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## DECISION NOTICE

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To: **Carillion plc (in liquidation)**

Address: **Official Receiver London Athens (Carillion) & Public Interest Unit  
(London), 16th Floor, 1 Westfield Avenue, Stratford, London, E20  
1HZ**

Date: **24 June 2022**

### **1. ACTION**

- 1.1. For the reasons given in this Decision Notice, the Authority has decided to publish a statement censuring Carillion plc for contraventions of the Market Abuse Regulation and the Listing Rules (pursuant to sections 123 and 91 of the Financial Services and Markets Act 2000). Specifically, between 1 July 2016 and 10 July 2017, Carillion contravened Article 15 of MAR (prohibition of market manipulation), Listing Rule 1.3.3R (misleading information must not be published), Listing Principle 1 (procedures, systems and controls) and Premium Listing Principle 2 (acting with integrity).
- 1.2. Were it not for Carillion's financial circumstances, the Authority would have imposed a financial penalty of £37,910,000.

### **2. SUMMARY OF REASONS**

#### Carillion

- 2.1. Carillion was, until it went into liquidation in January 2018, a leading international construction, project finance and support services business operating in the UK, Canada and Middle East.

- 2.2. On 10 July 2017, Carillion announced (amongst other things) an expected provision of £845 million as at 30 July 2017, of which £375 million was in relation to projects in Carillion Construction Services (CCS). The provision arose from a review following a deterioration in cash flows across several construction projects, including within the UK.
- 2.3. The nature of the required provision surprised many market analysts and Carillion's share price fell by 39% on the day of the announcement and by 70% within three days. Carillion subsequently went into liquidation on 15 January 2018.
- 2.4. The market's adverse reaction resulted from the unexpected nature and size of the provision, which effectively wiped out Carillion's profits over the previous six years. Carillion's previous announcements, specifically its trading update on 7 December 2016, its 2016 financial results published on 1 March 2017 and its AGM statement on 3 May 2017, had given no indication to the market that such a provision was likely to be required.
- 2.5. Such previous announcements were misleading and were made recklessly. They did not accurately or fully disclose the true financial performance of Carillion. They made positive statements about Carillion's financial performance generally and in relation to CCS's construction business segment in particular. They failed to disclose significant deteriorations in the expected performance of projects across the CCS portfolio and did not take account of a series of warning signs indicating anticipated losses and/or reduced profitability across a number of major construction projects. It was these matters that, when eventually acknowledged by Carillion, led to a significant proportion of the provision announced in July 2017.

Overly aggressive contract accounting judgments

- 2.6. There was significant pressure on CCS during the Relevant Period to meet very challenging financial targets maintained by Richard Adam (Group Finance Director until 31 December 2016), Zafar Khan (Group Finance Director from 1 January 2017) and Richard Howson (CEO throughout the Relevant Period) in the face of clear warning signs that CCS's business was deteriorating significantly. This led to an increasingly large gap between the assessments within CCS of its financial performance and its performance as budgeted and ultimately reported to the market.

- 2.7. This gap was bridged during the Relevant Period by the use of overly aggressive contract accounting judgements in order to maintain CCS's reported revenues and profitability, especially in connection with certain major construction projects. These judgements did not reflect the true financial position of the projects or the financial risks associated with them. They did not comply with IAS 11, one of the applicable accounting standards governing the recognition of revenue associated with construction contracts.
- 2.8. CCS's management highlighted the financial risks and exposures associated with these judgements to one or more of Mr Adam, Mr Khan and Mr Howson during the Relevant Period. In particular:
- (1) CCS internally reported "*hard risks*" associated with its construction projects. These were amounts included within budgeted forecasts but which were considered by CCS management as unlikely to be recovered. In August and October 2016, hard risks within CCS were reported to Messrs Adam and Howson as amounting to around £172 million. By April 2017, this figure had increased to just over £310 million.
  - (2) CCS, along with other Business Divisions within Carillion, reported to Messrs Adam, Howson and Khan about the potential exposures to amounts due on major projects. This was contained in a report known as the Major Contracts Summary (MCS). By October 2016, the total amount due to CCS that was considered to be contentious was just under £244 million, with a "*likely*" exposure for CCS of £173 million (71% of the contentious amounts due) and 11 out of 16 named major projects marked with a red flag status. By May 2017, the likely exposure figure had increased to over £430 million (71% of the contentious amounts due).
  - (3) Large and increasing divergences in financial performance were highlighted to Messrs Adam, Howson and Khan during the Relevant Period in relation to four major projects: Royal Liverpool University Hospital (RLUH), Phase 1 Battersea Power Station redevelopment (Battersea), Midland Metropolitan Hospital (MMH) and Aberdeen Western Peripheral Route (AWPR). This made clear that there was an increasingly large disparity for those projects between the assessments of financial performance by project and/or management teams within CCS and the financial performance as reflected in Carillion's budgeted forecasts. The following gaps were highlighted during the Relevant Period:

- a. RLUH: A £21 million loss (assessed by the relevant Project Team) against a budgeted forecast profit of £13.6 million by December 2016, a difference of almost £35 million. This difference increased to £72 million by April 2017 as RLUH's financial performance deteriorated.
- b. Battersea: A £25 million loss (assessed by the relevant Project Team) against a budgeted forecast profit of around £10 million by December 2016, a difference of £35 million. This gap rose to over £43 million by April 2017.
- c. MMH: A £15.7 million loss (assessed by the relevant Project Team) against a budgeted forecast profit of £17.7 million by April 2017, a difference of over £33 million.
- d. AWPR: A £78 million loss (assessed by the relevant Business Unit within CCS) against a budgeted forecast loss of £10 million by December 2016, a difference of £68 million. This increased to a gap of over £85 million by April 2017.

2.9. When Carillion made its provision in July 2017, a total of £240 million was provided against the above four projects, consistent with the amounts noted above. This represented almost two-thirds of CCS's total provision of £375 million.

#### Reporting to the Board and the Audit Committee

2.10. The financial risks and exposures described at paragraph 2.8 above were not reported by Messrs Adam, Howson or Khan (or otherwise to their knowledge) to the Board or the Audit Committee. The key information received by the Board and the Audit Committee in relation to the financial performance of CCS and its major projects during the Relevant Period was in the form of a monthly Overtrade Report and a quarterly Major Project Status Report (MPSR). They were also informed about the level of provisions applied to Carillion's major contracts (which, prior to the £845 million provision announced on 10 July 2017, totalled £50.1 million for the whole of Carillion's business). At half- and full-year the Group FD would provide a report to the Audit Committee which included a summary of financial risks and key judgements associated with major projects.

- 2.11. These reports to the Board and the Audit Committee were submitted and/or approved by one or more of Messrs Adam, Howson and Khan during the Relevant Period. They painted a much more optimistic picture of CCS's financial performance than that being internally reported by CCS. As stated in paragraph 2.8(2) above the MCS in October 2016 (which the Board and the Audit Committee did not see) was identifying a likely exposure of £173 million. In contrast, the Overtrade Report did not show what those within CCS thought were likely exposures; instead, it showed revenue "*traded not certified*" (i.e. amounts that had not yet been agreed with the client which the Overtrade Report reported as appropriate to recognise as revenue). Throughout the Relevant Period up to February 2017, it reported this revenue at between £42 million and £44 million.
- 2.12. The MPSR was aligned, on Mr Adam's instructions and to Mr Howson's and Mr Khan's knowledge, to the budgeted and reforecast figures and did not disclose increasing variances between these figures and the Project Team's or Business Unit's assessments of RLUH, Battersea, MMH and AWPR. It did not show any material deterioration in CCS's major projects during the Relevant Period. The Group FD's report for the 2016 full year similarly did not identify any material deterioration associated with major projects.
- 2.13. Before the announcement in July 2017, the amount of provisions in Carillion's monthly management accounts for CCS's projects remained broadly unchanged at up to £17 million for all risks.

#### The Announcements

- 2.14. The December Announcement made positive statements that Carillion's performance was "*meeting expectations*", with expectations for "*strong growth in total revenue and increased operating profit*" for the Group and "*operating margin*" for Construction Services (excluding the Middle East)<sup>1</sup> remaining within a target range of 2.5-3% for the 2016 year-end. It described Carillion as "*well positioned to make further progress in 2017*".
- 2.15. These positive statements were not justified. They did not reflect the true financial performance of CCS's construction contracts and the December Announcement omitted any reference to significant risks associated with these stated expectations that had arisen as at the date of this announcement, including

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<sup>1</sup> The business segment of Construction Services (excluding the Middle East) included CCS's construction business

a number of the hard risks, exposures and divergences described at paragraph 2.8 above.

- 2.16. The March Results Announcement made similar positive statements to those in the December Announcement. In particular, it described Carillion's performance as *"in line with expectations"*, with revenue growth for the Group of 11% and underlying profit before tax (PBT) of £178 million. The document published alongside (and linked from) the March Results Announcement stated that *"Revenue grew strongly by 21 per cent"* in Construction Services (excluding the Middle East) and confirmed that operating margin for this segment *"remains within our target range of 2.5 per cent to 3 per cent"*. It described the ambition for this segment in 2017 as being *"to maintain revenue and profit at broadly their current levels"*. The March Results Announcement went on to refer to Carillion having a *"good platform from which to develop the business in 2017"*.
- 2.17. The March Results Announcement was misleading because the above statements concerning the financial performance of Carillion and Construction Services (excluding the Middle East) for 2016 and stated expectations for 2017 did not reflect the true financial performance of CCS's construction contracts and the announcement omitted any reference to the significant risks associated with these stated expectations as described at paragraph 2.8 above. The revenue and profit / margin figures for the Group and Construction Services (excluding the Middle East) in the March Results Announcement were misstated because they did not accurately reflect the financial performance of RLUH, Battersea, MMH and AWPR. In particular, Carillion failed to recognise the costs and revenue associated with these projects in accordance with IAS 11. The revenue and profit / margin figures were materially overstated as a result. The positive statements for 2017 for Group and Construction Services (excluding the Middle East) were similarly not justified because they did not take account of matters arising before this date, as described at paragraph 2.8 above.
- 2.18. The tenor of the May Announcement was that nothing had materially changed since the March Results Announcement. This was reflected in its heading (*"Trading conditions unchanged"*) and opening sentence (*"Trading conditions across the Group's markets have remained largely unchanged since we announced our 2016 full-year results"*). This was not an accurate depiction of the Group's trading as at 3 May 2017, which was materially affected by the adverse and deteriorating financial performance of CCS's construction projects as at the date of this announcement, as described at paragraph 2.8 above.

- 2.19. The Group CEO (Mr Howson) and the Group FD (Mr Adam or Mr Khan) had a central role in reviewing the Announcements and approving them as Board members. They did so in the knowledge of information reported to them on a number of occasions and summarised at paragraph 2.8 above that was materially inconsistent with the positive statements made in the Announcements. Messrs Howson, Adam and Khan must have been aware, particularly having regard to the nature and cumulative effect of the information and the occasions on which it was reported to them, that this information would be highly relevant to the deliberations of the Board and the Audit Committee when they reviewed and approved the Announcements. However, they failed to ensure that this information was brought to the attention of the Board and the Audit Committee.
- 2.20. In light of the above, the Authority considers that Carillion disseminated information in the Announcements that gave false or misleading signals as to the value of its shares in circumstances where it ought to have known that the information was false or misleading, in breach of Article 15 of MAR.
- 2.21. Messrs Howson, Adam and Khan were aware that Carillion intended to announce a PBT figure of £178 million in its 2016 financial results. They were also aware that this PBT figure included financial reporting for RLUH, Battersea and AWPR that was aligned with the budgeted forecast figures at paragraph 2.8(3) above. They did not take any steps to address the material inconsistencies between (i) the proposed PBT figure and financial reporting for RLUH, Battersea and AWPR and (ii) other information of which they were aware (see paragraphs 2.11 and 2.12 above). They also failed to ensure that these matters were brought to the attention of the Board and the Audit Committee.
- 2.22. In light of the above, and the matters summarised at paragraphs 2.23 to 2.27 below in relation to Listing Principle 1, the Authority considers that Carillion failed to take reasonable care to ensure that the announcements were not misleading, false or deceptive and did not omit anything likely to affect the import of the information, in breach of LR 1.3.3R.

#### Procedures, systems & controls

- 2.23. The deterioration in CCS's business during the Relevant Period, coupled with the pressure to meet very challenging financial targets, significantly increased the risk that overly aggressive contract accounting judgements would be applied in order to maintain its financial performance. To counter this risk, Carillion's procedures,

systems and controls in relation to CCS needed to be sufficiently robust to ensure that these judgements were made and reported appropriately. They were not, significantly increasing the risk that market announcements in relation to Carillion's financial performance would not be accurate.

- 2.24. Carillion's policies aimed at complying with IAS 11 were not widely disseminated within CCS. Many of the individuals within CCS responsible for making contract accounting judgements were unaware of the existence of these policies or, if aware, did not typically refer to them when making judgements. As a result, whilst there was a general understanding of the broad principles that should be applied to these judgements, the specific requirements of the internal policies were not well known or consistently interpreted and applied within CCS.
- 2.25. The overly aggressive contract accounting judgements being applied to CCS's major projects were not properly documented at Performance Review Meetings held by CCS or in the preparation of Position Papers for major projects. This meant there was no clear record of the assessments being made, approved or reviewed. This contributed to a lack of rigour around these judgements and their approval and review.
- 2.26. The management information relating to hard risks, MCSs and certain major projects produced and reported by CCS to Messrs Adam, Howson and Khan highlighted large and increasing risks associated with the financial performance of CCS's construction projects during the Relevant Period. This information was inconsistent with other reports (such as Overtrade Reports and MPSRs) that contained much more optimistic assessments of the financial performance of those projects, as reported to the Board and the Audit Committee.
- 2.27. The Board and the Audit Committee were not made aware of the significant and increasing financial risks during the Relevant Period as described above. This meant they were hampered in providing proper oversight of CCS's financial performance and the overly aggressive contract accounting judgements being applied to its major projects.
- 2.28. In light of the above, the Authority considers that, during the Relevant Period, Carillion failed to take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations under the Listing Rules, in breach of Listing Principle 1.



- 2.29. The Authority considers that Messrs Adam, Howson and Khan acted recklessly in relation to the facts and matters set out at paragraphs 2.5 to 2.27 above. The Authority attributes their state of mind to Carillion in this regard. As a result, the Authority considers that Carillion failed to act with integrity towards its holders and potential holders of its premium listed shares, in breach of Premium Listing Principle 2.
- 2.30. The Authority has therefore decided to publish a statement censuring Carillion for contraventions of MAR and the Listing Rules.

### **3. DEFINITIONS**

- 3.1. The definitions below are used in this Notice:

"the Act" means the Financial Services and Markets Act 2000;

"AGM" means Annual General Meeting;

"Announcements" means the December Announcement, the March Results Announcement and the May Announcement;

"the Authority" means the body corporate known as the Financial Conduct Authority;

"AWPR" means Aberdeen Western Peripheral Route which was a project structured as a joint venture with two other partners;

"Battersea" means the Phase 1 Battersea Power Station redevelopment;

"Building" means the Buildings Business Unit within CCS;

"Business Division" means one of the following divisions that Carillion's business was divided into during the Relevant Period: CCS, Carillion Services, MENA, Canada, Al Futtaim Carillion and Carillion Private Finance;

"Business Unit" means a sub-division of CCS, including (amongst others) Building and Infrastructure;

"Carillion" means Carillion plc;

"CCS" means Carillion Construction Services, a Business Division of Carillion;

"CEO" means Chief Executive Officer;

"December Announcement" means Carillion's trading update published on 7 December 2016;

"DEPP" means the Decision Procedure and Penalties manual, part of the Handbook;

"Group" means the Carillion group of companies, of which Carillion plc was the ultimate parent company;

"Group FD" means the Group Finance Director for Carillion;

"the Handbook" means the Authority's Handbook of rules and guidance;  
 "IAS 11" means International Accounting Standard 11;  
 "Infrastructure" means the Infrastructure & Railways Business Unit within CCS;  
 "the Listing Rules" means those rules contained in the part of the Handbook entitled 'Listing Rules';  
 "MAR" means Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse;  
 "March Results Announcement" means Carillion's 2016 financial results published on 1 March 2017;  
 "May Announcement" means Carillion's AGM statement published on 3 May 2017;  
 "MCS" means Major Contracts Summary;  
 "MENA" means Middle East and North Africa, a Business Division of Carillion;  
 "MMH" means Midland Metropolitan Hospital;  
 "MPSR" means Major Project Status Report;  
 "MCRM" means Major Contracts Review Meeting;  
 "PBT" means underlying Profit Before Tax;  
 "PFI" means Private Finance Initiative  
 "PRM" means Performance Review Meeting  
 "Priority Contracts" means these four major projects: AWPR, Battersea, MMH and RLUH;  
 "Project Team" means the project and commercial managers assigned to individual major projects;  
 "RDC" means the Regulatory Decisions Committee of the Authority (see further under Procedural Matters below);  
 "Relevant Period" means 1 July 2016 to 10 July 2017;  
 "RIS" means Regulatory Information Service;  
 "RLUH" means Royal Liverpool University Hospital;  
 "the Tribunal" means the Upper Tribunal (Tax and Chancery Chamber); and  
 "the Warning Notice" means the warning notice given to Carillion dated 18 September 2020.

## **4. FACTS AND MATTERS**

### **SECTION A: BACKGROUND**

- 4.1. During the Relevant Period, Carillion was a leading construction, project finance and support services business operating in the UK, Canada and Middle East. It was created following a demerger of Tarmac Group in 1999 and subsequent

acquisitions of (amongst others) Mowlem and Alfred McAlpine. Carillion was admitted to the Official List of the London Stock Exchange.

