Edited for publication

IN THE MATTER OF

THE EXECUTIVE COUNSEL OF THE FINANCIAL REPORTING COUNCIL

-and-

(1) KPMG LLP

(2) MS NICOLA QUAYLE

EXECUTIVE COUNSEL'S FINAL SETTLEMENT DECISION NOTICE

Pursuant to Rule 108 of the Audit Enforcement Procedure

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

1. INTRODUCTION

1.1. The Financial Reporting Council (the "**FRC**") is the competent authority for statutory audit in the UK and operates the Audit Enforcement Procedure (the "**AEP**"), effective 5 January 2022. The AEP sets out the rules and 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. "**FY2017**" means the financial year ended 30 November 2017, "**FY2017 financial statements**" means Eddie Stobart Logistics plc's ("**ESL**" or "**the**

Group") consolidated financial statements for that period, and "**FY2017 Audit**" means the statutory audit of the FY2017 financial statements.

1.4. Pursuant to Rule 19(b) of the AEP, Executive Counsel has decided that KPMG LLP (**"KPMG"**) and Ms Nicola Quayle are liable for Enforcement Action, having found breaches of *Relevant Requirements*.

1.5. A *Proposed Settlement Decision Notice* was issued by Executive Counsel on 27 March 2023 pursuant to Rule 103 of the AEP in respect of the conduct of:

1.5.1. KPMG in relation to the FY2017 Audit. KPMG was the *Statutory Audit Firm* for the FY2017 Audit.

1.5.2. Ms Quayle, a former partner of KPMG, who was the *Statutory Auditor* of ESL and signed off the FY2017 audit report on behalf of KPMG.

1.6. KPMG and Ms Quayle provided written agreement to the *Proposed Settlement Decision Notice*, pursuant to Rule 105 of the AEP, on 29 March 2023. The *Convener* subsequently appointed an *Independent Reviewer*, pursuant to Rule 106 of the AEP, to consider the *Proposed Settlement Decision Notice*.

1.7. On 31 March 2023, the *Independent Reviewer* approved the issuance of a *Final Settlement Decision Notice* pursuant to Rule 107(a) of the AEP.

1.8. In this *Final Settlement Decision Notice*, KPMG and Ms Quayle are referred to as the "**Respondents**".

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

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

1.9.2. the *Sanctions* imposed on the Respondents with reasons; and

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

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

1.10.1. Section 2: Background;

1.10.2. Section 3: Executive Summary of the breaches of *Relevant Requirements*;

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

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

1.10.5. Section 6 and 7: *Sanctions*;

1.10.6. Section 8: *Costs*.

2. BACKGROUND

2.1. ESL was first listed on the Alternative Investment Market ("**AIM**") on 25 April 2017, having previously been privately held. ESL was formerly named Greenwhitestar UK Plc. It operated in the supply chain, transport and logistics business.

2.2. As a listed entity ESL was required to prepare financial statements in accordance with International Financial Reporting Standards ("**IFRS**").

2.3. KPMG Audit LLC (Isle of Man) was the auditor for Greenwhitestar UK Plc from incorporation in 2014 until 2016. KPMG was previously involved in the audit of other group companies, including the previous parent company of the operating companies, and became responsible for the newly listed Group's audit for the year ended 30 November 2017.

2.4. In 2017, KPMG was ranked as the fourth largest audit firm in the UK, with revenues of £2,172 million and 597 audit principals.

2.5. Ms Quayle was appointed as Senior Partner of KPMG's Manchester office on 1 October 2017 having previously been a non-executive director on the Board of KPMG UK and Chair of KPMG's Audit and Risk Committee (from 1 October 2014 to 30 September 2017) and Head of KPMG's Audit practice in the North (from 1 June 2016 to 30 September 2017). She retired as a partner in November 2021 but continues to work with KPMG on a contractual basis on internal projects.

2.6. The audit plan for the FY2017 Audit was presented to the ESL Audit Committee on 24 October 2017 and the original planned release date for the FY2017 financial statements was 29 March 2018. On 21 March 2018 KPMG reported to the Audit Committee that this date was not achievable because of the amount and significance of work that remained outstanding, and the release date was pushed back to 10 April 2018.

2.7. The audit report included in the FY2017 financial statements was unmodified and set out that key audit matters included the existence, accuracy and presentation of revenue.

2.8. KPMG elected to resign as auditors of the Group after the FY2017 Audit had been completed, because a breakdown in their relationship with management had followed difficulties in obtaining sufficient appropriate audit evidence.

2.9. The Respondents' statutory responsibility was to form an opinion as to whether the FY2017 financial statements showed a true and fair view and had been properly prepared in accordance with IFRS and the Companies Act 2006.

2.10. An audit involves obtaining sufficient appropriate audit evidence about the amounts and disclosures in the financial statements in order to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

2.11. Audit evidence is defined in International Standard on Auditing (UK) 500 ("**ISA 500**") as "*information used by the auditor in arriving at the conclusions on which the auditor's opinion is based*". Audit evidence is primarily obtained from audit procedures performed during the course of the audit.

2.12. ESL's financial statements for the year ended 30 November 2018 were approved on 28 March 2019. In July 2019, ESL announced that a review had been conducted into the Group's prior year financial statements and that a number of matters would be addressed by means of Prior Year Adjustments ("**PYA**"). The interim results for the 6 months ended 31 May 2019 (**"2019 interims"**[1]) were published on 26 February 2020 and included PYAs, (including restatements to previously reported profit) in a number of areas. The Respondents failed to obtain sufficient appropriate audit evidence and breached *Relevant Requirements* in some of these areas.

