

IN THE MATTER OF
THE EXECUTIVE COUNSEL OF THE FINANCIAL REPORTING COUNCIL

-and-

(1) DELOITTE LLP

(2) SIMON MANNING

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 additional definitions:
 - 1.3.1. “**FY2015**” means the financial year ended 31 December 2015, “**FY2015 financial statements**” means the consolidated financial statements of SIG plc (“**SIG**”) for that period, and “**FY2015 Audit**” means the statutory audit of the FY2015 financial statements.
 - 1.3.2. “**FY2016**” means the financial year ended 31 December 2016, “**FY2016 financial**

statements” means SIG’s consolidated financial statements for that period, and **“FY2016 Audit”** means the statutory audit of the FY2016 financial statements.

1.3.3. **“Respondents”** means:

a) Deloitte LLP (**“Deloitte”**) which was the *Statutory Audit Firm* for the FY2015 Audit and the FY2016 Audit.

b) Simon Manning (**“Mr Manning”**), who was the *Statutory Auditor* for the FY2015 Audit and the FY2016 Audit and signed the audit reports on behalf of Deloitte.

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

1.5. A *Proposed Settlement Decision Notice* was issued by Executive Counsel in relation to the conduct of the Respondents in respect of the FY2015 Audit and the FY2016 Audit, pursuant to Rule 103 of the AEP, on 6 October 2022. The Respondents provided written agreement to the *Proposed Settlement Decision Notice*, pursuant to Rule 105 of the AEP, by 13 October 2022. The *Convener* subsequently appointed an *Independent Reviewer* to consider the *Proposed Settlement Decision Notice*, pursuant to Rule 106 of the AEP.

1.6. The *Independent Reviewer* approved the issuance of a *Final Settlement Decision Notice*, pursuant to Rule 107(a) of the AEP, on 27 October 2022.

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

1.7.1. the breaches of *Relevant Requirements*, with reasons;

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

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

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

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

1.8.2. Section 3: Background;

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

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

1.8.5. Section 6: *Sanctions*;

1.8.6. Section 7: *Costs*.

1.9. Under the AEP, Deloitte are liable for the acts and omissions of their employees and partners within the scope of relevant audit engagements. Consequently, the conduct of the audit team described in this *Final Settlement Decision Notice* is to be treated as the conduct of Deloitte.

1.10. So far as Mr Manning is concerned, as Group engagement partner he was required to take

responsibility for the overall quality of the audit engagements, and their performance in compliance with professional standards and applicable legal and regulatory requirements¹. Where Mr Manning has, through his own actions and omissions, personally contributed to the breaches of *Relevant Requirements*, this is made clear.

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

2.1. SIG is a leading distributor of specialist building products throughout Europe. At all material times SIG consisted of a Corporate Office and a number of functional and geographic divisions, some of which were separate legal entities. The relevant significant subsidiary was SIG Trading Limited ("**SIGT**"). SIGT operated in divisions, the most significant of which was SIG Distribution ("**SIGD**").

2.2. SIG's financial statements for FY2017 included adjustments of figures in the FY2015 and FY2016 Financial Statements, to correct two historical issues:

2.2.1. Overstatement of profit due to overstatement of balances recognised in relation to rebates receivable from suppliers (rebates are financial incentives paid to SIG by the supplier if specified conditions are fulfilled).

2.2.2. Overstatement of cash and trade payables related to cash cut-off procedures associated with the issue of cheques around the previous year ends (several large cheques had been written and passed to suppliers prior to the year end, but not accounted for).

2.3. The overstatement of profit was at a level which was material to the FY2016 Financial Statements, and the overstatement of cash and trade payables was material to both the FY2015 and FY2016 Financial Statements.

2.4. As is set out in this *Final Settlement Decision Notice*, there were failures by the Respondents in the auditing of rebates and cash. In these two areas, the audits failed in their principal objectives of providing reasonable assurance that the financial statements were free from material misstatement.

2.5. In summary, in respect of rebates the Respondents:

2.5.1. Failed to obtain and document sufficient appropriate audit evidence in respect of the testing of rebate terms as set out in SIG's rebate workbooks, and the testing of rebate debtor balances, and

¹ See paragraphs 8 and 15 of ISA (UK and Ireland) 220: Quality control for an audit of financial statements (version effective for audits of financial statements for periods ending on or after 15 December 2010).

