

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.



DECISION NOTICE

To: **Richard John Howson**

Date of birth: **August 1968**

Date: **24 June 2022**

1. ACTION

1.1. For the reasons given in this Decision Notice, the Authority has decided to impose on Richard Howson a financial penalty of £397,800 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 Howson 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- (2) Listing Rule 1.3.3R (misleading information must not be published);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, specifically its trading update on 7 December 2016, its 2016 financial results published on 1 March 2017 and its AGM statement on 3 May 2017, had given no indication to the market that such a provision was likely to be required.
- 2.5. Such previous announcements were misleading and were made recklessly. They did not accurately or fully disclose the true financial performance of Carillion. They made positive statements about Carillion's financial performance generally and in relation to CCS's construction business segment in particular. They failed to disclose significant deteriorations in the expected performance of projects across the CCS portfolio and did not take account of a series of warning signs indicating anticipated losses and/or reduced profitability across a number of major construction projects. It was these matters that, when eventually acknowledged by Carillion, led to a significant proportion of the provision announced in July 2017.

Mr Howson

- 2.6. Mr Howson was Carillion's Group Chief Executive Officer from 1 January 2012 to 10 July 2017. This Notice relates to Mr Howson's conduct as Group CEO between 1 July 2016 and 10 July 2017 (the Relevant Period).

- 2.7. During the Relevant Period, Mr Howson, as Group CEO, was one of two executive directors on Carillion's Board. His responsibilities included working closely with the Group Finance Director (the other executive director on the Board) to ensure Carillion communicated effectively with investors and had appropriate internal control processes.

Overly aggressive contract accounting judgements and internal reporting to Mr Howson

- 2.8. There was significant pressure on CCS during the Relevant Period to meet very challenging financial targets maintained by Mr Howson (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 Howson 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 Howson and others as amounting to around £172 million. By April 2017, Mr Howson knew this figure had increased to just over £310 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 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 Howson and others. By May 2017, according to an MCS dated 4 May 2017 received by Mr Howson, the likely exposure figure had increased to over £430 million (71% of the contentious amounts due).

(3) Large and increasing divergences in financial performance were highlighted to Mr Howson and others during the Relevant Period in relation to four major projects: Royal Liverpool University Hospital (RLUH), Phase 1 Battersea Power Station redevelopment (Battersea), Midland Metropolitan Hospital (MMH) and Aberdeen Western Peripheral Route (AWPR). This made clear that there was an increasingly large disparity for those projects between the assessments of financial performance by project and/or management teams within CCS and the financial performance as reflected in Carillion's budgeted forecasts. The following gaps were highlighted to Mr Howson 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 by December 2016, a difference of almost £35 million. This difference increased to £72 million by April 2017 as RLUH's financial performance deteriorated;
- b. Battersea: A £25 million loss (assessed by the relevant Project Team) against a budgeted forecast profit of around £10 million by December 2016, a difference of £35 million. This gap rose to over £43 million by April 2017;
- c. MMH: A £15.7 million loss (assessed by the relevant Project Team) against a budgeted forecast profit of £17.7 million by April 2017, a difference of over £33 million; and
- d. AWPR: A £78 million loss (assessed by the relevant Business Unit within CCS) against a budgeted forecast loss of £10 million by December 2016, a difference of £68 million. This increased to a gap of over £85 million by April 2017.

2.11. When Carillion made its provision in July 2017, a total of £240 million was provided against the above four projects, consistent with the amounts noted

above. This represented almost two-thirds of CCS's total provision of £375 million.

Reporting to the Board and the Audit Committee

- 2.12. Mr Howson, as Group CEO, reported to the Board on a monthly basis and attended Audit Committee meetings during the Relevant Period.
- 2.13. The financial risks and exposures described at paragraph 2.10 above were not reported by Mr Howson (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 Howson, as Group CEO, would attend the Audit Committee, where a report was provided by the Group FD which included a summary of financial risks and key judgements associated with major projects.
- 2.14. As Mr Howson 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 in paragraph 2.10(2) above, the MCS in October 2016 (which the Board and the Audit Committee did not see) was identifying a likely exposure of £173 million. In contrast, the Overtrade Report did not show what those within CCS thought were likely exposures; instead, it showed revenue "*traded not certified*" (i.e. amounts that had not yet been agreed with the client which the Overtrade Report reported as appropriate to recognise as revenue). Throughout the Relevant Period up to February 2017, it reported this revenue at between £42 million and £44 million.
- 2.15. The MPSR was aligned, to Mr Howson's knowledge during the Relevant Period, to the budgeted and reforecast figures and did not disclose increasing variances between these figures and the Project Team's or Business Unit's assessments of RLUH, Battersea, MMH and AWPR. It did not show any material deterioration in CCS's major projects during the Relevant Period. The Group FD's report for the 2016 full year similarly did not identify any material deterioration associated with major projects.

- 2.16. Before the announcement in July 2017, the amount of provisions in Carillion's monthly management accounts for CCS's projects remained broadly unchanged at up to £17 million for all risks.

The Announcements

- 2.17. 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)¹ remaining within a target range of 2.5-3% for the 2016 year-end. It described Carillion as "*well positioned to make further progress in 2017*".
- 2.18. 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. The March Results Announcement made similar positive statements to those in the December Announcement. In particular, it described Carillion's performance as "*in line with expectations*", with revenue growth for the Group of 11% and underlying profit before tax (PBT) of £178 million. The document published alongside (and linked from) the March Results Announcement stated that "*Revenue grew strongly by 21 per cent*" in Construction Services (excluding the Middle East) and confirmed that operating margin for this segment "*remains within our target range of 2.5 per cent to 3 per cent*". It described the ambition for this segment in 2017 as being "*to maintain revenue and profit at broadly their current levels*". The March Results Announcement went on to refer to Carillion having a "*good platform from which to develop the business in 2017*".
- 2.20. The March Results Announcement was misleading because the above statements concerning the financial performance of Carillion and Construction Services (excluding the Middle East) for 2016 and stated expectations for 2017 did not reflect the true performance of CCS's construction contracts and the announcement omitted any reference to the significant risks associated with these

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

stated expectations as described at paragraph 2.10 above. The revenue and profit / margin figures for the Group and Construction Services (excluding the Middle East) in the March Results Announcement were misstated because they did not accurately reflect the financial performance of RLUH, Battersea, MMH and AWPR. In particular, Carillion failed to recognise the costs and revenue associated with these projects in accordance with IAS 11. The revenue and profit / margin figures were materially overstated as a result. The positive statements for 2017 for Group and Construction Services (excluding the Middle East) were similarly not justified because they did not take account of matters arising before this date, as described at paragraph 2.10 above.

- 2.21. The tenor of the May Announcement was that nothing had materially changed since the March Results Announcement. This was reflected in its heading ("*Trading conditions unchanged*") and opening sentence ("*Trading conditions across the Group's markets have remained largely unchanged since we announced our 2016 full-year results*"). This was not an accurate depiction of the Group's trading as at 3 May 2017, which was materially affected by the adverse and deteriorating financial performance of CCS's construction projects as at the date of this announcement, as described at paragraph 2.10 above.
- 2.22. Mr Howson as Group CEO and one of only two executive directors had a central role in reviewing the Announcements and approving them 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 the Announcements. Mr Howson must have been aware, particularly having regard to the nature and cumulative effect of the information and the occasions on which it was reported to him, and his extensive knowledge of the construction industry, that this information would be highly relevant to the deliberations of the Board and the Audit Committee when they reviewed and approved the Announcements. However, Mr Howson failed to ensure that this information was brought to the attention of the Board and the Audit Committee.
- 2.23. In light of the above, the Authority considers that Carillion disseminated information in the Announcements that gave false or misleading signals as to the value of its shares in circumstances where it ought to have known that the information was false or misleading, in breach of Article 15 of MAR, and that Mr Howson was knowingly concerned in Carillion's breach of Article 15 of MAR.

