

**This decision notice has been referred to the Upper Tribunal to determine what (if any) the appropriate action is for the Authority to take, and remit the matter to the Authority with such directions as the Tribunal considers appropriate.**



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## **DECISION NOTICE**

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To: **Richard Adam**

Date of birth: **November 1957**

Date: **24 June 2022**

### **1. ACTION**

1.1. For the reasons given in this Decision Notice, the Authority has decided to impose on Mr Adam a financial penalty of £318,000 pursuant to:

- (1) Section 123 (power to impose penalties in cases of market abuse); and
- (2) Section 91 (penalties for breach of Part 6 rules)

of the Financial Services and Markets Act 2000.

1.2. The Authority has decided to impose the aforementioned financial penalty on Mr Adam for being knowingly concerned in breaches by Carillion plc of:

- (1) Article 15 of MAR (prohibition of market manipulation);
- (2) Listing Rule 1.3.3R (misleading information must not be published);
- (3) Listing Principle 1 (procedures, systems and controls); and
- (4) Premium Listing Principle 2 (acting with integrity).

## **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 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, including its trading update on 7 December 2016, had given no indication to the market that such a provision was likely to be required.
- 2.5. The December Announcement was misleading and was made recklessly. It did not accurately or fully disclose the true financial performance of Carillion. It made positive statements about Carillion's financial performance generally and in relation to CCS's construction business segment in particular. It 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.

### Mr Adam

- 2.6. Mr Adam was Carillion's Group Finance Director from April 2007 up until his retirement on 31 December 2016. This Notice relates to Mr Adam's conduct as Group FD between 1 July 2016 and 31 December 2016 (the Relevant Period).

2.7. During the Relevant Period, Mr Adam was one of two executive directors on Carillion's Board. As Group FD, he was the director with primary responsibility for ensuring financial information disseminated to the market was accurate and not misleading. He was also responsible for ensuring that Carillion had adequate procedures, systems and controls in place relating to financial reporting.

Overly aggressive contract accounting judgements and internal reporting to Mr Adam

2.8. There was significant pressure on CCS during the Relevant Period to meet very challenging financial targets set and maintained by Mr Adam (along with other senior management) 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.

2.9. 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.

2.10. CCS's management highlighted the financial risks and exposures associated with these judgements to Mr Adam and others 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 Mr Adam and others as amounting to around £172 million.

(2) CCS, along with other Business Divisions within Carillion, reported 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 at just under £244 million, with a "*likely*" exposure of around £173 million (i.e. 71% of

the contentious amounts due) and 11 out of 16 named major projects marked with a red flag status. This was reported to Mr Adam and others.

(3) Large divergences in financial performance were highlighted to Mr Adam and others during the Relevant Period in relation to three major projects: Royal Liverpool University Hospital (RLUH), Phase 1 Battersea Power Station redevelopment (Battersea) and Aberdeen Western Peripheral Route (AWPR). This made clear that there was a 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 to Mr Adam and others 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, a difference of almost £35 million;
- b. Battersea: A £25 million loss (assessed by the relevant Project Team) against a budgeted forecast profit of around £10 million, a difference of £35 million; and
- c. AWPR: A £78 million loss (assessed by the relevant Business Unit within CCS) against a budgeted forecast loss of £10 million, a difference of £68 million.

2.11. When Carillion made its provision in July 2017, a total of £192 million was provided against the above three projects. This represented over half of CCS's total provision of £375 million.

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

2.12. Mr Adam, as Group FD, was responsible for internal financial reporting to the Audit Committee and the Board, and for determining the appropriate level of provisions for construction contracts during the Relevant Period.

2.13. The financial risks and exposures described at paragraph 2.10 above were not reported by Mr Adam (or otherwise to his 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 Mr Adam, as Group FD, would provide a report to the Audit Committee including a summary of financial risks and key judgements associated with major projects.

- 2.14. As Mr Adam was aware, these reports to the Board and the Audit Committee painted a much more optimistic picture of CCS's financial performance than that being internally reported by CCS. As stated 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, it reported this revenue at between £42 million and £44 million.
- 2.15. The MPSR was aligned, on Mr Adam's instructions, to the budgeted and reforecast figures and did not disclose material variances between these figures and the Project Team's or Business Unit's assessments of RLUH, Battersea and AWPR. It did not show any material deterioration in CCS's major projects during the Relevant Period. The Group FD report for the 2016 full year similarly did not identify any material deterioration associated with major projects.
- 2.16. The amount of provisions in Carillion's monthly management accounts for CCS's projects remained broadly unchanged during the Relevant Period at up to £17 million for all risks.

#### The December Announcement

- 2.17. 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 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*".

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

- 2.18. 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 the significant risks associated with these stated expectations that had arisen as at the date of this announcement, including a number of the hard risks, exposures and divergences described at paragraph 2.10 above.
- 2.19. Mr Adam as Group FD had a central role in preparing and finalising the December Announcement and approving it as a Board member. He did so in the knowledge of information reported to him on a number of occasions and summarised at paragraph 2.10 above that was materially inconsistent with the positive statements made in this announcement. Mr Adam must have been aware, particularly having regard to the nature and cumulative effect of the information and the number of occasions on which it was reported to him, that this information would be highly relevant to the deliberations of the Board and the Audit Committee when they reviewed and approved the December Announcement. However, Mr Adam 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 December Announcement 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, and that Mr Adam was knowingly concerned in Carillion's breach of Article 15 of MAR.
- 2.21. During the Relevant Period, Mr Adam was aware that Carillion intended to announce a PBT figure of £178 million in its 2016 financial results. He was also aware that this PBT figure included financial reporting for RLUH, Battersea and AWPR that was aligned with the budgeted forecast figures at paragraph 2.10 above. Mr Adam did not take any steps during the Relevant Period 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 he was aware (see paragraphs 2.14 and 2.15 above). He also failed to bring these matters to the attention of the Board and the Audit Committee before he retired on 31 December 2016.
- 2.22. In light of the above, and the matters summarised at paragraphs 2.23 to 2.28 below in relation to Listing Principle 1, the Authority considers that Carillion failed to take reasonable care during the Relevant Period to ensure that the December

Announcement 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, and that Mr Adam was knowingly concerned in Carillion's 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 in the year ending 31 December 2016. 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 in 2016 would not be accurate.
- 2.24. The overly aggressive contract accounting judgements being applied to CCS's major projects were not properly documented at Performance Review Meetings held by CCS (which Mr Adam attended) and in the preparation of Position Papers for major projects (that Mr Adam received). 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.
- 2.25. The management information relating to hard risks, MCSs and certain major projects produced and reported by CCS to (amongst others) Mr Adam 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.
- 2.26. The Board and the Audit Committee were not made aware during the Relevant Period of the significant and increasing financial risks 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.
- 2.27. 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.

- 2.28. As the Group FD with responsibilities for ensuring that Carillion had adequate procedures, systems and controls relating to financial reporting, the Authority considers that during the Relevant Period, Mr Adam was knowingly concerned in Carillion's breach of Listing Principle 1.
- 2.29. The Authority considers that Mr Adam acted recklessly, during the Relevant Period, in relation to the facts and matters set out at paragraphs 2.8 to 2.27 above. As a result, Carillion failed to act with integrity towards its holders and potential holders of its premium listed shares, in breach of Premium Listing Principle 2, and Mr Adam was knowingly concerned in Carillion's breach of Premium Listing Principle 2.
- 2.30. The Authority has therefore decided to impose a financial penalty on Mr Adam in the amount of £318,000 pursuant to sections 91 and 123 of the Act.

### **3. DEFINITIONS**

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

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

"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 Development;

"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) Buildings and Infrastructure;

"Carillion" means Carillion plc;

"CCS" means Carillion Construction Services, a Business Division of Carillion operated by Carillion through a number of subsidiaries;

"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;

"MCS" means Major Contracts Summary;

"MENA" means Middle East and North Africa, a Business Division of Carillion;

"MPSR" means Major Project Status Report;

"MCRM" means Major Contracts Review Meeting;

"PBT" means underlying Profit Before Tax;

"Priority Contracts" means these three major projects: AWPR, Battersea and RLUH;

"PRM" means Performance Review Meeting;

"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 31 December 2016;

"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 Mr Adam 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 £192 million in relation to three major UK construction projects: RLUH, Battersea and AWPR.

## **SECTION B: MR ADAM'S ROLES AND RESPONSIBILITIES**

- 4.6. Mr Adam is a qualified chartered accountant. He joined Carillion in 2007 as Group FD. He remained in post until his retirement on 31 December 2016. He was succeeded as Group FD by Zafar Khan. During the Relevant Period, Mr Adam was

responsible for the financial affairs of Carillion. In practice, this meant that he was responsible for the following:

- (1) Ensuring that Carillion's financial results were reported to the market accurately and in line with applicable accounting standards. This included financial reporting associated with Carillion's construction projects.
- (2) Ensuring accurate internal financial reporting to the Board and the Audit Committee to enable them to discharge their functions. This included attending Board and Audit Committee meetings and reporting at these meetings regarding Carillion's financial performance. Pursuant to this, Mr Adam provided a regular Group FD's report to the Board and the Audit Committee, which typically provided information concerning Carillion's financial performance.
- (3) Ensuring that there were adequate systems, controls and procedures around financial reporting to ensure appropriate accounting judgements were being made, including in relation to the financial performance of Carillion's construction projects.

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

- 4.7. 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.
- 4.8. IAS 11 applies a "*percentage of completion*" methodology to construction contracts. It provides that, where 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. 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), IAS11 requires that the total expected loss must be recognised in full immediately.

- 4.9. When the outcome of the contract cannot be estimated reliably, revenue can only be recognised up 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.
- 4.10. 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*".
- 4.11. 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).
- 4.12. 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.

- 4.13. Mr Adam as Group FD was the director primarily responsible during the Relevant Period for ensuring that Carillion's financial reporting to the market was accurate, not misleading and complied with applicable accounting standards. This included ensuring that any material contract accounting judgements around revenue and costs on CCS's construction projects were compliant with Carillion Group policy and with IAS 11.

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

- 4.14. 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.
- 4.15. During the Relevant Period, the budget and reforecasting challenges issued and maintained by senior management (including Mr Adam) 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**

- 4.16. The requirements of IAS 11 were 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.

4.17. 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, with ultimate responsibility resting with Mr Adam during the Relevant Period. 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.

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

4.18. 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 senior management (including Mr Adam). 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.

4.19. These financial risks and potential exposures arising from these overly aggressive accounting judgements were highlighted by CCS to Mr Adam and others 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 divergences in the financial performance in relation to certain major projects, making clear the 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.

4.20. Mr Adam did not respond appropriately to these warning signs. He did not adjust CCS's financial targets in response to them. He also did not report them to the Board or the Audit Committee (including in his own reporting to those bodies), even though to his knowledge they were not otherwise being reported, and even though he 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 him, that they would be highly relevant to the deliberations of the Audit Committee and the Board. 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.

4.21. There was no single, coherent process within CCS for making 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, Mr Adam and Richard Howson (Carillion's Chief Executive Officer during the Relevant Period), 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 Mr Adam

(i) *Contract Appraisals*

- 4.22. 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).
- 4.23. 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 (including Mr Adam). 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. Mr Adam was not himself involved in the making of management adjustments (because they were made at Business Unit or Divisional level). The practice of making management adjustments was, however, one of the tools used within CCS in response to the pressure placed on CCS to meet very challenging financial targets. This tool was used increasingly during the Relevant Period in order to maintain the reported profitability of projects, despite the increasing risks. By November / December 2016, these management adjustments amounted to around £245 million within CCS.

(ii) *Performance Review Meetings*

- 4.24. 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 Mr Howson;
- (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 Messrs Adam and Howson.

4.25. 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*

4.26. 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 three to four reforecasts (known as RF1, RF2, etc) throughout the year.

4.27. As explained above, the 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.

4.28. 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 senior management (including Mr Adam) required the Project Teams, Business Units and Business Divisions to work out ways of delivering the revenue and profitability targets. During the Relevant Period, this was done within CCS by, amongst other things, using increasingly aggressive judgements 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 paragraph 4.50 below).

(iv) *Hard risk*

- 4.29. 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 Mr Adam and others during the Relevant Period by means of reporting (what was known as) "*hard risk*" and via a management report called the MCS.
- 4.30. 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. As Mr Adam was aware, hard risks 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.
- 4.31. As explained below (see paragraphs 4.56 and 4.57), Mr Adam attended CCS PRMs during the Relevant Period at which the forecast level of hard risk for 2016 was highlighted as part of the budgeting and reforecasting process. By October 2016, the hard risk reported to Mr Adam amounted to around £172 million, up from £148 million in January 2016.

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

- 4.32. The MCS was a quarterly report submitted by the Business Divisions to (amongst others) Mr Adam during the Relevant Period. 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.

- 4.33. 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.
- 4.34. The MCS was discussed at Major Contracts Review Meetings typically attended during the Relevant Period by (amongst others) Mr Adam and management from each Business Division.

*(vi) Peer review*

- 4.35. 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.
- 4.36. Mr Adam did not receive peer review reports, although he was aware of the process.

Reporting to the Board and the Audit Committee

- 4.37. Mr Adam was a member of the Board throughout the Relevant Period and attended and reported to the Audit Committee as Group FD. Mr Howson was the only other executive director who was a member of the Board during the Relevant Period.
- 4.38. Mr Adam was responsible in his role as Group FD for ensuring that the Board and in particular the Audit Committee had sufficient information to provide proper oversight of Carillion's financial reporting, including significant contract accounting

judgements being applied and their impact on the overall Group results. 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".

