

Edited for publication

**IN THE MATTER OF**

**EXECUTIVE COUNSEL OF THE FINANCIAL REPORTING COUNCIL**

**- and -**

**(1) KPMG LLP**

**(2) ADRIAN WILCOX**

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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 terms defined in the AEP are used, they appear in italics.
- 1.3. This *Final Settlement Decision Notice* follows Executive Counsel’s investigation into the statutory audit of M&C Saatchi plc (“**M&C Saatchi**” or “**the Group**”) for the year

ended 31 December 2018 (the “**2018 Audit**”). KPMG LLP (“**KPMG**”) was the *Statutory Audit Firm* for the 2018 Audit. Adrian Wilcox, a member of the Institute of Chartered Accountants in England and Wales and a partner of KPMG, was the *Senior Statutory Auditor* responsible for the 2018 Audit. KPMG and Mr Wilcox are the Respondents to this *Final Settlement Decision Notice*.

- 1.4. As the *Senior Statutory Auditor* responsible for the 2018 Audit, Mr Wilcox was responsible for the overall quality of the 2018 Audit and the direction, supervision, and performance of the audit in compliance with the professional standards and applicable legal and regulatory requirements. Accordingly, Mr Wilcox is responsible for any established breaches of *Relevant Requirements* in relation to the 2018 Audit.
- 1.5. As the *Statutory Audit Firm* responsible for the 2018 Audit, KPMG is responsible for any established breaches of *Relevant Requirements* on the part of its partners or employees.
- 1.6. In accordance with Part 6 of the AEP, Executive Counsel entered into settlement discussions with the Respondents. A *Proposed Settlement Decision Notice* was issued by Executive Counsel on 24 October 2023. The Respondents provided written agreement to the *Proposed Settlement Decision Notice* on 25 October 2023.
- 1.7. The *Convener* subsequently appointed an *Independent Reviewer* to consider the *Proposed Settlement Decision Notice*. On 9 November 2023, the *Independent Reviewer* approved the issuance of a *Final Settlement Decision Notice*.
- 1.8. This *Final Settlement Decision Notice* is divided into the following sections:
  - 1.8.1. Section 2: Executive Summary;
  - 1.8.2. Section 3: Background;
  - 1.8.3. Section 4: *Relevant Requirements* that have been breached;
  - 1.8.4. Section 5: Detail of the breaches of *Relevant Requirements*;
  - 1.8.5. Section 6: *Sanctions*; and
  - 1.8.6. Section 7: *Costs*.

## **2. EXECUTIVE SUMMARY**

- 2.1. This *Final Settlement Decision Notice* sets out breaches of *Relevant Requirements* which fall into three over-arching categories:

2.1.1. **Category 1** is a failure properly to audit journal entries and year-end adjustments. In particular:

2.1.1.1. The Respondents failed properly to interrogate the reasons for the release of “WIP credits” (as defined below) which increased the revenue recognised in the P&L (and which were reversed in the subsequent year).

2.1.1.2. The Respondents did not test journal entries within 3 of 21 UK entities in the Group and/or failed to record the work that was done on such journal entries.

2.1.1.3. The Respondents did not test certain types of high-risk journal.

2.1.2. **Category 2** is a failure to document the change in approach to the audit of ageing “WIP debits” (as, again, defined below) specifically in relation to the assessment of their recoverability.

2.1.3. **Category 3** is a failure to audit rebates properly. On the face of a contract between Performance (an entity in the Group) and Client A (which has been anonymised), Performance was required to pass rebates received from suppliers back to Client A. The audit file records that there was no such obligation, but does not explain or evidence the basis on which the Respondents reached that contrary conclusion.

2.2. This *Final Settlement Decision Notice* also sets out the following *Sanctions* for these breaches of *Relevant Requirements*:

KPMG

2.2.1. a financial sanction of **£2.25 million**;

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

2.2.3. a declaration that the 2018 Audit report signed on behalf of KPMG did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*.

Adrian Wilcox

2.2.1. A financial sanction of **£75,000**;

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

- 2.2.3. a declaration that the 2018 Audit report signed by Mr Wilcox did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*.

### **3. BACKGROUND**

#### **M&C Saatchi**

- 3.1. M&C Saatchi is a global marketing services business. It was formed in 1995 in a split from Saatchi & Saatchi plc and was listed on the AIM market of the London Stock Exchange in July 2004. It achieved substantial growth through a combination of acquisitions and setting up agencies in various locations worldwide in partnership with local entrepreneurs who took minority shareholdings in those agencies. By the time of the 2018 Audit, M&C Saatchi had a global network of over 80 agencies, which employed approximately 2,600 staff.

