadequacies

[52] ISA 220, para A13
[53] ISA 220, para A15

would have been apparent to Ms Benjamin had she properly attempted to satisfy herself that the audit evidence was appropriate.

Conclusions

5.102. It follows that the Respondents acted in breach of the requirements related to quality control, namely paragraphs 9, 12, 14, 15 and 17 of ISA 220.

5.103. In breach of paragraph 8 of ISA 230, the Respondents failed to document (adequately or at all) the quality control procedures that were performed.

## 6. *SANCTIONS*

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

6.1.1. to declare and uphold proper standards of conduct amongst *Statutory Auditors* and *Statutory Audit Firms* and to maintain and enhance the quality and reliability of future audits;

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

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

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

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

6.3. In deciding on *Sanctions*, Executive Counsel has, in summary, considered the following matters in accordance with the Policy.

Nature, seriousness, gravity and duration of the breaches

6.4. The breaches were serious. It must be recognised at the outset that this was a single audit of only one month's financial statements, for a relatively small company with a loan book of about £1,250,000, a single borrower and 36 bondholders. However, even having regard to the limited scale of the engagement, the audit was wholly inadequate. There were numerous contraventions of requirements which are fundamental to the role of the

independent auditor, and they affected the auditing of several areas of the financial statements which were fundamental to LCF's business.

6.5. Executive Counsel is unable to determine whether the Respondents would necessarily have identified that LCF was potentially a fraudulent entity, or that the financial statements may have been materially misstated, if the breaches had not occurred. Executive Counsel does not, therefore, hold the Respondents directly responsible for the losses resulting from LCF's collapse. However, by failing to plan and perform the audit with adequate independence, competence and professional skepticism, the Respondents were not in a position to detect those matters, and failed to provide the reasonable assurance that is the objective of any statutory audit.

6.6. That failure is made more serious by the fact that the Respondents were aware that LCF was engaged in issuing bonds to retail investors, and that its business was growing rapidly. The explicit purpose of the audit was to aid that expansion, by allowing LCF to re-register as a PLC. On that basis, the breaches risked the loss of significant sums of money and had the potential to adversely impact significant numbers of people – risks that did, in fact, materialise when LCF collapsed. The breaches also had the potential to significantly undermine public confidence in the standard of UK auditing, and the truth and fairness of financial statements generally.

6.7. Conversely, the breaches were not deliberate, reckless or dishonest, and were not committed with a view to financial gain. It is also right to acknowledge that OCC took steps to improve audit quality within the firm before the problems with LCF and the 2015 Audit came to light, and an inspection of the firm by the Institute of Chartered Accountants of England and Wales (**"the ICAEW"**) in October 2018 suggests that those measures had begun to bear fruit.

6.8. The financial strength of the Respondents is a relevant consideration when determining the appropriate *Sanctions.* In that regard, OCC is by far the smallest firm that has been the subject of enforcement action under the AEP, with total turnover about 6% of that of the next largest firm. As an employee of OCC, Ms Benjamin's annual remuneration is very much smaller than that enjoyed by equity partners in larger firms. OCC have indicated that they will pay any financial penalty imposed on Ms Benjamin, but her level of remuneration should still be taken into account in ensuring that any such financial penalty is proportionate.

Identification of *Sanction*

6.9. Having assessed the nature, seriousness, gravity and duration of the breaches, Executive Counsel identified the following combination of *Sanctions* as appropriate in the case of each Respondent:

6.9.1. A financial penalty of £60,000 in the case of OCC and £20,000 in the case of Ms Benjamin;

6.9.2. A published statement in the form of a severe reprimand; and

6.9.3. A declaration that the 2015 Audit report signed on behalf of OCC did not satisfy the *Relevant Requirements.*

6.10. Executive Counsel has considered whether to make an order requiring the Respondents to take specified steps to prevent a recurrence of the breaches, but has concluded that such an order would not be proportionate having regard to the particular circumstances of the 2015 Audit, the length of time that has passed since it was carried out, the remedial steps taken by the Respondents since then, and the findings of the ICAEW's inspection of OCC in October 2018.

6.11. The ICAEW is required by law to inspect every *Statutory Audit Firm* registered with it at least once every six years, so its next inspection of OCC will take place before November 2024. Inspections usually involve a review of a sample of audit files, examination of the firm's policies and procedures (with a focus on quality management and compliance with ethical standards, among other matters), and a review of the training record of selected individuals. Any issues detected in an inspection may be reported to the ICAEW's Audit Registration Committee, which has powers to withdraw or suspend registration as a *Statutory Audit Firm*, or impose conditions or restrictions.