- 4.39. The internal reporting of hard risks, potential exposures in the MCSs and the large divergences from budgeted forecast in the financial performance of certain major projects represented significant financial risks associated with overly aggressive contract accounting judgements being applied within CCS during the Relevant Period. These risks were known to Mr Adam during the Relevant Period and he must have been aware, particularly having regard to the nature and cumulative effect of the information he received regarding these risks and the number of occasions on which it was reported to him, that they would be highly relevant to the deliberations of the Board and the Audit Committee. However, as Mr Adam was aware, these risks were not being disclosed to the Board or the Audit Committee (through his own reporting or otherwise). 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.
- 4.40. 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.
- 4.41. 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 Mr Adam as Group FD and Mr Howson as Group CEO.

- 4.42. 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 was done in accordance with Mr Adam's instructions. 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. Mr Adam received the information which was inconsistent with the MPSRs. The MPSRs also did not highlight the management adjustments applied to the projects, amounts identified as hard risk, exposures in the MCS or variances to peer review recommendations.
- 4.43. 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 management accounts for work that was not yet formally approved by the client. This included revenue recognised in relation to claims or variations that had not yet been agreed with the client.
- 4.44. 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.
- 4.45. Mr Adam understood the importance of the Overtrade Report and believed that it was supposed to depict where revenue had been recognised in Carillion's financial reports, despite it being contentious. Despite these matters, Mr Adam knew the figures reported in the Overtrade Report did not identify hard risks, exposures reported in the MCS or divergences from budgeted forecast in the financial performance of certain major projects.
- 4.46. 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.

- 4.47. 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 external auditors

- 4.48. 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, as well as 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.
- 4.49. The Position Papers did not refer to the financial risks associated with hard risks, MCS exposures or divergences between the latest budget or reforecast and the assessment of the Project Team, Business Unit or Business Division. Typically, the Position Papers would be sent to the Group Financial Controller and to Mr Adam for his consideration as Group FD before being provided to the external auditors. Mr Adam was therefore able to see that the Position Papers did not inform the external auditors of these matters.

- 4.50. 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 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. Whilst the Authority has not seen any evidence that Mr Adam was aware of this practice, the preparation of "*clean*" and "*adjusted*" Position Papers was one of the responses developed within CCS in response to the pressure placed on it to meet very challenging financial targets.

## **SECTION E: EVENTS LEADING UP TO THE DECEMBER ANNOUNCEMENT**

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

- 4.51. 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 Mr Adam and others on a number of occasions during the Relevant Period. Mr Adam must have been aware, particularly having regard to the nature and cumulative effect of the information he received and the number of occasions on which these increases were reported to him, that they would be highly relevant to the deliberations of the Board, the Audit Committee and external auditors. However, they were not reported to the Board, the Audit Committee or external auditors.

#### July, October and December 2016 MCSs

- 4.52. 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).

- 4.53. 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).
- 4.54. 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.
- 4.55. During the Relevant Period, 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. Mr Adam attended the MCRMs in July, October and December 2016 and received the MCSs which were prepared for these meetings. He did not, however, take any steps to address these exposures being reported to him.

#### Hard risk reported in August and October 2016 and January 2017

- 4.56. 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. This presentation was emailed to Mr Adam on 11 August 2016.
- 4.57. 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. Mr Adam attended this presentation.
- 4.58. In January 2017, CCS was reporting in its PRM that hard risk had increased to £258.4 million by the end of December 2016. Whilst Mr Adam had retired by the date of the report, it illustrates the increase in hard risk during the Relevant Period when he was the Group FD.



4.59. 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. Mr Adam understood that hard risk represented amounts viewed by CCS as unlikely to be recovered. This was indicated in emails sent to him in March 2016 specifically referring to "*what is hard risk vs genuinely collectable*" and characterising hard risk as "*not collectible*" (sic). He did not take any meaningful steps to understand, assess or address the increasing levels and accumulated values of hard risk being reported to him.

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

4.60. As Mr Adam knew, the significant increases in likely MCS exposures and high levels of hard risk during the Relevant Period 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.

4.61. The financial information available to the Board and the Audit Committee about these matters at CCS level during the Relevant 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 Mr 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 him (as he received the MCSs, unlike the Board and the Audit Committee).

4.62. In August 2016, a member of the Audit Committee sent an email to Mr Adam asking whether contract accounting judgements being made and their linkage to the financial statements could be made clearer because "*trying to assess the judgemental risks/opportunities is difficult*". As Mr Adam was aware, a member of Group Finance replied stating that this issue would be reviewed going forward. However, Mr Adam took no steps to provide the Audit Committee with any of the information being reported to him which would have assisted it in assessing the risks around the contract accounting judgements being made within CCS. No substantive changes were made during the Relevant Period to the level of information being provided to the Audit Committee.

#### No increase in provisions

4.63. 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.

4.64. Mr Adam was ultimately responsible for determining the appropriate level of provisions in the Relevant Period. Despite this, he did not materially increase 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 of which he was aware.

#### **The December Announcement**

4.65. The market consensus for Carillion's underlying profit before tax was around £180 million for the 2016 full year. In early December 2016, Mr Adam and others considered how to meet this expectation and explored 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 delivered an additional £20 million of profit for 2016. Mr Adam was instrumental in ensuring the completion of this one-off transaction. He viewed it as essential to meet Carillion's profit and cash targets for 2016 year-end. He stressed, in an internal email sent by him to Mr Howson on 29 November

2016 (entitled "No Plan B Email"), the importance of not doing "anything to undermine the [...] deal" as "We do not have a plan B to fill the profit and cash gap we have this year end." Following this one-off transaction Mr Adam reported 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."

- 4.66. 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" in relation to certain major projects, including AWPR, as well as the need to "understand whether trading performance of the business had deteriorated". Mr Adam did not take this opportunity to relay to the Board information about the increasing exposures in the MCSs or the high levels of hard risk within CCS. Instead the minutes of this meeting record Mr Adam as stating that it was "anticipated that the Group would show an underlying PBT of some £178m against the market consensus of £180m..." The December Announcement was approved for release at this Board meeting.
- 4.67. Carillion published its Full Year Trading Update (i.e. the December Announcement) on 7 December 2016. The December 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 December 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.
- 4.68. Mr Adam was closely involved in the process for preparing the December Announcement. He reviewed and edited various drafts of this announcement and tabled it in draft at the Audit Committee meeting on 1 December and the Board meeting on 6 December 2016. He approved the December Announcement as a member of Carillion's Board and was listed as the first point of contact in it.

4.69. Mr Adam retired as Group FD of Carillion on 31 December 2016.

### **Negative accruals**

4.70. Negative accruals were used within CCS as a tool for disguising the overly aggressive contract accounting judgements being applied to certain major projects. Whilst it is not alleged that Mr Adam was aware of their use (which was not permitted by Carillion's policies), they were used during the Relevant Period as a response to the pressure placed on individuals within CCS to meet financial targets regardless of increasing risks within its business.

4.71. During April and May 2017, the use of negative accruals within CCS during the Relevant Period was identified across a number of contracts. 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.

4.72. 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.

4.73. 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."*

- 4.74. An internal Carillion investigation in April and May 2017 identified that the majority of negative accruals identified in the investigation related to four major contracts (including the Priority Contracts) and amounted to a total of £102 million. The investigation reported its initial findings on 7 May 2017. It identified that Business Units had used negative accruals on certain contracts in CCS in order to "hold the position [*i.e. profit margin*]". This pressure to "hold the position" was said to have come from Mr Adam. This was a reference to the pressure to meet financial targets imposed on CCS described at paragraph **Error! Reference source not found.**4.15 above, not that Mr Adam was specifically aware of the use of negative accruals for this purpose.

#### **Enhanced Contracts Review**

- 4.75. 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".
- 4.76. 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.
- 4.77. 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, peer

reviews or variances between the figures contained in the “clean” and “adjusted” Position Papers. 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 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.

- 4.78. 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**

- 4.79. 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.
- 4.80. Carillion’s share price fell 39% that day, and within three days had fallen by a total of 70%.
- 4.81. In the provision announced by Carillion on 10 July 2017, three of the largest provisions within CCS were as follows:
- (1) RLUH: £68 million.
  - (2) Battersea: £38 million.

(3) AWPR: £86 million.

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

4.82. The facts relating to the above projects and their provisions are addressed below to the extent to which they are pertinent to the Relevant Period when Mr Adam was Group FD.

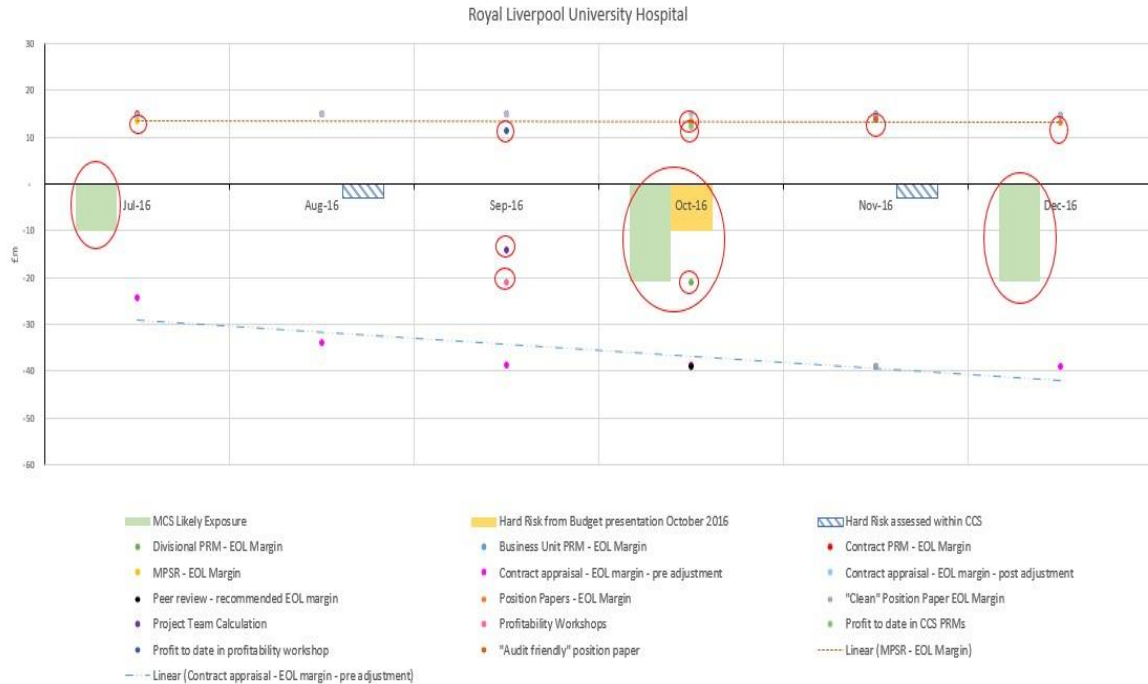
### **RLUH**

4.83. RLUH was a project to construct a new Private Finance Initiative 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.

4.84. The tender value of the project was £286 million, with an estimated end of life profit margin of £10.2 million (or 3.56%).

4.85. 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 £54 million by December 2016. During 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.

4.86. There were significant divergences between (on the one hand) the Project Team's views on RLUH's financial position and the financial risks reported by CCS to Mr Adam and others; and (on the other hand) those reflected in budgeted forecasts and/or reported to the Board and the Audit Committee throughout the second half of 2016. 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 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 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. The red circles show the figures of which Richard Adam was aware at that point in time (or subsequently in the case of MPSRs), whether that was by way of being present in meetings or receiving information directly by email.*

4.87. This divergence between the internal reporting within CCS and the reporting to the Board and the Audit Committee is summarised below:

*The Project Team's assessments*

- (1) 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%. These Appraisals and reports were not seen by Mr Adam. He was, however, made aware of the Project Team's views by other means.
- (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 others.

- (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. Mr Adam attended both of these meetings.
- (4) By November 2016, the Contract Appraisal was reporting an end of life forecast loss of £38.9 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*". The Authority has not seen any evidence that Mr Adam was aware of this Contract Appraisal or peer review during the Relevant Period.