- 4.2. Carillion was a non-trading investment holding company operating through a large number of subsidiaries and joint ventures. Its internal and external financial reporting to the market was broadly aligned with its business structure. Carillion's business was divided into the following divisions during the Relevant Period: CCS, Carillion Services, Middle East and North Africa, Canada, Al Futtaim Carillion and Carillion Private Finance.
- 4.3. Carillion's construction business was operated by CCS in the UK and by Canada and MENA respectively for its overseas construction business. Carillion externally reported its financial results for its UK construction business as part of a business segment called "*Construction Services (excluding the Middle East)*", including construction activities in CCS and Canada. This segment represented almost 30% (£1,520.2 million) of Carillion's revenue for 2016, of which CCS contributed £1,452.8 million.
- 4.4. In the UK, CCS as a Business Division of Carillion was led by Business Divisional management. CCS was sub-divided into Business Units, including (amongst others) Building and Infrastructure. Major construction projects reported directly into these Business Units. Smaller projects reported into Business Units via regional teams. Each of the Business Units was led by Business Unit management. Major projects also had their own project and commercial managers.
- 4.5. On 10 July 2017, Carillion announced that it was making a provision of £845 million in relation to 58 contracts within its construction business. Of this provision, £375 million related to CCS and £470 million to overseas markets (the majority of which related to existing markets in the Middle East and Canada). The CCS provision was made when Carillion acknowledged that accounting judgements it had previously made in relation to its construction projects needed to be revised significantly downwards. The provision included £240 million in relation to four major UK construction projects: RLUH, Battersea, AWPR and MMH.

## **SECTION B: IAS 11 AND CONTRACT ACCOUNTING JUDGEMENTS**

- 4.6. Carillion's construction business involved operating a large number of construction projects for different clients in the UK, the Middle East and Canada. These projects varied widely in terms of their size and complexity. Their financial reporting was

governed by international accounting standards applicable during the Relevant Period, especially IAS 11.

- 4.7. IAS 11 applies a "*percentage of completion*" methodology to construction contracts. It provides that, when the final outcome of the contract can be estimated reliably, revenue and costs are recognised in a financial period by reference to progress in the contract's stage of completion. The stage of completion can be assessed in a variety of ways, including (as was adopted in this case) by reference to the costs incurred to date as a percentage of the total costs expected to be incurred on a contract. In simple terms, this means that if 50% of the expected total costs have been incurred within a financial reporting period, 50% of the costs and revenue associated with the contract should be recognised in the financial statements for that period. For a profitable contract, the difference between revenue and costs on the contract represents the margin (e.g. a profit) that can be recognised. For a loss-making contract (i.e. where total costs to the end of the contract are expected to exceed total revenue), IAS 11 requires that the total expected loss must be recognised in full immediately.
- 4.8. When the outcome of the contract cannot be estimated reliably, revenue can only be recognised to the extent of costs incurred that it is probable will be recovered (i.e. if the outcome of the contract cannot be estimated reliably, no profit can be recognised), but costs are still recognised in the period they are incurred.
- 4.9. The percentage of completion method therefore typically requires assessment of the expected revenue and costs up to the end of the contract (commonly referred to as "*end of life*") and the percentage of costs incurred to date. Revenue can include the initial amount of revenue agreed in the contract, as well as amounts attributable to "*variations*" and "*claims*". A contract's profit or loss recognised in Carillion's financial reporting up to any particular point in time was called "*current traded margin*" or "*margin traded to date*" by Carillion. The overall profit or loss that it expected to earn to the end of the contract was known as "*end of life margin*".
- 4.10. Variations and claims are a common feature of construction contracts and can comprise a significant proportion of the revenue recognised in relation to a contract pursuant to IAS 11. Variations may occur when the scope, timing or specific requirements of a project are changed by a client. Claims can arise against a client or a sub-contractor in circumstances where there have been delays or increased costs in a project due to negligence or some other failure on

the part of the client or sub-contractor. Claims can also be brought by those parties against the construction company (e.g. Carillion).

- 4.11. The application of IAS 11 means that the reporting of a construction contract's financial performance is heavily influenced by judgements as to the estimated end of life revenue and costs of a contract and the likely future recoverability of value associated with claims and variations. This made the proper application of IAS 11 of fundamental importance to Carillion, ensuring that information it published in relation to its construction business was not false or misleading and/or did not contain material omissions (as required by LR 1.3.3R and Article 15 of MAR). It was also fundamental to Carillion's obligation pursuant to Listing Principle 1 to take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations under the Listing Rules.

### **SECTION C: CARILLION'S PROCEDURES, SYSTEMS AND CONTROLS**

- 4.12. Carillion's relevant procedures, systems and controls around contract accounting judgements within CCS were established prior to the Relevant Period and were designed around a forecasting process that was supposed to operate on a "*bottom up*" basis. In other words, judgements affecting the financial performance of construction projects were supposed to be led by those most directly involved in managing the projects, utilising the expertise and experience within the Project Teams, Business Units and Business Divisions. Their views could, however, be subject to challenge by more senior management, especially during Carillion's budgeting and reforecasting process, and the requirement to report in compliance with IAS 11 made challenge particularly important in the circumstances.
- 4.13. During the Relevant Period, the budget and reforecasting challenges issued by senior management (including Messrs Adam, Howson and Khan) became increasingly challenging and difficult to achieve as major projects in CCS faced mounting operational and financial difficulties. These challenges were issued to CCS and quantified at a Divisional level, as opposed to being referable to individual projects. They nonetheless put significant pressure on individuals within CCS to apply increasingly aggressive contract accounting judgements in order to raise the financial performance of projects to meet what the individuals believed were, unrealistic financial targets. This gave rise to the clear risk that these judgements would not comply with the requirements of IAS 11 and would misreport the financial performance of major projects within CCS. Carillion's procedures,

systems and controls were not sufficiently robust or transparent to address this risk.

#### **Carillion's internal policies on revenue and profit recognition**

4.14. The requirements of IAS 11 were adequately reflected in internal policies adopted by Carillion for financial reporting purposes. Carillion's profit recognition policy applicable to CCS construction projects during the Relevant Period provided, amongst other things, that:

- (1) potentially contentious claims against clients should only be recognised as revenue where a good draft of the claim had been completed, it was reasonably certain that the client would agree to the claim and the client had the ability to pay;
- (2) if not agreed with the client, variations should only be recognised if supported by a written instruction by the client and an assessment of the client's ability to pay; and
- (3) the recognition of any claims or variations must be approved by the Finance Directors and Commercial Directors of the relevant Business Unit and Business Division.

4.15. The above judgements within CCS primarily involved personnel within the Commercial and Finance functions within Carillion. The role of the Commercial function was to manage the commercial aspects of projects, including any claims or variations. The Finance function was responsible for the financial reporting of projects, including ensuring compliance with applicable accounting standards and internal policies. Decisions to recognise value associated with claims or variations required input from both functions to assess recoverability and value, and ensure that profits were appropriately recognised in Carillion's accounts.

#### **Availability and understanding of internal policies**

4.16. Carillion's policies aimed at complying with IAS 11, including its profit recognition policy, were made available within CCS on the firm's intranet, but not otherwise disseminated internally. Many of the individuals within CCS responsible for making contract accounting judgements were unaware of the existence of these policies or, if aware, did not typically refer to them when making judgements. As

a result, whilst there was a general understanding as to the broad principles that should be applied to these judgements, the specific requirements of the internal policies were not well known or consistently interpreted and applied within CCS.

### **Application of contract accounting judgements and their reporting within CCS**

- 4.17. During the Relevant Period, the application of contract accounting judgements within CCS was dominated by the need to meet the very challenging financial targets set and maintained by Messrs Adam, Howson and Khan. In practice, this meant that the judgements were no longer made in accordance with Carillion's internal policies or on a "*bottom up*" basis as envisaged in the forecasting process, but were aligned to meet the targets set and to maintain the reported profitability of CCS's major projects. These judgements did not reflect the true financial position of the projects or the financial risks associated with them. They did not comply with IAS 11, one of the applicable accounting standards governing the recognition of revenue and costs associated with construction contracts.
- 4.18. These financial risks and potential exposures arising from these overly aggressive accounting judgements were highlighted by CCS to Messrs Adam, Howson and Khan on a number of occasions and by various means, including by reporting on:
- (1) "*hard risks*" associated with CCS's projects, which were amounts included within budgeted forecasts, but which were considered by CCS management as unlikely to be recovered;
  - (2) potential exposures to amounts due on major projects by means of a quarterly report known as the Major Contracts Summary; and
  - (3) large and increasing divergences in the financial performance in relation to certain major projects, making clear the increasingly large disparity for those projects between the assessments of financial performance by project and/or management teams within CCS and the financial performance as reflected in Carillion's budgeted forecasts.
- 4.19. Messrs Adam, Howson and Khan did not respond appropriately to these warning signs. They did not adjust CCS's financial targets in response to them. They also did not report them to the Board or the Audit Committee during the Relevant Period, even though to their knowledge they were not otherwise being reported,

and even though they must have been aware, particularly having regard to the nature and cumulative effect of the warning signs and the number of occasions on which they were reported to them, that they would be highly relevant to the deliberations of the Board and the Audit Committee. This meant that the Board and the Audit Committee were unaware of the full extent of financial risks and potential exposures within CCS and their significant increase during the Relevant Period.

- 4.20. There was no single, coherent process within CCS for applying contract accounting judgements and obtaining approval of them in accordance with Carillion's policies. Instead, the financial performance of CCS's major projects and accounting judgements associated with them were subject to review and internal reporting by various processes involving the relevant Project Team, Business Unit management, Business Divisional management, Messrs Adam, Howson and Khan, and ultimately the Board and the Audit Committee. These processes ultimately determined how the financial performance of individual construction projects was externally reported by Carillion to the market.

Internal reporting on major projects from Project Team up to Executive Directors

(i) *Contract Appraisals*

- 4.21. The Project Teams typically produced monthly Contract Appraisals for each major project setting out the estimated end of life and current traded value, costs and margin ("traded" referring to the amounts entered into Carillion's financial reports). These figures incorporated the Project Team's ongoing judgements as to the potential recoverability of claims or variations, or cost savings, as well as any additional adjustments applied on top of the Project Team's judgements (typically known as "management adjustments" within CCS).
- 4.22. These management adjustments applied during the Relevant Period were often the means by which the financial performance of projects was adjusted upwards in order to meet budgeted forecasts in line with the targets for CCS set and maintained by senior management. Carillion's profit recognition policy specifically prohibited "*arbitrary management adjustments*" and indicated that "*items must be fully documented and supported at all times*". However, the policy was not followed in practice. There was no breakdown of the management adjustments applied to a project identifying the reasons for them and the specific claims,



variations or costs to which they had been applied. This was because they were increasingly used within CCS during the Relevant Period as one of the tools for maintaining the reported profitability of projects, despite the increasing risks, in response to pressure placed on CCS to meet very challenging financial targets. By November / December 2016, these management adjustments amounted to around £245 million within CCS. They had increased to approximately £310 million by February / March 2017.

*(ii) Performance Review Meetings*

4.23. The operational, commercial and financial progress of projects within CCS were considered at Performance Review Meetings. The following PRMs dealing with major projects took place each month:

- (1) a PRM for each individual major project, typically attended by the relevant Project Team and Business Unit and Divisional management, and sometimes by the Group CEO;
- (2) a Business Unit PRM for each Business Unit, typically attended by Business Unit and Divisional management;
- (3) a Divisional PRM for each Business Division, typically attended by Business Divisional management and the Group CEO and Group FD.

4.24. Discussions at PRMs would include discussion of claims, variations and costs on different projects, and the challenges or opportunities associated with them, including their recovery strategy. Despite the potential significance of these discussions in the context of financial reporting around projects, they were not minuted and the only record made was a list of agreed actions.

*(iii) Budgeting and reforecasting process*

4.25. The PRMs played an important role in the context of Carillion's budgeting and forecasting process. This process involved a budget being produced in October to December each year, with 3-4 reforecasts (known as RF1, RF2, etc) throughout the year.

- 4.26. As explained above, this process was intended to be “*bottom up*” and submissions would be reviewed at Business Unit and Divisional PRMs before being submitted to the Group finance function and ultimately the Board for approval.
- 4.27. The budget and reforecast submissions would be subject to challenge in the form of revised financial targets, first by management of the relevant Business Division and subsequently by the Group FD. The pressure to meet challenges imposed and maintained by Messrs Adam, Howson and Khan required the Project Teams, Business Units and Business Divisions to work out ways of delivering the revised revenue and profitability targets. During the Relevant Period, this was done within CCS by, amongst other things, using increasingly aggressive judgments as to the likely recoverability of claims, variations and anticipated cost savings on major projects, including by means of ever larger management adjustments to maintain profitability, the use of negative accruals and “*audit friendly*” Position Papers (see paragraphs 4.82 and 4.46 below).

(iv) *Hard risk*

- 4.28. The management of CCS and its associated Business Units had significant concerns about the increasing levels of risk associated with these judgements. Those risks were highlighted within CCS and to Messrs Adam, Howson and Khan by means of reporting (what was known as) “*hard risk*” and via a management report called the MCS.
- 4.29. CCS categorised risk associated with contract accounting judgements as “*hard risk*” or “*soft risk*”. Hard and soft risks represented attempts to quantify and report on financial risks associated with CCS’s projects, typically in the context of Carillion’s budgeting and reforecasting processes. Hard risk were amounts included within budgeted forecasts, but which were assessed by CCS as unlikely to be recoverable. Soft risk was understood within CCS to be amounts deemed recoverable, albeit there might still be challenges and recovery was not certain. The reporting of hard risk in PRMs and as part of the budgeting and reforecasting processes was considered to be especially important by individuals within CCS in order to highlight internally the risks associated with the increasingly aggressive contract accounting judgements being applied during the Relevant Period.
- 4.30. By October 2016, hard risk internally reported in the CCS PRM amounted to £172 million. This increased to £258.4 million by the end of December 2016 and to £310.6 million by April 2017.

(v) *Major Contracts Summary and Major Contracts Review Meeting*

- 4.31. The MCS was a quarterly report submitted by the Business Divisions to (amongst others) Messrs Adam, Howson and Khan. It highlighted financial exposures arising from contentious amounts due on individual major projects, including claims, flagging the projects with a "red", "amber" or "green" status. It specifically highlighted where a likely recovery was less than Carillion's current forecast, resulting in an exposure that might need to be written off or could call into question under IAS 11 the recognition of any revenue, and therefore of any profit, with respect to those projects. There was, however, no guidance provided to the Business Divisions for completing the report, which led to a lack of clarity and consistency in the figures submitted by different Business Divisions. The MCS nonetheless showed large and increasing exposures across different Business Divisions (including CCS) during the Relevant Period.
- 4.32. In October 2016, the MCS identified a "likely" exposure of £173.2 million within CCS (up from £159.9 million in July 2016), with 11 out of 16 named projects marked with a red flag status. By May 2017, this had increased to a "likely" exposure of over £430 million, with all bar two projects marked with a red flag status.
- 4.33. The MCS was discussed at Major Contracts Review Meetings typically attended during the Relevant Period by (amongst others) each Business Divisional management and Mr Adam and/or Mr Khan.

(vi) *Peer review*

- 4.34. Separate to the reporting processes described above, major projects were also subject to peer reviews which were carried out as part of Carillion's internal audit programme. They involved a review of selected projects undertaken by experienced contract managers from another part of the business. The review included consideration of the financial position of the relevant project and the contract accounting judgements applied to it. During the Relevant Period, the peer review recommendations on certain major projects identified significantly worse financial performance than the budgeted forecasts. There was, however, no formal process to ensure that a peer reviewer's recommendations were taken into account and no meaningful action taken in response, although as part of internal audit presentations to the Audit Committee, peer review recommendations were identified as being tracked and implemented.

#### Reporting to the Board and the Audit Committee

- 4.35. The Board and the Audit Committee were responsible for providing oversight of Carillion's business and the risks in that business, including those associated with its financial reporting to the market. The Audit Committee's Terms of Reference during the Relevant Period stated, amongst other things, that the Committee would review and where necessary challenge "*whether the Company has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditors*".
- 4.36. The internal reporting of hard risks, potential exposures in the MCS and the large and increasing divergences from budgeted forecast in the financial performance of certain major projects represented significant and increasing financial risks associated with overly-aggressive contract accounting judgements being applied within CCS during the Relevant Period. However, these risks were not being disclosed to the Board or the Audit Committee. Instead, the Board and the Audit Committee received different reports that painted a broadly positive picture and failed to highlight the increasing financial risks arising within CCS during the Relevant Period.
- 4.37. The Board received two key reports dealing with (amongst other things) the financial performance of CCS's projects: Major Project Status Reports and Overtrade Reports. Neither report showed the financial risks associated with increasing management adjustments, hard risks, MCS exposures, divergences from budgeted forecasts for major projects or variances to peer review recommendations. Instead, they identified much lower levels of risk associated with contract accounting judgements and largely maintained the status quo in terms of the reported financial performance of major projects.
- 4.38. MPSRs were quarterly reports on the estimated end of life and current traded value, costs and margin for individual major projects, with commentary about progress on each project and major issues and risks. The individual reports were summarised in a MPSR Executive Summary that identified the value and margin associated with each major project, together with any changes. Only the MPSR Executive Summary would be submitted to the Board, after it had been reviewed and approved by Messrs Adam, Howson and/or Khan.

- 4.39. Notwithstanding the significantly increasing financial risks within CCS, the figures in the MPSRs and the MPSR Executive Summary throughout the Relevant Period were aligned to the latest budget or reforecast figures for each project. This meant that the MPSRs and the MPSR Executive Summary failed to highlight any inconsistencies between the latest budget or reforecast and the assessment of the relevant Project Team, Business Unit or Business Division. The MPSRs also did not highlight the management adjustments applied to the project, amounts identified as hard risk, exposures in the MCS or variances to peer review recommendations.
- 4.40. The Overtrade Report showed the value of construction revenue traded by Carillion on projects, but not certified by the client. Certification is the formal acceptance by a client that work has been completed satisfactorily, allowing payment for it to be made. Revenue traded but not certified represented revenue that Carillion was recognising in its financial reporting for work that was not yet formally approved by the client. This would include revenue recognised in relation to claims or variations that had not yet been agreed with the client.
- 4.41. The Overtrade Report was regarded within Carillion as an important indicator of the amount of revenue subject to contract accounting judgements that was being recognised in Carillion's management accounts at a particular point in time. It was appended to Carillion's monthly management accounts circulated to the Board and separately provided to the Audit Committee. Despite its importance, the figures reported in the Overtrade Report did not identify the management adjustments applied to individual projects, hard risks, exposures reported in the MCS, divergences from budgeted forecast in the financial performance of certain major projects or variances to peer review recommendations. On 23 February 2017, Mr Khan, the Group FD at the time, also acknowledged that "*there was not a consistent practice*" between Business Divisions in relation to revenue traded but not certified, "*a position which had evolved over a number of years*".
- 4.42. The Board did not review contract accounting judgements collectively or on individual projects as a matter of course. As well as the MPSR Executive Summary and Overtrade Report, the Board received regular operational updates on major projects, but these did not typically cover financial performance. Other management information provided to the Board (such as budgets or monthly management accounts) included financial information and reflected contract accounting judgements at an aggregate level only.