- 2.24. During the Relevant Period, Mr Howson 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(3) above. Mr Howson 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 ensure that these matters were brought to the attention of the Board and the Audit Committee.
- 2.25. In light of the above, and the matters summarised at paragraphs 2.26 to 2.31 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 Announcements were not misleading, false or deceptive and did not omit anything likely to affect the import of the information, in breach of LR 1.3.3R, and that Mr Howson was knowingly concerned in Carillion's breach of LR 1.3.3R.

Procedures, systems & controls

- 2.26. The deterioration in CCS's business during the Relevant Period, coupled with the pressure to meet very challenging financial targets, significantly increased the risk that overly aggressive contract accounting judgements would be applied in order to maintain its financial performance. To counter this risk, Carillion's procedures, systems and controls in relation to CCS needed to be sufficiently robust to ensure that these judgements were made and reported appropriately. They were not, significantly increasing the risk that market announcements in relation to Carillion's financial performance would not be accurate.
- 2.27. 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 Howson chaired). 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.
- 2.28. The management information relating to hard risks, MCSs and certain major projects produced and reported by CCS to (amongst others) Mr Howson 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.

- 2.29. 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.
- 2.30. 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.
- 2.31. As the Group CEO with responsibilities for ensuring that Carillion had adequate procedures, systems and controls, including in relation to financial reporting, and the Board member with the most expertise on construction and contracting matters, the Authority considers that during the Relevant Period, Mr Howson was knowingly concerned in Carillion's breach of Listing Principle 1.
- 2.32. The Authority considers that Mr Howson acted recklessly in relation to the facts and matters at paragraphs 2.8 to 2.30 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 Howson was knowingly concerned in Carillion's breach of Premium Listing Principle 2.
- 2.33. The Authority has therefore decided to impose a financial penalty on Mr Howson in the amount of £397,800 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;

"AGM" means Annual General Meeting;

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

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

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

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

"Building" means the Buildings Business Unit within CCS;

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

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

"Carillion" means Carillion plc;

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

"CEO" means Chief Executive Officer;

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

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

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

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

"the Handbook" means the Authority's Handbook of rules and guidance;

"IAS 11" means International Accounting Standard 11;

"Infrastructure" means the Infrastructure & Railways Business Unit within CCS;

"the Listing Rules" means those rules contained in the part of the Handbook entitled 'Listing Rules';

"MAR" means Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse;

"March Results Announcement" means Carillion's 2016 financial results published on 1 March 2017;

"May Announcement" means Carillion's AGM statement published on 3 May 2017;

"MCS" means Major Contracts Summary;

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

"MMH" means Midland Metropolitan Hospital;

"MPSR" means Major Project Status Report;

"MCRM" means Major Contracts Review Meeting;

"PBT" means underlying Profit Before Tax;

"Priority Contracts" means these four major projects: AWPR, Battersea, MMH 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 10 July 2017;

“RIS” means Regulatory Information Service;

“RLUH” means Royal Liverpool University Hospital;

“the Tribunal” means the Upper Tribunal (Tax and Chancery Chamber); and

“the Warning Notice” means the warning notice given to Mr Howson dated 18 September 2020.

4. FACTS AND MATTERS

SECTION A: BACKGROUND

- 4.1. During the Relevant Period, Carillion was a leading construction, project finance and support services business operating in the UK, Canada and Middle East. It was created following a demerger of Tarmac Group in 1999 and subsequent acquisitions of (amongst others) Mowlem and Alfred McAlpine. Carillion was admitted to the Official List of the London Stock Exchange.
- 4.2. Carillion was a non-trading investment holding company operating through a large number of subsidiaries and joint ventures. Its internal and external financial reporting to the market was broadly aligned with its business structure. Carillion’s business was divided into the following divisions during the Relevant Period: CCS, Carillion Services, Middle East and North Africa, Canada, Al Futtaim Carillion and Carillion Private Finance.
- 4.3. Carillion’s construction business was operated by CCS in the UK and by Canada and MENA respectively for its overseas construction business. Carillion externally reported its financial results for its UK construction business as part of a business segment called “*Construction Services (excluding the Middle East)*”, including construction activities in CCS and Canada. This segment represented almost 30% (£1,520.2 million) of Carillion’s revenue for 2016, of which CCS contributed £1,452.8 million.
- 4.4. In the UK, CCS as a Business Division of Carillion was led by Business Divisional management. CCS was sub-divided into Business Units, including (amongst others) Building and Infrastructure. Major construction projects reported directly into these Business Units. Smaller projects reported into Business Units via

regional teams. Each of the Business Units was led by Business Unit management. Major projects also had their own project and commercial managers.

- 4.5. On 10 July 2017, Carillion announced that it was making a provision of £845 million in relation to 58 contracts within its construction business. Of this provision, £375 million related to CCS and £470 million to overseas markets (the majority of which related to existing markets in the Middle East and Canada). The CCS provision was made when Carillion acknowledged that accounting judgements it had previously made in relation to its construction projects needed to be revised significantly downwards. The provision included £240 million in relation to four major UK construction projects: RLUH, Battersea, AWPR and MMH.

SECTION B: MR HOWSON'S ROLES AND RESPONSIBILITIES

- 4.6. Mr Howson joined Tarmac in 1995, which became Carillion in 1999. On 1 January 2012, Mr Howson was appointed as Group CEO and remained in post until 10 July 2017. During the Relevant Period, Mr Howson's responsibilities included:

- (1) working closely with the Group FD to ensure Carillion communicated effectively with investors;
- (2) working closely with the Group FD to ensure Carillion had appropriate internal control processes, including systems and controls to facilitate the appropriate accounting in compliance with the relevant accounting standards; and
- (3) providing effective leadership to Carillion. As one of two executive directors (the other being the Group FD), he reported to the Board, in particular through the CEO updates which presented on, amongst other things, the performance of the construction business, in respect of which he was the Board member with the most expertise.

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), IAS 11 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.

SECTION D: CARILLION'S PROCEDURES, SYSTEMS AND CONTROLS

- 4.13. 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.
- 4.14. During the Relevant Period, the budget and reforecasting challenges issued and maintained by senior management (including by Mr Howson) 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

4.15. 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.

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

Application of contract accounting judgements and their reporting within CCS

4.17. During the Relevant Period, the application of contract accounting judgements within CCS was dominated by the need to meet the very challenging financial targets set and maintained by senior management (including Mr Howson). In practice, this meant that the judgements were no longer made in accordance with Carillion's internal policies or on a "*bottom up*" basis as envisaged in the forecasting process, but were aligned to meet the targets set and to maintain the

reported profitability of CCS's major projects. These judgements did not reflect the true financial position of the projects or the financial risks associated with them. They did not comply with IAS 11, one of the applicable accounting standards governing the recognition of revenue and costs associated with construction contracts.

4.18. These financial risks and potential exposures arising from these overly aggressive accounting judgements were highlighted by CCS to Mr Howson 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 and increasing divergences in the financial performance in relation to certain major projects, making clear the increasingly large disparity for those projects between the assessments of financial performance by project and/or management teams within CCS and the financial performance as reflected in Carillion's budgeted forecasts.

4.19. Mr Howson 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 communicate them to the Audit Committee, even though to his knowledge they were not otherwise being reported or communicated, 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 Board and the Audit Committee. This meant that the Board and the Audit Committee were unaware of the full extent of financial risks and potential exposures within CCS and their significant increase during the Relevant Period.