- 2.5.2. Failed to exercise sufficient professional scepticism, by failing to investigate indications that rebate debtor balances may have been overstated.
- 2.6. In respect of cash, the Respondents:
- 2.6.1. Failed to obtain sufficient appropriate audit evidence in respect of cheque payments made around the year end, and
- 2.6.2. Failed to exercise sufficient professional scepticism, by failing to investigate indications that cheque payments claimed to have been made post-year end should properly have been regarded as pre-year-end payments.
- 2.7. Section 5 of this *Final Settlement Decision Notice* sets out the detailed breaches of *Relevant Requirements*.
- 2.8. This *Final Settlement Decision Notice* sets out the following *Sanctions* in respect of the Respondents:

Deloitte

- 2.8.1. A financial penalty of £1,250,000, discounted for admissions and early disposal by 27.5%, so that the financial penalty payable is £906,250.
- 2.8.2. A published statement to the effect that Deloitte has breached *Relevant Requirements*, in the form of a severe reprimand.
- 2.8.3. A declaration that the FY2015 and FY2016 Audit reports signed on behalf of Deloitte did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*; and
- 2.8.4. An order requiring Deloitte to take the following action to mitigate the effect or prevent the recurrence of the contravention:
- a) Conduct a Root Cause Analysis (RCA) which:
- i. Identifies the root cause(s) of the breaches of *Relevant Requirements* in the FY2015 and FY2016 Audits, by specific reference to each of the particulars of breach set out in this *Final Settlement Decision Notice*,
 - ii. Identifies any remedial action already taken in order to prevent a recurrence of the breaches, and
 - iii. Identifies any further remedial action which will be taken for that purpose,
- and report to the FRC on the outcome of the RCA within 120 days of the date of this *Final Settlement Decision Notice*,

- b) Conduct an assessment, by reference to empirical evidence specifically in respect of the audit of supplier rebates and cash, of the extent to which the remedial action identified in the RCA has addressed the causal factors of failure and would result in a different outcome, and report to the FRC on the outcome of the assessment by 30 June 2023,
- c) Provide any further information or report, in connection with or as a result of the steps set out above, as required by the FRC.

Mr Manning

2.8.5. A financial penalty of £50,000, discounted for admissions and early disposal by 27.5%, so that the financial penalty payable is £36,250.

2.8.6. A published statement to the effect that Mr Manning has breached *Relevant Requirements*, in the form of a severe reprimand.

3. BACKGROUND

The Respondents

3.1 Deloitte was first appointed as SIG's auditor in 2002, and retained the appointment until 2018.

3.2 From 2013, Mr Manning was Deloitte's senior statutory auditor for SIG. He was the Group engagement partner responsible for the overall quality of the audit, took responsibility for the audit's direction, supervision and performance in compliance with professional standards and applicable legal and regulatory requirements, and was under a personal obligation to consider whether sufficient appropriate audit evidence had been obtained. Mr Manning was admitted as a member of the ICAEW in 1996 and registered as a statutory auditor in 2004.

3.3 The Respondents' statutory responsibility was to form an opinion as to whether the FY2015 and FY2016 financial statements showed a true and fair view of SIG's financial position, and had been prepared in accordance with the Companies Act 2006.

The FY2015 and FY2016 Financial Statements and Audits

3.4 The FY2015 Financial Statements showed revenue of £2.566bn, pre-tax profits of £51.3m and equity of £649.6m. The independent auditor's report was signed by Mr Manning on behalf of Deloitte on 8 March 2016. Materiality for the audit was determined to be £4.25m. The audit opinion was unmodified.

3.5 The FY2016 Financial Statements showed revenue of £2.845bn, a pre-tax loss of £106.3m and equity of £539.6m. The audit report was signed by Mr Manning on behalf of Deloitte on 13 March 2017. Materiality was determined at £3.1m (following a change from using underlying to adjusted pre-tax profit as the basis). The audit opinion was unmodified.