- 4.43. The Audit Committee received the Overtrade Report, but not the MPSR Executive Summary. Following the financial period end at half or full year, the Group FD also submitted a report to the Audit Committee identifying the financial risks and key judgements associated with major projects. This typically identified the forecast end of life margin for each major project and stated the value that would need to be achieved through claims, variations or cost savings in order to achieve that margin. It did not, however, explain the basis of the judgements made or describe the financial risks associated with them. It did not identify the level of management adjustments being applied, hard risks, the MCS exposures, divergences from budgeted forecast in the financial performance of certain major projects or variances to peer review recommendations. The values identified in the Group FD's Report were also different to, and at times inconsistent with, the figures in the Overtrade Report.

Carillion's financial statements and Position Papers provided to the auditors

- 4.44. For each financial reporting period, Position Papers on major projects were prepared by Business Units for the purposes of the external auditors' half and full year audit work. They set out the financial position of selected projects in terms of the estimated end of life and currently traded value, costs and margin. They identified the amounts being recognised in relation to claims, variations and costs, but only provided limited narrative or other explanation as to the judgements being made. They were reviewed at Divisional and Group level (including by the Group FD) before being provided to the external auditors. The figures set out in the Position Papers were broadly equivalent to the MPSRs and reflected the amounts recognised for those projects in Carillion's financial statements.
- 4.45. The Position Papers did not refer to the financial risks associated with management adjustments, hard risks, MCS exposures, divergences between the latest budget or reforecast and the assessment of the Project Team, Business Unit or Business Division, or peer review recommendations. Typically, the Position Papers would be sent to the Group Financial Controller and to Mr Adam (and latterly Mr Khan) as Group FD for consideration before being provided to the external auditors. Messrs Adam and Khan were therefore able to see that the Position Papers did not inform the external auditors of these matters.
- 4.46. For certain major projects, two versions of Position Papers were produced for the 2016 year-end: a "*clean*" version reflecting the Project Team's assessment of the project's financial position; and an "*adjusted*" version for the external auditors showing a much-improved financial position. The adjusted version was regarded

by the Business Unit as more "*audit friendly*" because it did not disclose the overly aggressive nature of the judgements being applied to maintain the budgeted margin and the associated financial risks to the project's reported financial performance. The external auditors were unaware that a separate, clean version of the Position Paper had been produced reflecting the Project Team's much more conservative assessment. The preparation of "*clean*" and "*adjusted*" Position Papers was one of the responses developed within CCS to the pressure placed on it to meet very challenging financial targets.

## **SECTION D: EVENTS LEADING UP TO THE ANNOUNCEMENTS**

### **Increase in exposures and risks associated with contract accounting judgements during the second half of 2016**

- 4.47. The second half of 2016 saw significant increases in the exposures and levels of risk associated with Carillion's contract accounting judgements being reported internally for CCS and the Group as a whole. For CCS, these increases reflected significant deteriorations in the financial performance of certain major projects within CCS as described in Section F below. They were highlighted by CCS to Messrs Adam, Howson and Khan (the latter as Group Financial Controller at that time) on a number of occasions. Messrs Adam, Howson and Khan must have been aware, particularly having regard to the nature and cumulative effect of the information they received and the number of occasions on which these increases were reported to them, that they would be highly relevant to the deliberations of the Audit Committee, the Board and the external auditors. However, they were not reported to the Audit Committee, the Board or the external auditors.

#### July, October and December 2016 MCSs

- 4.48. In July 2016, the MCS identified a "*likely*" exposure (ahead of any write-offs) in relation to contentious amounts considered due (e.g. via claims) to the Group as a whole of £439.9 million. The equivalent figure for CCS was £159.9 million (representing 66% of the contentious amounts considered due to CCS). The "*best*" case scenario in the MCS anticipated an exposure of just over £136 million for CCS (i.e. 56% of contentious amounts due).
- 4.49. By October 2016, the "*likely*" exposure in the MCS had increased to £566.6 million for the Group and to £173.2 million for CCS. The figure for CCS represented 71% of the contentious amounts considered due. The "*best*" case scenario in the MCS

was an exposure of just under £142 million for CCS (i.e. 58% of contentious amounts due).

- 4.50. The MCS figures for December 2016 showed "*likely*" exposures of over £550 million for the Group and £157.8 million for CCS. The CCS figure had slightly decreased from October 2016 because it omitted a figure for AWPR. In December 2016, AWPR was separately reporting via the CCS PRM a likely exposure of £68 million against its traded margin (a loss of £10 million). Taking this into account, the "*likely*" exposure for the Group was £618.7 million and for CCS was £225.8 million in December 2016. Even taking into account any inconsistencies in the production of this report, these figures highlighted very significant likely exposures.
- 4.51. Between July and December 2016, the MCSs (when taken together with the CCS PRM in December 2016) identified increases of £178.8 million for the Group and £65.9 million for CCS in the level of "*likely*" exposures. Messrs Adam, Howson and Khan received the MCSs for July and October. Messrs Adam and Khan attended the relevant MCRMs and additionally received the MCS for December 2016 and attended that MCRM. Despite their knowledge of these matters, Messrs Adam and Howson (Carillion's executive directors at the time) did not take any steps to address these exposures being reported to them.

Hard risk reported in August and October 2016 and January 2017

- 4.52. In August 2016, CCS's RF3 flash presentation forecast hard risk for the end of 2016 of £172.7 million, including £61.8 million of new hard risk since January 2016. This was an increase of new hard risk of £36.1 million from RF2 in April 2016.
- 4.53. In October 2016, CCS's Profit Update Year End & Budget forecast a similar level of hard risk of £171.8 million for 2016, with £149.6 million of hard risk forecast by the end of 2017. Messrs Adam, Howson and Khan attended this presentation.
- 4.54. In January 2017, CCS was reporting in its PRM that hard risk had increased to £258.4 million by the end of December 2016. Mr Howson and Mr Khan attended this PRM.
- 4.55. As a result, the hard risk forecast reported by CCS increased by £61.8 million between January and August 2016 and by a further £85.7 million between August



and December 2016. As explained above, hard risk represented amounts viewed by CCS as unlikely to be recovered. Despite this, no meaningful steps were taken by Messrs Adam, Howson or Khan to understand, assess or address the increasing levels and accumulated values of hard risk being reported to them.

Lack of proper reporting to the Board and the Audit Committee about increasing financial risks and exposures

- 4.56. The significant increases in likely MCS exposures and high levels of hard risk during the second half of 2016 were not highlighted to the Board or the Audit Committee, or set out in Position Papers sent to the external auditors. The Board was regularly updated during this period as to operational developments on major projects, but not their financial impact or the accounting judgements made on individual contracts.
- 4.57. The financial information available to the Board and the Audit Committee about these matters at CCS level during this period was contained in Overtrade Reports. The Overtrade Reports issued to the Board and the Audit Committee between July and December 2016 showed no significant increase in risk for the Group or CCS. In addition, the Overtrade Reports did not provide the Board or the Audit Committee with information about what those within CCS considered were likely exposures – instead the reports showed revenue “*traded not certified*” (i.e. amounts that had not yet been agreed with the client which were reported as being appropriate to recognise as revenue). In these Reports, construction revenue traded but not certified was consistently reported at around £295 million for the Group, as was the equivalent figure for CCS at around £42 to £44 million. These figures do not reconcile with or convey the much higher likely exposures and hard risks described above. No steps were taken by Messrs Howson or Adam to address these matters, despite the fact that Overtrade Reports were appended to the MCSs and the discrepancy in the reporting of these risks would have been readily apparent to them.
- 4.58. In August 2016, a member of the Audit Committee sent an email to Mr Adam (copied to Mr Khan) asking whether contract judgements being made and their linkage to the financial statements could be made clearer because “*trying to assess the judgemental risks/opportunities is difficult*”. It was noted that this would be reviewed going forward, but no substantive changes were made during 2016 or 2017 to the level of information being provided to the Audit Committee.

#### No increase in provisions

- 4.59. The level of provisions against risks associated with major projects was reported to the Board each month as part of the monthly management accounts. Total provisions for the Group reviewed by the Board were consistently maintained at £27.1 million throughout 2016, with other provisions and contingencies increasing this to £50.1 million in total by the 2016 year-end. The amount of provisions and contingencies allocated to CCS remained broadly at £16.9 million. There was no material increase in the size of the provisions or contingency to address the increasing exposures identified in the MCS and the high levels of hard risk internally reported by CCS.

#### **The December Announcement**

- 4.60. The market consensus for Carillion's underlying profit before tax was around £180 million for the 2016 full year. In early December 2016, Carillion was considering how to meet this expectation and was exploring possible one-off transactions or introducing more "stretch" for CCS in order to bridge a perceived Group PBT shortfall of £33 million against market expectations. In the end, the gap was bridged for the Group in part by means of a one-off transaction with an outsourcing supplier, which ostensibly delivered an additional £20 million of profit for 2016. This enabled Mr Adam to report to the Board *"The positive news that our overall expectations for Group profit and earnings are broadly in line with our expectations enabled us to keep the consensus forecasts for total underlying profit and earnings broadly unchanged."*
- 4.61. The trading performance of the Group was discussed at a Board meeting on 6 December 2016, including risks to Carillion's year-end profit forecast. Board members emphasised their reliance upon the *"judgment of the executive"* (i.e. Mr Adam and Mr Howson) in relation to certain major projects, including AWPR, as well as the need to *"understand whether trading performance of the business had deteriorated"*. They were not informed, however, about the increasing exposures in the MCSs or the high levels of hard risk within CCS. No specific consideration was given to possible changes to the proposed wording of the December Announcement, which was approved for release at this Board meeting.

- 4.62. Carillion published its Full Year Trading Update (i.e. the December Announcement) on 7 December 2016. The announcement was headed '*Meeting expectations led by a strong performance in support services*'. It referred to "*expected strong growth in total revenue and increased operating profit*". For Construction Services (excluding the Middle East), Carillion reported that "*We expect a solid revenue performance in this segment, with the operating margin remaining within our target range of 2.5 per cent and 3.0 per cent. This result once again reflects our selective approach to choosing the contracts for which we bid in order to focus on maintaining a healthy operating margin*". In terms of outlook, the announcement stated that Carillion was "*well positioned to make further progress in 2017*". The announcement did not mention or reflect the increasing financial risks being reported within CCS. Carillion's share price fell 3% on the announcement.

### **The March Results Announcement**

- 4.63. At the Board meeting on 26 January 2017, concerns were expressed by two Board members about lack of clarity over the Group's trading performance towards the end of 2016 and the need for transparency and clarity "*particularly if the position had deteriorated in the year*". Mr Khan (now Group FD) noted in response that trading for the last two months of 2016 was in line with forecast. This was broadly consistent with the MPSR Executive Summary for January 2017, which showed no material deterioration in the financial performance of CCS's major projects since the previous quarter.
- 4.64. However, it was not consistent with the MCS in February 2017. This showed a likely exposure of £528.4 million (ahead of any write-offs) for the Group and of £149.2 million for CCS. These exposures excluded any figures for two of the largest contracts within CCS (AWPR and RLUH). At around this time, Infrastructure was estimating a loss equivalent to an exposure of £68 million against its traded margin (-£10 million), and RLUH's Project Team was estimating a likely loss of £56.3 million (which equated to an exposure of almost £68 million against its traded margin). The inclusion of these figures in the MCSs would have increased the likely exposure to £664.4 million for the Group and to £285.2 million for CCS. This was an increase in exposures since December 2016 of £45.7 million for the Group and of £59.4 million for CCS.
- 4.65. Final Position Papers for selected contracts were submitted to the external auditors on 11 January 2017. The margin recorded in these Position Papers was

broadly consistent with the MPSRs prepared for January 2017. The Position Papers did not disclose the increase in hard risk since August 2016, the likely exposures identified against some of these projects in MCSs between July and December 2016, the scale of management adjustments being applied to them, the deterioration in the Project Teams' and Infrastructure's assessment of their financial performance, or variances to peer review recommendations.

- 4.66. On 23 February 2017, the Audit Committee met to review the draft 2016 Annual Report and Accounts. The Group FD's Year-End Report prepared by Mr Khan for this meeting referred to construction revenue traded not certified of £294 million for the Group and of £44 million for CCS, as set out in an appended Overtrade Report. It also identified the key judgements made in relation to certain major projects across the Group (including within CCS) and the claim recoveries and costs savings necessary in order to meet the margins traded for these contracts in Carillion's accounts. The Year-End Report asserted that a total provision of £17 million was appropriate at the year-end for the Construction Services segment (including CCS and Canada). This, when combined with other provisions and contingencies, gave a year-end provision for CCS of £16.9 million.
- 4.67. The Year-End Report did not comment upon the merits of the claims, the likelihood of successfully achieving the recoveries or cost savings, or the Project Teams' and Infrastructure's assessment of deteriorating financial performance in certain major projects. It did not identify the large financial risks associated with them, for example, as reflected in hard risks, the exposures identified in the MCS, the level of management adjustments being applied and variances to peer review recommendations. It was also inconsistent with the appended Overtrade Report with regard to AWPR, insofar as AWPR had a nil value cited in the Overtrade Report compared to a claim of £30 million against the client referenced in the Group FD's Report.
- 4.68. During the meeting, an Audit Committee member commented that the projects were complex and it was difficult to second-guess management judgements. This emphasised the importance of ensuring that those judgements were appropriately made and disclosed to the Audit Committee. It was also acknowledged by Mr Khan at the meeting that there was not a consistent practice between Business Divisions for completing the Overtrade Report and that a new methodology for reporting uncertified balances would be adopted.

- 4.69. The 2016 Annual Report and the March Results Announcement were reviewed by the Audit Committee at its meeting on 23 February 2017, approved at the Board meeting on 28 February 2017 and published on 1 March 2017. There were no material changes in this announcement to the expectations that had been communicated to the market in the December Announcement.
- 4.70. The March Results Announcement was headed '*Performance in line with expectations*'. It referred to revenue of £4,394.9 million for the Group (an increase of 11% from 2015), with PBT of £178 million (a 1% increase from 2015).
- 4.71. The attached document published with the March Results Announcement stated for "*Construction services (excluding the Middle East)*" that "*Revenue grew strongly by 21 per cent to £1,520.2 million (2015: £1,258.3 million), driven by growth in the UK where revenue increased to around £1.5 billion (2015: £1.2 billion), reflecting a number of high-quality contract wins for both infrastructure and building over the last 18 months*". It went on to state that "*Underlying operating profit increased to £41.3 million (2015: £37.8 million) with an operating margin of 2.7 per cent (2015: 3.0 per cent), which remains within our target range of 2.5 per cent to 3.0 per cent*". It described the ambition for 2017 in this business segment was "*to maintain revenue and profit broadly at their current levels*".
- 4.72. The Chairman's statement in the March Results Announcement stated that Carillion had a "*good platform from which to develop the business in 2017. We will accelerate the rebalancing of our business into markets and sectors where we can win high-quality contracts and achieve our targets for margin and cash flows, while actively managing the positions we have in challenging markets*". The statement about "*challenging markets*" was a reference to markets in the Middle East and Canada. There was, however, no reference to challenges in UK construction contracts.
- 4.73. Market analyst reports following the March Results Announcement broadly noted that the results were in-line with expectations, with a focus on debts and the performance of projects in support services, the Middle East and Canada. Following the announcement, Carillion's share price fell by 5%.

## SECTION E: RECOGNITION OF THE NEED FOR A PROVISION

### Events following publication of the 2016 year-end results

- 4.74. By March 2017, the hard risk for CCS reported to Messrs Howson and Khan had increased to £310.6 million. This was an increase of £137.9 million since the total level of CCS hard risk, as at 31 December 2016, was forecast in August 2016 and £52.2 million since hard risk, as of 1 January 2017, was reported at the CCS PRM on 18 January 2017.
- 4.75. During April and early May 2017, the position continued to worsen. An MCS dated 4 May 2017 showed a likely exposure against contentious amounts due of £872.3 million for the Group and £431.9 million for CCS (representing 71% of the contentious amounts due to CCS). This was an increase to the likely exposure of £207.9 million for the Group and of £146.7 million for CCS since February 2017.
- 4.76. A significant change in Carillion's debt position was reported to and discussed at a Board meeting on 3 May 2017. Concerns were raised by Board members during the course of that discussion that trading was *"going backwards"*, a *"significant number of major contracts were deteriorating"* and there were *"too many problem contracts"*.
- 4.77. Later that same day, Carillion issued its AGM Statement (the May Announcement) under the headings *"Trading conditions unchanged"* and *"Positive work winning performance"*. The May Announcement stated that:
- "Trading conditions across the Group's markets have remained largely unchanged since we announced our 2016 full-year results in March. Consequently, we continue to focus on the priorities we set out when we announced our 2016 results, namely to accelerate the rebalancing of our business into markets and sectors where we can achieve our objectives for margins and cash flows; and to manage challenging contract positions, particularly in our international markets, as these are key to achieving our objective of reducing average net borrowing."*
- 4.78. The reference to *"challenging contract positions"* was aimed at highlighting the deterioration in the financial performance of Carillion's contracts. As with the March Results Announcement, however, the statement was explicitly linked to Carillion's overseas markets, not the UK, and so gave the misleading impression that trading conditions in the UK market had not deteriorated.

- 4.79. Following the announcement there was some market commentary relating to challenging contracts in the Middle East, and the share price fell by 5%.