4.20. There was no single, coherent process within CCS for 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 Howson, Richard Adam (Carillion's Group FD during the Relevant Period until 31 December 2016) and Zafar Khan (Carillion's Group FD from 1 January 2017, who was previously the Group Financial Controller), 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 Howson

(i) Contract Appraisals

- 4.21. The Project Teams typically produced monthly Contract Appraisals for each major project setting out the estimated end of life and current traded value, costs and margin ("traded" referring to the amounts entered into Carillion's financial reports). These figures incorporated the Project Team's ongoing judgements as to the potential recoverability of claims or variations, or cost savings, as well as any additional adjustments applied on top of the Project Team's judgements (typically known as "management adjustments" within CCS).
- 4.22. These management adjustments applied during the Relevant Period were often the means by which the financial performance of projects was adjusted upwards in order to meet budgeted forecasts in line with the targets for CCS set and maintained by senior management (including Mr Howson). 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 Howson 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 one of the tools used within CCS, however, 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. Mr Howson was aware in January 2017 that by November / December 2016, these management adjustments amounted to around £245 million within CCS. He was also aware in April 2017 that they had increased to approximately £310 million by February / March 2017.

(ii) Performance Review Meetings

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

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

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

(iii) Budgeting and reforecasting process

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

4.26. As explained above, this process was intended to be "*bottom up*" and submissions would be reviewed at Business Unit and Divisional PRMs before being submitted to the Group finance function and ultimately the Board for approval.

4.27. The budget and reforecast submissions would be subject to challenge in the form of revised financial targets, first by management of the relevant Business Division and subsequently by the Group FD. The pressure to meet challenges imposed and maintained by senior management (including Mr Howson) 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 and the use of negative accruals and "audit friendly" Position Papers (see paragraphs 4.87 and 4.105 below).

(iv) *Hard risk*

- 4.28. The management of CCS and its associated Business Units had significant concerns about the increasing levels of risk associated with these judgements.
- 4.29. CCS categorised risk associated with contract accounting judgements as "*hard risk*" or "*soft risk*". Hard and soft risks represented attempts to quantify and report on financial risks associated with CCS's projects, typically in the context of Carillion's budgeting and reforecasting processes. As Mr Howson 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.
- 4.30. As explained below (see paragraphs 4.53 and 4.54), Mr Howson attended CCS PRMs during the Relevant Period at which the forecast level of hard risk was highlighted as part of the budgeting and reforecasting process. By October 2016, hard risk internally reported in the CCS PRM amounted to £172 million. This increased to £258.4 million by the end of December 2016 and to £310.6 million by April 2017.

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

- 4.31. The MCS was a quarterly report submitted by the Business Divisions to (amongst others) Mr Howson 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.

- 4.32. In October 2016, the MCS identified a "*likely*" exposure of £173.2 million within CCS (up from £159.9 million in July 2016), with 11 out of 16 named projects marked with a red flag status. By May 2017, this had increased to a "*likely*" exposure of over £430 million, with all bar two projects marked with a red flag status.
- 4.33. The MCS was discussed at Major Contracts Review Meetings and circulated in advance of these meetings. The attendees at the MCRMs would typically include the Group CEO, the Group FD and management from each Business Division. Mr Howson received the July and October MCSs by email in advance of MCRMs that he was due to attend, although it appears he did not subsequently attend those meetings.

(vi) Peer review

- 4.34. Separate to the reporting processes described above, major projects were also subject to peer reviews which were carried out as part of Carillion's internal audit programme. They involved a review of selected projects undertaken by experienced contract managers from another part of the business. The review included consideration of the financial position of the relevant project and the contract accounting judgements applied to it. During the Relevant Period, the peer review recommendations on certain major projects identified significantly worse financial performance than the budgeted forecasts. There was, however, no formal process to ensure that a peer reviewer's recommendations were taken into account and no meaningful action taken in response, although as part of internal audit presentations to the Audit Committee, peer review recommendations were identified as being tracked and implemented.
- 4.35. Mr Howson did not receive peer review reports, although he was aware of the process and indicated which projects he wanted to be peer reviewed.

Reporting to the Board and the Audit Committee

- 4.36. Mr Howson was a member of the Board throughout the Relevant Period and attended the Audit Committee. The Group FD was the only other executive director who was a member of the Board during the Relevant Period.
- 4.37. As Mr Howson knew, the Board and the Audit Committee were responsible for providing oversight of Carillion's business and the risks in that business, including those associated with its financial reporting to the market. The Audit Committee's Terms of Reference during the Relevant Period stated, amongst other things, that the Committee would review and where necessary challenge "*whether the Company has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditors*".
- 4.38. The internal reporting of hard risks, potential exposures in the MCSs and the large and increasing divergences from budgeted forecast in the financial performance of certain major projects represented significant and increasing financial risks associated with overly aggressive contract accounting judgements being applied within CCS during the Relevant Period. These risks were known to Mr Howson 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 Howson 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.
- 4.39. 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.

- 4.40. 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 Howson as Group CEO and by the Group FD.
- 4.41. Notwithstanding the significantly increasing financial risks within CCS, the figures in the MPSRs and the MPSR Executive Summary throughout the Relevant Period were aligned to the latest budget or reforecast figures for each project. This meant that the MPSRs and the MPSR Executive Summary failed to highlight any inconsistencies between the latest budget or reforecast and the assessment of the relevant Project Team, Business Unit or Business Division. Mr Howson 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.
- 4.42. 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.
- 4.43. 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.
- 4.44. Mr Howson understood the importance of the Overtrade Report. Whilst he believed "*Construction Revenue Traded Not Certified*" included both contentious and non-contentious amounts, he 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.

- 4.45. 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.
- 4.46. 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 (the meetings of which Mr Howson attended) 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

- 4.47. 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. The external auditors were therefore not informed of the internal reporting of hard risks, potential exposures in the MCSs or the large and increasing divergences from budgeted forecast in the financial performance of certain major projects.

- 4.48. Mr Howson did not receive Position Papers.

SECTION E: EVENTS LEADING UP TO THE ANNOUNCEMENTS

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

- 4.49. 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 G below. They were highlighted by CCS to Mr Howson and others on a number of occasions during the Relevant Period. Mr Howson 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 Audit Committee, the Board and the external auditors. However, they were not reported to the Audit Committee, the Board or the external auditors.

July and October 2016 MCSs

- 4.50. 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).
- 4.51. 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).
- 4.52. Mr Howson received the MCSs for July and October 2016. He did not, however, take any steps to address these increasing exposures being reported to him.

Hard risk reported in August and October 2016 and January 2017

- 4.53. 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 Howson on 11 August 2016 and he dialled into part of the PRM at which the presentation was discussed.
- 4.54. 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 Howson attended the relevant PRM.
- 4.55. In January 2017, CCS was reporting in its PRM that hard risk had increased to £258.4 million by the end of December 2016. Mr Howson attended this PRM.
- 4.56. As a result, the hard risk forecast reported by CCS increased by £61.8 million between January and August 2016 and by a further £85.7 million between August and December 2016. As explained above, hard risk represented amounts viewed by CCS as unlikely to be recovered. Mr Howson must have understood this to be the case given his accumulated knowledge and experience, together with an email sent to him on 18 March 2016 that specifically characterised hard risk as "*not collectible*" (sic). However, Mr Howson took no 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

- 4.57. As Mr Howson knew, the significant increases in likely MCS exposures and high levels of hard risk during the second half of 2016 were not highlighted to the Board or the Audit Committee. 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.
- 4.58. 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 Howson 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 July and October 2016 MCSs, unlike the Board and the Audit Committee).

- 4.59. In August 2016, a member of the Audit Committee queried 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*”. It was noted that this would be reviewed going forward, but no substantive changes were made during 2016 or 2017 to the level of information being provided to the Audit Committee.