2.13. As set out at paragraph 3.1 below, in some areas the Respondents failed to obtain reasonable assurance that the FY2017 financial statements were free from material misstatement. Notwithstanding this, it is not asserted that but for the breaches of *Relevant Requirements* the subsequent PYAs would not have occurred. The areas which are of relevance to this *Final Settlement Decision Notice* are as follows:

(i) property-related activities – for FY2017, £17m derived from ESL's property related activities was reversed and restated[2];

(ii) dilapidations – this PYA resulted in a £5.7m charge for the FY2017 financial statements and previous periods[3];

(iii) the consolidation of an investee company – the 2019 interims stated that a more appropriate treatment was to account for an investee company as an associate, the

[1] Note that KPMG did not audit ESL's financial statements for the year ended 30 November 2018 or the 2019 interims.
[2] 2019 interims, page 5.
[3] 2019 interims, page 20.

investee company's results previously having been fully consolidated in prior year financial statements[4]. This PYA had an impact of a reduction of £2.4m on retained earnings for FY2017[5].

3. EXECUTIVE SUMMARY OF THE BREACHES OF *RELEVANT REQUIREMENTS*

3.1. The breaches of *Relevant Requirements* in this *Final Settlement Decision Notice* relate to four areas of the audit:

Property transactions

3.1.1. The Respondents failed to obtain sufficient appropriate audit evidence of services provided by ESL in respect of certain property transactions in order for revenue to be ascribed to the provision of those services and recognised up front as revenue in FY2017.

Property transactions - disclosure

3.1.2. ESL, a logistics, distribution and warehousing company, had been entering into certain property transactions since 2016. Without the profit from the property transactions referred to at paragraph 3.1.1 above, ESL would have made a loss before tax. The disclosures in the FY2017 financial statements did not adequately reflect the fair presentation requirements of the accounting standard IAS 1 (Presentation of Financial Statements) (**"IAS 1"**). The disclosures did not make it clear that the revenue earned by ESL from the property transactions was equivalent to profit, because there were no costs incurred on those transactions beyond the expenditure of management time. The disclosures did not adequately explain the impact of the property transactions on ESL's financial performance.

3.1.3. The Respondents failed to properly evaluate whether the disclosures about the property transactions were adequate to enable users of the FY2017 financial statements to understand the impact of the transactions on profit.

Property leases

3.1.4. The Respondents failed to design and perform audit procedures that were appropriate in the circumstances for the purpose of obtaining sufficient

[4] 2019 interims, page 5.
[5] 2019 interims, page 24.

appropriate audit evidence to support management's view that dilapidations provisions were not required across the property lease portfolio.

3.1.5. The Respondents did not consider the possible implications of lease documents supplied to them being unsigned and/or undated, and so did not record any decisions whether or not to accept the documents at face value or request further information.

The consolidation of an investment in a company

3.1.6. In July 2017 ESL acquired 50% of the shares in a company (**'the investee company"**). KPMG concurred with management's assessment that the investee company should be accounted for as a subsidiary (with its results consolidated within the Group accounts), and not as an associate (with only the Group's share of profit or loss being recognised within the Group accounts). However, the Respondents had failed to take appropriate steps to corroborate representations made by management and did not review the terms of a shareholder agreement in sufficient detail. The Respondents misunderstood the effect of a put and call option, having failed to obtain and review the terms of the Put and Call Option Deed, and then in error treated it as determinative of the issue of control.

3.2. As is set out in this *Final Settlement Decision Notice*, there were numerous failures by the Respondents in the manner in which the FY2017 Audit was conducted. In some areas, the audit failed in its principal objective: that of providing reasonable assurance that the FY2017 financial statements were free from material misstatement.

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

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

<u>KPMG</u>

3.4.1. a financial sanction of £1.35 million, discounted for admissions and early disposal by 35% so that the financial sanction payable is £877,500; The financial sanction shall be paid no later than 28 days after the date of the *Final Settlement Decision Notice*;

3.4.2. a published statement in the form of a severe reprimand;

3.4.3. a declaration that the FY2017 audit report signed on behalf of KPMG did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*; and

3.4.4. other non-financial sanctions as outlined below imposing reporting obligations on KPMG.

<u>Ms Quayle</u>

3.4.5. A financial sanction of £70,000, discounted for admissions and early disposal by 35% so that the financial sanction payable is £45,500. The financial sanction shall be paid no later than 28 days after the date of the *Final Settlement Decision Notice*;

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

3.4.7. a declaration that the FY2017 audit report signed by Ms Quayle did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*.

4. *RELEVANT REQUIREMENTS*

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

4.2. The ISAs relevant to Executive Counsel's *Final Settlement Decision Notice* are those effective for audits of financial statements for periods ending on or after 15 December 2010 (in the case of ISA 500) and 17 June 2016.

4.3. The *Relevant Requirements* referred to in this *Final Settlement Decision Notice*, listed in the order in which they first appear, are the following:

4.3.1. Paragraph 17 of ISA 200 (Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing);

4.3.2. Paragraph 13(e) of ISA 700 (Forming an Opinion and Reporting on Financial Statements);

4.3.3. Paragraphs 6 and 7 of ISA 500 (Audit Evidence); and

4.3.4. Paragraphs 15 and 16 of ISA 200 (Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing).

4.4. Extracts from the ISAs setting out those parts which are of particular relevance to the breaches of *Relevant Requirements* are set out in Appendix 1 hereto.

4.5. As the Senior *Statutory Auditor* responsible for the FY2017 Audit, Ms Quayle was responsible for the overall quality of the FY2017 Audit and the direction, supervision, and performance of the FY2017 Audit in compliance with the professional standards and applicable legal and regulatory requirements. As the Senior *Statutory Auditor* Ms Quayle is responsible for all breaches of Relevant Requirements identified in this *Final Settlement Decision Notice* in relation to the FY2017 Audit.

4.6. Further as the *Statutory Audit Firm* responsible for the FY2017 Audit, KPMG is responsible for all breaches of *Relevant Requirements* on the part of its partners or employees.