#### **The appointment of KPMG**

- 3.2. KPMG were appointed as auditors of M&C Saatchi in 2012 and retained that appointment up until 29 September 2019 when they resigned. Mr Wilcox conducted the 2018 Audit. This was the first year in which he had acted as the audit engagement partner.
- 3.3. The financial statements for the year ended 31 December 2018 (the “**2018 Financial Statements**”) were signed on 28 May 2019. KPMG issued an unmodified audit opinion on the 2018 Financial Statements.

#### **The conduct of the 2018 Audit**

- 3.4. On 14 September 2018, KPMG presented a report to the Audit Committee of M&C Saatchi setting out the audit plan and strategy for the 2018 Audit. The audit plan identified five significant risks, including revenue recognition and management override of controls. The timetable for the audit recorded that the statutory accounts were to be approved in March 2019.
- 3.5. On 18 March 2019, KPMG presented a further report to the Audit Committee which recorded that the audit was not yet complete. It identified a number of significant areas

of audit work that would have to be completed before KPMG would be in a position to finalise and issue their audit report.

- 3.6. On 27 March 2019, M&C Saatchi announced its unaudited preliminary results for FY18. As an AIM-listed company, M&C Saatchi did not require KPMG's consent to announce these results.
- 3.7. On 29 March 2019, the audit team left the premises of M&C Saatchi and fieldwork was paused, while the finance team at M&C Saatchi gathered outstanding information. The audit team returned to the premises, to resume fieldwork, on 7 May 2019, targeting a date of 23 May 2019 to issue their opinion. This date was then moved back to 28 May 2019 as the Respondents were not satisfied that they had collected all the evidence required to form an opinion.
- 3.8. On 26 May 2019, KPMG issued a report on the 2018 Audit to the Audit Committee. This recorded that:

*"We have identified a large number of control deficiencies, audit differences and optimistic judgements which, combined with the delays and slow/poor explanations, gave us cause to consider whether the company's books and records and control environment were appropriate and as we are required to do so, consider under the Companies Act 2006 if adequate accounting records have not been kept.*

*However we only just concluded not to qualify because we received a first complete consolidation on 17 May 2019 which demonstrated that M&C Saatchi now has a full set of accounting records for the year ended 31 December 2018. The significant difficulties encountered made it harder to come to this conclusion that [sic] it otherwise should have been."*

- 3.9. On 28 May 2019, KPMG signed an unqualified audit opinion on the 2018 Financial Statements.

### **The WIP balances**

- 3.10. Certain of the breaches of *Relevant Requirements* set out below relate to "WIP" balances.
- 3.11. The acronym WIP was used by M&C Saatchi and the Respondents (in the context of the audit file) to refer to the treatment of the cost of goods or services provided by third parties for the benefit of M&C Saatchi's clients. Save for one isolated instance, the acronym was not used by M&C Saatchi or the Respondents in the more usual sense of work performed by M&C Saatchi itself which was not complete and for which an invoice had not been raised. For the purposes of this *Final Settlement Decision Notice*, there were two relevant phrases:

- 3.11.1. “WIP debits”: These were costs that had been incurred by M&C Saatchi on behalf of its clients, and for which the third party had issued an invoice to M&C Saatchi, but for which M&C Saatchi had not yet invoiced its clients. *“WIP debits”* thus represented an asset in M&C Saatchi’s balance sheet.
- 3.11.2. “WIP credits”: These were costs for which M&C Saatchi had received payment on account from its clients, but in respect of which it had not yet incurred a liability to a third party or (at least) had not yet been invoiced by a third party for goods and services procured on behalf of the applicable clients. *“WIP credits”* thus represented a liability in M&C Saatchi’s balance sheet.

#### **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”**). Those requirements include, but are not limited to, the International Standards on Auditing (UK) (**“ISAs”**) issued by the FRC.
- 4.2. The *Relevant Requirements* referred to in this *Final Settlement Decision Notice* are the following:
  - 4.2.1. ISA 200 (Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing);
  - 4.2.2. ISA 230 (Audit Documentation);
  - 4.2.3. ISA 240 (The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements);
  - 4.2.4. ISA 300 (Planning an Audit of Financial Statements); and
  - 4.2.5. ISA 500 (Audit Evidence).
- 4.3. Extracts from the ISAs of particular relevance to the breaches of *Relevant Requirements* are set out in the Appendix.