### **Negative accruals**

- 4.80. During April and May 2017, additional concerns were raised within CCS that *"the level of risk which is being held in the balance sheet appears too large relative to the size of the business"*. These concerns were prompted by the discovery of the use of negative accruals within CCS, a practice that was generally prohibited in Carillion's accounting policies.
- 4.81. Negative accruals (as prohibited by Carillion) describes the practice of using the value of claims to reduce costs accounted for on a project, instead of recognising the claim as revenue. This practice can be neutral from an accounting perspective because the profitability of a project should remain the same, whether the claim is recognised as a reduction to cost or an increase to revenue. Within Carillion, however, accounting judgements around claims were reported and assessed internally and to external auditors in the context of revenue recognition, not costs. This enabled negative accruals to be used on certain major projects within CCS to reduce costs by means of overly aggressive judgements on claim recoveries without disclosing that fact in Position Papers seen by the external auditors. For example, a claim for £8 million might have been recognised at the 2016 year-end, of which £5 million was recognised as revenue and £3 million as a negative accrual that reduced costs. The external auditors would only see a value of £5 million for the claim (i.e. the part recognised as revenue), not the additional £3 million recognised by means of the negative accrual. In this way, the profitability on these projects could be maintained without subjecting the overly aggressive accounting judgements being used to appropriate scrutiny.
- 4.82. An email sent by an individual within CCS in April 2017 explained the use of negative accruals as follows:

*"Our profit targets have mean [sic] that we have not been able to write these back to their correct positions. In order to get through audit with a justifiable route-map we have had to suppress costs. This has, unfortunately been done by applying negative accruals. Generally any overtrading we do push through is via revenue adjustments rather than through costs but in these cases we couldn't produce a position paper that would get through audit. We asked the sites to*

*produce a "clean" version of the position paper so that we had full visibility of the adjustments that were being made."*

- 4.83. An internal Carillion investigation into the use of negative accruals was commenced in April 2017, at which point Messrs Howson and Khan were informed. The investigation reported initial findings to Messrs Howson and Khan on 7 May 2017 (four days after the May Announcement). It identified that the majority of negative accruals related to four major contracts (including RLUH, Battersea and AWPR) and amounted to a total of £102 million. It also identified that Business Units had used negative accruals on certain contracts in CCS in response to pressure to *"hold the position [i.e. profit margin]"*. This was a reference to the pressure to meet financial targets imposed on CCS described at paragraph 4.13 above.
- 4.84. On 9 May 2017, the Board was informed about the use of negative accruals and a Board sub-committee was set up to oversee the internal investigation into their use. As part of the investigation, the negative accruals were reversed so that the full value of claims recognised at the 2016 year-end could be properly assessed in order to determine whether or not a prior year adjustment was required. The effect of reversing the negative accruals significantly increased the reported costs of the projects and required much more value from claims to be recognised as revenue in order to justify their originally reported year-end margin. Using the above example of a claim for £8 million, the effect of reversing the negative accrual meant that Carillion had to justify recognising the full £8 million of the claim as revenue, not £5 million as originally disclosed internally and to the external auditors. In its investigation, Carillion sought to justify the 2016 year-end position by significantly increasing the value of certain claims and in some cases introducing new claims or revenue streams that were said to have been in management's mind as at the year-end (albeit not recorded in the original Position Papers in December 2016).
- 4.85. Following the conclusion of this investigation, the Board concluded on 23 May 2017 that the value, costs and margin recognised at the 2016 year-end for each contract could be justified following the investigation and there was therefore no need to restate the 2016 year-end accounts. A lessons learnt report subsequently submitted to the Board noted that *"Management need to be aware that high-level instructions such as that to "hold the position" (i.e. maintain the traded margin) may, if crudely implemented, have unintended consequences."*



## **Enhanced Contracts Review**

- 4.86. By late May / early June 2017, Carillion recognised that the deterioration in the financial performance of its projects and increasing debt position meant it needed to raise additional capital. It explored the possibility of a rights issue. As part of any rights issue, Carillion was advised that it should de-risk its balance sheet. This essentially meant reviewing the values of assets on its balance sheet, including any values recognised in its accounts associated with variations or claims on construction projects across the Group, and writing off any values deemed to be at risk of non-recovery. This became known as the "Enhanced Contracts Review".
- 4.87. The Enhanced Contracts Review took place over June and early July 2017. It involved a review of 58 projects across the Group representing £1.58 billion of receivables and 47% of Group revenue for the period ending 31 May 2017. The review considered all aspects of the projects, including the judgements made on each project in relation to variations or claims included in estimated end of life forecasts.
- 4.88. The review was conducted with assistance from the external auditors, who do not appear to have been provided with details of hard risks, MCS exposures or peer reviews. It concluded that the traded value of a number of projects in Carillion's construction business exceeded the commercial assessment of those positions. It identified a possible exposure of between £378 million and £693 million, and recommended a provision of £695 million. Given the magnitude of the proposed impairment, the external auditors asked Carillion to consider whether any of the proposed provisions required a prior year adjustment to its 2016 results. Carillion's management, including Mr Khan, considered 11 major contract positions to assess whether there was evidence that should have been obtained and considered in preparing the Group's 2016 year-end results ahead of their publication on 1 March 2017. Carillion produced a paper assessing the issues that gave rise to the provision on these projects and considered whether those issues were known as at 31 December 2016. It concluded that the challenges on these projects had crystallised after publication of the 2016 results and no prior year adjustment was required.
- 4.89. The recommended provision of £695 million was reported to the Audit Committee at its meeting on 9 July 2017. The provision across CCS projects was £375 million. Even with a provision at that level, certain projects retained values being traded

that were identified as being at risk. The decision was therefore taken to increase the provision to £845 million to address those risks, which was later allocated to specific projects in September 2017. No prior year adjustment was made.

### **Trading update on 10 July 2017**

- 4.90. On 9 July 2017, the Board approved the Audit Committee's recommendation. On 10 July 2017, Carillion announced the contract provision of £845 million as part of a trading update, with £375 million being attributed to the UK and £470 million attributed to overseas markets. It stated that the majority of the overseas provision related to exiting markets in the Middle East and Canada.
- 4.91. Carillion's share price fell 39% that day, and within three days had fallen by a total of 70%.
- 4.92. In the provision announced by Carillion on 10 July 2017, the four largest provisions within CCS were as follows:
- (1) RLUH: £68 million.
  - (2) Battersea: £38 million.
  - (3) AWPR: £86 million.
  - (4) MMH: £48 million.

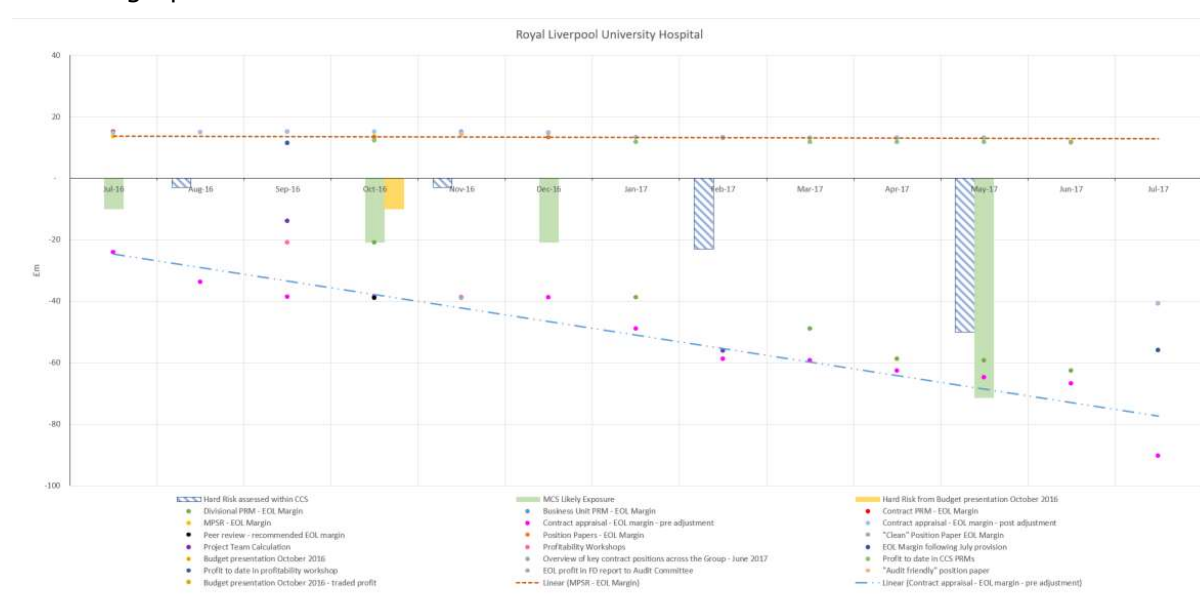
## **SECTION F: THE LARGEST WRITE-DOWNS ON UK MAJOR CONTRACTS**

### **RLUH**

- 4.93. RLUH was a project to construct a new PFI hospital located on the existing Royal Liverpool University Hospital site. It started in February 2014 and was originally forecast to be completed in March 2017. The project was operated by the Buildings Business Unit within CCS.
- 4.94. The tender value of the project was £286 million, with an estimated end of life profit margin of £10.2 million (or 3.56%).
- 4.95. Despite significant delays in the project in 2015 and 2016, Carillion had increased the end of life margin forecast associated with this project to £13.6 million (or 4.6%) by July 2016. The increased margin was maintained by the use of management adjustments, increasing from £38.9 million in July 2016 to almost

£72 million by February 2017. During most of the Relevant Period, the Board and the Audit Committee were not aware of the scale of management adjustments and the divergence between the internal reporting within CCS and what was being reported to them in relation to RLUH's financial performance.

- 4.96. There were significant and increasing divergences between (on the one hand) the Project Team's views on RLUH's financial position and the financial risks reported by CCS to Messrs Adam, Howson and Khan; and (on the other hand) those reflected in budgeted forecasts and/or reported to the Board and the Audit Committee during the Relevant Period. These are illustrated in the following graph:



Graph 1 - Each point on the graph shows the end of life (EOL) margin and/or traded to date margin recorded in various reports pertaining to RLUH as variously reported to Building, CCS, the executive directors, the Board, the Audit Committee and/or the external auditors. The orange and blue trend lines illustrate the increasing divergence of views across the year between the position as assessed by the Project Team and/or in peer reviews (blue line); and the view post-management adjustments reflecting the budgeted forecasts and/or reported to the Board, the Audit Committee and the external auditors (orange line). The graph also shows the level of hard risk reported in hard risk schedules and the "likely" exposure to traded amount reported in the Major Contract Summaries.

- 4.97. This divergence between the internal reporting within CCS and the reporting to the Board and the Audit Committee in the second half of 2016 is summarised below:

#### *The Project Team's assessments*

- (1) The Contract Appraisals and other commercial reports prepared by the Project Team from July to December 2016 reported a deteriorating end of

life margin loss for RLUH and increasing use of management adjustments to achieve the forecast profit margin of 4.9%.

- (2) In September 2016, the Project Team sent a spreadsheet by email to Mr Howson and certain Business Unit and Divisional management summarising what it saw as the realistic end of life position for RLUH. This identified a *"clean end out forecast position"* of a £50 million loss on the project, with *"realistic"* recovery targets potentially reducing this to a £14 million loss and other potential benefits further reducing it to an £8 million loss. Mr Howson forwarded the email and attached spreadsheet to Mr Adam and Mr Khan.
- (3) The Project Team's end of life margin forecast for RLUH was reported by CCS as a £21 million loss in a *"profitability workshop"* in September 2016. The same figure was highlighted in a CCS PRM in October 2016. Messrs Adam, Howson and Khan attended both of these meetings.
- (4) By November 2016, the Contract Appraisal was reporting an end of life forecast loss of £38.7 million (or -12.6%) before any management adjustments. This assessment was confirmed by a peer review in November 2016, which noted the use of management adjustments to maintain the profit margin and described this as *"extremely ambitious and would mean full success with all claims identified"*.

*CCS's reporting to Messrs Adam, Howson and Khan*

- (5) CCS reported the Project Team's views internally as described above. At the profitability workshop in September 2016 attended by Messrs Adam, Howson and Khan, CCS reported that for RLUH a 4.7% margin (equivalent to an £11.3 million profit) had been traded to date (i.e. recognised in Carillion's financial reporting) compared to the £21 million loss assessed by the Project Team. The presentation indicated that the Project Team had been challenged to achieve *"breakeven"* (i.e. no profit or loss).
- (6) At the CCS PRM in October 2016 attended by Messrs Adam, Howson and Khan, the margin traded for RLUH to date was reported by CCS as being £12.2 million compared to the Project Team's assessment of a £21 million loss (a difference of £33.2 million). The presentation highlighted hard risk of £10 million against RLUH, having previously been assessed at £3 million

in April 2016 and £7 million in August 2016. Shortly after the year-end, this was further increased to £23 million.

- (7) The July 2016 MCS reported a "*likely*" exposure to traded amount of £10 million for RLUH and assigned a "*Red*" flag status to the project. In the October and December 2016 MCSs, this had increased to £21 million with a "*Red*" status. This represented 100% (i.e. the full amount) of the contentious amounts identified as due in these MCSs. Mr Howson received the July and October 2016 MCSs. Mr Adam and Mr Khan received these and the December 2016 MCS, as well as attending the MCRMs at which these MCSs were discussed.

*Reporting to the Board and the Audit Committee*

- (8) The MPSR Executive Summaries, Overtrade Reports, CEO and Group FD's reports to the Board and/or the Audit Committee did not reflect the Project Team's assessments or peer review recommendation as to the financial performance of RLUH. They also did not highlight the financial risks associated with RLUH, including the level of management adjustments being applied or the hard risks and MCS exposures internally reported by CCS. To that extent, they omitted highly material and relevant information concerning RLUH's financial performance during the Relevant Period. Instead, the MPSR Executive Summaries maintained an end of life forecast profit of £13.6 million in July and October 2016 and of £13.2 million in January 2017 for RLUH and the Overtrade Reports identified £6 million or £8 million only as revenue traded not certified.
- 4.98. Ahead of the 2016 year-end, two versions of the RLUH Position Paper were produced by Building: a "*clean*" version reflecting the Project Team's assessment of a £38.7 million loss (-12.6% margin) and an "*audit friendly*" version incorporating management adjustments of £53 million to meet the forecast end of life profit of £14 million (4.44% margin). The "*audit friendly*" version was used for the purpose of the audit of Carillion's 2016 Annual Report and Accounts as announced on 1 March 2017; the external auditors were not provided with the "*clean*" version of the Position Paper.
- 4.99. The final version of the Position Paper submitted to the external auditors for the 2016 year-end accounts showed a slightly reduced end of life margin of £13.2 million (or 4.42%), with costs of £286.1 million. It recognised £25.4 million as

revenue to be recovered from claims (excluding any additional claim amounts recognised by means of negative accruals). As at the end of December 2016, all of these claims (which were not subject to formal legal proceedings at that stage) were disputed or no response had been received. Their progress was not sufficient to be deemed as "*reasonably certain*" (as per Carillion's internal policies) or "*probable*" (as per IAS 11) to be recovered. No revenue should have been recognised in relation to them.

- 4.100. At the CCS PRM on 18 January 2017, the Business Unit reported the Project Team's estimated loss of £39 million (-13%) as at November 2016, with a management adjustment of £53.9 million applied to help achieve a traded to date margin of 4.7% (£11.7m). Messrs Howson and Khan attended this PRM.
- 4.101. The February 2017 MCS excluded any figures for RLUH and it was given a "Red" flag status. Mr Khan received this MCS and attended the MCRM at which it was discussed.
- 4.102. On 8 February 2017, the Project Team sent a briefing on RLUH to Mr Howson and certain Business Unit and Divisional management. It was sent ahead of a RLUH presentation at a CCS PRM on 10 February 2017, which Mr Howson and Mr Khan attended. This included a financial analysis reporting a "*realistic*" estimated loss of £56.3 million for RLUH as at 2 February 2017, with a "*best case*" loss of £43 million and "*worst case*" loss of £76.1 million.
- 4.103. This information was not communicated to the Board or the Audit Committee. The RLUH MPSR for January 2017 was consistent with the final Position Paper submitted to the external auditors in reporting an estimated end of life margin of 4.4% (or profit of £13.2m). The Group FD's Report submitted to the Audit Committee meeting on 23 February 2017 referred to the need to achieve £25.5 million recoveries in relation to claims to achieve the forecast end of life margin of 4.44%. In their Audit Memorandum presented to the meeting, the external auditors noted that "*management [remain] confident of full recovery [on RLUH] due to the number of routes available*". No reference was made to the Project Team's assessments of a significant loss, the scale of management adjustments being applied, hard risks or MCS exposures, about which the Audit Committee and the external auditors remained unaware.
- 4.104. On 1 March 2017, Carillion announced its 2016 financial results in its March Results Announcement. The cost, value and margin recognised for RLUH as part

of the figures released in this announcement reflected the final Position Paper provided to the external auditors in January 2017, with costs of £286.1 million and a forecast end of life margin of 4.42% (i.e. a profit of £13.2 million). The recognition of these amounts meant that the revenue and profit / margin figures for the Group and Construction Services (excluding the Middle East) in the March Results Announcement were materially misstated due to an understatement of costs and the recognition of claims as revenue in non-compliance with Carillion's internal policies and IAS 11.