6.12. Executive Counsel will pass a copy of this *Final Settlement Decision Notice* to the ICAEW, along with further details of the findings of her investigation, and this will inform the next inspection of OCC and ensure that it addresses any remaining risk of recurrence of the breaches.

Aggravating and mitigating factors

6.13. Executive Counsel has considered whether there were any aggravating factors that have not already been taken into account in relation to the nature, seriousness, gravity and duration of the breaches, and concluded that there are none.

6.14. With regard to mitigating factors, the Respondents have clean disciplinary records, but this is not regarded as meriting any further reduction in the *Sanctions* against them, in

the circumstances. The Respondents co-operated with Executive Counsel's investigation, as they are required to do, but the co-operation was not of the exceptional nature necessary in order to merit a reduction in the *Sanctions*.

<u>Deterrence</u>

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

6.16. In determining the size of financial sanction required to achieve effective deterrence, Executive Counsel considers that the objective is to deter smaller firms that might be at risk of repeating the particular kinds of breach that occurred in this case. On that basis, a financial sanction that would be too small to have significant deterrent effect on the much larger firms that are the usual subjects of enforcement action under the AEP can still be effective.

<u>Discount for Admissions and Settlement</u>

6.17. Full admissions were made by the Respondents at an early point in Stage 1 of the case, in accordance with paragraph 84 of the Policy, but the admissions were not all made at the first opportunity. On that basis, Executive Counsel considers that a further reduction of 30% to the financial penalty imposed against each Respondent is appropriate.

<u>*Sanctions*</u>

6.14. For the reasons set out above Executive Counsel imposes the following *Sanctions*.

*Against OCC:*

6.14.1. A financial penalty of £60,000, discounted for admissions and early disposal by 30% so that the financial penalty payable is £42,000;

6.14.2. A published statement in the form of a severe reprimand; and

6.14.3. A declaration that the 2015 Audit report did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*.

*Against Emma Benjamin:*

6.14.4. A financial penalty of £20,000, discounted for admissions and early disposal by 30% so that the financial penalty payable is £14,000;

6.14.5. a published statement in the form of a severe reprimand; and

6.14.6. a declaration that the 2015 Audit report did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*.

7. **COSTS**

7.1. Executive Counsel requires that the Respondents pay her costs in full in this matter, being £220,692. Such costs shall be paid no later than 28 days after the date of this *Final Settlement Decision Notice*.

**Signed:**

[Redacted.]

**Jamie Symington**
**Deputy Executive Counsel**

**Date: 9 November 2023**

## APPENDIX – EXTRACTS FROM RELEVANT ESs AND ISAs

**ES1: Integrity, objectivity and independence**

Paragraph 30 states as follows:

*"The auditor identifies and assesses the circumstances which could adversely affect the auditor's objectivity ('threats'), including any perceived loss of independence, and applies procedures ('safeguards'), which will either:*

*(a) eliminate the threat (for example, by eliminating the circumstances, such as removing an individual from the engagement team or disposing of a financial interest in the audited entity); or*

*(b) reduce the threat to an acceptable level, that is a level at which it is not probable that a reasonable and informed third party would conclude that the auditor's objectivity is impaired or is likely to be impaired (for example, by having the audit work reviewed by another partner or by another audit firm).*

*When considering safeguards, where the audit engagement partner chooses to reduce rather than to eliminate a threat to objectivity and independence, he or she recognises that this judgment may not be shared by users of the financial statements and that he or she may be required to justify the decision."*

Paragraph 31 states as follows:

*"The audit firm shall establish policies and procedures to require persons in a position to influence the conduct and outcome of the audit to be constantly alert to circumstances that might reasonably be considered threats to their objectivity or the perceived loss of independence and, where such circumstances are identified, to report them to the audit engagement partner or to the Ethics Partner, as appropriate."*

Paragraph 38 states as follows:

*"The audit firm shall establish policies and procedures to require the audit engagement partner to identify and assess the significance of threats to the auditor's objectivity on an individual and cumulative basis, including any perceived loss of independence:*

*(a) when considering whether to accept or retain an audit engagement;*

*(b) when planning the audit;*

*(c) when forming an opinion on the financial statements;*

(d) *when considering whether to accept or retain an engagement to provide non-audit services to an audited entity; and*

(e) *when potential threats are reported to him or her.*

**ES 5: Non-audit services provided to audited entities**

Paragraph 160 states as follows:

*"The audit firm shall not undertake an engagement to provide accounting services to:*

(a) *an audited entity that is a listed company or a significant affiliate of such an entity, save where the circumstances contemplated in paragraph 164 apply; or*

(b) *any other audited entity, where those accounting services would involve the audit firm undertaking part of the role of management."*

Paragraph 165 states as follows:

*"For entities other than listed companies or significant affiliates of listed companies, the auditor may undertake an engagement to provide accounting services, provided that:*

(a) *such services:*

  (i) *do not involve initiating transactions or taking management decisions; and*

  (ii) *are of a technical, mechanical or an informative nature; and*

(b) *appropriate safeguards are applied to reduce the self-review threat to an acceptable level."*

**ISA 200: Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing**

Paragraph 15 states as follows:

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

**ISA 210: Agreeing the terms of audit engagements**

Paragraph 9 states as follows:

*"The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate."*

Paragraph 10 states as follows:

*"Subject to paragraph 11, the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:*

*(a) The objective and scope of the audit of the financial statements;*

*(b) The responsibilities of the auditor;*

*(c) The responsibilities of management;*

*(d) Identification of the applicable financial reporting framework for the preparation of the financial statements; and*

*(e) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content."*

**ISA 220: Quality control for an audit of financial statements**

Paragraph 9 states as follows:

*"Throughout the audit engagement, the engagement partner shall remain alert, through observation and making inquiries as necessary, for evidence of noncompliance with relevant ethical requirements by members of the engagement team."*

Paragraph 12 states as follows:

*"The engagement partner shall be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed, and shall determine that conclusions reached in this regard are appropriate."*

Paragraph 14 states as follows:

*"The engagement partner shall be satisfied that the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to:*

*(a) Perform the audit engagement in accordance with professional standards and applicable legal and regulatory requirements; and*

*(b) Enable an auditor's report that is appropriate in the circumstances to be issued."*

Paragraph 15 states as follows:

*"The engagement partner shall take responsibility for:*

*(a) The direction, supervision and performance of the audit engagement in compliance with professional standards and applicable legal and regulatory requirements; and*

*(b) The auditor's report being appropriate in the circumstances."*

Paragraph 17 states as follows:

*"On or before the date of the auditor's report, the engagement partner shall, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued."*

**ISA 230: Audit Documentation**

Paragraph 8 states as follows:

"*The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:*

*(a) The nature, timing and extent of the audit procedures performed to comply with the ISAs (UK and Ireland) and applicable legal and regulatory requirements;*

*(b) The results of the audit procedures performed, and the audit evidence obtained; and*

*(c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions*."

**ISA 240: The auditor's responsibilities relating to fraud in an audit of financial statements**

Paragraph 15 states as follows:

*"ISA (UK and Ireland) 315 requires a discussion among the engagement team members and a determination by the engagement partner of which matters are*

*to be communicated to those team members not involved in the discussion. This discussion shall place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur. The discussion shall occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity."*

Paragraph 16 states as follows:

*"When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity's internal control, required by ISA (UK and Ireland) 315, the auditor shall perform the procedures in paragraphs 17-24 to obtain information for use in identifying the risks of material misstatement due to fraud."*

**ISA 300: Planning an audit of financial statements**

Paragraph 7 states as follows:

*"The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan."*

Paragraph 9 states as follows:

*"The auditor shall develop an audit plan that shall include a description of:*

*(a) The nature, timing and extent of planned risk assessment procedures, as determined under ISA (UK and Ireland) 315.4*

*(b) The nature, timing and extent of planned further audit procedures at the assertion level, as determined under ISA (UK and Ireland) 330.5*

*(c) Other planned audit procedures that are required to be carried out so that the engagement complies with ISAs (UK and Ireland).*

Paragraph 12 states as follows:

*"The auditor shall include in the audit documentation:*

*(a) The overall audit strategy;*

*(b) The audit plan; and*

*(c) Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.*

**ISA 315: Identifying and assessing the risks of material misstatement through understanding the entity and its environment**

Paragraph 5 states as follows:

*"The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion."*

Paragraph 6 states as follows:

*"The risk assessment procedures shall include the following:*

*(a) Inquiries of management, of appropriate individuals within the internal audit function (if the function exists), and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error.*

*(b) Analytical procedures.*

*(c) Observation and inspection."*

Paragraph 7 states as follows:

*"The auditor shall consider whether information obtained from the auditor's client acceptance or continuance process is relevant to identifying risks of material misstatement."*