5. BREACHES OF *RELEVANT REQUIREMENTS*

Property Transactions and disclosure (Breaches 1 and 2)

Background

5.1. During the FY2017 Audit the Respondents identified a property transaction about which they had not been informed by management. Once it had been identified, the Respondents challenged management and received inconsistent explanations from management concerning the transaction. In response, the Respondents performed a number of additional audit procedures. This work included:

(a) Consulting internally with KPMG risk functions;

(b) Involving forensic specialists in the audit;

(c) Performing additional substantive audit procedures;

(d) Consulting with a technical panel;

(e) Regularly updating the Chair of the Audit Committee;

(f) Considering the impact of the issues encountered on the audit team's assessment of the potential for management bias and the audit opinion;

(g) Seeking independent confirmation of property revenue from third parties; and

(h) Seeking specific representations from management as to the completeness of transactions.

5.2. Despite management confirming that there were no further property transactions of which the Respondents were unaware, whilst undertaking these additional procedures the audit team identified a further property transaction involving a third party ("**the Third Party**") about which they had not been informed.

5.3. The FY2017 financial statements disclosed £10.4 million in revenue for "Sales of services – Property".

5.4. Revenue of £10.4 million was derived from three transactions where the Third Party conducted the initial purchase and onward sale of warehouse properties where ESL subsequently took out a lease from the end purchaser ("**the Third Party property transactions**"). Under a profit-sharing agreement, ESL received between 87% and 96% of the profit from the sale of each property, and the Third Party received the remainder of the profit. The Third Party property transactions were referred to as [Property Transaction A], [Property Transaction B], and [Property Transaction C]. The audit team's work on each of the Third Party property transactions was recorded in a separate work paper.

5.5. The FY2017 financial statements included disclosure of the accounting policy *for "Sales of Services – Property"* as follows:

> *"(e) Sales of services - Property*
>
> *…The Company continues to be successful in providing property related services included to third party investors as part of its core strategy and the growth of its warehousing estate. It has earned fees of £10.4m (2016: £4.6m; 2015: £9.1m) with a strong pipeline of future projects and work going into 2018. Management has made the judgement that the fees are payments for the provision of property services to a third party investor that may be recorded as the revenue at the time of the transaction.*
>
> *In forming that judgement the Company has considered whether the leases it has entered into are operating leases and whether the future rentals are at market value and accordingly, whether fees received can be attributed to delivered property services."*[6]

5.6. The FY2017 financial statements explained that the *"property services"* were included

[6] 2017 Annual Report, pages 58-59.

within the Group's Road Transport operating segment, as part of *"Special Operations"*[7]. This was the largest operating segment and accounted for nearly 90% of adjusted EBITDA and 66.4% of revenue[8]. In addition to Special Operations, the Group's Road Transport operating segment included results for general transport in the UK and Ireland, Ports and the investee company.

5.7. The Third Party property transactions accounted for only 2.5% of total Road Transport revenue, but the related profit accounted for 21.4% of Adjusted Road Transport EBITDA.

5.8. The Group's operating profit before exceptional items was £31 million in FY2017. Revenue from the Third Party property transactions totalled £10.4 million[9]. This accounted for 1.6% of the Group's total revenue, but 33.6% of its operating profit (before exceptional items), and 105% of its total profit before tax, because there were almost no direct costs associated with this revenue (the only costs being management time).

5.9. Management considered that it was appropriate for the profit on each transaction to be recognised as revenue in full on the date of the transaction because the subsequent lease rental was at market rate (in accordance with sale and leaseback accounting), and considered that the profit did not represent a lease incentive (which would have required the profit to be spread over the life of the lease). The audit team consulted KPMG's Real Estate Advisory Services on this issue, who confirmed that in each case the rent was at or below market rate.

5.10. The audit team's understanding of management's proposed treatment of the transactions was recorded as follows:

> *"The group have always undertaken property transactions as part of their warehousing operations, but these were previously instructed by the old parent company. These have historically been treated as sale and leaseback transactions in accordance with their substance. In this case, the client has used a third party,* [Third Party]*, to transact this."*
>
> *"The client considers that this transaction is the same as the previous ones, and so sale and leaseback accounting is appropriate per IAS17. As ESL identified the property and instructed* [Third Party] *to transact this, they consider that although they were not the principal, sale and leaseback accounting was appropriate.*

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[7] 2017 Annual Report, page 62.
[8] Earnings before interest, taxes, depreciation and amortisation.
[9] Materiality was £1.1 million.

The client considers that the rental is at market rates and so in accordance with IAS17, has recognised the profit in full. They have included this as revenue…."

5.11. The accounting treatment of these transactions was a very important judgement. If the revenue was allocated solely to services, this resulted in the amounts being recognised in full as revenue up front, whereas if the revenue was allocated solely to the lease that was subsequently taken on the property by ESL, then the revenue would be spread over the term of the lease as a lease incentive. If the revenue was considered to relate in part to services and in part to lease incentives, then the profit would be apportioned between the respective elements and accounted for accordingly.

5.12. The audit team consulted with KPMG's Department of Professional Practice Accounting and Reporting team ("**DPP**"), who concluded that a KPMG Technical Panel should be convened concerning the appropriate accounting treatment of the revenue for the Third Party property transactions.

5.13. The audit team also consulted the Technical Panel on how the revenue from the Third Party property transactions should be disclosed in the FY2017 financial statements.

5.14. IAS 1 provides as follows:

"9. Financial statements are a structured representation of the financial position and financial performance of an entity. The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions…"

"15. Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework…"

"17. In virtually all circumstances, an entity achieves a fair presentation by compliance with applicable IFRSs. A fair presentation also requires an entity:

(a)…

(b) to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.

(c) to provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial

performance".