Supplier rebates

- 3.6 SIG had rebate agreements in place with several of its key suppliers of building materials. The terms of each agreement were specific to the particular supplier, but they typically provided for rebates to be paid by the supplier to SIG based on the volume of products purchased over a given period. There were also some agreements providing for rebates to be paid in return for SIG promoting the supplier's products to its own customers (referred to as "marketing support").
- 3.7 SIG's FY2015 and FY2016 Financial Statements emphasised the importance of rebates to the business, and identified the treatment of rebates as a critical accounting judgment. It was noted that the amounts payable and receivable were often subject to negotiation after the balance sheet date, and some rebate agreements were non-coterminous with SIG's financial year, requiring judgment over the level of future purchases and sales. The FY2016 Financial Statements indicated that the total value of rebates due from suppliers was £126m in FY2015 and £130m in FY2016. Of these, the rebates receivable by SIGT were £60.5m in 2016 and £62.0m in 2015. The supplier rebate debtor balance was therefore clearly material to the financial statements in each financial year.
- 3.8 The audit team, at both the group and subsidiary level, identified the valuation of rebate income as a key audit matter in the signed audit reports for FY2015 and FY2016. At the planning stage of both audits, rebates were noted as a significant audit risk. The year end debtor was identified as an area of focus, and the need for a high level of professional scepticism was noted. It was recognised that rebate calculations could be complex and judgemental, with the risk of misstated income or debtor levels at the year end.
- 3.9 This was consistent with guidance previously issued by the FRC. In December 2014 a notice was published entitled "FRC urges clarity in the reporting of complex supplier arrangements by retailers and other businesses". This notice highlighted that arrangements such as volume rebates were often significant to operating margins and other key metrics, and may require companies to make significant judgements when estimating period end amounts receivable. The notice also stated that the FRC Conduct Committee planned to include it as an area of focus when reviewing statutory audits and accounts during 2015.
- 3.10 Further, the FRC's Plan & Budget and Levies 2015/16, published in March 2015, stated that the FRC would pay particular attention to the reporting of complex supplier income arrangements (among other matters) when carrying out its audit quality reviews.

Cash cut-off

- 3.11 The audit team planning discussions for FY2015 and FY2016 did not identify any significant audit risks in relation to cash and cash equivalents at a group or SIGT level.

3.12 In FY2016, no significant risks in relation to cash and cash equivalents were reported to the Audit Committee at the group level. However, cash was identified as an area with higher risk for material misstatement for the purposes of discussions with senior management, because of the large number of bank accounts, material reconciling items and historical issues identified.

Restatements of FY2015 and FY2016 figures

3.13 SIG's financial statements for FY2017 included restatements of prior year figures, arising from historical overstatements of rebate balances, cash and trade payables.

3.14 Rebate balances had been inflated as a result of a combination of intentional overstatement by SIG staff (in part by including balances for which there was known to be no contractual entitlement), over-optimistic forecasting, and factual errors. The overstatements were corrected by reducing prepayments and accrued income (included within trade and other receivables) by £3.3m and trade payables (included within trade and other payables) by £0.8m at 31 December 2016, and reducing prepayments and accrued income by £0.4m at 1 January 2016.

3.15 The impact on the Consolidated Income Statement for the year ended 31 December 2016 was an increase in cost of sales (before other items) of £3.7m, resulting in an increase in operating loss and loss before tax of £3.7m, and an increase in loss after tax of £3.0m. Net assets were £3.3m lower than previously reported at 31 December 2016, and £0.3m lower at 1 January 2016.

3.16 In respect of cash and trade payables, SIGD had issued cheques to suppliers that were dated with the period end date (such as 31 December) but were physically provided to suppliers before the period end. Staff in the division had an agreement with the suppliers that they would not present the cheques to the bank until after the period end. These payments would not be recorded in the division's cash book until after the year end and were not shown as subtractive items on the period end bank reconciliation. This resulted in overstatements of the year-end cash and creditor balances, and had the effect of reducing net working capital and net debt (which impacted on reported leverage).

3.17 The overstatements were corrected by reducing cash and cash equivalents and trade payables by £19.8m at 31 December 2016. This restatement had no impact on the reported Consolidated Income Statement or net assets. The Consolidated Cash Flow Statement was also restated, with cash and cash equivalents at 1 January 2016 reduced by £23.9m to £62.8m, and at 31 December 2016 by £19.8m to £104.3m, resulting in an increase in net cash generated from operating activities of £4.1m to £29.9m for the year ended 31 December 2016.

4. RELEVANT REQUIREMENTS TO WHICH THE BREACHES RELATE

- 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 International Standards on Auditing (UK and Ireland) (“**ISAs**”) issued by the International Auditing and Assurance Standards Board.
- 4.2. The ISAs relevant to this *Final Settlement Decision Notice* are those effective for audits of financial statements for periods ending on or after 15 December 2010.
- 4.3. The *Relevant Requirements* referred to in this *Final Settlement Decision Notice* are the following:
 - 4.3.1. ISA 200 (Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing);
 - 4.3.2. ISA 230 (Audit Documentation); and
 - 4.3.3. ISA 500 (Audit Evidence).
- 4.4. Extracts from the ISAs setting out those parts which are of particular relevance to the breaches are set out in an Appendix.