Paragraph 10 states as follows:

*"The engagement partner and other key engagement team members shall discuss the susceptibility of the entity's financial statements to material misstatement, and the application of the applicable financial reporting framework to the entity's facts and circumstances. The engagement partner shall determine which matters are to be communicated to engagement team members not involved in the discussion."*

Paragraph 25 states as follows:

*The auditor shall identify and assess the risks of material misstatement at:*

*(a) the financial statement level; and*

*(b) the assertion level for classes of transactions, account balances, and disclosures*

*to provide a basis for designing and performing further audit procedures.*

Paragraph 26 states as follows:

*"For this purpose, the auditor shall:*

*(a) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;*

*(b) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;*

*(c) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and*

*(d) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement."*

Paragraph 32 states as follows:

*"The auditor shall include in the audit documentation:*

*(a) The discussion among the engagement team where required by paragraph 10, and the significant decisions reached;*

*(b) Key elements of the understanding obtained regarding each of the aspects of the entity and its environment specified in paragraph 11 and of each of the internal control components specified in paragraphs 14-24; the sources of information from which the understanding was obtained; and the risk assessment procedures performed;*

*(c) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level as required by paragraph 25; and*

*(d) The risks identified, and related controls about which the auditor has obtained an understanding, as a result of the requirements in paragraphs 27-30."*

**ISA 500: Audit Evidence**

Paragraph 6 states as follows:

> "*The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.*"

Paragraph 7 states as follows:

> *"When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence."*

Paragraph 9 states as follows:

> *"When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including as necessary in the circumstances:*
>
> *(a) Obtaining audit evidence about the accuracy and completeness of the information; and*
>
> *(b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes."*

**ISA 510: Opening balances**

Paragraph 6 states as follows:

> *"The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:*
>
> *(a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated;*
>
> *(b) Determining whether the opening balances reflect the application of appropriate accounting policies; and*
>
> *(c) Performing one or more of the following:*
>
> > *(i) Where the prior year financial statements were audited, reviewing the predecessor auditor's working papers to obtain evidence regarding the opening balances;*
> >
> > *(ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or*

*(iii) Performing specific audit procedures to obtain evidence regarding the opening balances."*

**ISA 550: Related parties**

Paragraph 12 states as follows:

*"The engagement team discussion that ISA (UK and Ireland) 315 and ISA (UK and Ireland) 240 require shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions."*

Paragraph 18 states as follows:

*"In meeting the ISA (UK and Ireland) 315 requirement to identify and assess the risks of material misstatement, the auditor shall identify and assess the risks of material misstatement associated with related party relationships and transactions and determine whether any of those risks are significant risks. In making this determination, the auditor shall treat identified significant related party transactions outside the entity's normal course of business as giving rise to significant risks."*

Paragraph 24 states as follows:

*"If management has made an assertion in the financial statements to the effect that a related party transaction was conducted on terms equivalent to those*

*prevailing in an arm's length transaction, the auditor shall obtain sufficient appropriate audit evidence about the assertion."*

Paragraph 25 states as follows:

*"In forming an opinion on the financial statements in accordance with ISA (UK and Ireland) 700, the auditor shall evaluate:*

*(a) Whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework; and*

*(b) Whether the effects of the related party relationships and transactions:*

*(i) Prevent the financial statements from achieving fair presentation (for fair presentation frameworks); or*

*(ii) Cause the financial statements to be misleading (for compliance frameworks)."*

**ISA 560: Identification of subsequent events**

Paragraph 6 states as follows:

*"The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions."*

Paragraph 7 states as follows:

*"7. The auditor shall perform the procedures required by paragraph 6 so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following:*

*(a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.*

*(b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.*

(c) *Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.*

(d) *Reading the entity's latest subsequent interim financial statements, if any."*

**ISA 570: Going Concern**

Paragraph 10 states as follows:

*"When performing risk assessment procedures as required by ISA (UK and Ireland) 315 (Revised June 2013), the auditor shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. In so doing, the auditor shall determine whether management[1a] has already performed a preliminary assessment of the entity's ability to continue as a going concern, and:*

*(a) If such an assessment has been performed, the auditor shall discuss the assessment with management and determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern and, if so, management's plans to address them; or*

*(b) If such an assessment has not yet been performed, the auditor shall discuss with management the basis for the intended use of the going concern assumption, and inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern."*

Paragraph 11 states as follows:

*"The auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern."*