Breach 1 – Property transactions

5.15. The audit team considered management's proposed accounting treatment (sale and leaseback) and two other possible alternative accounting treatments (commission payment[10] and lease incentive), and these three accounting treatments were discussed with management. However, agreement could not be reached. The audit team consulted with DPP, and given that the treatment had *"the potential to significantly impact profit"*, a Technical Panel was convened. In a paper prepared for the Technical Panel, the audit team set out its assessment of management's proposed accounting treatment and the alternative treatments, stating that sale and leaseback accounting *"may be appropriate, on the basis that the transaction is not with a related party and the sale value and lease terms are considered to be at market value…"*:

> *"The client has currently accounted for both of these transactions consistent with the principles which would apply if it had been a sale and leaseback of a property which the company owned, which has resulted in the total amount of profit for each being recognised on day one, in revenue. The client has determined that the leases in place are operating leases, and we concur with this conclusion. As a result, and based on the fact that the lease is deemed to be at market value and* [Third Party] *are not a related party, if sale and leaseback accounting is deemed to be appropriate then the profit would be recognised immediately."*

5.16. The Technical Panel's view was recorded as follows:

> *"The Panel first noted that ESL never had beneficial ownership of the properties subject to the transactions. Since the properties had not been owned (legally or in substance) by ESL, the Panel concluded that the transactions were not in substance a sale and leaseback.*
>
> *…*
>
> *The Panel therefore focussed its discussion on a consideration of whether the nature of the £3.2m gain[11] was:*
>
> *(1) An incentive received for entering into a 15 year lease, which should be recognised*

[10] If treated as a commission payment this would result in revenue being recognised up-front, as set out in paragraph 5.11.

[11] Note that the figures specified in this document reflected a single transaction used as an example.

over the period of the lease in accordance with SIC 15.5[12]*; and/or*

(2) Commission received for providing services to identify and facilitate a deal for [Third Party]*, which should be recognised at the time the relevant services are delivered in accordance with IAS 18.*

…

The Panel noted that ESL had received cash upfront and entered into a lease. One way of looking at the transaction would be that it was similar in form to a lease incentive as contemplated by SIC 15.5 The Panel was therefore of the view that forming a judgement that the upfront payment was a lease incentive would be an acceptable accounting outcome.

However, the panel noted that the receipt of a lease incentive would be typically accompanied by subsequent rentals at higher than market rates. Furthermore, there were at least some services provided upfront to [Third Party] *by ESL in arranging and facilitating the transactions. It would, therefore, be appropriate to apportion at least some of the £3.2m to the provision of those services.*

…if the audit team was satisfied that it had obtained sufficient evidence to conclude that the future rental payments were at market rates then concluding that the £3.2m related to the provision of services would be appropriate.

On that basis, the Panel concluded that recognising the full £3.2m gain immediately when the series of transactions were completed was an appropriate treatment."

5.17. As set out above, the Technical Panel based its recommendations, at least in part, upon information provided by the audit team that there were "*at least some services provided upfront to* [Third Party] *by ESL in arranging and facilitating the transactions".*

5.18. The Respondents needed to obtain sufficient appropriate audit evidence of the property services provided by ESL in order for revenue to be ascribed to the provision of those services and recognised immediately. However, the Respondents did not obtain sufficient appropriate audit evidence as the information supplied to them did not adequately explain the nature and extent of the services provided in each transaction.

[12] The accounting standard SIC-15 (*Operating Leases – Incentives)*, in force at the relevant time, addresses accounting for lease incentives. Paragraph 1 provides: *"In negotiating a new or renewed operating lease, the lessor may provide incentives for the lessee to enter into the agreement. Examples of such incentives are an up-front cash payment to the lessee or the reimbursement or assumption by the lessor of costs of the lessee (such as relocation costs, leasehold improvements and costs associated with a pre-existing lease commitment of the lessee). Alternatively, initial periods of the lease term may be agreed to be rent-free or at a reduced rent."*

5.19. KPMG's work paper recorded management's explanation that *"ESL identified the property and instructed* [Third Party] *to transact this"*. Management's accounting papers stated:

> *"The profit split reflects an appropriate consideration of the following activities:*
>
> - *Covenant & brand strength of Eddie Stobart*
> - *Activities involved in originating the transaction*
> - *Activities involved in sourcing the independent purchasers*
> - *Activities involved in negotiating the transaction*
> - *Activities involved in managing the transactions"*

5.20. This implies that ESL were responsible for some or all of these activities, but does not identify which or to what extent.

5.21. The profit-sharing agreements did not specify the services to be provided by ESL.

5.22. Ms Quayle requested confirmation from the Third Party of the nature of the transactions. In a letter addressed to Ms Quayle, the Third Party outlined its role in each transaction, which included identifying the property to be purchased, identifying the end purchaser, negotiating the purchase and onward sale, and managing the purchase and onward sale.

5.23. This outline of the Third Party's role was potentially inconsistent with the information provided by management. The information provided by the Third Party should have prompted further enquiries and corroboration by the audit team to identify the precise nature of ESL's contribution to each transaction.

5.24. The Respondents did not properly consider the principal alternative to management's view, which was that the substance of ESL's role in the transactions was to take on the liability of a longer lease, and so they failed to properly evaluate whether the profits generated by the Third Party property transactions reflected services provided by ESL or lease incentives.

5.25. This failure was in breach of paragraph 17 of ISA 200, which provides that:

> *"17. To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion."*

Breach 2 – Property transactions: disclosure

5.26. In the paper prepared for the Technical Panel, the audit team explained:

"The client is reluctant to disclose these transactions separately, and has currently included the transactions within the results of their general transport operating segment. The basis of this reluctance is that they believe disclosing the value of profits realised from these transactions would be extremely commercially sensitive, and would prejudice the future value that can be generated from similar transactions."

5.27. The Technical Panel concluded that, given the size of the Third Party property transactions in the context of the Group's profit, and that their nature was different from ESL's core services of distribution and warehousing, the income from the Third Party property transactions should be separately disclosed in accordance with IAS 1 (defined at para 5.14 above). The Panel concluded that the gain did not need to be disclosed as a separate line in the FY2017 financial statements, but did expect:

"- *The income from the property transactions would be separately disclosed;*

- *In the absence of disclosure of the profit attributed to property transactions, a narrative description of the costs involved (being primarily management time) would be included; and*

- *Disclosure of the significant judgements taken in determining the nature of the transaction would be included".*

5.28. Management was opposed to disclosing the financial impact of the property transactions on profit, and challenged these conclusions. This resulted in a further Technical Panel being convened which upheld the conclusions of the original panel, and management subsequently agreed to make disclosures of the property transactions in the FY2017 financial statements.