## 5. BREACHES

### Category 1: Failures properly to audit journal entries and year-end adjustments

#### Adjustments releasing WIP credits at year-end

- 5.1. At the year-end, a number of adjustments were made as part of the UK sub-consolidation exercise to release “WIP credits” to revenue.
- 5.2. As noted at paragraph 3.11.2 above, a WIP credit arose where a client paid M&C Saatchi on account for the estimated cost of goods or services to be provided by a third party, but where M&C Saatchi had not yet received an invoice from that third party for those goods or services. WIP credits were released to the profit and loss account in circumstances where M&C Saatchi considered that (a) a third party would not present an invoice for goods and services that had already been paid for by a client (either because it was not in the event called upon to provide the goods or services, or because it did provide them but did not provide an invoice or the invoice was for a lesser amount), and (b) it was not required to reimburse that client with the monies that the client had already paid on account of those goods and services (including where the client had agreed to apply those funds to subsequent projects).
- 5.3. The circumstances in which WIP credits fell to be released thus required a specific chain of circumstances and represented a subjective judgement on the part of management. It was accordingly open to manipulation and posed a risk of material misstatement. That risk was particularly acute in circumstances where the release of WIP credits had the effect of increasing both revenue and profit; where revenue was a key performance indicator used by the management of M&C Saatchi; and where members of that management team were themselves incentivised by reference to increases in revenue. The release of WIP credits thus represented a risk, which needed to be addressed during the audit.
- 5.4. In circumstances where the aggregate releases made in FY18 were material, those releases would require cogent explanations and supporting evidence justifying the judgement made by management.
- 5.5. At the year-end, at the UK sub-consolidation level, revenue was increased by, *inter alia*, five adjustments in the combined sum of £1.2 million and identified as N2 (PL) to N6 (PL) in the applicable work papers. Collectively, these adjustments were material, when assessed against a materiality threshold on the 2018 Audit of £900,000. These journals

were also high risk as they were processed manually and were not subject to the controls in place for booking entries into the individual group entities' accounts.

5.6. As to these specific journals:

5.6.1. The work paper setting out the work done on the adjustments in the UK sub-consolidation records the debits and credits the wrong way round (as DR Revenue; CR WIP). This manifest error was not picked up on review.

5.6.2. In any event, the audit team did not test the appropriateness of any of these adjustments.

5.6.3. Of these five adjustments, N3, N4 and N5 represent releases of WIP credits. There is no evidence on the audit file that the audit team agreed these releases back to the WIP credits that had been recorded in the books of the applicable entities, and audited accordingly, to ensure that the releases being made at year end corresponded to a duly recorded WIP credit.

5.6.4. There is no evidence on the audit file of any consideration being given to the appropriateness of releasing these WIP credits.

5.7. This was a significant failure. In the financial statements for the year ending 31 December 2019 (the "**2019 Financial Statements**"), adjustments N2 to N6 were reversed on the basis that they represented "*UK sub-group consolidation journals with no support*" (see page 88 of the 2019 Financial Statements).

### *Breaches*

5.8. The Respondents breached paragraph 15 of ISA 200. They failed to perform the audit of UK sub-consolidation adjustments and, in particular, the release of WIP credits by those adjustments, with sufficient professional scepticism. These adjustments were inherently risky: they increased revenue and profit, and they bypassed the controls for booking entries into M&C Saatchi's accounts. Those tasked with performing the audit work and reviewing the work paper on the adjustments failed to bring a questioning mind to bear on the appropriateness of these adjustments. They were not alert to conditions that indicated possible misstatement due to error or fraud. In particular, they did not consider whether management's subjective assessment that these particular WIP credits should be released was justified. The high risk associated with these adjustments (which the audit team ought to have been aware of) should have resulted in detailed review of the audit work. However, the review that was undertaken failed to identify manifest errors in the presentation of those adjustments whereby the debits and credits were recorded the wrong way around. The other breaches below flow from



the audit team's failure to plan and perform the testing of these adjustments with professional scepticism.

- 5.9. The Respondents breached paragraph 6 of ISA 500. They failed to design and perform audit procedures that were appropriate in the circumstances for obtaining sufficient appropriate audit evidence on the release of WIP credits to revenue at year-end.
- 5.10. The Respondents breached paragraph 32 of ISA 240. They did not design and perform audit procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.

#### The failure to test journal entries in M&C Saatchi (UK) and Export

- 5.11. The audit file does not record any work on the journal entries for two of the 21 UK entities within the Group: M&C Saatchi (UK) and Export. This omission was not identified by the audit team's review procedures.

#### *Breaches*

- 5.12. The Respondents breached paragraph 32 of ISA 240. They did not test the appropriateness of journal entries in Export and M&C Saatchi (UK).