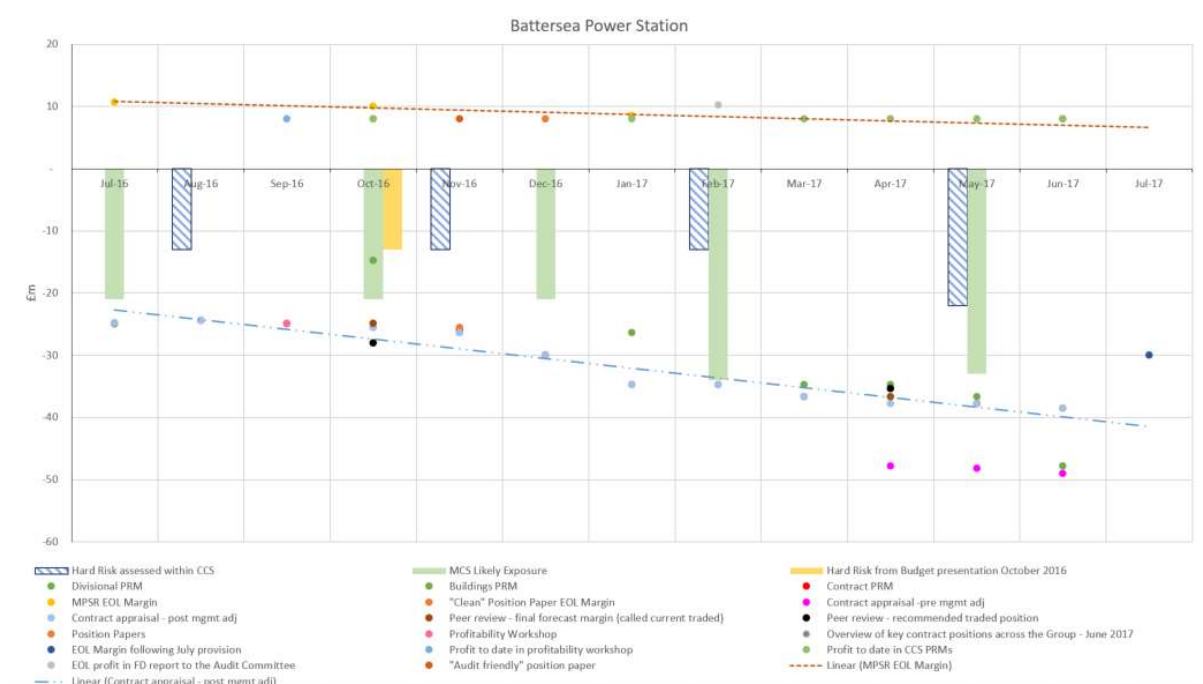
- 4.105. The financial performance of RLUH as reported internally continued to deteriorate after March 2017. The Project Team's forecast of a £49 million loss (-16.4%) as at January 2017 was reported in the CCS PRM in March 2017, with a management adjustment of £61.5 million being applied to help achieve a traded to date margin of £11.7 million (4.6%). The CCS PRM in April 2017 reported that the Project Team was estimating a loss of almost £60 million on RLUH as at February 2017, with a management adjustment of almost £65 million being applied to help support a traded to date margin of £11.7 million (4.5%). These traded to date margins were equivalent to an end of life margin of over £13 million. Messrs Howson and Khan attended both of these PRMs. At around the same time, the hard risk on RLUH was increased to £50 million. The MCS in May 2017 identified a likely exposure of £71.5 million for RLUH. None of these matters were reported to the Board or the Audit Committee.
- 4.106. The MCS exposure of £71.5 million was reflected in CCS's reporting at a PRM attended by Messrs Howson and Khan on 19 May 2017, which referred to the Project Team estimating a loss of £59.3 million, with a management adjustment of £67 million to help support a traded to date profit of £11.7 million as at March 2017.
- 4.107. On 7 June 2017, the Board held a strategy meeting attended by Messrs Howson and Khan. At this meeting, Mr Howson presented an *"Overview of Key Contract Positions across the Group"*. In the presentation, RLUH was reported as having a forecast end of life margin of £11.7 million (3%). This was expressly stated as including claims in the forecast traded at 100% (i.e. the entirety of the claim values was recognised in the forecast). At the CCS PRM on 22 June 2017 attended by Messrs Howson and Khan, the Project Team's estimated loss was reported as being £62.6 million, with a management adjustment of £74 million to help achieve a traded to date profit figure of £11.7 million as at April 2017.

- 4.108. Following the Enhanced Contracts Review, £68 million was provided against RLUH. This amount formed part of the contract provision of £845 million announced by Carillion on 10 July 2017.

### **Battersea**

- 4.109. Battersea was a project to design and build a mixed-use development including 866 apartments, leisure facilities and retail units. The contract was signed on 27 December 2013 with an original contract completion date in September 2016.
- 4.110. The contract was tendered at a value of £443.7 million with a 0% profit margin.
- 4.111. Carillion encountered a number of issues with the Battersea contract in 2015 and 2016, which caused significant delays to the project. These issues in large part arose from pressure caused by the client issuing a large volume of variations to the work and the late provision of key utilities to the work site.
- 4.112. By January 2016, there had been a contract reset on Battersea which increased the contract value to £472.4m and extended the contract completion date to 24 March 2017.
- 4.113. In July 2016, Carillion reported a positive end of life margin of £10.7 million (2.2%) in the MPSR Executive Summary for Battersea. This increase in value was partially attributed to a claim of £11.5 million for a further reset ("Reset 2"). By contrast, the Project Team estimated a forecast for an end of life loss of £24.7 million (-5%) in July 2016. This gap continued to increase during the Relevant Period and was bridged by means of large management adjustments, rising from a management adjustment of £28.6 million in July 2016 to around £34 million in December 2016. The Board and the Audit Committee were unaware of the scale of management adjustments and the divergence between the internal reporting within CCS and what was being reported to them in relation to Battersea's financial performance.
- 4.114. There were significant and increasing divergences between (on the one hand) the Project Team's views on Battersea's financial position and the financial risks reported by CCS to Messrs Adam, Howson and Khan; and (on the other hand) those reflecting budgeted forecasts and/or reported to the Board and the Audit Committee throughout the Relevant Period. These are illustrated in the following graph:





Graph 2 - Each point on the graph shows the end of life (EOL) margin and/or traded to date margin recorded in various reports pertaining to Battersea Power Station as variously reported to Building, CCS, the executive directors, the Board, the Audit Committee and/or the external auditors. The orange and blue trend lines illustrate the increasing divergence of views between the position as assessed by the Project Team and/or in peer reviews (blue line); and the view reflected in budgeted forecasts and/or reported to the Board, the Audit Committee and the external auditors (orange line). The graph also shows the level of hard risk reported in hard risk schedules and the "likely" exposure to traded amount reported in the Major Contract Summaries.

4.115. This divergence between the internal reporting within CCS and the reporting to the Board and the Audit Committee in the second half of 2016 can be summarised as follows:

#### *The Project Team's assessments*

- (1) The Contract Appraisals prepared by the Project Team from July to December 2016 reported a deteriorating end of life margin loss for Battersea. Increasing levels of management adjustments were applied to the current traded value and costs to maintain a positive current traded margin of just over 2% (a current traded profit margin of £8 million and equating to an end of life profit of around £10 million). By December 2016, the Project Team's forecast in the Contract Appraisal had worsened to a

forecast end of life loss of £30 million, end of life costs of £534.7 million and a management adjustment of just under £34 million to maintain the current traded margin of £8 million (or 1.8%). In October 2016, a peer review report on Battersea recommended recognising an end of life loss of £28 million.

- (2) The Contract Appraisals and peer review report were not seen by Messrs Adam or Howson, but they were aware of the Project Team's assessments by alternative means. In September 2016, the Project Team's end of life margin forecast for Battersea was reported by CCS as a £25 million loss in a "*profitability workshop*". An estimated £14.8 million loss was highlighted in a CCS PRM in October 2016. Mr Adam and Mr Howson attended both of these meetings.

*CCS's reporting to Messrs Adam and Howson*

- (3) CCS reported the Project Team's views internally as described above. At the profitability workshop in September 2016, CCS reported that Battersea had a traded margin of 2.1% to date (equivalent to just over £8 million) compared to the Project Team's projected end of life loss of £25 million, and that the Project Team had been challenged to achieve "*breakeven*" (i.e. no profit or loss).
- (4) At the CCS PRM in October 2016, CCS reported the margin traded to date on Battersea as being £8 million compared to the Project Team's assessment of a £14.8 million loss (a difference of £22.8 million). The presentation also highlighted hard risk of £13 million against Battersea, the same as previously internally reported for that project.
- (5) The July, October and December 2016 MCSs reported a "*likely*" exposure of £21 million for Battersea, and assigned a "*Red*" flag status to the project. This exposure represented 53% of the contentious amounts of £39.9 million identified in the MCSs as due on Battersea. Messrs Howson, Adam and Khan received the July and October MCSs. Mr Adam and Mr Khan also received the December MCS and attended the MRCMs at which all of the above MCSs were discussed.

*Reporting to the Board and the Audit Committee*

- (6) The MPSR Executive Summaries, Overtrade Reports, CEO and Group FD's reports presented to the Board and the Audit Committee did not reflect the Project Team's views or peer review recommendation as to Battersea's financial performance. They also did not highlight the financial risks associated with Battersea, including the level of management adjustments being applied or the hard risks and MCS exposures reported by CCS. To that extent, they omitted highly material and relevant information concerning Battersea's financial performance during the Relevant Period.
- (7) Instead, during the Relevant Period the MPSR Executive Summaries showed only a minor deterioration in end of life margin from £10.7 million (or 2.2%) in July 2016 to £10.1 million (or 2%) in October 2016 and £8.6 million (or 1.7%) in January 2017. The Overtrade Reports similarly only identified a small increase in revenue traded not certified, from £4 million in July 2016 to £6 million in December 2016.
- 4.116. At the 2016 year-end, two sets of figures were produced when drafting the Position Papers for the external auditors as described at paragraph 4.46 above, including for Battersea. The "*clean*" Position Paper for Battersea reported a forecast end of life loss of £25.6 million; the "*audit friendly*" version incorporated adjustments to maintain a positive end of life margin of £8 million, a difference of £33.6 million.
- 4.117. The final version of the Position Paper for Battersea submitted to the external auditors for the 2016 year-end accounts reflected the "*audit friendly*" version. It recognised £28.6 million of revenue by means of claims, an increase of over £21 million compared to the amount of £7 million for claims recognised in the "*clean*" Position Paper. The claim figure of £28.6 million appears to reflect sums associated with Contract Reset 2. At 31 December 2016, it was not "probable" that Contract Reset 2 would be approved nor was it supported by "*a client written instruction*" (as per IAS 11 and Carillion's own policies). Therefore, no revenue should have been recognised in relation to Contract Reset 2. The Position Paper for Battersea reported end of life costs of £516.4 million, £18.3 million lower than the Project Team's view at that time.
- 4.118. At the January CCS PRM on 18 January 2017, the Business Unit reported the Project Team's estimated loss of £26.3 million (-5.2%) as at November 2016, with

a management adjustment of £31.2 million to help achieve a traded to date margin of £8 million (or 1.9%). Messrs Howson and Khan attended this PRM.

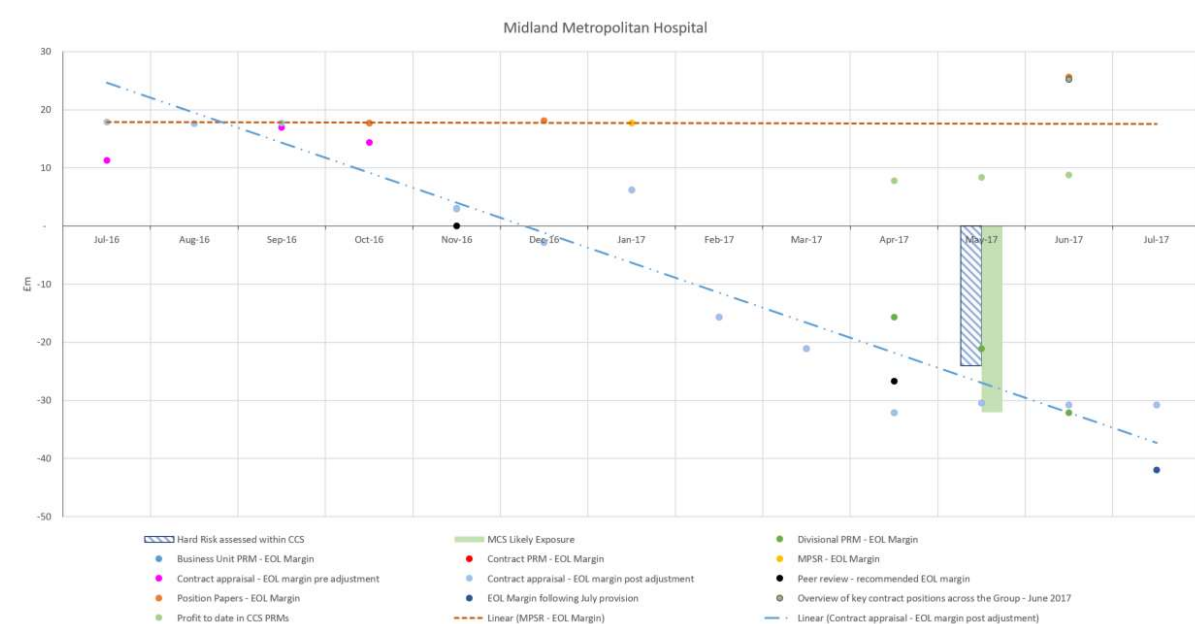
- 4.119. The February 2017 MCS showed a "likely" exposure to traded amount of £34 million (an increase of £13 million from December 2016) and a "Red" flag status was indicated. Mr Khan received this MCS and attended the MCRM at which it was discussed.
- 4.120. The Group FD's Report submitted to the Audit Committee meeting on 23 February 2017 referred to the need to achieve £28.6 million recoveries in relation to claims, which they expected to deliver through a contract reset to achieve the forecast end of life margin of 2.0% (equivalent to £10.1 million). In their Audit Memorandum presented to the meeting, the external auditors noted that "*Carillion no longer need to achieve £19.3 million in future cost savings, instead management is targeting an additional £28.6 million recovery from the client through a second reset*". No reference was made to the Project Team's assessment of a significant loss, the scale of management adjustments being applied, hard risks or MCS exposures, about which the Audit Committee and external auditors remained unaware.
- 4.121. On 1 March 2017, Carillion announced its 2016 financial results in its March Results Announcement. The cost, value and margin recognised for Battersea as part of the figures released in this announcement reflected the final Position Paper provided to the external auditors in January 2017, with a forecast end of life margin of 1.5% (i.e. a profit of just over £8 million). The recognition of these amounts meant that the revenue and profit / margin figures for the Group and Construction Services (excluding the Middle East) in the March Results Announcement were materially misstated due to the inclusion of £28.6 million associated with the contract reset in revenue and the understatement of costs, which should have more closely reflected the Project team's view of £534.7 million as opposed to the figure of £516.4 million traded in Carillion's accounts. This overstatement of revenue and understatement of costs was not in compliance with Carillion's internal policies or IAS 11.
- 4.122. The financial performance of Battersea did not improve after March 2017. A peer review in April 2017 confirmed the Project Team's forecast of an end of life loss of £35 million (-6.9%). It stated that, in the absence of the Contract Reset 2, the position would worsen by a further £15 million.

- 4.123. At the CCS PRMs in March and April 2017 (showing January and February 2017 figures), the Project Team reported an increased estimated loss of £34.8 million for Battersea. Management adjustments of over £39 million were applied to help bring the end of life back to a traded to date margin of £8 million (1.7%). This was equivalent to an end of life margin of around £8.5 million. Messrs Howson and Khan attended both of these PRMs.
- 4.124. By the end of April 2017, the Project Team was estimating an end of life loss of almost £47.8 million on Battersea, with a management adjustment of £42.7m applied to maintain the current profit margin of £8 million. At around the same time, the hard risk on Battersea was increased from £13 million to £22 million. The MCS in May 2017 identified a likely exposure of £33 million for Battersea. None of these matters were reported to the Board or the Audit Committee.
- 4.125. At the CCS PRM in May 2017 attended by Messrs Howson and Khan, the Project Team's reported estimates had worsened to a forecast loss of £36.6 million, with a £41.5 million management adjustment being applied to support a traded profit to date of £8 million as at March 2017.
- 4.126. On 7 June 2017, the Board held a strategy meeting attended by Messrs Howson and Khan. At this meeting, Mr Howson presented an *"Overview of Key Contract Positions across the Group"*. In the presentation, Battersea was reported as having a forecast end of life margin of £8 million (1.5%). This was expressly stated as including claims in the forecast traded at 100% (i.e. the entirety of the claim values was recognised in the forecast). At the CCS PRM on 22 June 2017 attended by Mr Howson and Mr Khan, the Project Team was estimating a £47.8 million loss, with a management adjustment of £42.7 million required to support a traded to date figure of £8 million as at April 2017.
- 4.127. Following the Enhanced Contract Review, £38 million was provided in relation to Battersea. This amount formed part of the contract provision of £845 million announced by Carillion on 10 July 2017.

## **MMH**

- 4.128. MMH was a project to construct a new PFI hospital in the West Midlands. The contract started on 11 December 2015, with an original completion date of 20 July 2018.

- 4.129. The contract was tendered at a value of £296.7 million at a 5.97% margin (or £17.7 million).
- 4.130. The period between Carillion bidding for MMH and financial close on 11 December 2015 was the shortest in Carillion's history.
- 4.131. The progress of MMH was disrupted at an early stage by two main issues:
- (1) Problems with the design and procurement processes arising from a short bid period; and
  - (2) Adverse weather, with heavy rainfall flooding parts of the building under construction, impacting on productivity.
- 4.132. As of July 2016, MMH was nine weeks behind the target construction programme as a result of the issues referenced above.
- 4.133. Despite the delay to the progress of MMH, Carillion was reporting in the MPSR Executive Summary for July 2016 that MMH had an estimated end of life margin of 6%, equating to £17.9 million. This forecast was not supported by the Project Team, who in the July 2016 Contract Appraisal for MMH reported a deterioration in the end of life margin to 3.8% (£11.3 million). Notwithstanding this, the end of life margin of £17.9 million was maintained by use of a management adjustment of £6.6 million.
- 4.134. From November 2016, there were significant and increasing divergences between (on the one hand) the Project Team's views on MMH's financial position and the financial risks internally reported by CCS; and (on the other hand) those reflecting budgeted forecasts and/or reported to the Board and the Audit Committee. This is illustrated in the following graph:



Graph 3 - Each point on the graph shows the end of life (EOL) margin and/or traded to date margin recorded in various reports pertaining to MMH as variously reported to Building, CCS, the executive directors, the Board, the Audit Committee and/or the external auditors. The orange and blue trend lines illustrate the increasing divergence of views across the year between the position as assessed by the Project Team and/or in peer reviews (blue line); and the view reflected in budgeted forecasts and/or reported to the Board, the Audit Committee and the external auditors (orange line). The graph also shows the level of hard risk reported in hard risk schedules and the "likely" exposure to traded amount reported in the Major Contract Summaries.