5. BREACHES OF RELEVANT REQUIREMENTS

Breach 1 – Audit work performed in respect of supplier rebates

The Respondents failed to:

- a) obtain and document sufficient appropriate audit evidence in respect of the testing of rebate terms as set out in SIG’s rebate workbooks, and the testing of rebate debtor balances, and
- b) exercise sufficient professional scepticism, by failing to investigate indications that rebate debtor balances may have been overstated,

in contravention of paragraph 15 of ISA 200, paragraph 8 of ISA 230 and paragraph 6 of ISA 500.

Particulars of Breach 1

Testing of the integrity of the rebate workbooks

- 5.1 An important feature of the audit work was the reliance placed on the rebate workbooks used by SIG staff to record the terms of the rebate agreements, the monthly purchase totals upon which rebate was payable, and the resulting rebate earnings. The audit team tested all three elements in FY2015 and FY2016, in order to test the integrity of the workbooks.
- 5.2 The rebate agreement terms as set out in the workbooks (which were crucial to the accurate calculation of rebate earnings, and hence the year-end debtor balance) were tested by agreeing a sample to the relevant signed rebate agreements. The conduct of this testing was deficient in several respects, in both FY2015 and FY2016:
- a) Every one of the sample of 25 supplier rebate terms tested in FY2015 was marked as “satisfactory”, although only 12 were recorded as having actually been agreed to a signed agreement. In the case of 10 of the remainder it was recorded that no signed agreement had been seen, while there were no rebate terms even recorded in the workbook for the remaining three (although they were recorded elsewhere on the audit file).
 - b) In FY2016, again 25 sample rebate terms were to be tested, and only 15 were recorded as actually having been agreed to signed agreements. For the remainder, the audit team noted that they had checked the rebate terms against unsigned copies of the agreements instead. Despite this, the result of the testing was recorded as “satisfactory” in each case.
 - c) In the case of one of the 15 samples recorded as having been agreed to a signed agreement with the supplier (a business which we will refer to as Supplier B), the agreement referenced to support this was signed on behalf of SIG but not Supplier B.
- 5.3 The overall conclusion on the testing of the rebate workbooks was noted as ‘satisfactory’, when clearly it was not. In the absence of signed agreements, the audit team should have challenged SIG to provide further evidence to support the rebate percentage terms used in the workbooks or sought such evidence from the suppliers themselves.
- 5.4 For completeness, it should be noted that the confirmation requests sent out to suppliers as part of the substantive rebate testing (see paragraph 5.5 below) did ask the supplier to confirm that the terms of their rebate agreement with SIG were as set out in a named agreement document. However, this could not be (and did not purport to be) evidence that rebate terms were accurately recorded in the workbooks, as there is no record that the terms of the agreement were set out in the confirmation request or that a copy was enclosed with it, and confirmations were not provided by all suppliers included in the workbook integrity

testing in any event.

Substantive testing of the existence and reasonableness of rebate debtor balances

- 5.5 In order to test the existence and reasonableness of the rebate debtor, the audit team requested confirmation from the supplier in respect of a sample of debtor balances in FY2015 and FY2016. Where no supplier confirmation was received, or where there was an unexplained difference between the figure provided by the supplier and the debtor balance recorded by SIG, the balance was subjected to alternative testing (see paragraphs 5.7 to 5.8 below).
- 5.6 If the audit team accepted SIG's explanation for a discrepancy between the supplier confirmation and the recorded debtor balance, this meant that the balance was not included in the alternative testing. A critical examination of the explanations given by SIG was therefore required. However, in FY2016 the audit team did not apply the required degree of professional scepticism in this regard. In particular, they used the rebate workbooks as audit evidence to reconcile the differences in the debtor circularisations without adequately considering the limitations in the evidence obtained when performing the integrity testing of the rebate workbooks (see paragraphs 5.2 to 5.3 above).
- 5.7 A significant proportion of the samples of rebate debtor balances were subjected to alternative testing on the basis that supplier confirmation had not been received, or it disclosed an unexplained discrepancy. This amounted to 10 of the sample of 32 balances in FY2015, and 23 out of the sample of 51 in FY2016 (although in the case of one of these, satisfactory supplier confirmation was received late). The alternative testing was therefore a key element of the testing of the rebate balances.
- 5.8 It was carried out in two parts. First, the monthly purchase figures as recorded in the SIG rebate workbooks were agreed to the suppliers' monthly returns. Second, a sample of credit notes issued by suppliers were agreed to remittances. Despite the importance of this testing to the audit of supplier rebates (itself a recognised and significant audit risk), there were a number of deficiencies in the way that it was designed and carried out:
- a) It was assumed that testing the monthly purchase figures would provide assurance that the rebate balance was correct, because the rebate agreement terms as set out in the workbooks had already been validated. However, the integrity of the workbooks with regard to the rebate agreement terms had not been adequately tested (see paragraphs 5.2 to 5.3 above).
 - b) It was further assumed that testing a sample of supplier credit notes would prove the accuracy of the rebate debtor, but:
 - i. The rebate balances selected for substantive audit testing were themselves a