#### Merlin

- 5.13. Work paper "4.6.1.0010.00170", documenting work done on journal entries in a third entity within the Group, Merlin, is incomplete.
- 5.14. The objective of the work paper records that it is to test all journals deemed to be high risk, and to gain supporting evidence for a sample of these journals. In terms of identifying high risk journals, only one criterion is listed: *"unusual pairings which are deemed as debit a liability account and credit a revenue account or debit a retained earnings account and credit a revenue account"*.
- 5.15. As to procedure, the work paper records that the audit team has received a full list of journals posted for 2018, and that *"we have pivoted the listing by selecting all the revenue entries and corresponding entries for Deferred income, Debtors, Bank and accrued Income"*. The suggestion is that the team will *"investigate the variance"* and *"also make sure that the revenue entries are not netting off with any Liability account"*. The work paper then sets out a pivot table, organised by general ledger account number, and a reiteration of the table recording the name of each account.
- 5.16. The work paper then states, under the heading *"Conclusion"*, that:

*“Since we do [not] have mapping of account according to the account codes as of now so we cannot conclude [at] this moment. The pivot will be updated accordingly once we have mapping of accounts.”*

- 5.17. No further work is recorded in the work paper. The pivot table was not updated as suggested. High risk journals were not identified and no investigations were conducted into any such journals. This omission was not discovered through the audit team’s review procedures.
- 5.18. The Respondents carried out journal completeness checks on the trial balance for Merlin. Differences were identified. However, the audit file does not record how these differences were resolved.

#### *Breaches*

- 5.19. The Respondents breached paragraph 32 of ISA 240. They did not test the appropriateness of journal entries in Merlin.
- 5.20. The Respondents breached paragraph 8 of ISA 230 as their completeness checks identified differences but the audit file did not record how these differences were resolved.

#### Performance and World Services

- 5.21. The Respondents carried out journal completeness checks on the trial balance for Performance and World Services. Differences were identified but the audit file does not record how those differences were resolved.

#### *Breach*

- 5.22. The Respondents breached paragraph 8 of ISA 230.

#### Worldwide and PR UK

- 5.23. For two other entities, Worldwide and PR UK, audit work on the completeness of journal entries was performed, but this work was not included on the audit file.

#### *Breach*

- 5.24. The Respondents breached paragraph 14 of ISA 230.

#### Failure to identify potentially high-risk journals for testing

- 5.25. In the work papers entitled “*Journals Approach Builder*”, the Respondents identified various criteria which rendered journal entries high-risk (“the **High-Risk Journals Criteria**”).

*UK NetSuite entities (UK entities which used NetSuite accounting software) & World Services*

5.26. The High-Risk Journals Criteria identified for the UK NetSuite entities and World Services were as follows:

*“[1] Journals made to unrelated accounts*

*[2] Journals made to unusual or seldom used accounts*

*[3] Journal entries containing round numbers, consistent ending numbers or are just below an authorization or review limit*

*[4] Posted to account linked to a fraud risk*

*[5] Unbalanced journal entries*

*[6] Accounts which would drive an important metric such as the bonus calculation, EBITDA or covenant calculations” (numbering added)*

5.27. The Journals Approach Builder records that *“[h]aving identified the high-risk criteria, we will test all journal entries that meet those high-risk criteria for evidence of possible material misstatement. We do not test a sample of high-risk journal entries.”*

5.28. The audit team did not test all of the journal entries within the UK NetSuite entities that met the criteria outlined above.

5.29. The Respondents have stated that, in the course of the audit, the audit team revisited and refined the high-risk criteria to be used to focus on unexpected journal entries to revenue that were posted in December 2018. That stated change in criteria was a significant change in the audit plan. It had the potential to change materially the level of audit work performed on high-risk journals. In any event, the explanation is not recorded on the audit file.

5.30. Moreover, while it may be appropriate to refine the journal selection criteria where the original criteria yield an unreasonable number of journals for testing, in this case the approach adopted was too restrictive. In particular, the audit team selected journals for testing only from a population where the journal had an impact on revenue. This restricted scope of testing did not sufficiently address the fraud risk of management override. For example, page 28 of M&C Saatchi’s 2018 Annual Report refers to directors’ options and conditional share awards, and notes that the vesting of such awards was in part subject to the achievement of certain earnings and total shareholder return targets. Accordingly, there was a management incentive to overstate earnings. Thus, journals that did not relate to revenue but which still impacted earnings also carried risk.