5.29. However, despite further challenge to management by the audit team, the final disclosure proposed by management (which was included in the FY2017 financial statements) stated that the revenue was recognised *"at the fair value of the consideration received/receivable, net of professional fees, associated costs and VAT"*[13], and did not include *"a narrative description of the costs involved (being primarily management time)"*. This disclosure was accepted by Ms Quayle following consultation with a partner from DPP (DPP having been required by the Technical Panel to review the disclosure in respect of the Third Party property transactions).

[13] 2017 Annual Report, page 56.

5.30. The draft disclosures did not adequately reflect the fair presentation requirements of IAS 1 and should not have been accepted by the Respondents.

5.31. The term *"net of…associated costs"* is opaque and would not drive a user of the FY2017 financial statements to conclude that the revenue figure was stated net of all costs. On the contrary, an informed user of the FY2017 financial statements would appreciate that revenue should not be reported net of costs[14] and so would not interpret the disclosure as meaning that revenue was equivalent to profit.

5.32. The disclosure should have explained that the costs were essentially limited to management time (as was suggested by the Technical Panel - see paragraph 5.27 above), making it plain that for these transactions revenue was equivalent to profit. The overall effect of the disclosures was to obscure the fact that the relatively small percentage of revenue generated by the property transactions had a significant impact on the profitability of the Road Transport division and the Group as a whole (see paragraph 5.7 and 5.8 above). An informed user of the FY2017 financial statements would therefore not be able to understand the impact of the property transactions on ESL's financial position and financial performance as required under IAS 1.

5.33. The impact of the deficiencies was compounded by the fact that the Strategic Report contained no clear description of the nature of the property transactions, and the effect they had on the performance of ESL and its profit.

5.34. The Respondents accordingly failed to properly evaluate whether the FY2017 financial statements provided adequate disclosure to enable the intended users to understand the impact of the property transactions on profit, in breach of paragraph 13 of ISA 700, which provides that:

> *"…the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework:*
>
> *…*
>
> *(e) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements".*

Property leases (Breach 3)

[14] Paragraph 32 of IAS 1 prohibits the offsetting of income and expenses, unless required or permitted by an IFRS.

Background

5.35. Dilapidations clauses are commonly included in lease agreements, and refer to the work a tenant is required to carry out, including repairs and maintenance, in order to preserve the property.

5.36. ESL had long-term leases in its property portfolio which were subject to dilapidations clauses. ESL's accounting policy in respect of provisions for lease remediation and site restoration was *"…provisions are established over the life of leases to cover remedial work necessary at termination under the terms of those leases. Guidance for the total cost is made with reference to independent third party quantity surveyors reports and spread over the terms of the lease"*.[15]

5.37. KPMG obtained copies of a number of property lease agreements which were unsigned by one or both parties and/or which were undated.

Breach 3 – Property leases

Failure to obtain sufficient appropriate audit evidence of the application of management's selected accounting policy concerning dilapidations provisions.

5.38. KPMG's work on property leases was summarised as follows:

> *"Procedure…For all new leases entered into during the year review the key terms of the agreement to ensure any specific terms which may impact upon the financial statements are identified…*
>
> *Result…We have reviewed all key leases to identify any specific terms which have been documented within the schedule with no issues arising."*

5.39. The work paper explained that *"we have reviewed the lease documentation for new leases…"* and set out the key terms of seven new leases. There is no reference to any consideration of dilapidation or reinstatement requirements either in respect of those seven new leases or generally.

5.40. KPMG has confirmed the audit team's understanding that management's position at the time of the FY2017 audit was that dilapidations provisions were not required as the Company had a policy of ensuring that warehouses were maintained to a very high standard, but site remediation provisions were required in two subsidiaries. However, this understanding was not recorded in the audit file.

[15] 2017 Annual Report, page 55.

5.41. There should also have been documented consideration of management's policy and its application, including an assessment of new obligations arising from lease agreements entered into in the financial year, historical dilapidations requirements, evidence of the extent to which properties had been maintained to a very high standard, and planned work to maintain them to that standard, especially given the size of ESL's property lease portfolio. However, no documented reference to this issue has been identified, with the exception of an email to a member of the audit team on 26 February 2018, in which Ms Quayle wrote:

> *"I think we concluded nothing needed on the basis that they are going to maintain the properties to the extent that they will mitigate any dilapidation exposure."*

5.42. The Respondents therefore failed to design and perform audit procedures that were appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence to support management's view that dilapidations provisions were not required across the property lease portfolio, in breach of paragraph 6 of ISA 500, which provides that:

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

<u>Failure to consider the reliability of unsigned lease agreements</u>

5.43. KPMG's work paper in respect of Property Transaction B recorded that the audit team had been provided with a copy of the lease agreement dated 19 July 2017, but did not consider or document the impact of the lease agreement not being signed by the counterparty.

5.44. KPMG's working paper in respect of Property Transaction C did not identify that the lease agreement dated 7 January 2009 was not signed by any party. The audit team was provided with a signed signature page for the reversionary lease agreement, but they did not consider or document the impact of the Deed of Variation being undated and unsigned.

5.45. The Respondents should have identified and documented the limitations of the documents supplied to them, their consideration of the possible implications of unsigned or undated documents, and their decisions whether or not to accept them at face value or request further information. However, there is no evidence that the Respondents considered the issue, and so they breached paragraph 7 of ISA 500, which provides that:

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

The consolidation of an investment in a company (Breach 4)

Background

5.46. In July 2017 ESL acquired 50% of the shares in the investee company. Management determined that ESL exercised control over the investee company and so consolidated the results of the investee company within the Group accounts. The circumstances in which an investor controls an investee are governed by IFRS 10. IFRS 10 provides as follows:

"…*an investor controls an investee if and only if the investor has all the following:*

(a) power over the investee (see paragraphs 10-14);
(b) exposure, or rights, to variable returns from its involvement with the investee (see paragraphs 15 and 16); and
(c) the ability to use its power over the investee to affect the amount of the investor's returns (see paragraphs 17 and 18)."