4.135. This divergence between the internal reporting within CCS and the reporting to the Board and the Audit Committee during the latter part of 2016 is summarised below:

- (1) The Contract Appraisals from October to December 2016 reported a deteriorating end of life margin for MMH, culminating in a forecast of an end of life margin loss of £2.8 million (-0.9%) and a current traded margin loss of £0.8 million (-0.9%) in December 2016. These margins reflected increasing costs from £283 million to £304.8 million. Increasing levels of management adjustment were applied, principally to the current traded figures during this period to maintain a current traded margin of 6% to 6.6% (approximately £6.5 million).
- (2) A peer review report dated 8 November 2016 recommended an end of life margin of £nil and that no further margin should be traded on MMH until detailed designs had been provided and procurement issues had been substantially advanced.

- (3) The MPSR Executive Summaries to the Board and/or Audit Committee for July and October 2016 did not reflect the Project Team's assessments or peer review recommendation as to the financial performance of MMH. Instead, they consistently maintained an end of life forecast profit of around £17.9 million (6%) for MMH.
- 4.136. The "*clean*" and "*audit friendly*" versions of the Position Paper for MMH were the same and did not contain similar adjustments to those for RLUH and Battersea (see paragraph 4.46 above). Both versions showed an end of life margin of £17.7 million (6%), with costs of £280.3 million and revenue of £298 million.
- 4.137. The final version of the Position Paper for MMH submitted to the external auditors for the 2016 year-end accounts was materially the same as the "*clean*" and "*audit friendly*" versions, with a small increase in costs (to £284 million), revenue (to £302 million) and forecast end of life margin (to £18.1 million). The true costs were, however, closer to £304.8 million as reported by the Project Team (i.e. almost £21 million more than reported in the Position Paper). This meant that the profit recognised on MMH at the 2016 year-end was not in accordance with IAS 11 and was materially misstated.
- 4.138. The January MPSR was broadly consistent with the Position Paper and referred to an end of life profit margin for MMH of 6%, which amounted to £17.7 million. By contrast, the Commercial Report for the CCS PRM in January 2017 identified MMH as amongst the top five projects within Building with the biggest deterioration in end of life margin. It reported that MMH's end of life margin had deteriorated from 6% in December 2015 to 4.8% in October 2016 to 1% in November 2016.
- 4.139. The Contract Appraisal for January 2017 incorporated a "*Margin Improvement Plan*" that provided for £15.5 million of claim recoveries. This had the effect of taking the end of life forecast margin to £6.2 million (2%). This was not consistent with the deterioration reported at the January CCS PRM above. The Contract Appraisal in February 2017 reversed these changes and showed a forecast end of life loss of £15.7 million (-5.2%), with a management adjustment of £12.9 million applied to help maintain a forecast profit margin of just under £18 million.
- 4.140. On 1 March 2017, Carillion announced its 2016 financial results in its March Results Announcement. The cost, value and margin recognised for MMH as part of the figures released in this announcement reflected the final Position Paper provided to the external auditors in January 2017, with costs of £284 million and



a forecast end of life margin of 6% (assessed as a profit of just over £18 million). This was a material misstatement of MMH's financial position due to the level of costs recognised, which should have more closely reflected the Project Team's estimate of £304.8 million. The understatement of costs was not in compliance with Carillion's internal policies or IAS 11.

- 4.141. The internal reporting about the financial performance of MMH continued to diverge in the second quarter of 2017. By April 2017, a Peer Review report stated that MMH was 10 weeks behind schedule and recommended that the traded margin should be a loss of £26.7 million, including recommended end of life costs of £330 million. By the end of April 2017, the Project Team reported an estimated end of life loss of £32.1 million (-10.6%). The forecast end of life costs had risen at this stage to £334 million. A management adjustment of almost £20 million was applied to the current traded margin for MMH to take it from a loss of £11.2 million (-10.6%) to a profit of £8.8 million (6.1%).
- 4.142. In April 2017, it was reported at a CCS PRM (attended by Messrs Howson and Khan) that the Project Team was forecasting a £15.7 million loss as at February 2017, with a management adjustment of £12.9 million applied to help maintain a traded to date profit margin of £7.8 million (consistent with an end of life margin of over £17.7 million).
- 4.143. MMH first appeared on the hard risk schedule in April 2017 as a new and emerging risk of £24 million. It also appeared for the first time in the MCS in May 2017. It was recorded with a "likely" exposure to traded amount of £32 million and a "Red" flag status was applied.
- 4.144. At the CCS PRM in May 2017 (attended by Messrs Howson and Khan), it was reported that the Project Team was estimating a loss of £21 million, with a management adjustment of £15.7 million being applied to support a traded profit to date of £8.4 million as at March 2017.
- 4.145. On 7 June 2017, the Board held a strategy meeting (attended by Messrs Howson and Khan). At this meeting, Mr Howson presented an "Overview of Key Contract Positions across the Group". In the presentation, MMH was reported as having a forecast end of life margin of £25.2 million (7%). This was expressly stated as including claims in the forecast traded at 100% (i.e. the entirety of the claim values was recognised in the forecast). At the CCS PRM on 22 June 2017 attended by Mr Howson and Mr Khan, the Project Team was estimating a £32.1 million loss

and a management adjustment of £20 million to support a traded to date figure of £8.8 million as at April 2017.

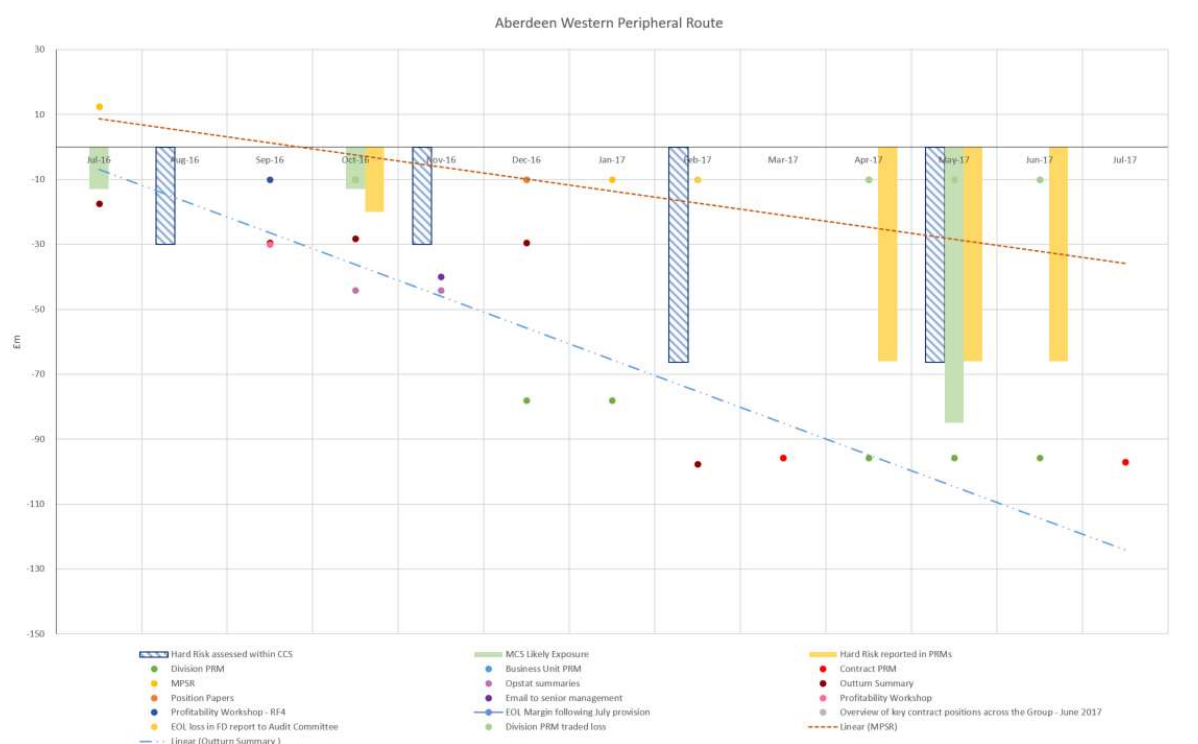
- 4.146. Following the Enhanced Contracts Review, £48 million was provided in relation to MMH. This amount formed part of the contract provision of £845 million announced by Carillion on 10 July 2017.

## **AWPR**

- 4.147. AWPR was a design build finance operate contract<sup>2</sup> for the construction of a 58km ring road around Aberdeen. It was structured as a joint venture with two other partners. The project started in January 2015. Within Carillion, it was managed by the Infrastructure Business Unit of CCS.
- 4.148. The tender value for AWPR was £533 million, including costs of around £496 million and a 7% profit margin of £37 million. Carillion's one-third share was £177.8 million, with a margin of £12.4 million.
- 4.149. During 2015 and 2016, AWPR was significantly delayed by poor weather and delays in diverting statutory utilities (such as water pipes, electricity cables, etc).
- 4.150. By July 2016, Infrastructure was reporting estimated end of life costs of £679 million and a final margin loss of £52 million at joint venture level, after taking into account estimated recoveries on claims for delays in diverting the statutory utilities and insurance claims for delays caused by bad weather. Despite this, however, an end of life profit margin of £12.4 million (7%) was reported in the July 2016 MPSR Executive Summary.
- 4.151. By October 2016, Carillion had reduced the forecast end of life margin for AWPR to a loss of £10 million. Despite this downwards revision, there were significant and increasing divergences during the Relevant Period between (on the one hand) Infrastructure's views on AWPR's financial position as reported to Messrs Adam, Howson and Khan; and (on the other hand) those reflecting budgeted forecasts and/or reported to the Board and the Audit Committee. These are illustrated in the following graph:

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<sup>2</sup> This type of contract is a project delivery structure in which a private sector party is awarded a contract to design, construct, finance and operate a capital project. In consideration for performing its obligations under the agreement, the private sector party may be paid by the government agency



Graph 4 - Each point on the graph shows the end of life (EOL) margin and/or traded to date margin recorded in various reports pertaining to AWPR as variously reported to Infrastructure, CCS, the executive directors, the Board, the Audit Committee and/or the external auditors. The orange and blue trend lines illustrate the increasing divergence of views between the position as assessed by the joint venture Project Team and Infrastructure (blue line); and the view reflecting budgeted forecasts and/or reported to the Board, the Audit Committee and the external auditors (orange line). The graph also shows the level of hard risk reported by the site teams in the hard risk schedules and the "likely" exposure to traded amount reported in the Major Contract Summaries.

4.152. This divergence between the internal reporting by Infrastructure and CCS to Messrs Adam, Howson and Khan and the reporting to the Board and the Audit Committee during the second half of 2016 is summarised as follows:

*Infrastructure and CCS reporting to Messrs Adam and Howson*

- (1) In September 2016, CCS reported in a "profitability workshop" attended by Messrs Adam and Howson that there was a potential end of life loss of £30 million on AWPR. This was compared in the presentation to a £10 million loss forecast within RF4 at around that date.
- (2) In October 2016, CCS reported at the CCS PRM Profit Update Year End & Budget attended by Messrs Adam and Howson that AWPR was being traded at a £10 million loss and there was no margin or write off forecast in the budget. The same presentation stated that hard risk for AWPR amounted to £20 million.

- (3) In the MCSs for July and October 2016, AWPR was identified as having a "likely" exposure of £13.1m, with a "Red" flag status. This represented 44% of the total contentious amount of £30 million identified in these MCSs as due on the project. Mr Howson and Mr Adam received these MCSs and the latter attended the MCRMs at which these MCSs were discussed.
- (4) On 19 November 2016, an internal Carillion email to (amongst others) Mr Howson, Mr Adam and Mr Khan addressed the cash position on AWPR and referred to an *"estimated end of life loss of £40m our share (after recovery) or £120 at a 100% JV level"*.
- (5) In the MCS for December 2016, AWPR retained its red flag status, but was reported without any figures and with the commentary that it was *"To be discussed"*. Mr Adam attended the MCRM at which this MCS was discussed.
- (6) On 16 December 2016, Infrastructure gave a presentation to the CCS PRM with an estimated *"most likely"* end of life margin loss for Carillion of £78 million on AWPR, with end of life costs estimated by the joint venture Project Team at £900 million (joint venture level) (Carillion share £300 million). Messrs Adam and Howson attended this PRM.

*Reporting to the Board and the Audit Committee*

- (7) The MPSR Executive Summaries, Overtrade Reports, CEO and Group FD's reports to the Board and/or the Audit Committee during the Relevant Period did not reflect the above matters. As noted above, the profit margin for AWPR in the October 2016 MPSR was revised downwards to a £10 million loss and this was subsequently maintained in the January 2017 MPSR Executive Summary for AWPR. The Overtrade Report showed AWPR as having no revenue traded not certified (i.e. it suggested that there was no client revenue recognised in Carillion's management accounts that was "at risk"). This was incorrect because Infrastructure was relying upon claims of over £33 million even to achieve its forecast £78 million loss for AWPR. It was also inconsistent with the two Group FD's Reports in the Relevant Period which referred to AWPR relying on claims.
- (8) On 9 November 2016, the Board was informed of *"an unexpected increase in the end out cost of the contract. The extent of the increase is not yet fully understood and further work is being undertaken to evaluate, control*

*and, where possible, reduce/mitigate these costs*". AWPR was also discussed at a Board meeting on 6 December 2016 as one of the potential risks to achieving Carillion's year-end profit forecast of £178 million. It was noted in the minutes that the Board was reliant on the judgement of the executives around AWPR as well as another project.

- (9) Whilst concerns around AWPR were raised with the Board, the end of life estimates being reported by Infrastructure, hard risks and likely MCS exposures were not reported to the Board or the Audit Committee by Mr Adam or Mr Howson.

- 4.153. The Position Paper for AWPR at the 2016 year-end reflected the position as reported in the October 2016 MPSR Executive Summary, with end of life costs estimated at £652.6 million at joint venture level (Carillion's cost being £217.5 million) and a margin loss of £30 million (Carillion's share being a £10 million loss).
- 4.154. In November 2016, concerns were expressed by one member of the Infrastructure management team that he felt "*compromised*" by the position adopted in the position paper and that there were "*some real credibility challenges going forward*." These concerns were not communicated to the Board, the Audit Committee or the external auditors.
- 4.155. The Position Paper submitted to the external auditors for the 2016 year-end accounts recognised £30 million as revenue to be recovered from claims (excluding any additional claim amounts recognised by means of negative accruals). This included a claim for which £23.3 million of revenue was recognised ("Claim 1"). As at the end of December 2016, the progress of Claim 1 was not sufficient to be deemed "*reasonably certain*" (as per Carillion's internal policies) or "*probable*" (as per IAS 11) to be recovered. No revenue should have been recognised in relation to it.
- 4.156. Infrastructure's estimate of a £78 million loss on AWPR was repeated in a further presentation given at the CCS PRM in January 2017. Shortly afterwards, the hard risk for AWPR was increased to £66 million. Despite this, the subsequent January 2017 MPSR was unchanged and continued to report an estimated end of life loss for AWPR of £10 million.

- 4.157. The February 2017 MCS excluded any figures for AWPR and it was given a "Red" flag status. Mr Khan received this MCS and attended the MCRM at which it was discussed.
- 4.158. The Group FD's Report submitted to the Audit Committee meeting on 23 February 2017 referred to the need to achieve £30 million recoveries in relation to claims and £25 million of costs savings to achieve a revised forecast end of life margin of -2.8%, which was a loss of £10 million as recognised in the 2016 Annual Accounts. In its Audit Memorandum presented to the meeting, the external auditors noted that, in order to achieve the £10 million loss, £55 million of value needed to be obtained which included claims and costs savings. No reference was made to the Project Team's assessment of a significant loss, the scale of management adjustments being applied, hard risks or MCS exposures, about which the Audit Committee and the external auditors remained unaware.
- 4.159. On 21 February 2017, a member of the Audit Committee emailed Mr Khan, the Group FD, (copying Mr Howson among others) to specifically question him on various points concerning AWPR ahead of the Audit Committee meeting on 23 February 2017. Despite being aware by this time that Infrastructure considered that the "*most likely*" forecast for AWPR was a loss of £78 million and that, even on the "*best case*" scenario, the forecast remained a loss of £49 million, neither Mr Khan nor Mr Howson informed the Audit Committee member of any of the matters raised in the CCS PRM presentations, including the forecast losses which far outstripped the figure reported to the Audit Committee. Mr Khan's email response to the Audit Committee member on 22 February 2017, which Mr Howson was copied into, instead described the position on AWPR as "*somewhat fluid*".
- 4.160. On 1 March 2017, Carillion announced its 2016 financial results in its March Results Announcement. The cost, value and margin recognised for AWPR as part of the figures released in this announcement reflected the final Position Paper provided to the external auditors, with a forecast end of life margin loss of £10 million and costs of £217.5 million. The recognition of these amounts meant that the revenue and profit / margin figures for the Group and Construction Services (excluding the Middle East) in the March Results Announcement were materially misstated due to an understatement of costs and the recognition of Claim 1 as revenue in non-compliance with Carillion's internal policies and IAS 11.
- 4.161. By April 2017, the estimated end of life costs had risen to £925 million (including cost reductions), with a forecast end of life margin loss of £308.3 million (£95.7

million Carillion share). This was reported at the CCS PRM that month attended by Mr Howson and Mr Khan, along with traded loss of £10 million and a hard risk figure of £66 million for AWPR. The margin figure of a £95.7 million loss (compared to a traded loss of £10 million) was reported again at the CCS PRMs in May and June 2017 attended by Messrs Howson and Khan, as was the hard risk figure of £66 million for AWPR.