5.31. Turning to the specific work done, in the context of the audit of the UK NetSuite entities:

- 5.31.1. The audit team did not consider whether or not other journals may have existed (apart from those impacting revenue) which were high-risk because they increased apparent profitability.
- 5.31.2. To the extent that there were such journals, they were not tested.
- 5.31.3. In any event, the audit team did not test all the journals that fell within the refined high-risk criteria. For example, in Human Digital, there were 70 revenue journals that were not tested because they were deemed to be too low in value. In Saatchi Shop, there were three revenue journals that were not tested because they were deemed to be too low in value. In both Saatchi Accelerator Limited and Saatchi Marketing Arts Limited, all journals affecting revenue were deemed to be “usual” and were not tested.
- 5.31.4. With the exception of the audit work performed on LIDA, the Respondents did not test all journals meeting the high-risk criteria that were raised in the two weeks before and the two weeks after the period end.
- 5.32. In contrast, in the context of the audit of World Services, the audit team did review the journals by reference to all of the original High-Risk Journal Criteria set out at paragraph 5.26 above, save that there is no documented consideration of Item 4 (namely, “[p]osted to account linked to a fraud risk”).
- 5.33. In relation to the UK NetSuite entities Sports Entertainment and Send me a Sample, the Respondents failed to record adequate details of the supporting documentation or evidence that had been inspected in relation to certain of the journal entries selected for testing. For each transaction, only a tick mark was recorded in the “Document Support” column of the work paper. While the “Nature of Journal” and “Nature of Journal per Client Explanation” columns in the respective work papers include some information regarding the supporting documentation reviewed by the audit team, the overall level of detail remains insufficient to understand the work performed.

### *Performance*

- 5.34. The High-Risk Journals Criteria for Performance were identified in the Journals Approach Builder as:

*“[1] Journal entries containing round numbers, consistent ending numbers or are just below an authorization or review limit*

*[2] Posted to account linked to a fraud risk*

*[3] Journal entries containing key words, e.g., reversal, restatement, reclassification*

*[4] Journal entries posted to accounts that contain significant estimates and period-end adjustments” (numbering added)*

- 5.35. The High-Risk Journals Criteria for Performance were, therefore, different from those identified for the UK NetSuite entities.
- 5.36. As noted at paragraph 5.27 above, the Journals Approach Builder records that “[h]aving identified the high-risk criteria, we will test all journal entries that meet those high-risk criteria for evidence of possible material misstatement. We do not test a sample of high-risk journal entries.”
- 5.37. The audit file does not record testing of all journal entries that meet these High-Risk Journals Criteria. In correspondence with Executive Counsel, the Respondents have explained that this was because the audit team performed “Revenue Account Analysis (RAA) work” which allowed them to focus testing on journals linked to estimates. That explanation is not recorded on the audit file.

#### *Breaches*

- 5.38. The Respondents breached paragraph 32 of ISA 240. In the course of the audit of the UK NetSuite entities, they omitted from the scope of their testing journals that did not impact revenue accounts. That meant that they did not consider whether there were other journals that did not impact revenue but which were nevertheless high-risk, and they did not perform testing on any such journals. They did not select an adequate sample of journal entries made at the end of the reporting period; or consider the need to test journal entries and other adjustments throughout the rest of the reporting period.
- 5.39. The Respondents breached paragraph 12(c) of ISA 300. Significant changes in the audit approach to high-risk journals for the UK Netsuite entities and Performance were not documented on the audit file.
- 5.40. The Respondents breached paragraph 8 of ISA 230. For Sports Entertainment and Send me a Sample, the identifying characteristics of the specific items or matters tested were not recorded and their audit documentation was therefore not sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the audit evidence obtained.

#### **Category 2: Failure to document change in approach to the audit of ageing WIP debits**

- 5.41. In their planning document, the audit team recorded an intention to perform an “analysis of the ageing of balances recorded within work in progress at period end”. This was a reference (*inter alia*) to the carrying value of WIP debits (as defined at sub-paragraph

3.11.1 above) in the balance sheet, and the need to consider whether or not particular WIP debits should be written off (on the basis that M&C Saatchi was unlikely to be able to recover the sums paid to third parties on account of goods and services from the applicable client). To the extent that there were WIP debits that related to old and closed projects, it was unlikely that M&C Saatchi would be able to recover these sums from clients.

- 5.42. In terms of the work performed, the audit team recalculated the value of a sample of WIP debits, by taking the amounts invoiced by M&C Saatchi to the applicable clients and deducting the associated supplier costs. While that work confirms the existence of the WIP debits, it does not confirm the recoverability of those balances.
- 5.43. There is no record on the audit file of the audit team separately considering the age of WIP debits and the extent to which they were recoverable, even though that formed part of the planned procedures. In particular, there is no record of any part of the WIP debits being agreed to cash receipts post year-end. There is no explanation on the audit file as to why the planned work was not performed.
- 5.44. Coupled with this, there are obvious indicators that some of these WIP debits might not be recoverable. Working paper “REV-TOD06.0010 WIP BALANCE TESTING.xlsx” includes, at Tab “WIP Listing”, a list of projects. Most of the projects against which debit balances are recorded are identified as “in progress”, but projects with a combined value of approximately £145k are identified as “cancelled”, “closed” or “delivered”. Moreover, there is a combined debit balance of approximately £265k that relates to projects with a date of 2017 or earlier. The total debit balance on these projects was thus approximately £410k.
- 5.45. In correspondence with Executive Counsel, the Respondents have stated that, as the audit work progressed, the audit team identified that WIP balances largely represented contract liabilities; and that as such, the audit team determined that it was not necessary to test the ageing of WIP balances in order to address the significant risk associated with the existence and accuracy of revenue. This change in approach was not documented on the audit file and there is no contemporaneous material (whether on or outside the audit file) setting out any analysis, consideration or justification for such a change in audit approach.