sample of the whole population. The apparent aim was to test all of the balances within that sample, either by supplier confirmation or alternative testing. However, the sample of credit notes selected for testing did not represent all of the balances that were subject to alternative testing.

- ii. There is no record that the month of each credit note was checked, to ensure that it actually related to the financial year in question.
- iii. It was stated that samples of both in-year and post-year-end credits would be tested, but in FY2016 no post-year-end credits were tested in respect of the significant balance for Supplier B (£3,494,646). As a result, the audit team did not verify that any of these balances were received post-year-end.
- iv. Agreeing a post-year-end credit note to a payment only proved the recoverability of the sum specified in that particular credit note. If the total debtor balance claimed by SIG was in a larger amount, the testing did nothing to prove that the difference was recoverable. An example is the FY2016 post- year-end credit note for a business which we will refer to as Supplier E, in the amount of £430,733, which was recorded as paid in January 2017. The description for this credit note states “December 16 Rebates”, which implies that it was in respect of rebate accrued in December 2016. However, the total recorded debtor balance for Supplier E was £2,002,249. The testing of the December 2016 credit note did not, and could not, establish that the remaining £1,571,516 was recoverable. Indeed, the fact that the supplier appeared to be issuing credit notes and paying rebate on a monthly basis might be thought to raise questions as to how the remaining balance had arisen and why it had not been paid, and therefore cast doubt on its recoverability. These questions do not appear to have been considered by the audit team.

Conclusions in respect of supplier rebates

- 5.9 In the absence of rebate agreements signed by the supplier, the audit team should have challenged SIG to provide further third party evidence to support the rebate percentage terms used in the workbooks. In particular, in the instances where audit evidence for the rebate terms had not been obtained from a completed debtors circularisation response from a supplier, the audit team should have performed additional robust alternative procedures. This was a breach of paragraph 6 of ISA 500.
- 5.10 The audit team failed to perform adequate alternative procedures testing of the rebate debtors not agreed through the debtors circularisation testing, and in particular the testing of supplier credit notes (both pre and post-year-end) was insufficient. This was also a breach of paragraph 6 of ISA 500.

- 5.11 The audit team failed to document on file that the relevant rebate agreements had been enclosed with the debtors circularisations sent to suppliers, and additionally in FY2015 only, the audit team failed to document adequately the testing of rebate terms to supplier agreements for three suppliers in the sample of 25. These were breaches of paragraph 8 of ISA 230.
- 5.12 By accepting explanations given by SIG for discrepancies in the recorded figures for rebate earnings and debtor balances without further enquiry, the audit team failed to perform the audit with professional scepticism, in breach of paragraph 15 of ISA (UK and Ireland) 200. It is not alleged that the audit team had particular grounds to be alert to the specific risk of fraud, but they should have recognised that circumstances existed that may have caused the financial statements to be materially misstated, whether due to fraud or error, in accordance with paragraphs 11(a) and 15 of the ISA.
- 5.13 In respect of Mr Manning, as Group engagement partner for the FY2015 audit he reviewed two relevant working papers which should have made him aware of some of the errors summarised in paragraphs 5.9 and 5.12 above. He did not review, but ought to have reviewed, one further working paper which should have made him aware of some of the errors summarised in paragraph 5.10 above. In the FY2016 audit Mr Manning did not review, but ought to have reviewed, three working papers (two of which were the equivalents of working papers which he had reviewed in FY2015) which should have made him aware of the remainder of the errors summarised in paragraphs 5.9 to 5.12 above. All of these working papers were reviewed by other members of the audit team.

Breach 2 – Audit work performed in respect of cash and cash equivalents

The Respondents failed to:

- a) obtain sufficient appropriate audit evidence in respect of cheque payments made around the year-end, and
- b) exercise sufficient professional scepticism, by failing to investigate indications that cheque payments claimed to have been made post-year-end should properly have been regarded as pre-year-end payments,

in contravention of paragraph 15 of ISA (UK and Ireland) 200 and paragraph 6 of ISA (UK and Ireland) 500.