No increase in provisions

- 4.60. The level of provisions against risks associated with major projects was reported to the Board each month as part of the monthly management accounts. Total provisions for the Group reviewed by the Board were consistently maintained at £27.1 million throughout 2016, with other provisions and contingencies increasing this to £50.1 million in total by the 2016 year-end. The amount of provisions and contingencies allocated to CCS remained broadly at £16.9 million. There was no material increase in the size of the provisions or contingency to address the increasing exposures identified in the MCS and the high levels of hard risk reported by CCS.
- 4.61. As a member of the Board, Mr Howson was aware of the provisions seen by the Board during the Relevant Period. Despite this, he did not take steps to address the discrepancy between (i) the level of Group provisions and (ii) 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

- 4.62. The market consensus for Carillion's underlying profit before tax was around £180 million for the 2016 full year. In early December 2016, Carillion was considering how to meet this expectation and was exploring possible one-off transactions or introducing more "stretch" for CCS in order to bridge a perceived Group PBT shortfall of £33 million against market expectations. In the end, the gap was bridged for the Group in part by means of a one-off transaction with an outsourcing supplier, which delivered an additional £20 million of profit for 2016. This enabled the Group FD, Mr Adam, to report to the Board *"The positive news that our overall expectations for Group profit and earnings are broadly in line with our expectations enabled us to keep the consensus forecasts for total underlying profit and earnings broadly unchanged."* Mr Howson attended the Board meeting at which this was reported.
- 4.63. 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 Howson 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.
- 4.64. 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 risk being reported within CCS. Carillion's share price fell 3% on the announcement.

- 4.65. Mr Howson was closely involved in the process for preparing and reviewing the December Announcement. At the Board meeting on 6 December 2016, he approved the December Announcement as a member of Carillion's Board.

The March Results Announcement

- 4.66. At the Board meeting on 26 January 2017, concerns were expressed about lack of clarity over the Group's trading performance towards the end of 2016 and the need for transparency and clarity "*particularly if the position had deteriorated in the year*". It was noted, however, that trading for the last two months of 2016 was in line with forecast. This was broadly consistent with the MPSR Executive Summary for January 2017, which showed no material deterioration in the financial performance of CCS's major projects since the previous quarter.
- 4.67. However, it was not consistent with the MCS in February 2017. This showed a likely exposure of £528.4 million (ahead of any write-offs) for the Group and of £149.2 million for CCS. These exposures excluded any figures for two of the largest contracts within CCS (AWPR and RLUH).
- 4.68. Whilst the Authority has not seen any evidence that Mr Howson reviewed the February MCS, at around this time Infrastructure was estimating a loss for AWPR equivalent to an exposure of £68 million against its traded margin (-£10 million), and RLUH's Project Team was estimating a likely loss of £56.3 million (which equated to an exposure of almost £68 million against its traded margin). Mr Howson received both of these forecasts. The inclusion of these figures in the MCSs would have increased the likely exposure to £664.4 million for the Group and to £285.2 million for CCS. This was an increase in exposures since December 2016 of £45.7 million for the Group and of £59.4 million for CCS.
- 4.69. Final Position Papers for selected contracts were submitted to the external auditors on 11 January 2017. The margin recorded in these Position Papers was broadly consistent with the MPSRs prepared for January 2017. The Position Papers did not disclose the increase in hard risk since August 2016, the likely exposures identified against some of these projects in MCSs between July and December 2016, the scale of management adjustments being applied to them, the deterioration in the Project Teams' and Infrastructure's assessment of their financial performance, or variances to peer review recommendations. Mr Howson did not receive these Position Papers, but he was aware of the figures in the MPSRs

which were consistent with the margin recorded in the Position Papers (see paragraph 4.47 above).

- 4.70. On 23 February 2017, the Audit Committee met to review the draft 2016 Annual Report and Accounts. The Group FD's Year-End Report for this meeting referred to construction revenue traded not certified of £294 million for the Group and of £44 million for CCS, as set out in an appended Overtrade Report. It also identified the key judgements made in relation to certain major projects across the Group (including within CCS) and the claim recoveries and costs savings necessary in order to meet the margins traded for these contracts in Carillion's accounts. The Year-End Report asserted that a total provision of £17 million was appropriate at the year-end for the Construction Services segment (including CCS and Canada). This, when combined with other provisions and contingencies, gave a year-end provision for CCS of £16.9 million. Mr Howson attended this meeting.
- 4.71. The Year-End Report did not comment upon the merits of the claims, the likelihood of successfully achieving the recoveries or cost savings, or the Project Teams' and Infrastructure's assessment of deteriorating financial performance in certain major projects. It did not identify the large financial risks associated with them, for example, as reflected in hard risks, the exposures identified in the MCS, the level of management adjustments being applied and variances to peer review recommendations. It was also inconsistent with the appended Overtrade Report with regard to AWPR, insofar as AWPR had a nil value cited in the Overtrade Report compared to a claim of £30 million against the client referenced in the Group FD's Report.
- 4.72. During the meeting, an Audit Committee member commented that the projects were complex and it was difficult to second-guess management judgements. This emphasised the importance of ensuring that those judgements were appropriately made and disclosed to the Audit Committee. In the meeting, the Group FD, Mr Khan, acknowledged there was not a consistent practice between Business Divisions for completing the Overtrade Report and that a new methodology for reporting uncertified balances would be adopted.
- 4.73. The 2016 Annual Report and the March Results Announcement were reviewed by the Audit Committee at its meeting on 23 February 2017, approved at the Board meeting on 28 February 2017 and published on 1 March 2017. Mr Howson reviewed and approved the Annual Report and the March Results Announcement as a Board member. There were no material changes in this announcement to the

expectations that had been communicated to the market in the December Announcement.

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

SECTION F: RECOGNITION OF THE NEED FOR A PROVISION

Events following publication of the 2016 year-end results

- 4.78. By March 2017, the hard risk for CCS had increased to £310.6 million. This was an increase of £137.9 million since the level of CCS hard risk was forecast in

August 2016 and £52.2 million since hard risk was reported at the CCS PRM on 18 January 2017. Mr Howson was aware of the March 2017 hard risk figure of £310.6 million through his attendance at the CCS PRM meeting in April 2017, at which it was reported.

- 4.79. During April and early May 2017, the position continued to worsen. An MCS dated 4 May 2017 showed a likely exposure against contentious amounts due of £872.3 million for the Group and £431.9 million for CCS (representing 71% of the contentious amounts due to CCS). This was an increase to the likely exposure of £207.9 million for the Group and of £146.7 million for CCS since February 2017. Mr Howson was sent this MCS on 5 May 2017.
- 4.80. In April 2017, Mr Howson attended a CCS PRM which highlighted further deteriorations in CCS contracts, notably RLUH, MMH and Battersea. These are described in more detail in Section G below.
- 4.81. A significant change in Carillion's debt position was reported to and discussed at a Board meeting on 3 May 2017. Mr Howson attended this meeting. Concerns were raised by Board members during the course of that discussion that trading was *"going backwards"*, a *"significant number of major contracts were deteriorating"* and there were *"too many problem contracts"*.
- 4.82. Later that same day, Carillion issued its AGM Statement (the May Announcement) under the headings *"Trading conditions unchanged"* and *"Positive work winning performance"*. Mr Howson was closely involved in drafting the May Announcement and approved it as a Board member. It stated that Mr Howson would make the following comments at that day's AGM:
- "Trading conditions across the Group's markets have remained largely unchanged since we announced our 2016 full-year results in March. Consequently, we continue to focus on the priorities we set out when we announced our 2016 results, namely to accelerate the rebalancing of our business into markets and sectors where we can achieve our objectives for margins and cash flows; and to manage challenging contract positions, particularly in our international markets, as these are key to achieving our objective of reducing average net borrowing."*
- 4.83. The reference to *"challenging contract positions"* was aimed at highlighting the deterioration in the financial performance of Carillion's contracts. As with the March Results Announcement, however, the statement was explicitly linked to

Carillion's overseas markets, not the UK, and so gave the misleading impression that trading conditions in the UK market had not deteriorated.