#### *CCS's reporting to Mr Adam*

- (5) CCS reported the Project Team's views internally as described above. At the profitability workshop attended by Mr Adam in September 2016, CCS reported that for RLUH a 4.7% margin (equivalent to a £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 attended by Mr Adam in October 2016, 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 (after Mr Adam retired), 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 Adam received the July, October and December MCSs, as well as attending the MRCMs 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 subsequently of 13.2 million in January 2017) for RLUH and the Overtrade Reports identified £6 million only as revenue traded not certified.
- (9) Mr Adam was in receipt of the MPSR Executive Summaries for July and October 2016 and the monthly Overtrade Reports submitted to the Board and/or the Audit Committee. He was therefore aware of the divergence between the forecast profits and limited financial risks for RLUH being reported to the Board and the Audit Committee by these means compared to what was being reported by the Project Teams and CCS as described above. He failed to bring this divergence to the attention of the Board or the Audit Committee.
- 4.88. 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 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. The Authority has not seen any evidence that Mr Adam was

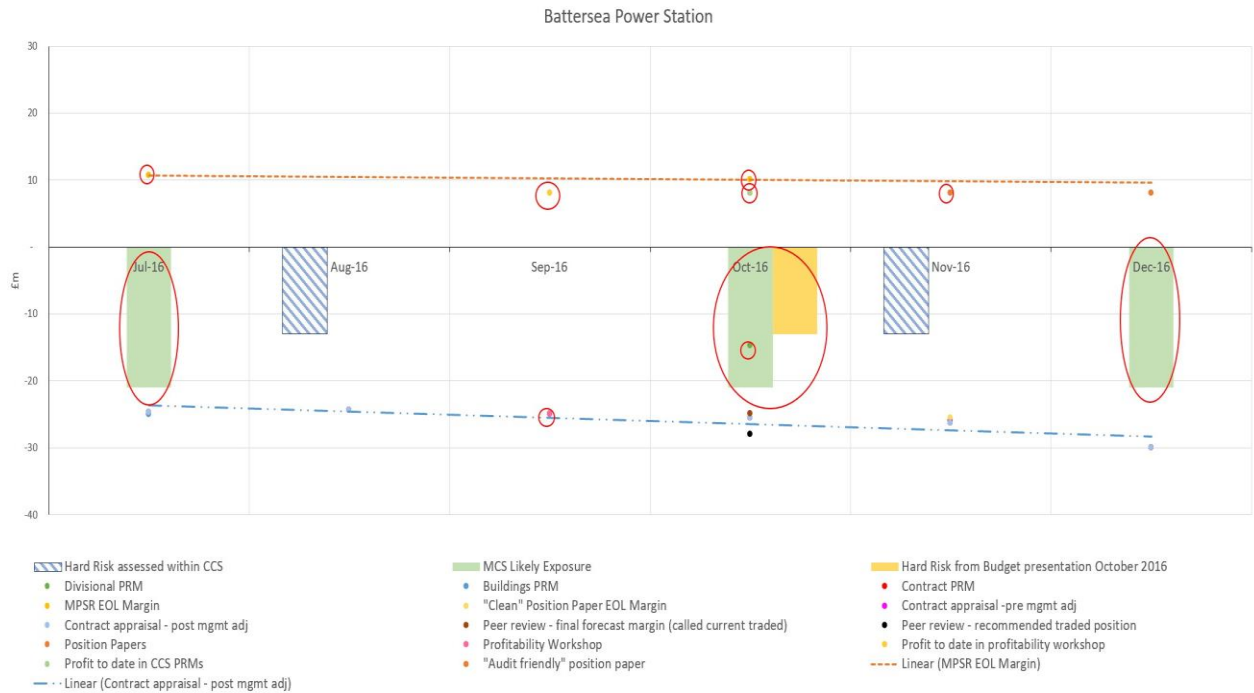
aware of the preparation of these different versions. The need to produce them at all emphasises the overly aggressive nature of the accounting judgements being used in response to pressure to achieve the targets set and maintained by senior management (including Mr Adam).

- 4.89. In late November 2016, Mr Adam requested and was provided with draft Position Papers for (amongst other major projects) RLUH. These were the "*audit friendly*" Position Papers referred to above. Mr Adam was aware that, when finalised, they would form the basis of the profit recognised for RLUH in Carillion's financial results for the year ended 31 December 2016. The Position Paper as provided to Mr Adam was materially inconsistent with the information reported to Mr Adam identified at paragraph 4.87 above. Despite this, he did not take steps to resolve or make others (including the external auditors) aware of these inconsistencies.
- 4.90. The final version of the Position Paper for RLUH submitted to the external auditors for the 2016 year-end accounts in January 2017 was materially the same as the draft seen by Mr Adam, albeit with a slightly reduced end of life margin of 4.4% (or profit of £13.2 million) 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 this stage) were disputed or no response had been received. Their progress 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 them.
- 4.91. 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**

- 4.92. 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.
- 4.93. The contract was tendered at a value of £443.7 million with a 0% profit margin.

- 4.94. 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.
- 4.95. 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.
- 4.96. 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 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. The Board and the Audit Committee were unaware of the scale of the 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.
- 4.97. There were significant divergences between (on the one hand) the Project Team's views on Battersea's financial position and the financial risks reported by CCS to Mr Adam and others; and (on the other hand) those reflecting budgeted forecasts and/or reported to the Board and the Audit Committee throughout the second half of 2016. 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 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. The red circles show the figures of which Richard Adam was aware at that point in time (or subsequently in the case of MPSRs), whether that was by way of being present in meetings or receiving information directly by email.*

4.98. This divergence was reflected in the internal reporting within CCS and to the Board and the Audit Committee 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 adjustment 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, with 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 Mr Adam, but he was aware of the Project Team's assessments by alternative means as set out below.

#### *CCS's reporting to Mr Adam*

- (3) CCS reported the Project Team's views internally as described above. At the profitability workshop in September 2016, attended by Mr Adam, 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, attended by Mr Adam, 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. Mr Adam received the aforementioned MCSs and attended the MCRMs at which they 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 subsequently £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.
- (8) Mr Adam was in receipt of the MPSR Executive Summaries for July and October 2016 and the monthly Overtrade Reports submitted to the Board and/or the Audit Committee. He was therefore aware of the divergence between the forecast profits and limited financial risks for Battersea being reported to the Board and the Audit Committee by these means compared to what was being reported by the Project Teams and CCS as described above. He did not, however, raise these matters, or otherwise take steps to ensure these matters were raised, with the Board or the Audit Committee.
- 4.99. At the 2016 year-end, two sets of figures were produced when drafting the Position Papers for the external auditors as described at paragraph 4.50 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. The "*audit friendly*" version was used for the purpose of preparing Carillion's 2016 Annual Report and Accounts as announced on 1 March 2017.
- 4.100. The Authority has not seen any evidence that Mr Adam was aware of the preparation of these different versions, but he requested and was provided with the "*audit friendly*" Position Paper for Battersea in late November 2016. Mr Adam was aware that, when finalised, this would form the basis of the profit recognised for Battersea in Carillion's financial results for the year ended 31 December 2016. The Position Paper as provided to Mr Adam was materially inconsistent with the information reported to Mr Adam identified at paragraph 4.98 above. Despite this, he did not take steps to resolve these inconsistencies.
- 4.101. The Position Paper for Battersea submitted to the external auditors for the 2016 year-end accounts was materially the same as the draft seen by Mr Adam. 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. On 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 this time.

- 4.102. Following the Enhanced Contract Review, £38 million was provided against Battersea. This amount formed part of the contract provision of £845 million announced by Carillion on 10 July 2017.

### **AWPR**

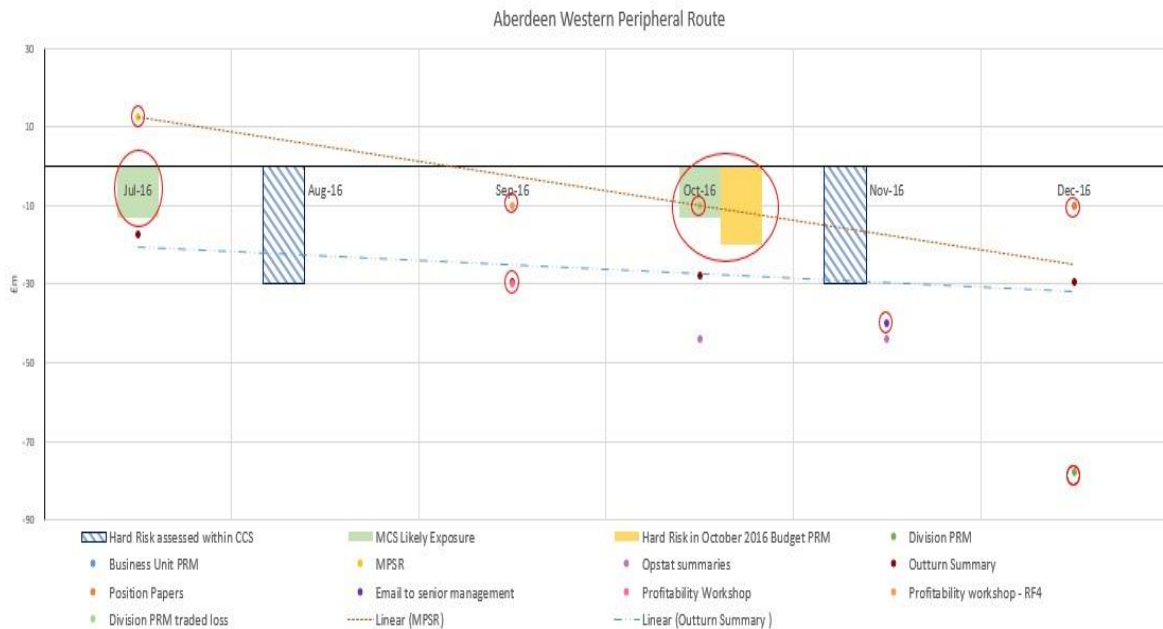
- 4.103. AWPR was a design build finance operate contract<sup>2</sup> for the construction of a 58km ring road around Aberdeen. It was structured as a joint venture with two other partners. The project started in January 2015. Within Carillion, it was managed by the Infrastructure Business Unit of CCS.
- 4.104. The tender value for AWPR was £533m, 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.
- 4.105. During 2015 and 2016, AWPR was significantly delayed by poor weather and delays in diverting statutory utilities (such as water pipes, electricity cables, etc).
- 4.106. 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.
- 4.107. 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 divergences during the Relevant Period between (on the one hand)

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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.



Infrastructure's views on AWPR's financial position as reported to Mr Adam and others; 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:



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 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 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. The red circles show the figures of which Mr Adam was aware at that point in time (or subsequently in the case of MPSRs), whether that was by way of being present in meetings or receiving information directly by email.

4.108. This divergence between the internal reporting by Infrastructure and CCS to Mr Adam and the reporting to the Board and the Audit Committee during the Relevant Period can be summarised as follows:

*Infrastructure and CCS reporting to Mr Adam*

- (1) In September 2016, CCS reported in a "profitability workshop", attended by Mr Adam, 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 Mr Adam, 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 £13.1 million, 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 Adam received these MCSs and attended the MCRMs at which they were discussed.
- (4) On 19 November 2016, an internal Carillion email to (amongst others) Mr Adam addressed the cash position on AWPR and referred to an "estimated end of life loss of £40m our share (after recovery) or £120m 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 received this MCS and attended the MCRM at which it 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). Mr Adam 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. 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.

- (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 (of which Mr Adam was aware) were not reported to the Board or the Audit Committee. Mr Adam was aware of the disparity between these matters and what was reported in the MPSR Executive Summaries for July and October 2016 and the monthly Overtrade Reports submitted to the Board and/or the Audit Committee. Despite this, he did not take steps to draw these matters to their attention.
- 4.109. 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). Shortly after the year-end, the hard risk for AWPR was increased to £66 million.
- 4.110. 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.
- 4.111. In late November 2016, Mr Adam requested and was provided with draft Position Papers for (amongst other major projects) AWPR. Mr Adam was aware that, when finalised, this would form the basis of the profit recognised for AWPR in Carillion's financial results for the year ending 31 December 2016.
- 4.112. The Position Paper submitted to the external auditors for the 2016 year-end accounts was materially the same as the draft seen by Mr Adam. It was materially inconsistent with the information reported to Mr Adam identified at paragraph

4.108 above. Despite this, he did not take steps to resolve these inconsistencies. It 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. As at the end of December 2016, the progress of this claim 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.

4.113. 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. In light of the facts and matters above, Mr Adam was:

- (1) in respect of the December Announcement, knowingly concerned in Carillion's dissemination of information 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) in respect of the December Announcement, knowingly concerned in Carillion's failure to take reasonable care to ensure that the announcement 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);
- (3) knowingly concerned in Carillion's failure 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); and
- (4) knowingly concerned in Carillion's failure to act with integrity towards the holders and potential holders of its premium listed securities (in breach of Premium Listing Principle 2).

5.2. These breaches are set out below and the provisions referred to are set out at Annex A 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.
- 5.5. Article 12(4) of MAR states that *"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"*.
- 5.6. The *"national law"* for the purpose of Article 12(4) can be found in section 131AD of the Act, which provides that *"An individual participates in a decision by a body corporate for the purposes of... Article 12(4) (market manipulation)... where: (a) the individual was an officer of the body corporate when the decision was made; and (2) the [Authority is] satisfied that the individual was knowingly concerned in the decision."*

### The December Announcement

- 5.7. Mr Adam in his capacity as Group FD was an officer of Carillion at the time of the December Announcement. He had a central role in preparing and finalising the December Announcement, including reviewing its content, tabling it in draft at the Audit Committee meeting on 1 December and the Board meeting on 6 December 2016 and approving it as a member of Carillion's Board.
- 5.8. 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*".

5.9. 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 December 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, Carillion and Mr Adam were aware that 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 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 this announcement. Mr Adam 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) 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), 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 had with others 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 was shown with a red flag status.
- 5.10. The Authority considers that Mr Adam and 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 another person, to Carillion for its finding in this regard.
- 5.11. 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. In the circumstances, and by virtue of his knowledge and involvement in the December Announcement, Mr Adam was knowingly concerned in Carillion's breach of Article 15.
- 5.12. The Authority considers that Mr Adam was aware that there was a risk that the December Announcement was false or misleading due to the matters at paragraphs 5.7 to 5.9 above. He did not respond appropriately to this risk and failed to take it properly into account when reviewing and approving the December Announcement. He also failed to inform the Board and the Audit Committee about these matters for the purpose of their review and approval of the December Announcement. This is despite the fact that he must have been aware, particularly having regard to the nature and cumulative effect of the information he 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 him, that these matters would be highly relevant to their deliberations. The Authority considers that Mr Adam acted recklessly as a result.