5.47. IFRS 10 provides that to have power over an investee, the investor must have *"…existing rights that give it the current ability to direct the relevant activities"* (B9). Potential voting rights are to be considered only if they are substantive (B47). To be substantive, voting rights need to be exercisable when decisions about the direction of the relevant activities need to be made (B24).

5.48. IFRS 10 (B42) provides that:

"When assessing whether an investor's voting rights are sufficient to give it power, an investor considers all facts and circumstances, including:

(a) The size of the investor's holding of voting rights relative to the size and dispersion of holdings of the other vote holders…
(b) Potential voting rights held by the investor…
(c) …
(d) Any additional facts and circumstances that indicate the investor has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings."

5.49. IFRS 10 (B46) provides that if it is not clear, having considered these factors, that the investor has power, the investor does not control the investee.

5.50. IFRS 10 (B18) provides that:

"In some circumstances it may be difficult to determine whether an investor's rights are sufficient to give it power over an investee. In such cases, to enable the assessment of power to be made, the investor shall consider evidence of whether it has the practical ability to direct the relevant activities unilaterally. However, having more than a passive interest in the investee may indicate that the investor has other related rights sufficient to give it power or provide evidence of existing power over an investee".

5.51. The standard then lists factors which suggest *"…that the investor has more than a passive interest in the investee and, in combination with other rights, may indicate power"*.

5.52. The FY2017 financial statements record the position as follows:

"In the view of management, the acquisition of the remaining available equity is probable through the existence of a call option and a put option, exercisable in future periods…

The Directors have undertaken a review of the relevant acquisition and shareholder agreements and have determined, based on that review and actual operational arrangements since acquisition, that they have the power to direct the relevant activities of the [investee company] *business and that they have exposure to variable returns from the exercise of that power. On this basis, and also taking into account the existence of the put and call arrangements…the Group has consolidated the results of* [investee company] *from the date of acquisition*[16]*."*

5.53. For the period from acquisition to financial year end the investee company contributed £9.5 million in sales, and operating profit before exceptional items of £1 million.[17]

5.54. Had the acquisition been accounted for as an associate, the equity method of accounting would have been appropriate, and would have resulted in only ESL's 50% share of the profit or loss of the investee company (£0.5 million rather than the total profit of £1 million) being recognised in the FY2017 financial statements.

Breach 4 – The consolidation of investment in a company

5.55. KPMG's work paper stated that:

"Management have determined that they have control, as defined under IFRS 3, based on the shareholder agreement and sale and purchase agreement, together with the

[16] 2017 Annual Report, page 66.
[17] 2017 Annual Report, pages 11 and 64.

existence of the put and call option"

"The client's accounting paper shows that they consider ESL exercise control over [the investee company] *despite holding only 50% of the shares. Their main justifications are:*

a) ESL hold 50% of the voting rights, whereas the other 50% is split across three shareholders

b) The put and call option make the acquisition of the remaining equity virtually certain, meaning [the investee company] *have an incentive to take direction from ESL*

c) ESL board members provide strategic direction to [the investee company]*"*

5.56. Under the heading *"KPMG Conclusions"* the work paper stated:

"KPMG are satisfied with the client's responses in relation to control and strategic direction. In fact, during the course of the audit KPMG have seen evidence of this while performing their review of [accounting firm] *work and attending closeout meetings.*

In relation to consideration of the put and call options, KPMG confirmed with DPP that these should be included in the consideration despite the length of term, providing that ESL has control in the meantime. Based on the other assessments above, KPMG are satisfied that this is the case.

From the work performed we are satisfied that, whilst it is judgemental, sufficient evidence exists to indicate that ESL do exercise control over [the investee company] *with their 50% shareholding. This judgement needs to be disclosed in the AR&A* [Annual Report & Accounts]*."*

5.57. The Shareholders' Agreement referred on numerous occasions to the *"Put and Call Option Deed"* and described some of its terms. However, KPMG did not request a copy of the Deed, and so did not review its terms.

5.58. At the time of the audit, the put and call option was an existing right, but it did not convey a current ability to direct relevant activities because it was exercisable by ESL only from 1 June 2022 onwards. The put and call option was therefore not a substantive voting right and KPMG should not have relied upon it in their assessment of control.

5.59. In considering existing voting rights, KPMG questioned whether there was evidence that the other shareholders had a voting arrangement or past practice of acting in concert. Management responded that there was no knowledge of such arrangements or practice. However, KPMG should have recognised that ESL's existing 50% voting rights did not

by themselves, convey control, and it remained open to the three other shareholders to act in concert.

5.60. Management's paper "[the investee company] – *Accounting Treatment"* states:

> *"The constitution of the company as set out by the SHA* [Shareholders' Agreement] *conveys certain additional powers to ESL which are not enjoyed by the other shareholders:*
>
> *(i) ESL have the sole power to appoint the chairman, (ii) the quorum at a board meeting must involve all three of the ESLL*[18] *directors but only two of the shareholders nominated directors, otherwise no business may be conducted and (iii) any decision to dismiss a nominated* [the investee company] *Director is made solely by the ESL Directors..."*

5.61. KPMG's work paper stated that *"…a review of the sale and purchase and shareholders agreements…have been performed…"* and included an almost identical summary. However, the summary set out in both management's paper and KPMG's work paper was inaccurate and/or incomplete because:

i. ESLL did have the sole power to appoint the chairman, but the Shareholders' Agreement states that *"The chairman shall not be entitled to a second or casting vote either in general meetings of the Company or at any meeting of the Board"*, meaning that the power to appoint the chairman did not convey any additional rights.

ii. The Shareholders' Agreement does state that the quorum at Board meetings was three ESLL Directors and any two of the other directors, but it also states that numerous decisions concerning relevant activities require shareholder consent.

iii. The Shareholders' Agreement does state that only the ESLL Directors are entitled to vote, without a requirement for shareholder consent, on a Board resolution to dismiss a [investee company] director, but only in respect of dismissal for gross misconduct.