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

Negative accruals

- 4.85. During April and May 2017, additional concerns were raised within CCS that *"the level of risk which is being held in the balance sheet appears too large relative to the size of the business"*. These concerns were prompted by the discovery of the use of negative accruals within CCS, a practice that was generally prohibited in Carillion's accounting policies.

- 4.86. 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. The 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.

- 4.87. 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."

- 4.88. An internal Carillion investigation into the use of negative accruals was commenced in April 2017, at which point Mr Howson was informed. The investigation reported its initial findings to Mr Howson on 7 May 2017 (four days after the May Announcement). It identified that the majority of negative accruals related to four major contracts (including RLUH, Battersea and AWPR) and amounted to a total of £102 million. It also identified that Business Units had used negative accruals on certain contracts in CCS in response to pressure to "hold the position [*i.e. profit margin*]". This was a reference to the pressure to meet financial targets imposed on CCS described at paragraph 4.14 above.
- 4.89. On 9 May 2017, the Board was informed about the use of negative accruals and a Board sub-committee was set up to oversee the internal investigation into their use. The sub-committee did not include Mr Howson, but he (together with the Board and the Audit Committee) was regularly updated as to the progress of the investigation.
- 4.90. As part of the internal investigation, the negative accruals were reversed so that the full value of claims recognised at the 2016 year-end could be properly assessed in order to determine whether or not a prior year adjustment was required. The effect of reversing the negative accruals significantly increased the reported costs of the projects and required much more value from claims to be recognised as revenue in order to justify their originally reported year-end margin. Using the above example of a claim for £8 million, the effect of reversing the negative accrual meant that Carillion had to justify recognising the full £8 million of the claim as revenue, not £5 million as originally disclosed internally and to the external auditors. In its investigation, Carillion sought to justify the 2016 year-end position by significantly increasing the value of certain claims and in some cases introducing new claims or revenue streams that were said to have been in management's mind as at the year-end (albeit not recorded in the original Position Papers in December 2016).
- 4.91. Following the conclusion of this investigation, the Board concluded on 23 May 2017 that the value, costs and margin recognised at the 2016 year-end for each contract could be justified following the investigation and there was therefore no

need to restate the 2016 year-end accounts. A lessons learnt report subsequently submitted to the Board noted that *“Management need to be aware that high-level instructions such as that to “hold the position” (i.e. maintain the traded margin) may, if crudely implemented, have unintended consequences.”*

Enhanced Contracts Review

- 4.92. 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”.
- 4.93. The Enhanced Contracts Review took place over June and early July 2017. It involved a review of 58 projects 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.
- 4.94. The review was conducted with assistance from the external auditors, who do not appear to have been provided with details of hard risks, MCS exposures or peer reviews. It concluded that the traded value of a number of projects in Carillion’s construction business exceeded the commercial assessment of those positions. It identified a possible exposure of between £378 million and £693 million, and recommended a provision of £695 million. Given the magnitude of the proposed impairment, the external auditors asked Carillion to consider whether any of the proposed provisions required a prior year adjustment to its 2016 results. Carillion’s management (not including Mr Howson) 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 results and no prior year adjustment was required.

- 4.95. The recommended provision of £695 million was reported to the Audit Committee at its meeting on 9 July 2017, which Mr Howson attended. 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

- 4.96. 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.
- 4.97. Carillion's share price fell 39% that day, and within three days had fallen by a total of 70%.
- 4.98. In the provision announced by Carillion on 10 July 2017, the four largest provisions within CCS were as follows:
- (1) RLUH: £68 million.
 - (2) Battersea: £38 million.
 - (3) AWPR: £86 million.
 - (4) MMH: £48 million.
- 4.99. It was announced that Mr Howson had stepped down as CEO on 10 July 2017.

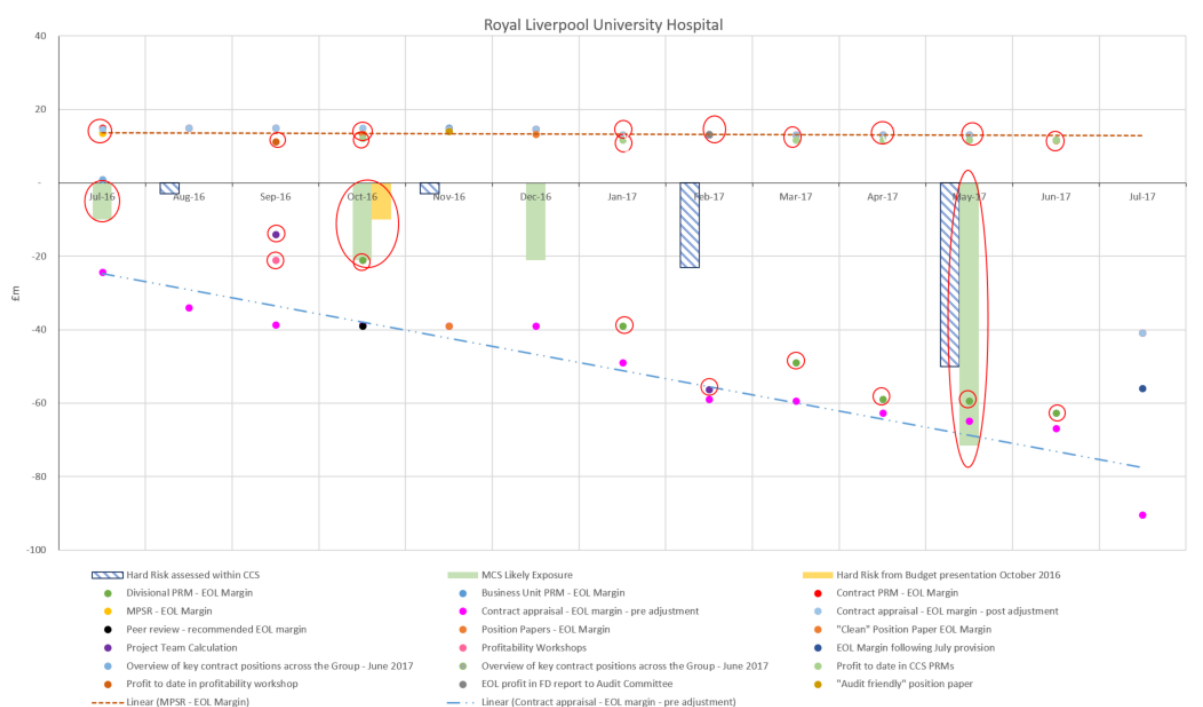
SECTION G: THE LARGEST WRITE-DOWNS ON UK MAJOR CONTRACTS

RLUH

- 4.100. 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.
- 4.101. The tender value of the project was £286 million, with an estimated end of life profit margin of £10.2 million (or 3.56%).

4.102. Despite significant delays in the project in 2015 and 2016, Carillion had increased the end of life margin forecast associated with this project to £13.6 million (or 4.6%) by July 2016. The increased margin was maintained by the use of management adjustments, increasing from £38.9 million in July 2016 to almost £72 million by February 2017. During most of the Relevant Period, the Board and the Audit Committee were not aware of the scale of management adjustments and the divergence between the internal reporting within CCS and what was being reported to them in relation to RLUH's financial performance.

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



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

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

The Project Team's assessments

- (1) The Contract Appraisals and other commercial reports prepared by the Project Team from July to December 2016 reported a deteriorating end of life margin loss for RLUH and the increasing use of management adjustments to achieve the forecast profit margin of 4.9%. These Appraisals and reports were not seen by Mr Howson. 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.
- (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 Howson 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 Howson was aware of this Contract Appraisal or peer review during the Relevant Period.

CCS's reporting to Mr Howson

- (5) CCS reported the Project Team's views internally as described above. At the profitability workshop in September 2016 attended by Mr Howson, CCS reported that for RLUH a 4.7% margin (equivalent to an £11.3 million profit)

had been traded to date (i.e. recognised in Carillion's financial reporting) compared to the £21 million loss assessed by the Project Team. The presentation indicated that the Project Team had been challenged to achieve "breakeven" (i.e. no profit or loss).