### **Listing Rule 1.3.3R**

#### Carillion's obligations and knowing concern

- 5.13. 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.
- 5.14. Section 91(2) of the Act provides that *"If, in the case of a contravention [by an issuer]... the [Authority] considers that [another person] who was at the material time a director of [the issuer] was knowingly concerned in the contravention, it may impose upon him a penalty of such amount as it considers appropriate."*

#### Carillion's breach and Mr Adam's knowing concern

- 5.15. By failing to take proper account of the matters at paragraph 5.9 above in the December Announcement, and by failing to ensure that the matters at paragraphs 5.18 to 5.31 below in relation to Listing Principle 1 were properly addressed, Carillion failed to take reasonable care to ensure that it 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.
- 5.16. By virtue of his knowledge and involvement in the December Announcement as detailed above, and by failing to ensure that the matters at paragraphs 5.20 to 5.29 below in relation to Listing Principle 1 were properly addressed during the Relevant Period, Mr Adam was knowingly concerned in Carillion's breach of LR 1.3.3R with regard to the December Announcement.
- 5.17. For the reasons given in paragraph 5.12 above, and in paragraph 5.32 below, the Authority considers that Mr Adam acted recklessly in respect of his knowing concern in Carillion's breach of LR 1.3.3R.



## **Listing Principle 1**

### Carillion's obligations and knowing concern

- 5.18. 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.
- 5.19. As a premium listed company, Carillion was required to comply with Listing Principle 1. Section 91(2) of the Act provides that *"If, in the case of a contravention [by an issuer]... the [Authority] considers that [another person] who was at the material time a director of [the issuer] was knowingly concerned in the contravention, it may impose upon him a penalty of such amount as it considers appropriate."*

### Carillion's procedures, systems & controls

- 5.20. Throughout the Relevant Period, Mr Adam was the Group FD of Carillion and his responsibilities included working closely with the Group CEO to ensure Carillion communicated effectively with investors and had appropriate internal control processes. 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.
- 5.21. 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 projects and assess material risks associated with their financial reporting.

5.22. Carillion's procedures, systems and controls did not meet these standards. Mr Adam was aware of and involved in the following matters that, when taken together, made Carillion's procedures, systems and controls inadequate during the Relevant Period:

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

Pressure on CCS to meet targets

5.23. Significant pressure was placed on CCS to meet very challenging budgeted and reforecast targets for the year ending 31 December 2016 through the budgeting and reforecasting process headed by Carillion's two executive directors, Mr Adam and Mr Howson. 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 in 2016 would not be accurate.

5.24. During the Relevant Period, despite knowing the pressure placed on CCS to meet targets set by him, and despite his obligations as Group FD, Mr Adam did not take any meaningful steps to satisfy himself 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 proper records

5.25. The contract accounting judgements being applied were not properly documented, which meant there was no clear and comprehensive 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. Mr Adam was aware of the following inadequacies in this regard:

- (1) 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. Mr Adam attended the CCS PRMs during the Relevant Period, but there were no minutes taken of PRM discussions and no record of any detailed review or changes to contract account judgements made or the reasons for them.
- (2) Position Papers reflected the contract accounting judgements made, but absent any other records, did not provide adequate explanation or support for them. Mr Adam received Position Papers and was aware of this omission during the Relevant Period. The judgements applied in the Position Papers were often inconsistent with other management information being reported by those responsible for making contract judgements, as reflected in MCS exposures, hard risk and Project Teams' forecasts reported in CCS PRMs. Mr Adam did not take any steps to resolve these inconsistencies, or to ensure that they were explained or otherwise addressed in the Position Papers.

#### Inconsistent management information on financial performance

5.26. The management information produced and reported by CCS to (amongst others) Mr Adam 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. In particular, Mr Adam was aware of the following matters during the Relevant Period:

- (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 to Mr Adam 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 by Mr Adam in response.
- (2) The MCSs highlighted likely financial exposures associated with Carillion's contracts, including CCS's construction projects. To Mr Adam's knowledge, no guidance was given to those preparing the MCS and the figures reported in it were inconsistent. It was nonetheless another means by which Business Divisions (including CCS) reported large exposures that significantly increased during the Relevant Period. The increasingly large exposures reported in it were not addressed by Mr Adam.
- (3) There were large 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 to (amongst others) Mr Adam by means of CCS PRMs or in some cases by email. Mr Adam did not make proper enquiries as to the reasons behind these divergences or seek to resolve them.
- (4) The above information provided to Mr Adam 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. Mr Adam failed to undertake any enquiries to understand why these inconsistencies had arisen and failed to take steps to resolve them.

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

- 5.27. 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 (amongst others) Mr Adam, as described in paragraph 5.26 above. This meant they were hampered in providing effective 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"*.

- 5.28. Instead, as Mr Adam was aware, 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.
- 5.29. 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 Finance Director's Report (prepared by Mr Adam in August 2016) and the external auditors' half 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 to effectively assess whether or not the judgements were being applied appropriately.
- 5.30. 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.
- 5.31. By virtue of his knowledge of the matters at paragraphs 5.20 to 5.30 above, and his failure to ensure that they were properly addressed during the Relevant Period, Mr Adam was knowingly concerned in Carillion's breach of Listing Principle 1.
- 5.32. Further, the Authority considers that Mr Adam was aware in light of the matters at paragraphs 5.21 to 5.30 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. He did not respond appropriately to this risk and failed to take any steps to address these matters during the Relevant Period. The Authority considers that Mr Adam acted recklessly as a result.

### **Premium Listing Principle 2**

- 5.33. Premium Listing Principle 2 requires a listed company to act with integrity towards the holders and potential holders of its premium listed securities.
- 5.34. 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.
- 5.35. As explained in paragraphs 5.12, 5.17 and 5.32 above, Mr Adam acted recklessly in relation to the facts and matters described above during the Relevant Period. The Authority attributes Mr Adam's state of mind to Carillion in this regard.
- 5.36. For these reasons, Carillion breached Premium Listing Principle 2 by failing to act with integrity towards its holders and potential holders of its premium listed shares. Mr Adam was knowingly concerned in Carillion's breach.

## **6. SANCTION**

### **Financial penalty**

- 6.1. The Authority's policy for imposing a financial penalty is set out in Chapter 6 of DEPP. The Authority applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5B and DEPP 6.5C set out the details of the five-step framework that applies in respect of financial penalties imposed on individuals in non-market abuse cases and market abuse cases respectively.

#### Step 1: disgorgement

- 6.2. Pursuant to DEPP 6.5B.1G and DEPP 6.5C.1G, at Step 1 the Authority seeks to deprive an individual 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 Mr Adam derived directly from the breach.

6.4. Step 1 is therefore £0.

Step 2: the seriousness of the breach

6.5. Pursuant to DEPP 6.5B.2G and DEPP 6.5C.2G, at Step 2 the Authority determines a figure that reflects the seriousness of the breach. That figure is based on a percentage of the individual's relevant income and, for market abuse cases, the greater of that amount, a multiple of the profit or loss avoided by the individual for his own benefit or £100,000 for cases the Authority has assessed as seriousness level 4 or 5. The individual's relevant income is the gross amount of all benefits received by the individual from the employment in connection with which the breach occurred, and for the period of the breach. In circumstances in which the breach lasted for less than 12 months, the relevant income is that earned by the individual in the 12 months preceding the end of the breach.

6.6. The period of Mr Adam's breach was from 1 July 2016 until 31 December 2016, so Mr Adam's relevant income is that which he earned between 1 January 2016 and 31 December 2016. The Authority considers the relevant income for this period to be £1,060,000. The Authority considers that Mr Adam did not make a direct profit or avoid a loss as a result of his knowing concern in Carillion's breach of Article 15 of MAR, and therefore DEPP 6.5C.2G(b) does not apply.

6.7. In deciding on the percentage of the relevant income that forms the basis of the Step 2 figure, the Authority considers the seriousness of the breach and chooses a percentage between 0% and 40%. This range is divided into five fixed levels which represent, on a sliding scale, the seriousness of the breach; the more serious the breach, the higher the level. For penalties imposed on individuals in non-market abuse and market abuse cases there are the following five levels:

Level 1 – 0%

Level 2 – 10%

Level 3 – 20%

Level 4 – 30%

Level 5 – 40%

*Level of seriousness*

6.8. In assessing the seriousness level, the Authority takes into account various factors which reflect the impact and nature of the breach.

*Impact of the breach*

6.9. DEPP 6.5B.2G(8) and DEPP 6.5C.2G(11) set out factors relating to the impact of a breach. The Authority considers the following factors to be relevant to Mr Adam's knowing concern in Carillion's breaches:

- (1) Mr Adam did not personally financially benefit from the breaches;
- (2) 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
- (3) 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*

6.10. DEPP 6.5B.2G(9) and DEPP 6.5C.2G(12) set out factors relating to the nature of a breach. Of these, the Authority considers the following factors to be relevant to Mr Adam's knowing concern in Carillion's 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 of LR 1.3.3R and Listing Principle 1, in respect of which Mr Adam was knowingly concerned, took place over a sustained period and resulted in the misleading December Announcement.
- (3) Mr Adam held a senior position within Carillion as its Group Finance Director.
- (4) As Group Finance Director Mr Adam held a position of trust for investors, creditors and employees of Carillion, all of whom were entitled to rely on the announcements being made by Carillion.



- (5) Mr Adam was an experienced accountant in the construction services sector.
- 6.11. DEPP 6.5B.2G(12) and DEPP 6.5C.2G(15) set 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 caused a significant loss or risk of loss to individual consumers, investors or other market users.
  - (2) The breaches resulted in an effect on the orderliness of, or confidence in, markets.
  - (3) Mr Adam breached a position of trust.
  - (4) The breaches were committed recklessly.
- 6.12. DEPP 6.5B.2G(13) and DEPP 6.5C.2G(16) list factors likely to be considered 'level 1, 2 or 3 factors'. Of these, the Authority considers the following factor to be relevant to the breaches:
- (1) No profits were made or losses avoided by Carillion as a result of the breaches, either directly or indirectly.
- 6.13. Taking all of these factors into account, the Authority considers the seriousness of the breaches to be level 4 and so the Step 2 figure is 30% of £1,060,000, which equates to £318,000.

Step 3: mitigating and aggravating factors

- 6.14. Pursuant to DEPP 6.5B.3G and DEPP 6.5C.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.
- 6.15. The Authority considers that there are no aggravating or mitigating factors.
- 6.16. Step 3 is therefore £318,000.

#### Step 4: adjustment for deterrence

- 6.17. Pursuant to DEPP 6.5B.4G and 6.5.C.4G, if the Authority considers the figure arrived at after Step 3 is insufficient to deter the individual who committed the breach, or others, from committing further or similar breaches, then the Authority may increase the penalty.
- 6.18. The Authority considers that the Step 3 figure of £318,000 represents a sufficient deterrent to Mr Adam and others, and so has not increased the penalty at Step 4.
- 6.19. Step 4 is therefore £318,000.

#### Step 5: Settlement discount

- 6.20. Pursuant to DEPP 6.5B.5G and DEPP 6.5C.5G, if the Authority and the individual 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 individual reached agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.
- 6.21. No settlement discount applies.
- 6.22. Step 5 is therefore £318,000.

#### Penalty

- 6.23. The Authority therefore has decided to impose a financial penalty of £318,000 on Mr Adam.

## **7. REPRESENTATIONS**

- 7.1. Annex B contains a brief summary of the key representations made by Mr Adam and how they have been dealt with. In making the decision which gave rise to the obligation to give this Notice, the Authority has taken into account all of the representations made by Mr Adam, whether or not set out in Annex B.

## **8. PROCEDURAL MATTERS**

8.1. This Notice is given to Mr Adam 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. Mr Adam 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, Mr Adam 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 1388/email: [Stephen.Robinson@fca.org.uk](mailto:Stephen.Robinson@fca.org.uk)).

**Tim Parkes**  
**Chair, Regulatory Decisions Committee**

## ANNEX A

### 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 31 December 2016 (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.

#### Market Abuse Statutory Provisions

##### Power to Impose Penalties for Market Abuse

- 1.2. Section 123 of the Act sets out the Authority's power to impose penalties 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."*

##### Individual Liability for Legal Persons under MAR

- 1.3. Section 131 AD of the Act sets out the provisions for individual liability in respect of legal persons under Article 12 of MAR. It states as follows:

*"(1) An individual participates in a decision by a body corporate for the purposes of [...] Article 12.4 (market manipulation) of the market abuse regulation where—*

*(a) the individual was an officer of the body corporate when the decision was made; and*

*(b) the [Authority is] satisfied that the individual was knowingly concerned in the decision.*

*(2) In this section "officer", in relation to a body corporate, means–*

*(a) a director, member of the committee of management, chief executive, manager, secretary or other similar officer of the body, or a person purporting to act in any such capacity; or*

*(b) an individual who is a controller of the body."*

### **Listing Rules Statutory Provision**

#### Power to Impose Penalties for Breach of Listing Provisions

1.4. 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."*

## 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 Procedures and Penalties Manual**

2.9. In determining the level of financial penalty to be paid in respect of conduct occurring on or after 6 March 2010 the Authority has had regard to the provisions of DEPP, particularly DEPP 6.5B and DEPP 6.5C.

## ANNEX B REPRESENTATIONS

1. A summary of the key representations made by Mr Adam, and the Authority's conclusions in respect of them (in bold), is set out below.