- 4.162. The MCS in May 2017 identified a likely exposure of £85 million for AWPR, with a "red" flag status. However, the MPSR Executive Summary appended to it indicated that Carillion was continuing to a forecast margin loss of £10 million only.
- 4.163. On 7 June 2017, the Board held a strategy meeting attended by Messrs Howson and Khan. At this meeting, Mr Howson presented an *"Overview of Key Contract Positions across the Group"*. In the presentation, AWPR was reported as having a forecast end of life margin of a loss of £10 million, with over £121 million of value to be recovered from claims. This was expressly stated as including claims in the forecast traded at 80% (i.e. the majority of the claim values were recognised in the forecast).
- 4.164. Following the Enhanced Contracts Review, AWPR was written down by £86 million. This amount formed part of the contract provision of £845 million announced by Carillion on 10 July 2017.

## **5. FAILINGS**

- 5.1. The facts and matters referred to above resulted in Carillion committing market abuse contrary to Article 15 of MAR and breaching Listing Principle 1, LR 1.3.3R and Premium Listing Principle 2 during the Relevant Period.
- 5.2. These breaches are set out below and the provisions referred to are set out in the Annex to this Notice.

### **Article 15 MAR**

#### Carillion's obligations

- 5.3. Article 15 of MAR states that a person shall not engage in or attempt to engage in market manipulation.

- 5.4. Article 12(1)(c) of MAR provides that market manipulation comprises disseminating information through the media, including the internet, or by any other means, which gives, or is likely to give, false or misleading signals as to (amongst other things) the price of a financial instrument, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading.

#### The December Announcement

- 5.5. The December Announcement referred to Carillion's performance "*meeting expectations*", with expectations for "*strong growth in total revenue and increased operating profit*" for the Group and "*operating margin*" for CCS remaining within a target range of 2.5-3% for the 2016 year-end. It described Carillion as "*well positioned to make further progress in 2017*".
- 5.6. These positive statements were not justified and were made notwithstanding that at the Board meeting, which took place on the day before the December Announcement, there had been discussions around a possible deterioration in the trading performance of the business and the 2017 Budget had been described as "*challenging*". They did not reflect the true financial performance of CCS's construction contracts and the announcement omitted any reference to the significant financial risks associated with these stated expectations. This is despite the fact that, as at 7 December 2016, the following issues had been identified and reported within Carillion:
- (1) The MCS prepared for the quarterly meeting on 5 December 2016 attended by Mr Adam identified a likely financial exposure of over £550 million for the Group and £157.8 million for CCS. Even taking into account any inconsistencies in the production of this report, these figures highlighted very significant likely exposures and excluded a further major loss-making project (AWPR), which would (if included) have further increased the amount of the likely exposures.
  - (2) As part of its 2016 RF3 and 2017 Budget submissions, CCS had reported to (amongst others) Mr Adam and Mr Howson that hard risk was forecast to amount to £171.8 million by the end of 2016 and £149.6 million by the end of 2017 respectively. These were amounts that were not likely to be



recovered, a significant proportion of which should have been written off in accordance with IAS 11.

(3) In the period prior to the release of the December Announcement, the expected financial performance of certain major contracts was much worse than the budget and reforecasts providing the basis for the December Announcement. Mr Adam and/or Mr Howson was aware of the following facts in this regard:

- a. For RLUH, the Project Team had internally reported an expected loss of between £14 million and £21 million, not the profit of £13.6 million forecast in the July and October 2016 MPSRs. A likely financial exposure of £21 million for RLUH in the October and December 2016 MCSs and hard risk of £10 million had been internally reported by CCS.
- b. For Battersea, the Project Team had internally reported an expected loss of between £14 million and £25 million, compared to the forecast profit of around £10 million in the July and October 2016 MPSRs. A likely financial exposure of £21 million in the October and December 2016 MCSs and hard risk of £13 million had been internally reported by CCS.
- c. For AWPR, the Board (including Mr Adam and Mr Howson) had been informed on 9 November 2016 about an *"unexpected increase in the end out cost of the contract"*. At the Board meeting on 6 December 2016 (attended by Mr Adam and Mr Howson), AWPR was identified and discussed as one of the potential risks to the profit forecast for the 2016 year-end. In the period between these two Board meetings, Mr Adam and Mr Howson had received an email referring to an *"estimated end of life loss of £40m"*. This compared to a forecast loss of £10 million in the October 2016 MPSR. The hard risk for AWPR had been internally reported at £20 million. The MCS in December 2016 excluded any figures for AWPR but it was still shown with a red flag status.

5.7. The Authority considers that Carillion ought to have known that the information in the December Announcement was false or misleading by reason of the above matters. The Authority attributes the knowledge of Mr Adam and Mr Howson to Carillion for its finding in this regard.

### The March Results Announcement

- 5.8. The March Results Announcement reported on Carillion's financial results for the year ended 31 December 2016.
- 5.9. The March Results Announcement and the document published alongside it described Carillion's performance as "*in line with expectations*", with increased revenue of £4,394.9 million and PBT of £178 million for the Group and revenue of £1,520.2 million and operating profit of £41.3 million for "*Construction Services (excluding the Middle East)*". It described strong revenue growth in this segment and confirmed that operating margin for this segment "*remains in our target range of 2.5 per cent to 3 per cent*". It referred to its ambition "*to maintain revenue and profit at broadly their current levels*" in 2017. It went on to refer to Carillion as a whole having a "*good platform from which to develop the business in 2017*". These statements were consistent with the expectations set out in the December Announcement.
- 5.10. The revenue and profit / margin figures for the Group and Construction Services (excluding the Middle East) in the March Results Announcement were misstated because they did not accurately reflect the financial performance of the Priority Contracts. In particular, Carillion failed to recognise the costs and revenue associated with these projects in accordance with IAS 11. The revenue and profit / margin figures were materially overstated as a result. This also made false and misleading references to Carillion's performance being "*in line with expectations*", with strong revenue growth and operating profit targets being met for the business segment including CCS. While it referred to "*actively managing the positions we have in challenging markets*", this statement was specifically made in relation to markets in the Middle East and Canada and in the context of rebalancing Carillion's business. There was no reference to challenges in the UK market or to the deteriorating financial performance of CCS's construction projects.
- 5.11. The positive statements in the March Results Announcement about expected performance in 2017 were similar to those contained in the December Announcement. These statements were not justified by the facts and matters known to Carillion as at the date of the March Results Announcement on 1 March 2017. In addition to the matters identified above, far from improving since December 2016 the financial performance of Carillion's construction contracts had

continued to deteriorate. The MCS for February 2017 identified significantly increased likely exposures at Group and CCS-level. Within CCS (and to the knowledge of Mr Howson and Mr Khan):

- (1) hard risk had increased to £258.4 million by the end of December 2016;
- (2) for RLUH, the Project Team had internally reported a likely end of life loss of £56.3 million against a forecast profit margin of 4.4% (i.e. a profit of £13 million);
- (3) for Battersea, the Project Team was estimating an end of life loss of £26.3 million against a forecast profit margin of around 2% (i.e. a profit of around £8 million);
- (4) for AWPR, Infrastructure had internally reported a likely end of life loss of £78 million against a forecast loss of £10 million.

5.12. Two versions of Position Papers were produced, in relation to certain major contracts, for the purpose of the 2016 year-end, one "*clean*" and one "*audit friendly*" (Mr Khan knew the latter versions were being provided to the external auditors during the Relevant Period).

5.13. The above matters made the positive statements and revenue and profit / margin figures in the March Results Announcement false or misleading.

5.14. The Authority considers that Carillion ought to have known that the information in the March Results Announcement was false or misleading by reason of the above matters. The Authority attributes the knowledge of Mr Howson and Mr Khan to Carillion for its finding in this regard.

#### The May Announcement

5.15. The tenor of the May Announcement was that nothing had materially changed since the March Results Announcement. This was reflected in its heading ("*Trading conditions unchanged*") and opening sentence ("*Trading conditions across the Group's markets have remained largely unchanged since we announced our 2016 full-year results*"). This was not an accurate depiction of the Group's trading as at 3 May 2017, which was materially affected by the adverse and

deteriorating financial performance of CCS's construction projects leading up to that date.

5.16. The facts and matters described above in relation to the December Announcement and the March Results Announcement indicated a significant deterioration in the financial performance of Carillion and CCS in particular. This deterioration continued, with hard risk within CCS increasing to £310.6 million by March 2017. Significant concerns were raised at the Board meeting on 3 May 2017 about the deterioration in financial performance of Carillion's major projects. These concerns were consistent with the continued deterioration of CCS's major projects, including (to Mr Howson and Mr Khan's knowledge):

- (1) RLUH, where in April 2017 the Project Team had estimated a £58.8 million loss and a management adjustment of £64.9 million was applied to help maintain the forecast profit margin of over £13 million;
- (2) Battersea, where in April 2017 the Project Team had forecast a £34.8 million loss and a management adjustment of just under £40 million was applied to help maintain the forecast profit margin of over £8 million;
- (3) MMH, where in April 2017 the Project Team had forecast a £15.7 million loss, with a management adjustment of almost £12.9 million applied to help maintain a forecast profit margin of £17.7 million; and
- (4) AWPR, where in April 2017 Infrastructure had internally reported the most likely end of life loss as being over £95 million, compared to the forecast £10 million loss.

5.17. The comment in the May Announcement about challenging contract positions did not adequately address these matters. It was expressly linked to the similar statement made in the March Results Announcement, which was specific to the Middle East and Canada. This impression was reinforced by use of the words "*particularly in our international markets*". It therefore did not convey significant problems within Carillion's UK construction business (i.e. CCS).

5.18. The Authority considers that Carillion ought to have known that the information in the May Announcement was false or misleading by reason of the above matters. The Authority attributes the knowledge of Mr Howson and Mr Khan to Carillion for its finding in this regard.

- 5.19. In respect of each of the Announcements, by disseminating false or misleading information in circumstances where it ought to have known the information was false or misleading, Carillion committed market manipulation in breach of Article 15 of MAR.
- 5.20. The Authority considers that Messrs Adam, Howson and Khan (as applicable) were aware that there was a risk that the Announcements were false or misleading due to the matters at paragraphs 5.5 to 5.17 above. They did not respond appropriately to this risk and failed to take it properly into account when reviewing and approving the Announcements as Board members. They also failed to inform the Board and the Audit Committee about these matters for the purpose of their review and approval of the Announcements. This is despite the fact that they must have been aware, particularly having regard to the nature and cumulative effect of the information they received from CCS management highlighting increasing levels of financial risks and exposures associated with the financial performance of CCS's construction contracts and the number of occasions on which such information was reported to them, that these matters would be highly relevant to the deliberations of the Board and the Audit Committee. The Authority considers that Messrs Adam, Howson and Khan acted recklessly as a result. The Authority attributes the state of mind of Messrs Adam, Howson and Khan (as applicable) to Carillion in this regard. Carillion's breach of Article 15 of MAR was therefore committed recklessly.

### **Listing Rule 1.3.3R**

#### Carillion's obligations

- 5.21. Listing Rule 1.3.3R requires an issuer to take reasonable care to ensure that any information it notifies to a RIS or makes available through the Authority is not misleading, false or deceptive and does not omit anything likely to affect the import of the information. As a listed company, Carillion was required to comply with LR 1.3.3R.

#### Carillion's breaches

- 5.22. By failing to take account of the matters at paragraphs 5.5 to 5.17 above in its announcements, and by failing to ensure that the matters at paragraphs 5.24 to 5.37 below in relation to Listing Principle 1 were properly addressed, Carillion

failed to take reasonable care to ensure that information it notified to a RIS was not misleading, false or deceptive and did not omit anything likely to affect the import of the information, in breach of LR 1.3.3R.

- 5.23. For the reasons given in paragraph 5.20 above and in paragraph 5.38 below, Carillion's breach of LR 1.3.3R was committed recklessly. The Authority attributes the state of mind of Messrs Adam, Howson and Khan (as applicable) to Carillion in this regard.

### **Listing Principle 1**

#### Carillion's obligations

- 5.24. Listing Principle 1 requires a listed company to take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations. These obligations include compliance with the Listing Rules, in particular the timely and accurate disclosure of information to the market, as set out in LR 7.2.2G and LR 7.2.3G.
- 5.25. As a listed company, Carillion was required to comply with Listing Principle 1 during the Relevant Period.

#### Carillion's procedures, systems & controls

- 5.26. The shortcomings in Carillion's procedures, systems and controls around the financial reporting of its construction contracts meant that Carillion was unable to comply with its obligations under the Listing Rules.
- 5.27. The Authority considers that a listed company should have in place procedures, systems and controls that provide clear, consistent and transparent reporting throughout the company. This should include procedures, systems and controls that:
- (1) ensure the financial performance of construction contracts is assessed in accordance with applicable accounting standards, including IAS 11;
  - (2) identify and internally report on material financial risks associated with such assessments;

- (3) produce consistent management and financial information about such assessments and any associated risks, as well as ensuring that any inconsistencies are identified and resolved with appropriate enquiry and follow-up actions as required; and
- (4) provide sufficient information to the Board and the Audit Committee to enable them properly to consider the financial performance of construction contracts and assess material risks associated with their financial reporting.

5.28. Carillion's procedures, systems and controls did not meet these standards. They were inadequate for the following reasons:

- (1) Significant pressure placed on CCS to meet targets;
- (2) Lack of awareness and application of Carillion's internal policies;
- (3) Lack of proper records around contract accounting judgements;
- (4) Inconsistent management and financial information; and
- (5) Failure to inform the Board and the Audit Committee about the significant financial risks being reported by CCS.

Pressure on CCS to meet targets

5.29. Significant pressure was placed on CCS to meet very challenging budgeted and reforecast targets through the budgeting and reforecasting process headed by Carillion's two executive directors, the Group CEO and the Group FD. The targets were maintained even as CCS reported deteriorating financial performance in certain major projects and increasing hard risks and MCS exposures during the Relevant Period. This greatly increased the risk that contract accounting judgements under IAS 11 would be applied too aggressively by CCS in order to meet those targets and would not comply with IAS 11 as a result. In those circumstances, the control framework around CCS's contract accounting judgements needed to be especially transparent and robust to minimise the risk of non-compliance. It was not, significantly increasing the risk that market announcements in relation to Carillion's financial performance would not be accurate.

- 5.30. During the Relevant Period, despite knowing the pressure placed on CCS to meet targets, no meaningful steps were taken by Mr Howson, Mr Adam or Mr Khan to ensure that contract accounting judgements were being applied appropriately or to ensure that the control framework around those judgements was sufficiently transparent and robust to ensure compliance with IAS 11.

Lack of awareness and use of internal policies

- 5.31. Carillion's policies aimed at complying with IAS 11 were not well known or consistently interpreted and applied by those making contract accounting judgments. This undermined the effectiveness of the policies in ensuring a consistent and transparent approach to contract accounting judgments.

Lack of proper records

- 5.32. The contract accounting judgements themselves were not properly documented, which meant there was no clear record of the assessments being made, approved or reviewed. This contributed to a lack of rigour around contract accounting judgements and their approval and review. In particular:

- (1) The Contract Appraisals recorded the management adjustments, but they were not "*fully documented and supported*" as required by Carillion's profit recognition policy. This increased the risk of "*arbitrary management adjustments*", which were prohibited by Carillion's revenue recognition policy.
- (2) The PRM process was a key forum at which the financial performance of projects was discussed and reviewed at different levels within CCS, often in the context of Carillion's budgeting and reforecasting process. There were no minutes taken of PRM discussions and no record of any detailed review of or changes to contract accounting judgements made or the reasons for them.
- (3) Position Papers reflected the contract accounting judgements made, but absent any other records, did not provide adequate explanation or support for them. The judgements applied in the Position Papers were often inconsistent with the true assessment of those responsible for making contract judgements, as reflected in Contract Appraisals, "*clean*" Position Papers, hard risks, MCS exposures, Project Team's forecasts reported in



CCS PRM and peer review reports. These inconsistencies were not properly identified and resolved.

- (4) Peer reviews were a key control mechanism to ensure some independent scrutiny of, amongst other things, contract accounting judgements. On certain major projects, these reviews identified a significant variance between the financial performance of the project as reported in the Contract Appraisals (after management adjustments had been applied) and the peer reviewer's recommended position. There was, however, no formal process to ensure that the peer reviewer's recommendations were properly considered and actioned if appropriate.

#### Inconsistent management information on financial performance

5.33. The management information produced and reported by CCS highlighted large and increasing risks associated with the reported financial performance of CCS's construction projects during the Relevant Period. This information was inconsistent with other reports that contained much more optimistic assessments of the financial performance of those projects. These inconsistencies were not properly investigated or resolved.

- (1) The increasingly large risks associated with the contract accounting judgements being applied to CCS's construction projects and underpinning their financial performance were identified by means of CCS reporting internally on hard risk. This was seen by those making the judgements as an increasingly important means of highlighting those risks to enable appropriate action to be taken, for example by means of write-offs, provisions or changes to budgets and reforecasts. Despite this, no meaningful action was taken to address the increasing levels of hard risk in CCS during the Relevant Period.
- (2) The MCSs highlighted likely financial exposures associated with Carillion's contracts, including CCS's construction projects. No guidance was given to those preparing the MCSs and the figures reported in them were inconsistent. It was another means by which Business Divisions (including CCS) reported large exposures that significantly increased during the Relevant Period. Despite this, there was no common understanding within Carillion as to their purpose and content. The increasingly large exposures

reported in them were ignored by those receiving them and no meaningful action was taken to address these exposures.

- (3) There were large and increasing divergences during the Relevant Period between the Project Teams' assessments of the financial performance of the Priority Contracts and the much more optimistic forecasts contained in budgets and reforecasts. These divergences were reported by CCS in CCS PRMs or in some cases by email. No proper enquiries were made as to the reasons behind these divergences or to seek to resolve them.
- (4) The above management information was inconsistent with the figures reported to the Board and the Audit Committee in the MPSR Executive Summaries and Overtrade Reports. It was also inconsistent with the financial position of CCS's construction projects, as contained in Position Papers and typically reflected in budgets and reforecasts.