#### Breach

- 5.46. The Respondents breached paragraph 12(c) of ISA 300. They did not document why they did not complete the planned testing of ageing WIP debits.

### Category 3: Failure to audit rebates properly

5.47. The value of rebate income booked by M&C Saatchi in FY18 was US\$6,024,332. All of this rebate income appears to have been attributable to Performance, which records a figure (in sterling) for rebates of £4,558,149 in its revenue summary.

5.48. In work paper “2.14.3.3 Revenue Recognition – Media Income” the audit team identified that:

*“Assessing the timing of recognition and accuracy of rebate income earned is an area of complexity and judgement is required in determining the value of media rebates recognised. The Group’s processes for capturing and processing data to calculate rebate income is reliant upon complex spreadsheet models which are potentially prone to processing and formula error.*

*Assessing the accuracy of rebate income is also an area of complexity with regards to whether such income earned is required to be shared and on what basis to calculate such passback.”*

5.49. In the section of the work paper that recorded the approach to be adopted to address the significant risk inherent in revenue recognition, the audit team recorded that the following procedures would be performed (amongst others):

*“For rebates accrued for at year end, select a sample of rebates and obtain confirmation from the media owner verify the level of expenditure during the year.*

...

*Review a sample of customer contracts to ensure that rebates are passed back if contractually required.*

*Perform an analytical review comparing current year balances to prior year. Understand material movements in individual rebates...”*

5.50. In the event, the first and third of those tests (namely, seeking confirmation from media owners of the level of rebates granted and performing analytical review) were not performed. In correspondence with Executive Counsel, the Respondents have said that in the course of the audit they identified weaknesses in the controls over rebates; that they increased the level of detailed testing; and that they decided that they had obtained sufficient audit evidence to conclude on the completeness, existence and accuracy of Media Income (including rebates) without performing those tests. That significant change in approach was justified in all the circumstances. However, that explanation is not recorded in the audit file.

5.51. As to the second test referred to above (reviewing contracts to determine whether or not M&C Saatchi was under an obligation to pass rebates on to clients) the test was performed and the work done was recorded in work paper “3.2.5.4.2.0060 REBATES

IN 2018.xlsx” (the “**Rebate Work Paper**”) at the tab “*Rebate passback considerations*”.

Five contracts were selected for testing. As to which:

- 5.51.1. There is no record on the audit file of the basis on which this sample was selected, or as to how the Respondents satisfied themselves that this sample reduced the risk of misstatement to an acceptably low level.
- 5.51.2. One of the contracts reviewed was with Client A. This contract was significant: in FY18, Client A represented over 60% of the gross spend of Performance with suppliers (and hence was likely to account for the bulk of the rebate income booked).
- 5.51.3. Clause 1.10 of the Client A contract recorded in terms that: “*M&C Saatchi will use best efforts to obtain all early-payment, volume, and/or other discounts or rebates (collectively ‘Discounts’) in connection with the Services, and will advise Client A sufficiently in advance of any payment dates to enable Client A to avail itself of such Discounts*”.
- 5.51.4. The audit team identified that this clause might give Client A the right to receive the benefit of any rebates negotiated with suppliers. A member of the audit team raised this issue in an email to a senior finance executive of Performance; and also arranged a call with a senior executive of Performance outside the finance team.
- 5.51.5. In a one-line response, the senior finance executive indicated to the audit team that Performance was not required to pass back rebates to Client A because the level of rebates was based on the combined value of purchases made by M&C Saatchi on behalf of clients, and was not attributable to any particular client. This answer did not address the question of M&C Saatchi’s contractual obligations to Client A and the legal effect of Clause 1.10.
- 5.51.6. According to the Respondents, the arranged call with the senior executive outside the finance team went ahead, and the member of the audit team who spoke to him was satisfied with the explanations that he had been given. However, the nature of the explanation, and the basis on which the audit team were assured that rebates were not payable to Client A notwithstanding Clause 1.10 of the contract has not been identified by the Respondents.



- 5.51.7. Neither the email exchange with the senior finance executive nor the telephone conversation with the senior executive outside the finance team is recorded on the audit file; and there is no documentary record at all of the telephone call.
- 5.51.8. The audit team recorded in the Rebate Work Paper that the Client A contract did not contain a “*passback obligation*” (*i.e.* an obligation to pass the benefit of any rebates back to the applicable client).
- 5.51.9. There was no sufficient basis for that conclusion. On the basis of the express terms of the Client A contract, the audit file ought to have recorded that Client A was entitled to rebates; or (at the very least) that there was a real possibility that Client A was entitled to the benefit of rebates; or the basis on which the audit team concluded that Performance was entitled to retain rebates notwithstanding Clause 1.10 of the contract with Client A (by reference to the aforementioned email exchange and/or the alleged telephone conversation or otherwise).
- 5.51.10. This deficiency in the audit work, and its record on the file, was not picked up on review.