### Knowing concern

2. Even if Carillion's breaches are established, there is no proper basis for finding that Mr Adam was knowingly concerned in the contraventions.
3. The leading case on what a person must actually know in order to be knowingly concerned in a contravention is *Scandex*<sup>3</sup>, where it was held that it depends on whether the person knew the facts which made the act complained of a contravention. Further, the person must have been actually involved in the contravention.
4. Mr Adam's position on knowing concern is supported by the recent decision by the Court of Appeal in *Ferreira*<sup>4</sup>. The Court of Appeal confirmed that there is nothing illogical about a secondary party's liability depending on a state of knowledge different from that of the primary infringer, and in fact made it clear that there is intended to be a difference in the test for liability for a primary infringer and a secondary party. The Court of Appeal also rejected policy reasons which the Authority has raised in support of its construction of knowing concern.
5. **The Authority agrees that, in order for Mr Adam to be knowingly concerned in a contravention by Carillion of Article 15 of MAR, LR 1.3.3R, Listing Principle 1 and/or Premium Listing Principle 2, the judgment of the Court of Appeal in *Scandex* indicates that he must be shown: (i) to have been actually involved in the contravention; and (ii) to have had "knowledge of the facts upon which the contravention depends". As explained below in respect of each specific contravention, the Authority disagrees with Mr Adam's view as to what (ii) requires the Authority to establish.**
6. **The Court of Appeal's decision in *Ferreira* is not inconsistent with the Authority's analysis of the knowingly concerned test. In *Ferreira*, the Court of Appeal was considering a contravention which included a disapplication provision (i.e. a provision identifying the circumstances in which the contravention does not apply) and a factual element relating to that disapplication provision, but no equivalent disapplication provision or factual element exists in relation to the contraventions in this case. As *Ferreira* was concerned with knowledge of a purely factual question, it does not support Mr Adam's interpretation of the knowingly concerned test, which effectively requires him to have had knowledge of legal conclusions or evaluations, as opposed to primary facts. The Court of Appeal's analysis of the relevant policy arguments arose in the context of a primary offence of strict liability; fundamentally different considerations apply in this case, where the primary contraventions are fault-based. As the primary contraventions in this case are established by reference to the knowledge of Mr Adam and others who are alleged to be knowingly concerned in the breach, in the Authority's view there is no rationale for including a requirement of additional knowledge on the part of the secondary party.**

### *Article 15 MAR*

7. The allegation against Mr Adam is that there was a contravention of Article 15 of MAR because the information disseminated was incorrect. That is an ingredient of the

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<sup>3</sup> *SIB v Scandex Capital Management A/S* [1998] 1 WLR 712

<sup>4</sup> *FCA v Ferreira* [2022] EWCA Civ 397

contravention and a fact of which Mr Adam needed to have actual knowledge if he is to be held liable for participating in a contravention of Article 15 of MAR.

8. There has not been a decided case which addresses how the principles set out in *Scandex* are to be applied to the knowing concern of individual directors in market abuse cases. There has never been a previous case where it has been established that an individual can be knowingly concerned in the dissemination of false or misleading information to the market, contrary to MAR, without knowing that the information was incorrect.
9. As the criteria of liability for the firm and the individual are not the same, it is reasonable for the fault element necessary to establish the liability of the firm and the individual to differ. It is commonly the case that the criteria for establishing secondary liability are more stringent than the criteria for primary liability. As mentioned above, this is supported by the Court of Appeal's decision in *Ferreira*.
10. The allegation that Carillion ought to have known that the December Announcement was false requires only that Carillion was in effect negligent, not that it possessed any particular knowledge. In contrast, Mr Adam's liability depends on intentional participation, i.e. on actual knowledge of each fact necessary for the conduct complained of to amount to a contravention of the statute, including knowledge that the announcement was actually incorrect. Individual accessory liability for market abuse therefore cannot depend on mere negligence. There is nothing incoherent in the fact that Mr Adam's knowledge may support a finding that Carillion has contravened MAR, but not a finding that Mr Adam is liable as a participant therein.
11. Australian case law supports Mr Adam's position. It shows that the false or misleading nature of a representation is a fact of which an individual must be aware before they can be liable on a knowing concern basis.
12. **The Authority does not agree that Mr Adam needed to know that the information disseminated was incorrect, in order to have had knowledge of the facts upon which Carillion's contravention of Article 15 of MAR depends. Instead, the Authority considers that it is necessary to show that Mr Adam knew: (i) the information contained in the December Announcement; and (ii) sufficient facts to support the conclusion that Carillion ought to have known that the December Announcement was false or misleading.**
13. **If Mr Adam's submission was correct, as he acknowledges, the Authority would effectively have to show that he acted deliberately. The Authority considers that is not the correct test. Carillion's breach of Article 15 of MAR is based on the attribution of knowledge from Mr Adam (and others) to Carillion, as a result of which Carillion *ought to have known* that the Announcements were false or misleading. There is no need to prove actual knowledge that the December Announcement was false or misleading for the purpose of Carillion's primary contravention. Likewise, there is no need to establish that Mr Adam had such knowledge in order for him to be knowingly concerned.**
14. **The proposition that information is "*false or misleading*" is not a primary fact, but rather a legal conclusion reached by applying the relevant legal test to the facts. Instead, the facts relied upon in respect of Carillion's contravention of Article 15 of MAR are facts concerned with the December Announcement and, by contrast, what was said and known within Carillion as to the matters addressed in the December Announcement, for example, the financial risks and exposures reported as high risks and likely major contract exposures.**
15. **Further, Mr Adam's approach to the knowingly concerned test would fundamentally undermine the market abuse regime and its objectives, as the implication would be that a director could remain passive in response to warning signs, so as to avoid acquiring actual knowledge that an**

**announcement contained false or misleading information, and thereby insulate himself/herself from individual liability. In addition, if a director did not have the personal responsibility to take steps to satisfy himself/herself that information is true and not misleading, the obligation on a company to take reasonable care in respect of its announcements would be significantly undermined. In the Authority's view, it is not unfair for a director of a listed issuer to be held to be knowingly concerned in circumstances where it is their own conduct which gives rise or contributes to the primary breach.**

- 16. Although there has not been a previous knowing concern case specifically in relation to the MAR offence, the approach to knowing concern outlined above is consistent with the approach taken by the Authority in past knowing concern cases involving systems and control breaches and/or Listing Rules breaches.**
- 17. The Authority considers that Australian case law does not support Mr Adam's position because there are judgments in Australian cases which are both consistent and inconsistent with his position, and the fact that there are two differing lines of authority does not appear to have been resolved. Further, the Authority considers that little weight should be placed on Australian case law, as it is directed to the specific statutory provisions which were in issue in those cases.**

*LR 1.3.3R*

- 18. In order for there to be a breach of LR 1.3.3R, misleading information must be published. That follows from the language of LR 1.3.3R, which is headed 'Misleading information not to be published' and provides that an issuer must take reasonable care to "ensure" that any information provided to a RIS or the Authority is not misleading. Therefore, for Mr Adam to have been knowingly concerned, he had actually to know that the information provided was incorrect.**
- 19. The Authority does not agree with Mr Adam's view as to what is required in order for him to have had knowledge of the facts upon which Carillion's contravention of LR 1.3.3R depends. Similar to Article 15 of MAR, the matters which Mr Adam submits he requires knowledge of in order to be knowingly concerned are legal conclusions, rather than primary facts.**
- 20. Instead, the Authority considers that Mr Adam was knowingly concerned in Carillion's contravention of LR 1.3.3R because he knew the following facts: (i) the information contained in the December Announcement; (ii) information (such as that contained in MCSs on potential exposures in the Priority Contracts) which indicated that the statements in the December Announcement regarding Carillion's financial position did not reflect the true financial performance of CCS's construction contracts; and (iii) the (inadequate) steps taken by Carillion during the Relevant Period to ensure that the December Announcement was not false or misleading, which included knowledge that the Board and the Audit Committee were not provided with the above information (which in turn hampered their ability to ensure that the December Announcement was accurate).**
- 21. The Authority considers that, for the reasons set out in this Notice, the December Announcement clearly was misleading, but does not consider it is necessary to show that Mr Adam knew this or that the steps taken by Carillion to ensure that the December Announcement was not misleading were inadequate. As with Article 15 of MAR, if the Authority was required to establish such knowledge, it would effectively be required to prove that he acted deliberately, which the Authority considers goes too far and is not the correct test.**

### *Listing Principle 1*

22. In respect of Listing Principle 1, in order to have been knowingly concerned, Mr Adam had actually to know about each and every shortcoming on which the allegation that Carillion failed to take reasonable steps to establish and maintain adequate procedures, systems and controls is based, and each and every matter of fact which made that alleged shortcoming a shortcoming.
23. **The Authority considers that, in order for Mr Adam to be knowingly concerned in Carillion's contravention of Listing Principle 1, it is necessary to establish that he knew of the (inadequate) steps taken by Carillion during the Relevant Period to seek to establish and maintain adequate procedures, systems and controls, to enable it to comply with its obligations. The Authority does not consider it is necessary for it to establish that Mr Adam knew that those steps fell short of what reasonable care required; that is a legal conclusion and not a primary fact. Further, the Authority considers that Mr Adam did not need to know of every fact and shortcoming on which Carillion's contravention is based; rather, he needed to have sufficient knowledge that, on the basis of that knowledge, it is reasonable for the Authority to conclude that Carillion failed to take reasonable steps to establish and maintain adequate procedures, systems and controls.**

### *Premium Listing Principle 2*

24. In respect of Premium Listing Principle 2, the contravention by Carillion only follows if and to the extent that the other contraventions are established, and none of those contraventions are sustainable in law or fact. In any event, recklessness is not sufficient to establish lack of integrity in every case.
25. **For the reasons given in this Notice, the Authority considers that Carillion breached Article 15 of MAR, LR 1.3.3R and Listing Principle 1. As explained below, the Authority considers that Carillion's recklessness amounts to a lack of integrity in the circumstances of this case.**

### Recklessness and lack of integrity

26. Mr Adam denies that he was aware of any of the alleged risks, and therefore denies that he was reckless.
27. In any case, a lack of integrity does not automatically follow from a finding of recklessness. The alleged failure by Mr Adam to take reasonable care in the preparation of the December Announcement, and his alleged failure to take reasonable steps to establish and maintain adequate procedures, systems and controls, was not necessarily conduct lacking in integrity merely because, according to the Authority, it was engaged in recklessly. The Tribunal has stated<sup>5</sup> that in its view integrity "*connotes moral soundness, rectitude and steady adherence to an ethical code. A person lacks integrity if unable to appreciate the distinction between what is honest or dishonest by ordinary standards.*"
28. The Authority should not find that Mr Adam behaved immorally or unethically by the standards of listed companies at the time, even if he is found to have appreciated a risk that reasonable care or reasonable steps had not been taken.
29. **As explained below, the Authority considers that Mr Adam was aware of the alleged risks and that he acted recklessly by failing to respond appropriately to them.**
30. **The Authority considers that Mr Adam's reckless conduct demonstrates an objective failing of ethics or morals on his part and thereby a lack of integrity. In respect of the breach of Article 15 of MAR, recklessness on the part of a**

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<sup>5</sup> *Geoffrey Alan Hoodless and Sean Michael Blackwell v Financial Services Authority* [2003]

**finance director of a listed company as to the accuracy of its market announcements is, objectively, an ethical or moral failing. Shareholders and potential shareholders rely on the accuracy of market announcements. For Mr Adam to sign off on a positive market announcement despite clear warning signs about significant deterioration in the performance of the company is a serious form of recklessness. Further, in respect of the breaches of LR 1.1.3R and Listing Principle 1, Mr Adam's failings included a failure to ensure that the Board and the Audit Committee were informed of the warning signs of which he was aware, in circumstances where he knew that these warning signs were inconsistent with other management and financial information provided to Carillion. The Authority considers that Mr Adam's recklessness in this regard amounts to a lack of integrity. The Authority considers that the recklessness of Mr Adam (and of another person) should be attributed to Carillion and that Carillion therefore also acted recklessly and without integrity.**

Mr Adam's awareness of the alleged risks

31. Mr Adam was not aware of any of the alleged risks. He had no motivation to ignore the risk that CCS's performance was such that he was misleading the market, the Board, the Audit Committee and the external auditors. The only plausible explanation for him not informing the Board, the Audit Committee and the external auditors of the alleged risks is that he was not aware of them.
32. The Authority's case against Mr Adam relies on the fact that a limited pool of documents, particularly the MCS and those containing references to hard risk figures, were made available to him. That limited pool of documents cannot carry the evidential weight placed on them. On the occasions they were drawn to his attention, Mr Adam considered they were prepared for different purposes and in order to convey different types of information to that contained in the "core" reports.
33. If it was the case that the MCS and hard risk documents contained the accurate reporting figures, the only possible conclusion to draw is that individuals within CCS were concealing their view of the relevant figures by deliberately reporting inaccurate figures in the "core" reporting documents.
34. Mr Adam relied on the "core" reporting systems. He was not aware (if true) that CCS believed that the MCS and hard risk figures contained the more accurate information or conveyed a risk that the "core" reports were not IAS 11 compliant. The external auditors and the Audit Committee were also not aware that CCS's true views contradicted the official "core" reporting documents and they had a better understanding of CCS's position.
35. The position reported to Mr Adam, even outside the "core" reporting documents, is only consistent with that set out in the Position Papers. In contrast to the apparently frank distinctions drawn in intra-CCS emails between the true position and the Position Papers, there was no such frankness with Mr Adam.
36. The accounts of CCS individuals in interview should not be accepted as giving a true and accurate account of events. The evidence shows admissions of apparent wrongdoing by those at CCS level, whereas there is no direct evidence of any wrongdoing by Mr Adam. Nobody interviewed by the Authority ever stated or indicated that Mr Adam suspected that the traded sums which underlay the December Announcement were or might be incorrect. Where there is conflict between the interview accounts of CCS individuals and Mr Adam's evidence, Mr Adam should be believed.
37. Mr Adam's position is supported by the fact that: (i) reassessment of the contracts was not felt necessary until the second half of 2017, in the face of more compelling warning signs; and (ii) after Mr Adam retired from Carillion, reviews were undertaken yet nobody concluded that any restatement of the 2016 results was required. Further,

any misstatement was not detected during the preparation of the 2017 half-year accounts in September 2017, or during the negative accruals review, the Enhanced Contracts Review, by the external auditors or by two subsequent combinations of Group FD and CEO.