#### Failure to inform the Board and the Audit Committee

- 5.34. The Board and the Audit Committee were not made aware of the significant and increasing financial risks during the Relevant Period that were being highlighted by CCS to Messrs Adam, Howson and Khan, as described in paragraph 5.33 above. This meant they were hampered in providing proper oversight of CCS's financial performance and the contract accounting judgements being applied to its major projects. This was especially important for the Audit Committee since it was responsible for reviewing and challenging whether Carillion had *"followed appropriate accounting standards and made appropriate estimates and judgements [in its financial statements], taking into account the views of the external auditor"*.
- 5.35. Reports to the Board and discussions at Board meetings tended to focus on operational issues associated with individual projects, not their financial impact. Financial reporting to the Board in relation to financial risks associated with Carillion's construction contracts mainly consisted of the MPSR Executive Summaries and Overtrade Reports. They did not reflect the financial risks identified and highlighted by CCS by means of, for example, hard risks, MCS exposures, CCS PRMs or otherwise.
- 5.36. The information provided to the Audit Committee in order to enable them to assess contract accounting judgements was contained in or appended to the

Group FD's Report and the external auditor's half-year and year-end memorandums. These documents only reported the outcome of the judgements, not their basis or the risks associated with them. As a result, and in the absence of information about hard risks, MCS exposures and the adverse assessments made by Project Teams (of which the external auditors were also not aware), they did not provide the Audit Committee with information which was important in order effectively to assess whether or not the judgements were being applied appropriately.

- 5.37. In light of the above matters, the Authority considers that Carillion failed to take reasonable steps to ensure that it had adequate procedures, systems and controls during the Relevant Period to comply with its obligations under the Listing Rules. Carillion breached Listing Principle 1 as a result.
- 5.38. Further, the Authority considers that Messrs Adam, Howson and Khan were aware in light of their knowledge of the matters at paragraphs 5.26 to 5.36 above that there was a risk that Carillion did not have adequate procedures, systems and controls to enable it to comply with its obligations under the Listing Rules. They did not respond appropriately to this risk and failed to take any steps to address these matters during the Relevant Period (or until 31 December 2016 in the case of Mr Adam, and from 1 January 2017 in the case of Mr Khan). The Authority considers that they acted recklessly as a result. The Authority attributes the state of mind of Messrs Adam, Howson and Khan to Carillion in this regard. Carillion's breach of Listing Principle 1 was therefore committed recklessly.

### **Premium Listing Principle 2**

- 5.39. Premium Listing Principle 2 requires a listed company to act with integrity towards the holders and potential holders of its premium listed securities.
- 5.40. As a listed company, Carillion was required to comply with Premium Listing Principle 2 in relation to its Premium listed securities during the Relevant Period.
- 5.41. As explained in paragraphs 5.20, 5.23 and 5.38 above, Carillion acted recklessly in relation to the facts and matters described above.
- 5.42. For these reasons, Carillion breached Premium Listing Principle 2 during the Relevant Period by failing to act with integrity towards its holders and potential holders of its premium listed shares.

## **6. SANCTION**

### **Financial penalty**

- 6.1. The Authority's policy for imposing a financial penalty is set out in Chapter 6 of DEPP. In respect of conduct occurring on or after 6 March 2010, the Authority applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5A sets out the details of the five-step framework that applies in respect of financial penalties imposed on firms.

#### Step 1: disgorgement

- 6.2. Pursuant to DEPP 6.5A.1G, at Step 1 the Authority seeks to deprive a firm of the financial benefit derived directly from the breach where it is practicable to quantify this.
- 6.3. The Authority has not identified any financial benefit that Carillion derived directly from its breaches.
- 6.4. Step 1 is therefore £0.

#### Step 2: the seriousness of the breach

- 6.5. Pursuant to DEPP 6.5A.2G, at Step 2 the Authority determines a figure that reflects the seriousness of the breach. Where the amount of revenue generated by a firm from a particular product line or business area is indicative of the harm or potential harm that its breach may cause, that figure will be based on a percentage of the firm's revenue from the relevant products or business area.
- 6.6. However, in this case, the Authority considers that the revenue generated by Carillion is not an appropriate indicator as it does not reflect the harm or risk of harm resulting from Carillion's breaches.
- 6.7. The Authority considers the appropriate indicator is Carillion's average daily market capitalisation throughout the Relevant Period as it reflects the harm or risk of harm resulting from the breaches. Carillion's average daily market capitalisation over this period was £1.011 billion.

### *Scale*

- 6.8. The Authority considers that a scale of 0-0.5% of market capitalisation (applied according to the seriousness of the breach) is appropriate in order that the penalty properly reflects the seriousness of the breach. The range is divided into five fixed levels that represent, on a sliding scale, the seriousness of the breach; the more serious the breach, the higher the level:

Level 1 – 0%

Level 2 – 0.125%

Level 3 – 0.25%

Level 4 – 0.375%

Level 5 – 0.5%

### *Level of seriousness*

- 6.9. In assessing the seriousness level for the purpose of penalty, the Authority takes into account various factors which reflect the impact and nature of the breach.

### *Impact of the breach*

- 6.10. The Authority considers the following factors to be relevant to the impact of Carillion's breaches:

- (1) the breaches had a seriously adverse effect on the orderliness of, or confidence in, the market. The public nature of Carillion's business, the size and scope of its reporting failures and its subsequent liquidation have together undermined public confidence in the financial reporting regime, including the listing regime; and
- (2) the breaches meant that Carillion's shares were significantly overpriced for a considerable period. Following the announcement of 7 July 2017, which included the £375 million construction services provisions, Carillion's share price fell 39% by the end of the day.

### *Nature of the breach*

- 6.11. The nature of the breaches by Carillion are serious. This is because:

- (1) the breaches revealed serious and systemic weaknesses in Carillion's procedures and/or in the management systems or internal controls relating to Carillion's business; and

- (2) The breaches of LR 1.3.3R and Listing Principle 1 continued for a period of over a year and resulted in the misleading Announcements.

6.12. DEPP 6.5A.2G(11) sets out factors which are likely to be considered 'level 4 factors' or 'level 5 factors'. Of these, the Authority considers the following factors to be relevant to the breaches:

- (1) the breaches revealed serious and systemic weaknesses in Carillion's procedures and/or in the management systems or internal controls relating to Carillion's business;
- (2) The breaches caused a significant loss or risk of loss to individual consumers, investors or other market users;
- (3) The breaches resulted in an effect on the orderliness of, or confidence in, markets; and
- (4) The breaches were committed recklessly.

6.13. DEPP 6.5A.2G(12) sets out factors which are likely to be considered 'level 1 factors', 'level 2 factors' or 'level 3 factors'. Of these, the Authority considers the following factor to be relevant:

- (1) No profits were made or losses avoided by Carillion as a result of the breaches, either directly or indirectly.

6.14. Taking all of these factors into account, the Authority considers the seriousness of the breaches to be level 4. Therefore, the Step 2 figure is 0.375% of £1.011 billion, which equates to £3,791,000.

Step 3: mitigating and aggravating factors

6.15. Pursuant to DEPP 6.5A.3G, at Step 3 the Authority may increase or decrease the amount of the financial penalty arrived at after Step 2, but not including any amount to be disgorged as set out in Step 1, to take into account factors which aggravate or mitigate the breach.

6.16. The Authority considers that there are no aggravating or mitigating factors.

- 6.17. Step 3 is therefore £3,791,000.

Step 4: adjustment for deterrence

- 6.18. Pursuant to DEPP 6.5A.4G, if the Authority considers the figure arrived at after Step 3 is insufficient to deter the firm who committed the breach, or others, from committing further or similar breaches, then the Authority may increase the penalty.
- 6.19. The Authority considers that the Step 3 figure of £3,791,000 does not represent a sufficient deterrent to others, and so has increased the penalty by a multiple of 10 at Step 4.
- 6.20. Step 4 is therefore £37,910,000.

*Serious financial hardship*

- 6.21. Pursuant to DEPP 6.5D.4G, the Authority will consider reducing the amount of a penalty if a firm will suffer serious financial hardship as a result of having to pay the entire penalty. In deciding whether it is appropriate to reduce the penalty, the Authority will take into consideration the firm's financial circumstances, including whether the penalty would render the firm insolvent or threaten the firm's solvency. The Authority will also take into account its statutory objectives. As Carillion is in liquidation, the payment of a penalty of £37,910,000 would be borne by Carillion's creditors rather than Carillion itself. The Authority has therefore decided to reduce the penalty to £nil.

Step 5: settlement discount

- 6.22. Pursuant to DEPP 6.5A.5G, if the Authority and the firm on whom a penalty is to be imposed agree the amount of the financial penalty and other terms, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the Authority and the firm reached agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.
- 6.23. No settlement discount applies as the proposed financial penalty is £nil.
- 6.24. Step 5 is therefore £nil.

### *Penalty*

- 6.25. The Authority therefore has decided not to impose a financial penalty on Carillion for contravening Article 15 of MAR, Listing Rule 1.3.3R, Listing Principle 1 and Premium Listing Principle 2. But for its financial circumstances, the Authority would have imposed a financial penalty on Carillion of £37,910,000.

### **Public censure**

- 6.26. The Authority's position in relation to the imposition of a public censure is set out in Chapter 6 of DEPP. DEPP sets out non-exhaustive factors that may be of particular relevance in determining whether it is appropriate to issue a public censure rather than a financial penalty. DEPP 6.4.2G(1) indicates that whether or not deterrence may be effectively achieved by issuing a public censure may be a relevant consideration. Further DEPP 6.4.2G(7) indicates that the Authority's approach in previous similar cases may also be a relevant consideration, and that the Authority will seek to achieve a consistent approach to its decisions on whether to impose a financial penalty or issue a public censure.
- 6.27. As is explained in paragraph 6.21 above, the Authority has had regard to the need to balance deterrence against the need to act in the wider interests of creditors and has decided not to impose a financial penalty on Carillion on the basis that a financial penalty would impact adversely on creditors. This is consistent with the Authority's approach in previous cases involving insolvent firms where the imposition of a penalty would impact adversely on creditors. Instead, the Authority has decided to issue a statement censuring Carillion pursuant to sections 123 and 91 of the Act.

## **7. REPRESENTATIONS**

- 7.1. Carillion had a statutory right to make representations to the Authority in response to the Warning Notice. However, because Carillion is in insolvent liquidation (and because, for that reason, the Authority has not sought to impose any penalty), Carillion (acting by the Official Receiver as its liquidator) has not sought to make any such representations. In the circumstances and having regard to allocation of resources, Carillion's position is that it neither admits nor denies the matters which were set out in the Warning Notice. The matters found in this Decision Notice have therefore been determined by the Authority



independently and the lack of any representations from Carillion has not been treated by the Authority as any form of admission.

## **8. PROCEDURAL MATTERS**

8.1. This Notice is given to Carillion plc under sections 127 and 92 of the Act and in accordance with section 388 of the Act.

8.2. The following statutory rights are important.

### **Decision maker**

8.3. The decision which gave rise to the obligation to give this Notice was made by the RDC. The RDC is a committee of the Authority which takes certain decisions on behalf of the Authority. The members of the RDC are separate to the Authority staff involved in conducting investigations and recommending action against firms and individuals. Further information about the RDC can be found on the Authority's website:

<https://www.fca.org.uk/about/committees/regulatory-decisions-committee-rdc>

### **The Tribunal**

8.4. Carillion has the right to refer the matter to which this Notice relates to the Tribunal. Under paragraph 2(2) of Schedule 3 of the Tribunal Procedure (Upper Tribunal) Rules 2008, Carillion has 28 days from the date on which this Notice is given to him to refer the matter to the Tribunal. A reference to the Tribunal is made by way of a signed reference notice (Form FTC3) filed with a copy of this Notice. The Tribunal's contact details are: The Upper Tribunal, Tax and Chancery Chamber, Fifth Floor, Rolls Building, Fetter Lane, London EC4A 1NL (tel: 020 7612 9730; email: [fs@hmcts.gsi.gov.uk](mailto:fs@hmcts.gsi.gov.uk)). Further information on the Tribunal, including guidance and the relevant forms to complete, can be found on the HM Courts and Tribunal Service website:

<http://www.justice.gov.uk/forms/hmcts/tax-and-chancery-upper-tribunal>

8.5. A copy of the reference notice (Form FTC3) must also be sent to the Authority at the same time as filing a reference with the Tribunal. It should be sent to Stephen Robinson at the Financial Conduct Authority, 12 Endeavour Square, London E20 1JN.

- 8.6. Once any such referral is determined by the Tribunal and subject to that determination, or if the matter has not been referred to the Tribunal, the Authority will issue a final notice about the implementation of that decision.

#### **Access to evidence**

- 8.7. Section 394 of the Act applies to this Notice.
- 8.8. The person to whom this Notice is given has the right to access:
- (1) the material upon which the Authority has relied in deciding to give this Notice; and
  - (2) the secondary material which, in the opinion of the Authority, might undermine that decision.

#### **Confidentiality and publicity**

- 8.9. This Notice may contain confidential information and should not be disclosed to a third party (except for the purpose of obtaining advice on its contents). In accordance with section 391 of the Act, a person to whom this Notice is given or copied may not publish the Notice or any details concerning it unless the Authority has published the Notice or those details.
- 8.10. However, the Authority must publish such information about the matter to which a decision notice or final notice relates as it considers appropriate. The person to whom this Notice is given or copied should therefore be aware that the facts and matters contained in this Notice may be made public.

#### **Authority contact**

- 8.11. For more information concerning this matter generally, contact Stephen Robinson at the Authority (direct line: 020 7066 1338/email: [Stephen.Robinson@fca.org.uk](mailto:Stephen.Robinson@fca.org.uk)).

**Tim Parkes**

**Chair, Regulatory Decisions Committee**

## **ANNEX**

### **RELEVANT STATUTORY AND REGULATORY PROVISIONS**

The statutory and regulatory provisions set out below are the versions that were in force in the period between 1 July 2016 and 10 July 2017 (i.e. the Relevant Period).

#### **1. STATUTORY PROVISIONS**

- 1.1. The Authority's general duties established in section 1B of the Act include the strategic objective of ensuring that relevant markets function well and the operational objectives of protecting and enhancing the integrity of the UK financial system and securing an appropriate degree of protection for consumers.

##### **Power to Impose Penalties or Issue Censures for Market Abuse**

- 1.2. Section 123 of the Act sets out the Authority's power to impose penalties or issue censures in cases of market abuse. It states as follows:

*"(1) The [Authority] may exercise its power under subsection (2) if it is satisfied that—*

*(a) a person has contravened [...] Article 15 (prohibition of market manipulation) of the market abuse regulation;*

*[...]*

*(2) The [Authority's] power under this subsection is a power to impose a penalty of*

*such amount as it considers appropriate on the person.*

*(3) The [Authority may, instead of imposing a penalty on a person, publish a statement censuring the person."*

##### **Power to Impose Penalties or Issue Censures for Breach of Listing Provisions**

- 1.3. Section 91 of the Act states as follows:

*"(1) If the [Authority] considers that-*

*(a) an issuer of listed securities, or*

*(b) an applicant for listing,  
has contravened any provision of listing rules, it may impose on him a penalty of  
such amount as it considers appropriate.*

*[...]*

*(2) If, in the case of a contravention by a person referred to in subsection (1)  
[("P")], the [Authority] considers that another person who was at the material  
time a director of P was knowingly concerned in the contravention, it may  
impose upon him a penalty of such amount as it considers appropriate.*

*(3) If the [Authority] is entitled to impose a penalty on a person under this  
section in respect of a particular matter it may, instead of imposing a penalty on  
him in respect of that matter, publish a statement censuring him."*

## **2. REGULATORY PROVISIONS**

### **Market Abuse Regulation (EU No. 596/2014)**

#### Market Manipulation

- 2.1. Article 12(1)(c) of MAR states that market manipulation will comprise of the following activities:

*"disseminating information through the media, including the internet, or by any other means, which gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument, a related spot commodity contract or an auctioned product based on emission allowances or secures, or is likely to secure, the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances at an abnormal or artificial level, including the dissemination of rumours, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading".*

- 2.2. Article 12(4) of MAR states as follows:

*"Where the person referred to in this Article is a legal person, this Article shall also apply, in accordance with national law, to the natural persons who participate*

*in the decision to carry out activities for the account of the legal person concerned."*

2.3. Article 15 of MAR states as follows:

*"A person shall not engage in or attempt to engage in market manipulation."*

### **Listing Rule, Listing Principle and Premium Listing Principle**

#### Listing Rule

2.4. Listing Rule 1.3.3R states as follows:

*"An issuer must take reasonable care to ensure that any information it notifies to a RIS or makes available through the [Authority] is not misleading, false or deceptive and does not omit anything likely to affect the import of the information"*

#### Listing Principle

2.5. Listing Principle 1 states as follows

*"A listed company must take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations."*

#### *Guidance on the Listing Principles*

2.6. LR 7.2.2 G states as follows:

*"Listing Principle 1 is intended to ensure that listed companies have adequate procedures, systems and controls to enable them to comply with their obligations under the listing rules, disclosure requirements, transparency rules and corporate governance rules. In particular, the [Authority] considers that listed companies should place particular emphasis on ensuring that they have adequate procedures, systems and controls in relation to, where applicable:*

*[...]*

*(2) the timely and accurate disclosure of information to the market."*

2.7. LR 7.2.3 G states as follows:

*"Timely and accurate disclosure of information to the market is a key obligation of listed companies. For the purposes of Listing Principle 1, a listed company should have adequate systems and controls to be able to:*

*(1) ensure that it can properly identify information which requires disclosure under the listing rules, disclosure requirements, transparency rules or corporate governance rules in a timely manner; and*

*(2) ensure that any information identified under (1) is properly considered by the directors and that such a consideration encompasses whether the information should be disclosed. "*

#### Premium Listing Principle

2.8. Premium Listing Principle 2 states as follows:

*"A listed company must act with integrity towards the holders and potential holders of its premium listed securities."*

#### **Decision Procedure and Penalties Manual**

2.9. In determining the appropriate level of financial penalty in respect of the breaches, and in proposing to impose a public censure, the Authority has had regard to the provisions of DEPP, particularly DEPP 6.5A, DEPP 6.5D and DEPP 6.4.