- (6) At the CCS PRM in October 2016 attended by Mr Howson, the margin traded for RLUH to date was reported by CCS as being £12.2 million compared to the Project Team's assessment of a £21 million loss (a difference of £33.2 million). The presentation highlighted hard risk of £10 million against RLUH, having previously been assessed at £3 million in April 2016 and £7 million in August 2016. Shortly after the year-end, this was further increased to £23 million.
- (7) The July 2016 MCS reported a "likely" exposure to traded amount of £10 million for RLUH and assigned a "Red" flag status to the project. In the October 2016 MCS, this had increased to £21 million with a "Red" status. This represented 100% (i.e. the full amount) of the contentious amounts identified as due in these MCSs. Mr Howson received the July and October 2016 MCSs.

Reporting to the Board and the Audit Committee

- (8) The MPSR Executive Summaries, Overtrade Reports, CEO and Group FD's reports to the Board and/ or the Audit Committee did not reflect the Project Team's assessments or peer review recommendation as to the financial performance of RLUH. They also did not highlight the financial risks associated with RLUH, including the level of management adjustments being applied or the hard risks and MCS exposures internally reported by CCS. To that extent, they omitted highly material and relevant information concerning RLUH's financial performance during the Relevant Period. Instead, the MPSR Executive Summaries maintained an end of life forecast profit of £13.6 million in July and October 2016 and of £13.2 million in January 2017 for RLUH and the Overtrade Reports identified £6 million or £8 million only as revenue traded not certified.

4.105. Mr Howson was in receipt of the MCS 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, or otherwise take steps to ensure it was brought to the attention, of the Board or the Audit Committee.

- 4.106. 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 Papers. The Authority has not seen any evidence that Mr Howson 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 Howson).
- 4.107. The final version of the Position Paper submitted to the external auditors for the 2016 year-end accounts showed a slightly reduced end of life margin of £13.2 million (or 4.42%), with costs of £286.1 million. It recognised £25.4 million as revenue to be recovered from claims (excluding any additional claim amounts recognised by means of negative accruals). As at the end of December 2016, all of these claims (which were not subject to formal legal proceedings at that stage) were disputed or no response had been received. Their progress was not sufficient to be deemed as "*reasonably certain*" (as per Carillion's internal policies) or "*probable*" (as per IAS 11) to be recovered. No revenue should have been recognised in relation to them.
- 4.108. At the CCS PRM on 18 January 2017, the Business Unit reported the Project Team's estimated loss of £39 million (-13%) as at November 2016, with a management adjustment of £53.9 million applied to help achieve a traded to date margin of 4.7% (£11.7 million). Mr Howson attended this PRM.
- 4.109. On 8 February 2017, the Project Team sent a briefing on RLUH to Mr Howson and certain Business Unit and Divisional management. It was sent ahead of a RLUH presentation at a CCS PRM on 10 February 2017, which Mr Howson attended. This

included a financial analysis reporting a "realistic" estimated loss of £56.3 million for RLUH as at 2 February 2017, with a "best case" loss of £43 million and "worst case" loss of £76.1 million.

- 4.110. This information was not communicated to the Board or the Audit Committee by Mr Howson or, to his knowledge, by anyone else. The RLUH MPSR for January 2017 was consistent with the final Position Paper submitted to the external auditors in reporting an estimated end of life margin of 4.4% (or profit of £13.2 million). The Group FD's Report submitted to the Audit Committee meeting on 23 February 2017 referred to the need to achieve £25.5 million recoveries in relation to claims to achieve the forecast end of life margin of 4.44%. In their Audit Memorandum presented to the meeting, the external auditors noted that "*management [remain] confident of full recovery [on RLUH] due to the number of routes available*". No reference was made to the Project Team's assessments of a significant loss, the scale of management adjustments being applied, hard risks or MCS exposures, about which the Audit Committee and the external auditors remained unaware.
- 4.111. On 1 March 2017, Carillion announced its 2016 financial results in its March Results Announcement. The cost, value and margin recognised for RLUH as part of the figures released in this announcement reflected the final Position Paper provided to the external auditors in January 2017, with costs of £286.1 million and a forecast end of life margin of 4.42% (i.e. a profit of £13.2 million). The recognition of these amounts meant that the revenue and profit / margin figures for the Group and Construction Services (excluding the Middle East) in the March Results Announcement were materially misstated due to an understatement of costs and the recognition of claims as revenue in non-compliance with Carillion's internal policies and IAS 11.
- 4.112. The financial performance of RLUH as reported internally continued to deteriorate after March 2017. The Project Team's forecast of a £49 million loss (-16.4%) as at January 2017 was reported in the CCS PRM in March 2017, with a management adjustment of £61.5 million being applied to help achieve a traded to date margin of £11.7 million (4.6%). The CCS PRM in April 2017 reported that the Project Team was estimating a loss of almost £60 million on RLUH as at February 2017, with a management adjustment of almost £65 million being applied to help support a traded to date margin of £11.7 million (4.5%). These traded to date margins were equivalent to an end of life margin of over £13 million. Mr Howson

attended both of these PRMs. Mr Howson did not report these divergences, or otherwise take steps to ensure they were reported, to the Board or to the Audit Committee.

- 4.113. The MCS in May 2017 identified a likely exposure of £71.5 million for RLUH. A copy of this MCS was sent to Mr Howson by email on 5 May 2017. The size of this exposure was reflected in CCS's reporting at a PRM attended by Mr Howson on 19 May 2017, which referred to the Project Team estimating a loss of £59.3 million, with a management adjustment of £67 million to help support a traded to date profit of £11.7 million as at March 2017.
- 4.114. On 7 June 2017, the Board held a strategy meeting. At this meeting, Mr Howson presented an "*Overview of Key Contract Positions across the Group*". In the presentation, RLUH was reported as having a forecast end of life margin of £11.7 million (3%). This was expressly stated as including claims in the forecast traded at 100% (i.e. the entirety of the claim values was recognised in the forecast). At the CCS PRM on 22 June 2017 attended by Mr Howson, the Project Team's estimated loss was reported as being £62.6 million, with a management adjustment of £74 million to help achieve a traded to date profit figure of £11.7 million as at April 2017.
- 4.115. 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.

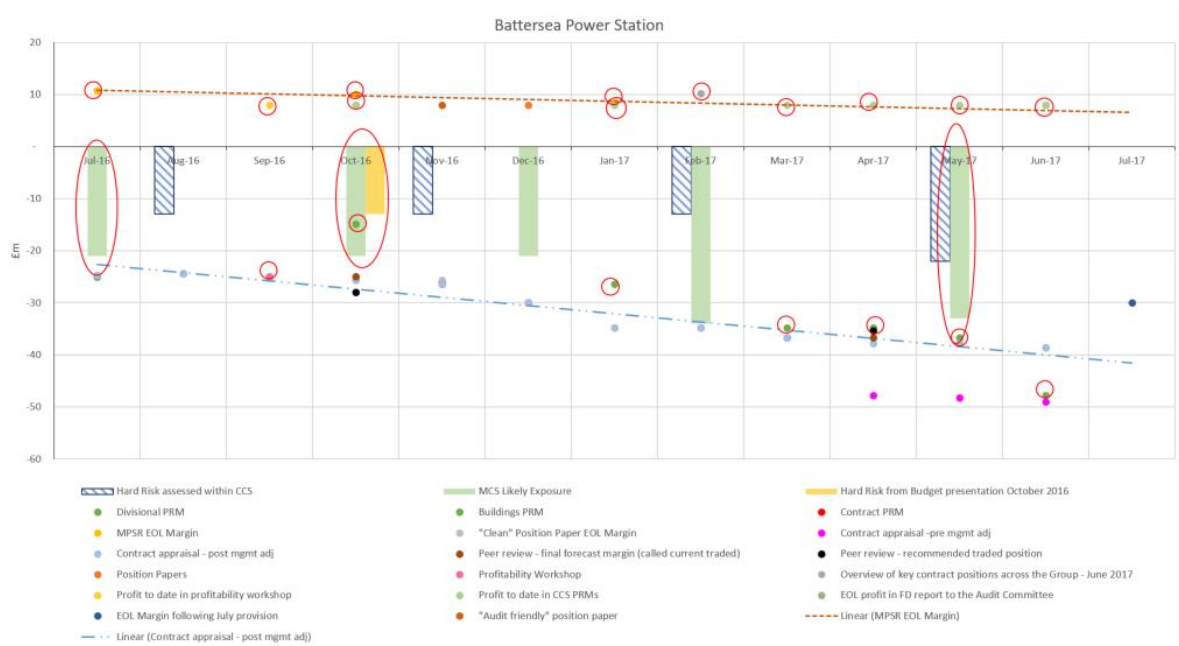
Battersea

- 4.116. 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.
- 4.117. The contract was tendered at a value of £443.7 million with a 0% profit margin.
- 4.118. 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.