### Breaches

- 5.52. The Respondents breached paragraph 6 of ISA 500. There is no evidence on the audit file that demonstrates that they adequately tested the extent to which M&C Saatchi was entitled to retain rebates received. In particular, there is no proper evidence on the file that they completed enquiries into the effect of Clause 1.10 of the Client A contract. They concluded the audit on the basis that Client A was not entitled to receive rebates when, on the face of the contract, it did appear to be so entitled. They did not record on the audit file any explanation received from senior executives as to why it was appropriate to proceed on that basis. The Respondents have not identified any contemporaneous evidence that the conversation with the senior executive outside the finance team did in fact take place. The explanation given by the senior finance executive by email was not adequate to establish that rebates were not to be paid to Client A.
- 5.53. Further and in any event, the Respondents breached paragraph 12(c) of ISA 300. They failed to record in the audit file why they had departed from the planned procedures (namely, seeking confirmation from media owners of the level of rebates granted and performing analytical review) in circumstances where the change was significant.

5.54. The Respondents breached paragraph 15 of ISA 200. The audit team failed to maintain sufficient professional scepticism when considering whether or not the Client A contract contained a provision requiring rebates to be passed back to the client. Given that on the face of the contract there appeared to be an obligation to pass back rebates, professional scepticism required the audit team to continue their enquiries of the divisional senior finance executive and senior executive outside the finance team, reach a settled view on the effect of Clause 1.10 of the Client A Contract, and record the outcome of those enquiries on the audit file.

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

### Nature, seriousness, gravity and duration of the breaches

6.4. Following the identification of various accounting issues and the conclusion of its 2019 audit, M&C Saatchi made an adjustment to its historical (2018 and prior years) headline profit before tax of £14.0 million in the 2019 Financial Statements. When the accounting errors at M&C Saatchi were identified and announced, alongside a trading update

signalling a significant reduction in forecast results for the 2019 financial year, the market responded negatively and the company's share price dropped sharply. The board members resigned, including the three founders.

- 6.5. The year-end sub-consolidation WIP adjustments totalling £1.2 million (which were not audited properly during the 2018 Audit as reflected by the breaches of *Relevant Requirements* at paras 5.8 to 5.10 above) were reversed in the 2019 Financial Statements as part of the adjustments referred to above.
- 6.6. Executive Counsel considers that the breaches of *Relevant Requirements* in the area of the UK sub-consolidation adjustments affected or potentially affected a significant number of people in the United Kingdom (such as the public, investors or other market users).
- 6.7. The breaches of the *Relevant Requirements*:
  - 6.7.1. included serious failings; moreover those relating to the year-end sub-consolidation WIP adjustments and the auditing of the Client A contract resulted in two separate breaches of the requirement to plan and perform an audit with professional scepticism;
  - 6.7.2. related to three areas of the audit;
  - 6.7.3. were in areas of the audit which KPMG had identified as a significant risk, namely revenue recognition and management override of controls;
  - 6.7.4. included breaches of basic and fundamental audit concepts, including the requirements to prepare sufficient audit documentation and to design and perform audit procedures in order to obtain sufficient appropriate audit evidence;
  - 6.7.5. related to only one audit year;
  - 6.7.6. were not repeated or ongoing; and
  - 6.7.7. were not intentional, dishonest, deliberate or reckless.
- 6.8. 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 2018 Audit).
- 6.9. KPMG is a large audit firm, with 691 partners across all functions, and 309 *Statutory Auditors* in 2022. Its UK fee income in 2022 was approximately £2,723 million and its audit fee income was approximately £709 million. The audit fee for the 2018 Audit was

£768,000. KPMG has implemented a number of significant changes and improvements to their audit processes and procedures since the 2018 Audit was performed which reduce the risk of recurrence of the breaches.