- 38. The Authority considers that Mr Adam was aware of the risk that the December Announcement was false or misleading and the risk that Carillion did not have adequate procedures, systems and controls to enable it to comply with its obligations under the Listing Rules. This conclusion is based on assessing the information known to Mr Adam at the relevant times. As a result, the Authority does not need to reach, nor has it reached, a conclusion with respect to Mr Adam's motives, but it notes the importance which he and Carillion gave to meeting investors' and market expectations.**
- 39. In concluding that Mr Adam was aware of the risk that the December Announcement was false or misleading, the Authority has relied not only on the MCS and hard risk figures that Mr Adam received before the December Announcement was approved, but also the information provided to him by experienced CCS personnel by a variety of means indicating that the expected performance of the Priority Contracts was much worse than the budget and re-forecasts providing the basis for the December Announcement. These differences were significant, amounting to around £35 million in respect of RLUH and Battersea and £68 million in respect of AWPR.**
- 40. The Authority considers that, in reaching its conclusions, it is appropriate for it to rely on these warning signs, in particular given: (i) their cumulative effect, (ii) their straightforward use of language, (iii) the fact that they provided considerable detail of the risks, (iv) their very large potential impact on Carillion's reported profit figures, and (v) the context in which they were reported, namely by a number of experienced senior employees within CCS and/or as part of key and established internal reporting processes, such as PRMs and budgets and reforecasts.**
- 41. Mr Adam's failure to respond appropriately to the warning signs he received is not excused by the fact that he did not receive them through what he describes as the "core" reporting systems. The nature and scale of the warning signs and the context in which they were reported, along with the nature of IAS 11 judgements and their significance to Carillion's business, meant that he needed to take all reasonable steps to address them and to bring them to the attention of the Board and the Audit Committee. In addition, rather than simply relying on the "core" reporting systems, as a result of his awareness of the warning signs he should have questioned their adequacy.**
- 42. Further, Mr Adam's submissions regarding reliance on what he describes as "core" reports are undermined by the fact that he confirmed in interview that the budget and re-forecast process was part of the "core" reporting system and that hard risk reporting was an established part of the budgeting and re-forecasting process. In addition, it was not reasonable for him to take the view that the MCS figures should carry little weight, in circumstances where the MCS report was created on Mr Adam's own initiative with a view to capturing all of the major contract exposures across the Group.**
- 43. As Mr Adam received the Position Papers, he would have been aware that the judgements set out therein were inconsistent with the warning signs of which he was aware, but he failed to take any steps to resolve these inconsistencies or to ensure that they were explained or otherwise addressed in the Position Papers.**

44. **The Authority has had regard to all the evidential material before it in reaching its conclusions. Where Mr Adam's interview evidence conflicts with that provided by CCS individuals, the Authority has given most weight to interview evidence that is supported by contemporaneous documents.**
45. **Given Mr Adam's responsibilities as Group FD, and the fact that the Board, the Audit Committee and the external auditors were not aware of the warning signs at the relevant times, the Authority does not consider that Mr Adam's submissions regarding: (i) the lack of reassessment of the contracts until the second half of 2017; (ii) the fact that a prior year adjustment was not considered necessary; and (iii) the lack of detection of any misstatement, demonstrate that he acted reasonably in response to the warning signs of which he was aware.**

Mr Adam's career and role

46. Mr Adam has had a distinguished and previously unblemished career of over 30 years. Character references provide a picture of an individual who simply would not have acted in the reckless manner alleged, particularly without any apparent reason for doing so.
47. As Group FD, Mr Adam was responsible for the financial affairs of the company (which was ultimately a collective Board responsibility), but he was also charged with overseeing 10 other areas within the business. He did not have direct responsibility for CCS's performance.
48. It follows from the nature of IAS 11, and from the standard structure of large construction companies, that a Group FD is dependent upon the knowledge and judgement of commercial teams at lower levels, and on the information and judgements provided by those commercial teams being distilled into manageable and reliable reports.
49. Mr Adam did satisfy himself that Carillion's figures were correct. However, he had neither the role nor expertise necessary to go behind the figures in the "core" reporting systems which had been checked by the divisional commercial team. He necessarily relied heavily upon the qualifications, knowledge, skills and experience of those within the CCS Division when determining whether the accounting standards and policies applicable to Carillion's construction contracts were satisfied.
50. **The Authority has had regard to Mr Adam's submissions regarding his career and the character references provided. However, as noted above, the Authority has reached its conclusions based on an analysis of all the material it has seen, and considers that this material supports the conclusion that Mr Adam acted recklessly, notwithstanding his stated lack of reason for doing so.**
51. **As Group FD, Mr Adam was primarily responsible for ensuring that the financial results of the Group were accurately reported. He was therefore required, at the very least, to take all reasonable steps to satisfy himself, in the light of the information that he received, that the financial performance of Carillion's construction contracts was being accurately reported in compliance with financial reporting requirements, including IAS 11. This necessarily involved taking reasonable steps to assess and address the warning signs that he received in relation to CCS, not just the subset of information in what he has described as "core" reporting systems.**
52. **The nature of IAS 11 judgements and their significance to Carillion's business meant that it was particularly important for Mr Adam to take all reasonable steps to address the warning signs that he received. The magnitude of the risks and inconsistencies revealed by the information received by Mr Adam is a further factor which underscored the need for him to take reasonable steps to satisfy himself that Carillion's financial reporting was true and accurate.**



53. **Mr Adam's submissions that he did not have the role or expertise to go behind the figures in the "core" reporting systems, and that he relied on senior management in the Business Divisions, neglect the important personal responsibilities that he owed in relation to: (i) the financial affairs of Carillion as a whole, including its financial reporting to the market; (ii) the preparation of the December Announcement (in which he played an integral role); (iii) his approval of the December Announcement as a director of the Board; (iv) the adequacy of Carillion's systems and controls with respect to financial reporting; (v) the overall adequacy of Carillion's provisions; and (vi) providing the Audit Committee with assurance that the level of provisions made for risks in connection with Carillion's major contracts was appropriate.**
54. **Further, the evidence from contemporaneous emails and from interviews carried out by the Authority shows that Mr Adam had a detailed level of involvement in respect of the information provided to him. He should have reviewed and addressed the warning signs, yet he took no meaningful steps to do so.**

Carillion's procedures, systems and controls

55. Mr Adam denies that Carillion failed to take reasonable steps to establish and maintain adequate procedures, systems and controls.
56. The information presented to Mr Adam through Carillion's reporting systems, which the Authority accepts were IAS 11 compliant, gave him no real means of being able to recognise that CCS's management was overriding the views of individuals with first-hand understanding of the Priority Contracts.
57. It was not unreasonable for Mr Adam to rely on the systems and procedures which were actually in place, particularly as the Authority accepts that, if CCS management had been complying with those same policies and procedures, they would have been appropriate and IAS 11 compliant.
58. Mr Adam would have expected a team at site level to have a more negative view of revenue and costs than at the commercial level, because it was the commercial team who had the expertise and were responsible for judging the revenue and costs that would probably flow from claims and variations.
59. Had CCS believed that there was a material risk that the figures in, for example, the Position Papers were no longer recoverable, that should have been conveyed through the "core" systems, in accordance with the relevant policy.
60. **Mr Adam was responsible for ensuring there were adequate systems, controls and procedures with respect to financial reporting to ensure appropriate accounting judgements were being made, including in relation to the financial performance of Carillion's construction projects. In light of the clear warning signs that he was aware of, he needed to take all reasonable steps to address the apparent inconsistencies in Carillion's management and financial information, and ensure that the Board and the Audit Committee were kept properly informed, so that they could satisfy themselves that Carillion's systems and controls were adequate.**
61. **There were serious failings in Carillion's systems and controls, in particular: (i) the inconsistency between the information reported by CCS (on the one hand) and the information set out in Carillion's Position Papers and escalated to the Board and the Audit Committee (on the other); and (ii) the failure to inform the Board and the Audit Committee of CCS's more pessimistic assessments. There was also a failure to keep proper records with respect to contract accounting judgements.**
62. **Mr Adam was aware of the inconsistencies and of a number of warning signs, so he must have appreciated the risk that Carillion's procedures, systems and**

**controls were inadequate. In the circumstances, it was not reasonable for him simply to rely on the procedures, systems and controls in place. He failed to undertake any enquiries to understand why the inconsistencies had arisen and failed to take any steps to resolve them or to address the risk that Carillion's procedures, systems and controls were inadequate.**

#### Pressure exerted

63. No wrongdoing is alleged in relation to other Divisions, and the evidence is that there was none. Therefore, the suggestion that CCS's apparent wrongdoing was a result of pressure at Group level should be treated with scepticism. On the contrary, the alleged wrongful conduct appears to have been confined to those individuals within CCS.
64. The Authority accepts that any pressure exerted on the Divisions for them to meet targets was not untoward, which can only mean that it was legitimate. Indeed, it is legitimate and normal for a Group FD to impose targets and to hold the business to those targets. Given that acceptance, Mr Adam should not be criticised if CCS personnel responded to legitimate targets by, as alleged, making overly aggressive accounting judgements and concealing them from the external auditors and from the Board.
- 65. The Authority considers that the evidence shows that there was significant pressure on CCS to meet very challenging financial targets set and maintained by Mr Adam (and other senior management), in the face of clear warning signs that CCS's business was deteriorating significantly. This pressure, whilst not itself undue, was an important factor which necessitated a robust control framework, to ensure that inappropriate contract accounting judgements were not made in consequence. However, as explained above, Carillion's control framework was inadequate.**

#### CCS PRMs

66. PRM packs contained rolling action lists rather than formal minutes, and these lists were specifically designed to record important points arising from PRMs and ensure they were actioned. There is no evidence to show that the PRMs needed to be minuted in a different way, in order for Carillion's procedures, systems and controls to be characterised as adequate.
67. CCS PRMs had an operational focus. Recovery strategies were discussed, but management adjustments and the probability of recovery were not. It is therefore difficult to understand what might have been minuted at a CCS PRM that would have made a difference to this case.
- 68. The PRM process was an important 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. As a result, minutes needed to be made of discussions in the meetings and proper records made of any detailed review or changes to contract accounting judgements and the reasons for them. It was therefore not sufficient only for a list of agreed actions to be made. This was a serious inadequacy in Carillion's systems and controls.**
- 69. Mr Adam attended CCS PRMs and must have been aware that these matters were not properly recorded.**

#### The scale of the risks and exposures

70. In Mr Adam's view, the hard risk figures and the MCS were not part of the Group's "core" reporting, were unreliable (certainly relative to the "core" reports), and did not reflect CCS's considered view in accordance with the requirements of IAS 11. In any event, whatever their scale, they represented sums which had been assessed as probably recoverable.

71. Further, the risks reported to him were far lower than those identified from January 2017, when Mr Adam had left Carillion.
72. **It was not appropriate for Mr Adam to proceed on the basis that the hard risk and MCS figures were unreliable because they were not part of what he describes as the "core" reporting systems. The magnitude of the risks revealed by these figures meant it was imperative that Mr Adam take reasonable steps to satisfy himself that Carillion's financial reporting was accurate.**
73. **Although the size of the risks increased after Mr Adam had left Carillion, in October 2016 the hard risk figure totalled £171.8 million and the MCS reported "likely" potential exposures of around £173 million. As explained further below, the Authority does not agree that they represented sums which had been assessed as probably recoverable. Given that Carillion's underlying PBT for the 2016 full year was £178 million, these figures were large in both absolute and relative terms and it was not reasonable for Mr Adam to fail to take steps to address them and bring them to the attention of the Board and the Audit Committee.**

#### Hard risk

74. There was no common written definition in any of Carillion's policies and procedures as to what hard risk meant, and certainly not at Group level. Different individuals had different understandings of the term, and it is plausible to conclude that Mr Adam understood hard risk in one way, and individuals in CCS understood it in a different way. There is no evidence of anyone outside of CCS understanding hard risk in the way alleged by the Authority.
75. Mr Adam did not understand hard risk as sums that would need to be written off because they were probably not recoverable. If he had understood it that way, he would have promptly acted on that understanding. Instead, he understood that hard risk was a tool used to measure risk.
76. The two emails sent to Mr Adam in March 2016 are the only evidence in support of the contention that Mr Adam was told that hard risk figures were probably not recoverable and are taken out of context. On a reasonable interpretation, having regard to the referenced schedules, the only contrast being drawn was between hard risk sums and those which were collectable in cash in the short term. He therefore understood hard risk as being contrasted with immediately collectable sums. Mr Adam did not understand these emails to be disclosing any risk that the "core" reports were wrong.
77. The hard risk documents were non-"core" documents that Mr Adam received sporadically amongst a large volume of other communications and documents. If there was revenue traded on a contract that either was or became improbable, Mr Adam expected that position to be reflected through the established financial reporting system. The importance now placed on hard risk is entirely disproportionate to the importance it would have had at the time to Mr Adam.
78. As Mr Adam did not understand the hard risk figures to contradict the figures provided for the purpose of the financial reporting of actual results, and which he believed reflected CCS's considered commercial and accounting judgements, there was no reason for him to believe that CCS was misrepresenting its figures in the Position Papers.
79. Hard risk relief was purely a budgeting tool. It was relief from a profit target in the budgeting and reforecasting process, not permission to write down or not write down a contract for reporting purposes. If there was to be a write-off, CCS was able and required to do so without permission from the Group; it had nothing to do with hard risk relief, which was a tool for the budgeting and forecasting process only.