5.62. Accordingly, although the existence of these *"additional powers"* does indicate a significant degree of influence, they are not sufficient to demonstrate control.

5.63. The Respondents should have corroborated management's assertions by a detailed

[18] ESLL Group Limited ("ESLL"), a subsidiary of Eddie Stobart Logistics plc ("ESL").

review of the Shareholders' Agreement. However, the work paper contains no adequate analysis of its terms, and there is no other documented consideration of its terms.

5.64. Management's paper also identified examples of factors demonstrating the Group's ability to direct the relevant activities of the investee company. KPMG requested further information, and management responded.

5.65. KPMG's work paper included the following summary of management assertions:

> *"This is consistent with KPMG's understanding and experience of* [the investee company]*, during the course of our review.*
>
> - *How in practice ESL provide strategic direction. The client explained the structure of the Board, notably that* [the investee company director] *reports into the ESL CEO. This was evidenced in the discussions during the course of the* [the investee company] *audit, and our review of that work. They also noted that they have been able to offer support around the funding of franchisees which had been a restricting factor for growth previously.*
> - *…*
> - *ESL advised that* [the investee company]'s *brand has been changed to be "*[the investee company] *powered by ESL", publicly demonstrating the control ESL has.*
> - *Some of the back office functions are now integrated with ESL, and ESL do have control over the customers that* [the investee company] *work with."*

5.66. KPMG concluded that they were *"satisfied"* with management's responses. Notwithstanding the reference in the work paper to the audit team seeing (or observing) evidence of ESL's control and strategic direction, the work paper does not record what steps, if any, were taken to corroborate management's assertions. Whilst the audit team stated they were able to observe that ESL was exercising control, that was effectively with the consent of the other three shareholders rather than because ESL had the power to control the investee company. The consent could have been withdrawn at any time.

5.67. In conclusion, KPMG's analysis of control was not adequate because the audit team failed to obtain and/or review key documents and instead relied too heavily upon representations made by management. The Respondents failed to obtain an accurate understanding of the terms of the Shareholders' Agreement because they did not corroborate management assertions by conducting their own detailed review of its terms. They relied upon the existence of the put and call option, having failed to obtain and review the terms of the Put and Call Option Deed, and then mistakenly treated it as

determinative of the issue of control. They did not corroborate assertions made by management concerning their assessment of control. This failure to properly assess, challenge, and seek corroboration of management's view was in breach of paragraphs 15, 16 and 17 of ISA 200, which provide that:

"15. 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.

16. The auditor shall exercise professional judgment in planning and performing an audit of financial statements.

17. To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion."

6. *SANCTIONS* – KPMG

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 considering *Sanctions* to be imposed on the Respondents, Executive Counsel has, in summary, considered the following matters in accordance with the Policy.

<u>Nature, seriousness, gravity and duration of the breaches</u>

6.4. As a result of the breaches of *Relevant Requirements*, the FY2017 Audit failed in its principal objective namely to obtain reasonable assurance about whether the FY2017 financial statements as a whole were free from material misstatement.

6.5. Revenue recognition was identified as a significant risk in the audit. The property transactions had a significant impact on profit recognised in the financial year due to the accounting treatment adopted by management and as such it was important that sufficient appropriate audit evidence relevant to the accounting treatment was obtained. Without the profit from the property transactions, ESL would have reported a pre-tax loss in FY17.

6.6. Fair presentation is a fundamental part of financial reporting. The disclosure regarding the property transactions was inadequate and did not achieve fair presentation given the impact of transactions on the reported profit for the ESL group as a whole and for the operating segments.

6.7. The breaches of *Relevant Requirements*:

6.7.1. were serious (in particular relating to the property transactions and the disclosure concerning the same);

6.7.2. related to three areas of the audit;

6.7.3. were isolated as opposed to pervasive;

6.7.4. related only to one audit year; and

6.7.5. were not repeated or ongoing.

6.8. The breaches:

6.8.1. had the *potential* to adversely affect a significant number of people in the United Kingdom (such as the public, investors or other market users), and could have harmed investor, market and public confidence in the truth and fairness of the FY2017 financial statements published by *Statutory Auditors* or *Statutory Audit Firms*. ESL's shares were AIM listed. For the avoidance of doubt, the Executive Counsel has not alleged or found that there was in fact such harm or that such

people were in fact adversely affected.

6.8.2. undermine confidence in the standards of conduct in general of *Statutory Auditors* and *Statutory Audit Firms*, and/or in S*tatutory Audit*.

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

6.10. The Respondents did not derive or intend to derive any profit or benefit from the breaches of the Relevant Requirements (beyond the audit fee chargeable for the Audit).

6.11. KPMG has implemented a number of significant changes and improvements to their audit processes and procedures since the FY2017 Audit was performed which reduce the risk of recurrence of the breaches. However, Executive Counsel considers the risk of recurrence can be further reduced by way of non-financial sanctions which are set out below.

6.12. KPMG has a poor regulatory track record. There have been eleven FRC Enforcement decisions against KPMG since 2019, some of which contain breaches of the same standards to the breaches contained within this *Final Settlement Decision Notice*.

6.13. KPMG is a large audit firm, with 533 partners across all functions, and 311 Statutory Auditors in 2021. Its UK fee income in 2021 was approximately £2,433 million and its audit fee income was approximately £646 million. The audit fee for the audit was £324,000.