Particulars of Breach 2

Testing of unrecorded liabilities (FY2015 only)

- 5.14 The cash cut-off issue related to a small number of high-value cheques issued by SIGD. The four relevant cheques in 2015 were part of the sample selected for testing in relation to

unrecorded liabilities in the FY2015 audit. The purpose of the testing was to ensure that they had been appropriately accounted for in creditors or accruals if they related to pre-year-end transactions, and excluded from the accounting records if they related to post-year-end transactions.

5.15 There were deficiencies in the way this testing was carried out:

- a) In relation to the cheque for £15,205,010 payable to a division of Supplier A, the audit team noted: "Cheque 3080 dated 31/12/15 has been viewed and therefore this is a pre year end payment - it has been included in the bank reconciliation correctly and so has been accounted for correctly in cash. Reconciliation testing has been performed at <23101>". This statement was clearly incorrect: if it was a pre-year-end payment, it should not have been accounted for in cash. The payment had not, in fact, been included in the bank reconciliation.
- b) In relation to the cheque payment of £6,737,638 to Supplier B, this was incorrectly recorded in the work paper as being payable to a different supplier. The audit team noted, similarly to the cheque to Supplier A: "Cheque 3084 dated 31/12/15 has been viewed and therefore this is a pre year end payment - it has been included in the bank reconciliation correctly and so has been accounted for correctly in cash. Reconciliation testing has been performed at <23101>". Again this was incorrect, for the reasons noted above.
- c) In relation to the cheque payments of £1,144,821 to Supplier E and £503,381 to a business which we will refer to as Supplier F, the work paper does not document that the audit team reviewed the date of the cheques for these samples. Both of these payments were noted as having been made from the Purchase Ledger Account (22019065), but no consideration appears to have been given to the fact that the cash lead sheet does not include any reconciling item under the heading "Unpresented cheques", as would be expected for cheques dated pre-year-end but not cashed by the supplier until after year-end.
- d) The work paper records that the four balances referred to above were included in creditors or accruals. Had the payments been appropriately recorded in the cashbook, the balances would not be expected to remain in the creditors or accruals balance at year-end, as the payment of the balance would reduce the associated liability to nil.

5.16 The objective of the work paper was to ensure liabilities were recorded in the appropriate period, and therefore to ensure that the year-end liability figure was not misstated. The audit team identified as part of their testing that two cheques which cleared the bank post- year-end were dated pre-year-end, however they failed to ensure that these were appropriately included in the bank reconciliation work paper, and therefore failed to identify that these

amounts had not been appropriately deducted from cash and creditors.

Testing of creditor balances (FY2015 and FY2016)

- 5.17 The audit team also undertook testing to reconcile the year end creditor balances with supplier statements. The testing for FY2015 was performed on a sample of 18 creditors, including the creditor balances for Supplier A and Supplier B.
- 5.18 The work paper documented reconciling items of £15,207,739 in relation to Supplier A and £6,862,503 in relation to Supplier B under the heading “Paid for items not on statement” – in other words, they were not on the creditor statement provided by the supplier. This could have been an indication that the supplier regarded the items as having been paid, which would be inconsistent with them remaining in the creditor balance, but the audit team do not appear to have explored this possibility.
- 5.19 The audit team tested a sample of these reconciling items, including invoices relating to Supplier A for which the statement date was noted as 4 January 2016 and the date per the bank statement as 6 January 2016, and invoices relating to Supplier B for which the statement date was similarly noted as 4 January 2016 and the date per the bank statement as 5 January 2016. There is no indication in the work paper that the audit team considered the payment method, or when the payment was likely to have been initiated (pre- or post-year-end).
- 5.20 This was another missed opportunity to identify that these were pre-year-end payments which had been incorrectly included in SIG’s cash balance at the year-end.
- 5.21 In FY2016 the audit team’s testing to reconcile the year end creditor balances with supplier statements was performed on a sample of 37 creditors, including Supplier A, Supplier B, Supplier E and Supplier F.
- 5.22 The reconciliation included balances of £15,872,577.25 in relation to Supplier A, £1,462,873.42 in relation to Supplier B and £1,142,521.03 in relation to Supplier E, under the heading “Payments allocated on statement” – in other words, the supplier statement showed these amounts as having been paid, but SIG were recording them as still outstanding, and so the cash would still be shown in SIG accounts. The audit team do not appear to have enquired into this.
- 5.23 A sample of 20 items were tested in relation to these balances, including invoices in relation to Supplier A for which the statement date was noted as 17 January 2017 and the date per the bank statement as 5 January 2017, and invoices in relation to Supplier E for which the statement date was 18 January 2017 and the date per the bank statement was 4 January 2018. Given that the team would have been aware of the use of cheques by SIG from the prior year, there is no evidence that they checked the date of the cheques to confirm if they

were pre- or post-year-end, and therefore if the accounting treatment was correct.