80. There is no evidence that hard risk relief had a role to play in the Position Papers or that it altered the values ascribed to particular projects for the purposes of preparing Carillion's published accounts.
81. **The Authority considers that contemporaneous evidence shows that hard risk was generally understood within CCS to be "the likely amount required to be written off". Mr Adam has failed to identify a single contemporaneous document which supports his asserted understanding of hard risk.**
82. **In any case, irrespective of his and others' understanding as to the precise meaning of hard risk, Mr Adam was aware that hard risk was a type of risk with a potentially significant impact on Carillion's balance sheet and profitability. He was also aware that it was reported by CCS as part of the quarterly budgeting and re-forecasting process, a well-established and important process within Carillion, which formed the basis on which CCS set out its expected financial performance for the year as assessed, amongst other things, against market expectations. Given the size of the hard risk reported by CCS (£171.8 million as at October 2016), which was large both in absolute terms and relative to Carillion's underlying PBT of £178 million for the 2016 full year, Mr Adam needed to take meaningful steps to address the high levels of hard risk being reported to him, but he did not do so.**
83. **As a result of the email characterising hard risk as "not collectible" that he received in March 2016, Mr Adam must have appreciated at the very least the risk that sums reported as hard risk were not genuinely collectable. In respect of the "what is hard risk vs genuinely collectable" email, Mr Adam's submission that he understood "genuinely collectable" to mean collectable in the short term is not what the email said and is inconsistent with the supporting analysis attached to the email.**
84. **CCS reported hard risk figures in order to highlight financial risks and exposures and to enable the Group to take a view on whether, and if so how, to deploy central provisions and contingencies at Group level, by means of "hard risk relief" or otherwise. The amount of hard risk relief allocated to CCS represented an amount by which CCS was permitted to adjust its overall profit forecast downwards to take account of hard risk. CCS applied the hard risk relief via write-offs or profit adjustments to its budget and re-forecasts. How hard risk operated was well illustrated by the budget and reforecasting presentation at the October 2016 CCS PRM, which Mr Adam attended. It was Mr Adam's role, as the Group FD, to determine how much hard risk relief should be allocated to CCS. He allocated hard risk relief of £15 million to CCS, which was far lower than the level of hard risk reported by CCS.**
85. **The Position Papers sent to the external auditors displayed the position after the application of hard risk relief. The application of hard risk relief thereby altered the values ascribed to particular projects for the purposes of preparing Carillion's published accounts.**

#### The MCS

86. Mr Adam did not regard the MCS as a significant source of financial information or as a part of the financial reporting; instead, he relied on the "core" reports. Broadly, its purpose was to allow people to examine Carillion's traded revenue at a more detailed level than just confirming that Carillion's Revenue Recognition Policy and the requirements of IAS 11 were satisfied (i.e. that it was probable that the relevant amounts would be recovered). Operational and commercial managers were to give some thought to how high that level of probability was, in order to provide a very broad-brush and high-level assessment of Carillion's resilience. For example, if all of Carillion's traded construction revenue was considered to have a 55% prospect of being recovered, that would satisfy Carillion's revenue recognition policy and the

requirements of IAS 11, but would nonetheless be a very different operational position from one where all of the construction traded revenue was considered to have an 85% prospect of successful recovery. Mr Adam wanted to gain some idea of "how probable was probable?".

87. **The MCS was a report prepared for the purpose of a quarterly MCRM between senior management at Divisional and Group level within Carillion. The MCS recorded "exposure to traded amount" by reference to best, likely and worst outcomes. It was created in 2014 on the initiative of Mr Adam and was intended to be a central summary capturing all of the major contract exposures across the Group. It was therefore a finance-led initiative, not a purely commercial or operational document, and Mr Adam's contention that the MCS was not a significant source of financial information is therefore not credible.**
88. **The MCS section for CCS was compiled and submitted by the same senior individuals upon whom Mr Adam says he relied for the purpose of forming IAS 11 judgements. Mr Adam's asserted understanding that the MCS exposures were sums assessed as being probably recoverable and appropriately recognised under IAS 11 is unsupported by both the documentary evidence and the interview evidence of senior CCS individuals, and is inconsistent with the content of the MCS report, which identified significant losses even on the "best" case scenario.**
89. **Having received the information contained in the MCS, which showed MCS exposures on a large scale with a potentially large impact on Carillion's balance sheet, Mr Adam had a duty to take all reasonable steps to satisfy himself that the December Announcement was true and not misleading. Even if the MCS was entirely separate from other forms of reporting within Carillion, it was not reasonable for Mr Adam to disregard this source of information.**

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

90. There was no reason for Mr Adam to inform the Board or the Audit Committee of the hard risk and other figures unless he understood them as casting doubt over the figures reported via the "core" reports, which he did not.
91. As CCS did not tell Mr Adam what hard risk and other figures meant to them, he did not appreciate their purported significance and so was in the same position as the Board and the Audit Committee in providing effective oversight.
92. **Mr Adam received numerous warning signs, including hard risk and MCS figures, highlighting the financial risks and exposures associated with contract accounting judgements made within CCS. He was aware that this information was inconsistent with that provided to the Board and the Audit Committee, and that the risks and divergences reported were of such scale that they could have a potentially significant impact on Carillion's balance sheet. In these circumstances, it was unreasonable for Mr Adam not to ensure that the Board and the Audit Committee were aware that CCS was internally reporting figures which were inconsistent with the figures in the papers provided to them.**
93. **As explained above, Mr Adam must have appreciated at the very least the risk that sums reported as hard risk were not genuinely collectable. In any event, he was informed of the large size of the hard risk and other figures and he must have appreciated their significance. At the very least he should have made enquiries to ascertain what CCS meant by such figures. As Mr Adam was provided with these figures, clearly he was not in the same position as the Board and the Audit Committee.**

### The role of the external auditors

94. It is inconsistent to conclude that Mr Adam was aware of the risk that the December Announcement was misleading, in circumstances where the external auditors were provided with far more granular information than him, were specifically charged with determining whether the accounts gave a true and fair view, and key information which was deliberately kept from the external auditors by CCS was also kept from Mr Adam.
95. **Mr Adam received the Position Papers before they were sent to the external auditors. He was therefore aware that they did not reflect CCS's hard risk reporting, MCS reporting or any of the other warning signs that he was aware of. It is therefore not reasonable for Mr Adam to take the position that, if the external auditors did not uncover significant issues, he could not have been aware of the risk that the December Announcement was misleading.**
96. **Further, the responsibility of the external auditors only extended so far as to provide an opinion on whether the financial statements were 'true and fair', not to ensure that they were. In contrast, as a director, Mr Adam had primary responsibility for the preparation and approval of the financial statements and ensuring that they were indeed 'true and fair'. Since he was aware of warning signs regarding CCS's financial position, Mr Adam needed to take action to discharge his responsibilities and he could not reasonably disregard these warning signs on the ground that he expected the external auditors to uncover the same matters, if they were significant. In addition, as a director, pursuant to section 418 of the Companies Act 2006, Mr Adam was obliged to take reasonable steps to make himself aware of any "relevant audit information" (defined as information that the company's auditors needed in connection with preparing their report) and to establish that the company's auditors were aware of that information, so Mr Adam had a duty to bring the warning signs regarding CCS's deteriorating financial position to the attention of the external auditors.**

### The Priority Contracts

97. The Priority Contracts amounted to less than 1% of the number of all active projects within CCS, a Division representing much less than half of Carillion's overall revenue of £5.2 billion in 2016. At tender they were together to provide Carillion with a total profit of £23 million, which if entirely realised in 2016 would have represented only 8.65% of Carillion's total £268.4 million operating profit for the year.
98. The Priority Contracts' subsequent significance does not justify giving a distorted and hindsight-driven view of the attention which it was reasonable for Mr Adam (as Group FD) to give them at the time of the December Announcement.
99. Only five documents have been introduced to support the case that Mr Adam had sufficient evidence that he ought to have known that Carillion was misleading the market and Mr Adam does not accept that they constituted red flags.
100. The first of these documents is the spreadsheet sent by email in September 2016 by the RLUH Project Team to Mr Howson (and others), which Mr Howson forwarded to Mr Adam (and others). This appears to predict an end of life margin loss of £50 million on the project, reduced to a £14 million loss by realistic recoveries and reduced further to an £8 million loss by other potential benefits. There is no indication that this represented a considered view with the benefit of experienced commercial input, or any input from the CCS management team. Mr Adam has no recollection of the email and expected that CCS's considered view would in due course be appropriately accounted for and reported in the "core" reports on which he relied.
101. The second document is the presentation for a "profitability workshop" in September 2016 which reported end of life margin losses for the Priority Contracts forecast by the Project Teams. Mr Adam cannot recall attending that meeting or seeing

the presentation. However, it is likely that he would have interpreted the figure for each project as setting out the 'raw view' of the site team before the commercial team had considered and evaluated the position. He did not understand this 'raw view' to be a definitive record of the financial position of the project and he did not regard it as evidence that the estimated final margin, as reported to the Board from time to time, was incorrect.

102. The third document is a presentation for the October 2016 CCS PRM which reported, for RLUH and Battersea, differences between the Project Team's assessment of the financial position and the margin traded to date. Mr Adam cannot remember seeing this document and does not recall it. In any event, Mr Adam generally understood the site view to be a 'raw view', absent the input of the commercial team at divisional level necessary to reach a considered conclusion. The fact that the site team was at that time predicting an overall loss on the project would not have been of any particular concern to him for that reason.
103. The fourth document is an internal Carillion email sent to Mr Adam (and others) on 19 November 2016, regarding the cash position on AWPR. Although this email referred to an end of life loss in respect of AWPR of £40 million for Carillion, it and subsequent emails in the chain made clear that the costs to complete on the project remained uncertain. The email concerned the cash budget for a single year and Mr Adam would not have expected it to contain important new information about the estimated end of life profit on the project, still less information which he should have preferred to that contained in the "core" reports.
104. The final document is the AWPR Update presentation delivered at the December 2016 CCS PRM on 16 December 2016, which suggested that the 'likely' outcome of the project was a £78 million loss for CCS. This presentation occurred after the December Announcement and shortly before Mr Adam retired. If CCS had concluded that this information was sufficiently reliable that a further change needed to be made to Carillion's traded position in respect of AWPR, Mr Adam would have expected this to be reflected appropriately in the "core" reporting documents. However, there is no evidence that such a position was or should have been reached before Mr Adam retired. In addition, Mr Adam has no recollection of this presentation and, given that he missed at least two thirds of the meeting at which it was given, it is to be inferred that he did not see it.
105. **Whilst the anticipated profit at tender of the Priority Contracts might not have been especially significant to Carillion, the size of the potential losses being reported by experienced senior employees within CCS in respect of these three contracts during the Relevant Period was potentially of far greater significance to Carillion's financial position. At the time of the December Announcement, Mr Adam was aware that the scale of the potential losses being reported was considerable and equated to a substantial proportion of the underlying PBT for the whole Group.**
106. **As Mr Adam was aware, where contracts were assessed to be loss-making, the full extent of the loss needed to be recognised immediately in the accounts by way of an appropriate write-down under IAS 11. RLUH and Battersea were recognised in the Position Papers and reported to the Board as profit-making contracts throughout the Relevant Period, so the information seen by Mr Adam indicating that they were in fact assessed as loss-making needed to be treated with the utmost seriousness, due to the significant impact of such loss having to be recognised in full immediately. AWPR was recognised in the Position Papers and reported to the Board as a profit-making contract until October 2016, whereupon it was adjusted to an end of life loss of £10 million. The information received by Mr Adam indicating that the loss was assessed as potentially much higher was extremely serious as**

**the full extent of the loss would need to have been recognised in the accounts immediately under IAS 11.**

- 107. Mr Adam was informed by a variety of means of large divergences between the assessments of financial performance by the Project Teams and/or management teams within CCS and the financial performance as reflected in Carillion's budgeted forecasts. However, he failed to take any meaningful steps to address these warning signs and to satisfy himself that contract accounting judgements were being applied appropriately, and he failed to bring them to the attention of the Board and the Audit Committee.**
- 108. Mr Adam was sent the first document with a specific invitation to discuss, so the Authority considers that he was aware of the information contained in it. The email was sent by an experienced contractor on the RLUH project and needed to be taken seriously. His assessment was supported by an itemised loss of proposed recoveries amounting to £42 million, but even taking these into account the RLUH Project was considered to be loss-making, which would then have triggered the immediate recognition of the full extent of the loss. Mr Adam therefore had good reason to consider whether any further alteration to his estimate by way of management adjustment was in fact justified or at least to take steps to understand the basis for such an adjustment. However, he did not take such steps or inform the Board or the Audit Committee of this assessment.**
- 109. Mr Adam attended the 'profitability workshop' on 28 September 2016. The CCS presentation for the workshop consisted of eight slides, with the final slide headed "*Challenging Contracts*". It only mentioned three contracts – the Priority Contracts – and set out end of life estimates for all three contracts as heavy losses. The purpose of the workshop was to allow the Group to understand the performance and progress of the various Business Divisions and Business Units and how this compared to the existing re-forecasts and budgeted figures. In that context, a presentation showing such large divergences between the traded figures to date and the site end of life assessments was a clear warning sign, yet Mr Adam did nothing to address or make enquiries about the discrepancy between these assessments and the margins subsequently contained in the Position Papers and reported to the Board and the Audit Committee.**
- 110. Mr Adam attended the CCS PRM on 19 October 2016 and in advance of the meeting received a copy of the presentation by email, which reported differences of £33.2 million and £22.8 million respectively between the site view end of life forecasts for RLUH and Battersea and the traded figures to date. These very large disparities were an important warning sign as, on the site-view estimate, both of these contracts were loss-making contracts such that the entire loss would need to be recognised immediately. It was not reasonable for Mr Adam to disregard this warning sign on the basis that the site-view end of life assessments were subject to revision by way of management adjustments, given that he took no steps to satisfy himself that any management adjustment was warranted.**
- 111. The email of 19 November 2016 was sent by a senior CCS individual. Although the email made clear that costs to complete on the AWPR project were uncertain, this does not assist Mr Adam's position given that the outcome of the revised cost-to-complete exercise was actually an even worse end of life assessment: the £78 million projected loss mentioned in the report presented at the CCS PRM on 16 December 2016. Further, whatever Mr Adam's expectation with respect to what was in the email, it clearly stated that Carillion's projected end of life loss for the project was £40 million, and**



Mr Adam had no basis for disregarding such information, even if it emanated from sources outside what he describes as the “core” reporting system.