4.119. By January 2016, there had been a contract reset on Battersea which increased the contract value to £472.4 million and extended the contract completion date to 24 March 2017.

4.120. 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 2016. 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.

4.121. There were significant and increasing divergences between (on the one hand) the Project Team's views on Battersea's financial position and the financial risks reported by CCS to Mr Howson and others; and (on the other hand) those reflecting budgeted forecasts and/or reported to the Board and the Audit Committee during the Relevant Period. These are illustrated in the following graph:



Graph 2 - Each point on the graph shows the end of life (EOL) margin and/or traded to date margin recorded in various reports pertaining to Battersea Power Station as variously reported to Building, CCS, the executive directors, the Board, the Audit Committee and/or the external auditors. The

orange and blue trend lines illustrate the increasing divergence of views between the position as assessed by the Project Team and/or in peer reviews (blue line); and the view reflected in budgeted forecasts and/or reported to the Board, the Audit Committee and the external auditors (orange line). The graph also shows the level of hard risk reported in hard risk schedules and the "likely" exposure to traded amount reported in the Major Contract Summaries. The red circles show the figures of which Richard Howson 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.

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

The Project Team's assessments

- (1) The Contract Appraisals prepared by the Project Team from July to December 2016 reported a deteriorating end of life margin loss for Battersea. Increasing levels of management adjustments were applied to the current traded value and costs to maintain a positive current traded margin of just over 2% (a current traded profit margin of £8 million and equating to an end of life profit of around £10 million). By December 2016, the Project Team's forecast in the Contract Appraisal had worsened to a forecast end of life loss of £30 million, 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 Howson, but he was aware of the Project Team's assessments by alternative means. In September 2016, the Project Team's end of life margin forecast for Battersea was reported by CCS as a £25 million loss in a "*profitability workshop*" in September 2016. An estimated £14.8 million loss was highlighted in a CCS PRM in October 2016. Mr Howson attended both of these meetings.

CCS's reporting to Mr Howson

- (3) CCS reported the Project Team's views internally as described above. At the profitability workshop in September 2016, CCS reported that Battersea had a traded margin of 2.1% to date (equivalent to just over £8 million) compared to the Project Team's projected end of life loss of £25 million, and

that the Project Team had been challenged to achieve "*breakeven*" (i.e. no profit or loss).

- (4) At the CCS PRM in October 2016, CCS reported the margin traded to date on Battersea as being £8 million compared to the Project Team's assessment of a £14.8 million loss (a difference of £22.8 million). The presentation also highlighted hard risk of £13 million against Battersea, the same as previously internally reported for that project.
- (5) The July and October 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 Howson received these MCSs.

Reporting to the Board and the Audit Committee

- (6) The MPSR Executive Summaries, Overtrade Reports, CEO and Group FD's reports presented to the Board and the Audit Committee did not reflect the Project Team's views or peer review recommendation as to Battersea's financial performance. They also did not highlight the financial risks associated with Battersea, including the level of management adjustments being applied or the hard risks and MCS exposures reported by CCS. To that extent, they omitted highly material and relevant information concerning Battersea's financial performance during the Relevant Period.
- (7) Instead, during the Relevant Period the MPSR Executive Summaries showed only a minor deterioration in end of life margin from £10.7 million (or 2.2%) in July 2016 to £10.1 million (or 2%) in October 2016 and £8.6 million (or 1.7%) in January 2017. The Overtrade Reports similarly only identified a small increase in revenue traded not certified, from £4 million in July 2016 to £6 million in December 2016.
- (8) Mr Howson was in receipt of the MPSR Executive Summaries for July and October 2016 and January 2017 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 with the Audit Committee.

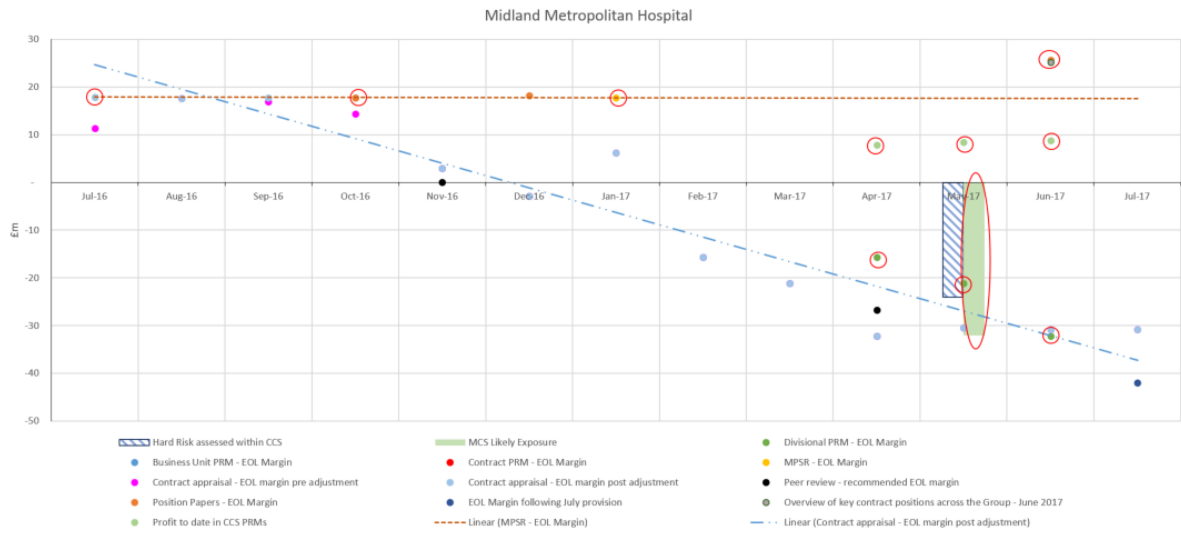
- 4.123. At the 2016 year-end, two sets of figures were produced when drafting Position Papers for the external auditors, including for Battersea. The "*clean*" Position Paper reported a loss of £25.6 million; the "*audit friendly*" version incorporated adjustments to maintain a positive end of life 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. The Authority has not seen any evidence that Mr Howson 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 Howson).
- 4.124. At the January CCS PRM on 18 January 2017, the Business Unit reported the Project Team's estimated loss of £26.3 million (-5.2%) as at November 2016, with a management adjustment of £31.2 million to help achieve a traded to date margin of £8 million (or 1.9%). Mr Howson attended this PRM.
- 4.125. The Group FD's Report submitted to the Audit Committee meeting on 23 February 2017 referred to the need to achieve £28.6 million recoveries in relation to claims, which they expected to deliver through a contract reset to achieve the forecast end of life margin of 2.0% (equivalent to £10.1 million). In their Audit Memorandum presented to the meeting, the external auditors noted that "*Carillion no longer need to achieve £19.3 million in future cost savings, instead management is targeting an additional £28.6 million recovery from the client through a second reset.*" No reference was made to the Project Team's assessment of a significant loss, the scale of management adjustments being applied, hard risks or MCS exposures, about which the Audit Committee and the external auditors remained unaware.
- 4.126. On 1 March 2017, Carillion announced its 2016 financial results in its March Results Announcement. The cost, value and margin recognised for Battersea as part of the figures released in this announcement reflected the final Position Paper provided to the external auditors in January 2017, with a forecast end of life margin of 1.5% (i.e. a profit of just over £8 million). The recognition of these amounts meant that the revenue and profit / margin figures for the Group and

Construction Services (excluding the Middle East) in the March Results Announcement were materially misstated due to the inclusion of £28.6 million associated with the contract reset in revenue and the understatement of costs, which should have more closely reflected the Project team's view of £534.7 million as opposed to the figure of £516.4 million traded in Carillion's accounts. This overstatement of revenue and understatement of costs was not in compliance with Carillion's internal policies or IAS 11.