- 5.24 The sample also included invoices in respect of two other suppliers which had dates per the bank statement of 3 or 4 January 2017, but the supplier statement date was 31 December 2016, indicating that they could be pre-year-end payments. The audit team do not appear to have enquired into this possibility.

Conclusions in respect of cash

- 5.25 The deficiencies in the testing of unrecorded liabilities and creditor balances meant that the audit team failed to obtain sufficient appropriate audit evidence to properly test whether sums had been correctly included in the cash and creditor balances, in breach of paragraph 6 of ISA (UK and Ireland) 500.
- 5.26 By failing to enquire into the indicators that certain cheque payments were made pre- rather than post-year-end, the audit team failed to perform the audit work with professional scepticism, in breach of paragraph 15 of ISA (UK and Ireland) 200. It is not alleged that the audit team had particular grounds to be alert to the specific risk of fraud, but they should have recognised that circumstances existed that may have caused the financial statements to be materially misstated, whether due to fraud or error, in accordance with paragraphs 11(a) and 15 of the ISA.

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

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

Nature, seriousness, gravity and duration of the breaches

6.4. The breaches of *Relevant Requirements*:

6.4.1. Affected two different areas of the audit.

6.4.2. Occurred over two different audit years.

6.4.3. Involved breaches of *Relevant Requirements* concerning the exercise of professional skepticism and the obtaining and documentation of sufficient appropriate audit evidence, which are fundamental to the work of the auditor.

6.4.4. In some instances involved simple errors in the execution of basic audit procedures, which were not prevented or detected by the quality management procedures applied at the engagement level.

6.5. As a result of the breaches, the FY2015 and FY2016 audits failed in their principal objective, namely to obtain reasonable assurance about whether the financial statements as a whole were free from material misstatement, whether due to fraud or error. The FY16 Financial Statements were in fact materially misstated in respect of supplier rebates, and both the FY2015 and FY2016 Financial Statements were materially misstated in respect of cash.

6.6. Supplier rebates were a significant aspect of SIG's business and were identified as an area of significant audit risk. They had also been highlighted in guidance issued by the FRC in December 2014 as an area requiring particular care. Further, the FRC's 2014-15 Audit Quality Inspection Report on Deloitte, published in May 2015, identified supplier rebate issues in the audit of a retailer which were similar in some respects to the failings in this case. These matters all make the supplier rebate breaches significantly more serious.

6.7. The breaches 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 financial statements published by Statutory Auditors or Statutory Audit Firms. SIG is listed on the Main Market of the London Stock Exchange and had a market capitalisation in excess of £800m at the time when the FRC began its investigation. It is not alleged that the particular misstatements associated with the breaches had any impact on the Entity's share price in themselves.

6.8. Because of the various features mentioned above, the breaches also had the potential to undermine confidence in the standards of conduct in general of *Statutory Auditors* and *Statutory Audit Firms*, and/or in *Statutory Audit*.

6.9. As against this, however:

- 6.9.1. All of the breaches occurred in the audit of one of SIG's subsidiaries (although a significant subsidiary).
- 6.9.2. There was intentional overstatement of rebate balances by SIG staff.
- 6.9.3. The restatements associated with the supplier rebate breaches were only just material to the FY2016 financial statements, and not material in FY2015.
- 6.9.4. The restatements associated with the cash breaches were essentially balance sheet reclassifications, with no overall effect on net assets and no impact on the income statement.
- 6.9.5. Whilst Deloitte was paid fees of £2.9m for the audit services provided to SIG in FY2015 and FY2016, it did not stand to gain from the breaches.
- 6.9.6. The breaches were not intentional, reckless or dishonest, and in Mr Manning's case no negligent or incompetent act or omission is alleged against him in respect of the cash breaches.
- 6.9.7. With regard to the last of these points, however, Mr Manning was responsible as group engagement partner for the overall quality and performance of the audit engagements, and for the audit reports being appropriate in the circumstances. The FY2015 and FY2016 Audit reports failed to satisfy *Relevant Requirements* and, as noted above, the audits failed in their overall objective of obtaining reasonable assurance.
- 6.9.8. Deloitte has taken steps both to mitigate the risk of repeat and to learn from the breaches. These actions include refreshing and updating its supplier rebate work programme to reinforce the requirement to obtain sufficient appropriate evidence regarding supplier rebate terms, and providing an update briefing to audit teams on the risks relating to supplier rebates and common pitfalls. In addition, a reminder was provided to audit teams and audit delivery centres on the need for care to be taken when testing cash reconciling items in order to ensure sufficient appropriate audit evidence has been obtained.