112. Following the 19 November 2016 email, Mr Adam attended the Board meeting on 6 December 2016 at which AWPR was forecast as an end of life loss of only £10 million. In his Group FD’s report for this meeting, Mr Adam forecast the Group’s underlying PBT as £178 million for the 2016 full year. It appears from the Board minutes that Mr Adam did not volunteer any information regarding the risks to this forecast, but on questioning acknowledged the importance of AWPR and the fact that it presented a risk. In light of this discussion, it was emphasised that the Board was “*reliant*” on the judgement of the executive and that it was important for the Board to understand whether the trading performance of the business had deteriorated. Mr Adam was therefore aware of the importance of the AWPR project and the degree to which the Board was dependent on executive judgements as to the trading position in respect of it. As a result, the AWPR Update on 16 December 2016 was a matter of obvious interest and importance to Mr Adam. The documentary evidence suggests that he did attend the relevant part of the meeting. Further, given the information provided to him in the 19 November 2016 email, and his knowledge of the Board’s position, the Authority considers that he must have acquainted himself with the outcome of the revised cost-to-complete exercise for AWPR. In the unlikely event he did not, that would not help his position, as he would have had no basis for assuming that the AWPR position had improved since the assessment of a £40 million loss in the 19 November 2016 email. In addition, the Authority does not consider it reasonable for Mr Adam to have disregarded the AWPR Update on the basis that it was not part of the “core” reporting systems, and the fact that the presentation was provided after the December Announcement and soon before he retired does not excuse his failure to take appropriate actions in response, given that he continued to have responsibilities to Carillion until the end of 2016.

#### The December Announcement

113. Mr Adam does not admit that the December Announcement was false, or that Carillion failed to take reasonable care to ensure that the December Announcement was not misleading.
114. If the information on which the December Announcement was based was inaccurate, it was only because CCS was deliberately reporting the wrong figures to the Group in the Position Papers, MPSRs and Overtrade Reports. Mr Adam was not aware of the inconsistency between the “core” reports and the hard risk figures, MCS figures and the other alleged red flags.
115. **The December Announcement made positive statements that Carillion’s performance was “*meeting expectations*”. It referred to “*expected strong growth in total revenue and increased operating profit*” and stated that a solid revenue performance was expected in respect of Construction Services (excluding the Middle East). It also stated that Carillion was “*well positioned to make further progress in 2017*”.**
116. **The Authority considers that these positive statements were not justified. The December Announcement did not disclose significant deteriorations in the expected performance of projects across the CCS portfolio. It also did not take account of a series of warning signs indicating anticipated losses and/or reduced profitability across a number of major construction projects. The Authority therefore considers that the December Announcement did not accurately or fully disclose the true financial performance of Carillion and that it was misleading.**

117. **Mr Adam was aware of these warning signs and therefore ought to have known that the information in the December Announcement was false or misleading. He did not take any steps during the Relevant Period to address the warning signs and failed to bring them to the attention of the Board and the Audit Committee. As a result, the Authority considers that Carillion failed to take reasonable care to ensure that the December Announcement was not misleading in breach of LR 1.3.3R and that Mr Adam was knowingly involved in that breach.**
118. **The Authority considers that the evidential material does not support Mr Adam's submission that the information in the December Announcement was inaccurate because CCS deliberately reported the wrong figures to the Group. As the Group FD, Mr Adam had primary responsibility for ensuring that the financial results of the Group were accurately reported. He saw both the papers which were provided to the Board and the Audit Committee and the hard risk figures, MCS figures and the figures showing the large divergences between the assessments of financial performance by teams within CCS and the financial performance as reflected in Carillion's budgeted forecasts. He therefore must have been aware of the inconsistency between these reporting streams, and it was incumbent upon him to address this inconsistency and ensure that it was brought to the attention of the Board and the Audit Committee.**

#### Limitation

119. The Authority is not permitted to impose a financial penalty in respect of Mr Adam's alleged knowing concern in the alleged breaches of LR 1.3.3R, Listing Principle 1 and Premium Listing Principle 2 because the Warning Notice was not issued within three years of the date on which the Authority had information from which the alleged misconduct could reasonably be inferred.
120. The matter was referred to the Authority's Enforcement division on 25 September 2017 by way of an Investigation Recommendation which was based on information held by the Authority over three years before 18 September 2020, the date the Warning Notice was issued. The Investigation Recommendation mistakenly identified Mr Khan as the Group FD during 2016, when it was actually Mr Adam. Therefore, the implication of the Group FD in the potential breaches was an implication of Mr Adam. The Authority therefore had sufficient knowledge to justify an investigation into Mr Adam prior to 18 September 2017, and so the Authority is time-barred from imposing a financial penalty on Mr Adam in respect of those alleged breaches.
121. **The Authority does not agree that it is time-barred from imposing a financial penalty in respect of the breaches of LR 1.3.3R, Listing Principle 1 and Premium Listing Principle 2. Section 91 of the Act requires the Authority to issue a warning notice within three years of the date on which it first knew of a breach of the Listing Rules or had information from which it could reasonably be inferred. Pursuant to *Jeffery*<sup>6</sup>, the correct approach to the issue of limitation is "*first, to determine what the misconduct is that the Authority contends that [the person] is guilty of, and secondly to determine the earliest date on which the Authority knew of the misconduct or had information from which the misconduct could reasonably be inferred.*"**
122. **In summary, the particular misconduct alleged against Mr Adam, as set out in the Warning Notice given to him (and repeated in this Notice), is that he was knowingly concerned in breaches by Carillion of LR 1.3.3R, Listing Principle 1 and Premium Listing Principle 2. This is as a result of his failure to act in response to numerous warning signs highlighting financial risks and exposures associated with contract accounting judgements made within CCS,**

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<sup>6</sup> *Andrew Jeffery v the Financial Conduct Authority*: FS/2010/0039

**for example by failing to bring these matters to the attention of the Board and the Audit Committee and by failing to ensure that the content of the December Announcement appropriately reflected them. As at 18 September 2017 (i.e. three years prior to the Warning Notice was issued), the Authority did not have information concerning any of the warning signs identified in the Warning Notice or Mr Adam's failure to respond appropriately to them. Accordingly, the Authority did not have information from which Mr Adam's breaches could reasonably be inferred.**

123. **Further, the Authority notes that the decision to refer the matter to the Authority's Enforcement division on 25 September 2017 only concerned Carillion as a firm and not any individual. Further, the Investigation Recommendation stated that the Authority did not have "sufficient information to establish whether any of the directors were knowingly concerned and or responsible for the alleged breaches".**

Proposed financial penalty

*Mr Adam's income in 2016*

124. The relevant income figure should be an accurate and fair reflection of what Mr Adam earned in 2016, otherwise he will be penalised in a manner which is neither commensurate with his responsibilities in the Relevant Period nor necessary to act as a credible deterrent.
125. Mr Adam disagrees that his relevant income for 2016 was £1,060,000. This amount wrongly includes an amount of £278,000 for deferred bonus and long-term incentives, which relates to the value of certain shares awarded to Mr Adam. Mr Adam was awarded the shares in 2014 and the vesting was deferred until 2017, with the proportion which would vest depending on Carillion's performance over a three-year period. He ultimately received 60.55%, which vested on 8 May 2017 with a value of approximately £242,000.
126. These shares cannot be regarded as a benefit earned by Mr Adam in 2016 simply because the extent to which he ultimately enjoyed that benefit may have been contingent, in part, on what happened in 2016. They must therefore be disregarded. Alternatively, the figure should be one third of the amount for which they were actually sold, on the basis that it relates to one of the three years. Mr Adam's relevant income for 2016 was therefore actually £782,000 or, at most, £862,666.
127. **Mr Adam's income figure is primarily drawn from the Remuneration Report in Carillion's 2016 Annual Report and Accounts. It is clear from that report that the shares awarded to Mr Adam in 2014 were regarded as being earned in respect of the year ended 31 December 2016, not over a three-year period. Further, it is the amount to which Mr Adam was entitled which is relevant in determining his relevant income, not the amount for which he may have eventually sold the shares after the end of the Relevant Period. This is the approach taken in the Remuneration Report, which values the shares awarded to him at a three-month average price as at 31 December 2016.**
128. **The overall relevant income figure of £1,060,000 is also consistent with the "single figure of remuneration" disclosed in the 2016 Remuneration Report.**

*Seriousness*

129. Mr Adam disputes that he committed any wrongdoing and therefore no financial penalty should be imposed. However, should the Authority disagree, the level of seriousness should be 2 rather than 4.
130. Mr Adam's alleged conduct did not cause the liquidation of Carillion. It is also not obvious that the December Announcement had an effect on confidence in the market,

in circumstances where the provision was made and the fall in share price occurred half a year later, following a significant deterioration in CCS's financial position.

131. Any failings in relation to Carillion's procedures, systems and controls were principally the responsibility of others.
132. Mr Adam occupied a position of trust in relation to Carillion only, and he did not abuse a position of trust.
133. There is no evidence that the alleged breaches caused significant loss to individual consumers, investors and other market users.
134. **The Authority considers that Mr Adam's breaches are of seriousness level 4, having regard to all relevant factors, in particular those set out in paragraphs 6.11 and 6.12 of this Notice.**
135. **The Authority is not alleging that the breaches by Carillion and Mr Adam resulted in Carillion's liquidation. However, the public nature of Carillion's business, the size and scope of its reporting failures, and Carillion's subsequent liquidation have together undermined confidence in the financial reporting regime. The December Announcement was part of a series of announcements regarding the financial performance of Carillion which were eventually corrected, at least in respect of the performance of CCS, by the announcement in July 2017. It is therefore reasonable to assess the impact of the December Announcement on the market by assessing the reaction to the announcement in July 2017.**
136. **As Group FD, Mr Adam was responsible for ensuring that Carillion had adequate procedures, systems and controls in place relating to financial reporting. He was therefore required to respond appropriately to the risk that these procedures, systems and controls were inadequate, rather than to rely on others.**
137. **As Group FD, Mr Adam held a position of trust not only in relation to Carillion, but in relation to all users of its market announcements (including investors, creditors and Carillion employees), who were entitled to rely on those announcements not being misleading, false or deceptive and not omitting anything likely to affect the import of the information. Mr Adam breached that position of trust with respect to the December Announcement.**
138. **Carillion was a significant and well-known listed company with widely traded shares. The Authority therefore considers it is reasonable to infer that some of its shareholders would have been individual consumers and investors, and that the breaches caused a risk of loss to them and also other market users, such as holders of related derivatives.**

#### *Mitigating factors*

139. Mr Adam cooperated fully with the Authority's investigation, including by making himself available for several days of interview, and has an exemplary 30-year professional record. These factors should merit a 15% discount at Step 3 of the penalty calculation.
140. **The Authority acknowledges that Mr Adam attended a voluntary interview, but considers that he did not show any exceptional cooperation during his investigation which merits a Step 3 mitigation discount. Similarly, the Authority acknowledges that Mr Adam has no prior disciplinary history with the Authority, but does not consider that this merits a reduction to the financial penalty.**

#### Introduction of new material following issue of the Warning Notice

141. The Authority's Enforcement division disclosed new material following issue of the Warning Notice and made new factual points based on this material. It is neither

appropriate nor fair to introduce new points based on new evidence at this stage of the case.

142. **Mr Adam was given the opportunity to make, and did make, further written representations in respect of the new material produced by the Authority's Enforcement division following the issue of the Warning Notice and the points made by the Authority's Enforcement division based on that new material. He also made oral representations following the disclosure of the new material. In the circumstances, the Authority considers that Mr Adam has been given a fair and reasonable opportunity to make representations in respect of this new material and that it is not unfair for the Authority to have regard to this material in reaching its decision.**