Identification of *Sanction*

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

6.14.1. a financial sanction of £1.35 million;

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

6.14.3. a declaration that the FY2017 audit report signed on behalf of KPMG did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*; and

6.14.4. an order for KPMG to take action to prevent the recurrence of the breach of the *Relevant Requirements* by:

i. reporting to its FRC supervisor on or around a date of one year from the date of the *Final Settlement Decision Notice* as to whether advice provided in accounting and disclosure technical consultations carried out by audit teams has been implemented properly and effectively and to inform its FRC

supervisor when its 'close the loop'[19] monitoring is no longer a priority in its quality plan. KPMG's FRC supervisor may extend the reporting requirement to cover up to two further reports provided annually if the results set out in KPMG's first report to its FRC supervisor give rise to reasonable concern that there have been failings by audit teams in the area relevant to the report or that there have been flaws in the form of monitoring undertaken by KPMG for the purposes of its report; and

ii. reporting to and consulting with its FRC supervisor by 30 September 2023 on its policies and procedures and any enhancements required to those procedures to manage potential risks to audit quality as regards (a) audit responsibilities for partners practising audit who have firm managerial and non-client responsibilities within KPMG; and (b) Responsible Individuals who have received adverse Audit Quality Review or Enforcement findings.

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

Aggravating factors

6.16. In the case of KPMG, the only notable aggravating factor is the fact that KPMG has a poor disciplinary record. This has already been taken into account in assessing the nature, seriousness, gravity and duration of the breaches, and no further adjustment to the level of *Sanctions* is required.

Mitigating factors

6.17. As paragraph 69 of the Policy explains:

> *"In order for cooperation to be considered as a mitigating factor at the point of determining appropriate sanction it will therefore be necessary for the Statutory Auditors and Statutory Audit Firms to have provided an exceptional level of cooperation."*

6.18. The Respondents have provided a good level of co-operation throughout the investigation as required but not the exceptional level of co-operation which would amount to a positive mitigating factor.

[19] Close the loop is an internal KPMG audit quality monitoring process.

Deterrence

6.19. 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.

Discount for Admissions and Settlement

6.20. Having taken into account the admissions by KPMG and the stage at which those admissions were made (at an early point within Stage 1 of the case for the purposes of paragraph 84 of the Policy), Executive Counsel determined that a further reduction of 35% to the financial sanction for early disposal is appropriate, such that a financial sanction of £877,500 is payable.

Other considerations

6.21. In accordance with paragraph 47(c) of the Policy, Executive Counsel has taken into account the size / financial resources and financial strength of KPMG and the effect of a financial penalty on its business and whether any financial penalty would be covered by insurance.

7. *SANCTIONS* – MS QUAYLE

7.1. Executive Counsel imposes the following *Sanctions* against Ms Quayle:

7.1.1. A financial sanction of £70,000, discounted for admissions and early disposal by 35% so that the financial sanction payable is £45,500. The financial sanction shall be paid no later than 28 days after the date of the *Final Settlement Decision Notice*;

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

7.1.3. a declaration that the FY2017 audit report signed by Ms Quayle did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*.

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

Nature, seriousness, gravity and duration of the breaches

7.3. The factors cited at paragraphs 6.4 - 6.10 above are repeated.

7.4. Ms Quayle held senior management responsibilities within KPMG, including within the audit practice, referred to in paragraph 2.5 above.

7.5. With respect to Ms Quayle's regulatory track record:

7.5.1. Deficiencies in Ms Quayle's audit work have been identified by the FRC's Audit Quality Review team on several occasions.

7.5.2. She has been the subject of *Sanctions* imposed by Executive Counsel in two FRC Enforcement decisions made under the AEP in 2019 and 2021 respectively.

Identification of *Sanction*

7.6. Having assessed the nature, seriousness, gravity and duration of the breaches, Executive Counsel has identified the combination of *Sanctions* as set out in paragraph 7.1 above as appropriate.

7.7. Ms Quayle ceased performing Statutory Audits in 2020, and no longer holds a practising certificate. She has provided an undertaking that she will not carry out Statutory Audits or sign Statutory Audit reports in the future. In view of these points, Executive Counsel has not imposed a prohibition on Ms Quayle from carrying out audit work for a specified period.

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

Aggravating factors

7.9. Notable aggravating factors are Ms Quayle's seniority at the point of signing the audit report and past disciplinary record. Executive Counsel has already taken into account these factors in assessing the nature, seriousness, gravity and duration of the breaches, and no further adjustment to the level of *Sanctions* is required.

Mitigating factors

7.10. Paragraphs 6.17 and 6.18 are repeated. Executive Counsel has not identified any mitigating factors and no further adjustment is therefore required.

Deterrence

7.11. 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.

Discount for Admissions and Settlement

7.12. Having taken into account the admissions by Ms Quayle and the point at which those admissions were made (at an early point within Stage 1 of the case in accordance with paragraph 84 of the Policy), Executive Counsel determined that a reduction of 35% as to the financial sanction for early disposal is appropriate, such that a financial sanction

of £45,500 is payable.

Other considerations

7.13. Executive Counsel has considered the applicability of 47(d) and 50 of the Policy as regards Ms Quayle.

8. COSTS

8.1. The Respondents shall pay the costs in full in this matter, being £320,300. Such costs shall be paid no later than 28 days after the date of the *Final Settlement Decision Notice*.

Signed:

[Redacted.]

DEPUTY EXECUTIVE COUNSEL

Date: 31 March 2023

APPENDIX 1 – EXTRACTS OF RELEVANT REQUIREMENTS

Extracts from ISAs

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

1.1. 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."

1.2. Paragraph 16 states as follows:

"The auditor shall exercise professional judgment in planning and performing an audit of financial statements."

1.3. Paragraph 17 states as follows:

"To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion."

2. ISA 500: Audit evidence

2.1. 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".

2.2. 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."

3. ISA 700: Forming an Opinion and Reporting on Financial Statements

3.1. Paragraph 13(e) states as follows:

“…the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework:

…

(e) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements”.