6.10. Although the breaches occurred a number of years ago and changes have been made to Deloitte's practices and procedures since, Executive Counsel is not satisfied that the same type of breach could not occur again in the absence of further remedial action, bearing in mind that it is not yet known why Deloitte's quality management arrangements were ineffective to prevent or detect the breaches.

- 6.11. Deloitte is one of the largest audit firms in the UK, with 674 partners, audit fee income of £573m and total fee income of £3,863m in 2021². Average distributable profit per equity partner was £854,000 in 2021. It is understood that any financial penalty imposed on Mr Manning would be paid by Deloitte.
- 6.12. Deloitte has been the subject of enforcement action by the FRC on five occasions since 2016, resulting in the imposition of a severe reprimand in four out of the five cases, and financial penalties ranging from £0.5m to £15m before any discount for admissions and early disposal.
- 6.13. Mr Manning has a clean disciplinary record spanning 29 years.
- 6.14. Both Deloitte and Mr Manning have acknowledged their responsibility for the breaches and apologised.

Identification of *Sanction*

- 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 Deloitte:
- 6.15.1. A financial penalty of £1,250,000.
- 6.15.2. A published statement to the effect that Deloitte has breached *Relevant Requirements*, in the form of a severe reprimand.
- 6.15.3. A declaration that the FY2015 and FY2016 Audit reports signed on behalf of Deloitte did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*; and
- 6.15.4. An order requiring Deloitte to take specified action to mitigate the effect or prevent the recurrence of the contravention, as set out at paragraph 2.8.4 above.
- 6.16. And the following combination of *Sanctions* as appropriate for Mr Manning:
- 6.16.1. A financial penalty of £50,000.
- 6.16.2. A published statement to the effect that Mr Manning has breached *Relevant Requirements*, in the form of a severe reprimand.

Aggravating factors and mitigating factors

- 6.17. Executive Counsel has not identified any aggravating or mitigating factors that have not already been considered in the context of the seriousness of the breaches. In particular, regard has already been had to the different disciplinary records of Deloitte and Mr Manning.

² *Key Facts and Trends in the Accountancy Profession*, FRC, August 2022.

Deterrence

6.18. 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

6.19. Having taken into account the admissions by Deloitte and Mr Manning and the stage at which those admissions were made (Stage 1 of the case, within the meaning of paragraph 84 of the Policy, but not at the earliest possible point in time), Executive Counsel has determined that a reduction of 27.5% as to the financial penalty is appropriate in the case of both Deloitte and Mr Manning. As a result, a discounted financial penalty of £906,250 is payable by Deloitte, and a discounted financial penalty of £36,250 by Mr Manning.

7. COSTS

7.1. Executive Counsel requires that the Respondents pay her *Costs* in full in this matter, being £120,481. Such costs shall be paid no later than 28 days after the date of the *Final Decision Notice*.

Signed:

[Redacted]

Jamie Symington

DEPUTY EXECUTIVE COUNSEL

Date: 31 October 2022

APPENDIX – EXTRACTS FROM RELEVANT REQUIREMENTS

Extracts from ISAs

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

“11. In conducting an audit of financial statements, the overall objectives of the auditor are:

- (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- (b) To report on the financial statements, and communicate as required by the ISAs (UK and Ireland), in accordance with the auditor’s findings.

...

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. (Ref: Para. A18-A22)”

ISA 230: Audit Documentation

“8. The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand: (Ref: Para. A2-A5, A16-A17)

- (a) The nature, timing and extent of the audit procedures performed to comply with the ISAs (UK and Ireland) and applicable legal and regulatory requirements; (Ref: Para. A6-A7)
- (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. (Ref: Para. A8-A11)”

ISA 500: Audit Evidence

“6. The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. (Ref: Para. A1-A25)”