- 6.10. To their credit, the Respondents paused the 2018 Audit in late March 2019 because of difficulties in obtaining audit evidence. They removed the audit team from the client site and delayed signing the 2018 Audit report until 28 May 2019 when they considered they had received sufficient evidence.
- 6.11. KPMG has a poor disciplinary record. Four FRC disciplinary outcomes predated the start of the 2018 Audit, and two further disciplinary outcomes predated the signing of the 2018 Audit report on 28 May 2019. Mr Wilcox has a clear disciplinary record.
- 6.12. In addition, the FRC's Audit Quality Review identified weaknesses in journals testing in KPMG audits and reported this to KPMG before the 2018 Audit. Whilst KPMG subsequently implemented firm-wide measures to address these findings, the breaches in relation to journals in the 2018 Audit still occurred.
- 6.13. Taken together, the breaches of *Relevant Requirements* undermine confidence in: a) the standards of conduct in general of *Statutory Auditors* and *Statutory Audit Firms*, and/or in *Statutory Audit*; and b) the truth and fairness of financial statements. As a result of the breaches of *Relevant Requirements*, the 2018 Audit failed in its principal objective, namely to obtain reasonable assurance about whether the 2018 Financial Statements as a whole were free from material misstatement.

#### Identification of Sanctions

- 6.14. Having assessed the nature, seriousness, gravity and duration of the breaches, Executive Counsel has identified the following combination of *Sanctions* as appropriate for KPMG:
  - 6.14.1. a financial sanction of **£2.25 million**;
  - 6.14.2. a published statement in the form of a severe reprimand; and
  - 6.14.3. a declaration that the 2018 Audit report signed on behalf of KPMG did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*.
- 6.15. Having assessed the nature, seriousness, gravity and duration of the breaches, Executive Counsel has identified the following combination of *Sanctions* as appropriate for Mr Wilcox:
  - 6.15.1. A financial sanction of **£75,000**;

- 6.15.2. a published statement in the form of a severe reprimand; and
- 6.15.3. a declaration that the 2018 Audit report signed by Mr Wilcox did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*.

#### Aggravating factors

- 6.16. Potentially aggravating factors, including the disciplinary record of KPMG, have been considered above in the context of the seriousness of the breaches.

#### Mitigating factors

- 6.17. Both Respondents have apologised and expressed contrition for the breaches.
- 6.18. Other potential mitigating factors, including the robust actions of the Respondents in pausing the 2018 Audit and delaying signing the audit report, have been considered above in the context of the seriousness of the breaches.

#### 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 made by the Respondents and the stage at which those admissions were made (at a relatively 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 financial sanctions of **£1,462,500** and **£48,750** are payable by KPMG and Mr Wilcox respectively.

#### 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.
- 6.22. Executive Counsel has decided not to require KPMG to undertake any additional non-financial sanctions in this matter because it considers that the programmes of audit improvement work performed by KPMG since the 2018 Audit (more particularly as a result of other FRC Enforcement investigations and following engagement with the FRC's Supervision Division) are effectively designed and implemented to likely reduce the risk of the particular breaches of *Relevant Requirements* identified in this Notice reoccurring.

**7. COSTS**

Executive Counsel requires that the Respondents pay her costs in full in this matter, being £535,000. Such costs shall be paid no later than 28 days after the date of the *Final Settlement Decision Notice*.

**Signed:**

[Redacted].

**CLAUDIA MORTIMORE  
DEPUTY EXECUTIVE COUNSEL**

**Date: 14 November 2023**

## APPENDIX: EXTRACTS OF RELEVANT REQUIREMENTS

### Extracts from ISAs

*ISA (UK) 200 (Revised June 2016): 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 (UK) 230 (Revised June 2016): Audit Documentation*

Paragraphs 8 and 14 state as follows:

- “8. *The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:*
- (a) The nature, timing and extent of the audit procedures performed to comply with the ISAs (UK) and applicable legal and regulatory requirements;*
  - (b) The results of the audit procedures performed, and the audit evidence obtained; and*
  - (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.*
14. *The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor’s report. In the UK, the assembly of the final audit file shall be completed no later than 60 days from the date of the auditor’s report.”*

*ISA (UK) 240 (Revised June 2016) (Updated July 2017): The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*

Paragraph 32 states as follows:

- “32. *Irrespective of the auditor’s assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to:*
- (a) Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. In designing and performing audit procedures for such tests, the auditor shall:*
    - (i) Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;*



- (ii) *Select journal entries and other adjustments made at the end of a reporting period; and*
  - (iii) *Consider the need to test journal entries and other adjustments throughout the period.*
- (b) *Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, the auditor shall:*
- (i) *Evaluate whether the judgments and decisions made by management in making the accounting estimates included in the financial statements, even if they are individually reasonable, anticipate a possible bias on the part of the entity's management that may represent a risk of material misstatement due to fraud. If so, the auditor shall re-evaluate the accounting estimates taken as a whole; and*
  - (ii) *Perform a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year.*
- (c) *For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment and other information obtained during the audit, the auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets."*

*ISA (UK) 300 (Revised June 2016): Planning an Audit of Financial Statements*

Paragraph 12(c) of ISA 300 states that:

*"The auditor shall include in the audit documentation: ... (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 (UK) 500 (Updated July 2017): Audit Evidence*

Paragraph 6 of ISA 500 states that:

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