- 4.127. At the CCS PRMs in March and April 2017 (showing January and February 2017 figures), the Project Team reported an increased estimated loss of £34.8 million for Battersea. Management adjustments of over £39 million were applied to help bring the end of life margin back to a traded to date margin of £8 million (1.7%). This was equivalent to an end of life margin of around £8.5 million. Mr Howson attended both of these PRMs.
- 4.128. The MCS in May 2017 identified a likely exposure of £33 million for Battersea. A copy of this MCS was sent to Mr Howson by email on 5 May 2017.
- 4.129. At the CCS PRM in May 2017 attended by Mr Howson, the Project Team's reported estimates had worsened to a forecast loss of £36.6 million, with a £41.5 million management adjustment being applied to support a traded profit to date of £8 million as at March 2017.
- 4.130. On 7 June 2017, the Board held a strategy meeting. At this meeting, Mr Howson presented an *"Overview of Key Contract Positions across the Group"*. In the presentation, Battersea was reported as having a forecast end of life margin of £8 million (1.5%). This was expressly stated as including claims in the forecast traded at 100% (i.e. the entirety of the claim values was recognised in the forecast). At the CCS PRM on 22 June 2017 attended by Mr Howson, the Project Team was estimating a £47.8 million loss, with a management adjustment of £42.7 million required to support a traded to date figure of £8 million as at April 2017.
- 4.131. Following the Enhanced Contract Review, £38 million was provided in relation to Battersea. This amount formed part of the contract provision of £845 million announced by Carillion on 10 July 2017.

MMH

- 4.132. MMH was a project to construct a new Private Finance Initiative hospital in the West Midlands. The contract started on 11 December 2015, with an original completion date of 20 July 2018.
- 4.133. The contract was tendered at a value of £296.7 million at a 5.97% margin (or £17.7 million).
- 4.134. The period between Carillion bidding for MMH and financial close on 11 December 2015 was the shortest in Carillion's history.
- 4.135. The progress of MMH was disrupted at an early stage by two main issues:
- (1) Problems with the design and procurement processes arising from a short bid period; and
 - (2) Adverse weather, with heavy rainfall flooding parts of the building under construction, impacting on productivity.
- 4.136. As of July 2016, MMH was nine weeks behind the target construction programme as a result of the issues referenced above.
- 4.137. Despite the delay to the progress of MMH, Carillion was reporting in the MPSR Executive Summary for July 2016 that MMH had an estimated end of life margin of 6%, equating to £17.9 million. This forecast was not supported by the Project Team, who in the July 2016 Contract Appraisal for MMH reported a deterioration in the end of life margin to 3.8% (£11.3 million). Notwithstanding this, the end of life margin of £17.9 million was maintained by use of a management adjustment of £6.6 million.
- 4.138. From November 2016, there were significant and increasing divergences between (on the one hand) the Project Team's views on MMH's financial position and the financial risks reported by CCS to Mr Howson and others; and (on the other hand) those reflecting budgeted forecasts and/or reported to the Board and the Audit Committee. This is illustrated in the following graph:



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

4.139. This divergence between the internal reporting within CCS and the reporting to the Board and the Audit Committee during the latter part of 2016 is summarised below. There is no evidence that Mr Howson was aware of the facts and matters referenced at sub-paragraphs (1) and (2) below, but they are set out to provide context to the financial performance of MMH in 2017.

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

detailed designs had been provided and procurement issues had been substantially advanced.

- (3) The MPSR Executive Summaries to the Board and/or the Audit Committee for July and October 2016 did not reflect the Project Team's assessments. Instead, they consistently maintained an end of life forecast profit of around £17.9 million (6%) for MMH, as Mr Howson was aware.

4.140. The final version of the Position Paper for MMH submitted to the external auditors for the 2016 year-end accounts reported costs of £284 million, revenue of £302 million and forecast an end of life margin of £18.1 million. The true costs were, however, closer to £304.8 million as reported by the Project Team (i.e. almost £21 million more than reported in the Position Paper). This meant that the profit recognised on MMH at the 2016 year-end was not in accordance with IAS 11 and was materially misstated. Mr Howson did not see this Position Paper.

4.141. The January 2017 MPSR was broadly consistent with the Position Paper and referred to an end of life profit margin for MMH of 6%, which amounted to £17.7 million. By contrast, the Commercial Report for the CCS PRM in January 2017 identified MMH as amongst the top five projects within Building with the biggest deterioration in end of life margin. It reported that MMH's end of life margin had deteriorated from 6% in December 2015 to 4.8% in October 2016 to 1% in November 2016. Mr Howson attended this PRM.

4.142. The Contract Appraisal for January 2017 incorporated a "*Margin Improvement Plan*" that provided for £15.5 million of claim recoveries. This had the effect of taking the end of life forecast margin to £6.2 million (2%). This was not consistent with the deterioration reported at the January CCS PRM above. The Contract Appraisal in February 2017 reversed these changes and showed a forecast end of life loss of £15.7 million (-5.2%), with a management adjustment of £12.9 million applied to help maintain a forecast profit margin of just under £18 million.

4.143. On 1 March 2017, Carillion announced its 2016 financial results in its March Results Announcement. The cost, value and margin recognised for MMH as part of the figures released in this announcement reflected the final Position Paper provided to the external auditors in January 2017, with costs of £284 million and a forecast end of life margin of 6% (assessed as a profit of just over £18 million). This was a material misstatement of MMH's financial position due to the level of

costs recognised, which should have more closely reflected the Project Team's estimate of £304.8 million. The understatement of costs was not in compliance with Carillion's internal policies or IAS 11. The Authority has not seen any evidence that Mr Howson was aware of this understatement as at 1 March 2017.

- 4.144. The internal reporting about the financial performance of MMH continued to diverge in the second quarter of 2017. By April 2017, a Peer Review report stated that MMH was 10 weeks behind schedule and recommended that the traded margin should be a loss of £26.7 million, including recommended end of life costs of £330 million. By the end of April 2017, the Project Team reported an estimated end of life loss of £32.1 million (-10.6%). The forecast end of life costs had risen at this stage to £334 million. A management adjustment of almost £20 million was applied to the current traded margin for MMH to take it from a loss of £11.2 million (-10.6%) to a profit of £8.8 million (6.1%).
- 4.145. In April 2017, Mr Howson attended a CCS PRM at which it was reported that the Project Team was forecasting a £15.7 million loss as at February 2017, with a management adjustment of £12.9 million applied to help maintain a traded to date profit margin of £7.8 million (consistent with an end of life margin of over £17.7 million).
- 4.146. MMH first appeared on the hard risk schedule in April 2017 as a new and emerging risk of £24 million. It also appeared for the first time in the MCS in May 2017. It was recorded with a "likely" exposure to traded amount of £32 million and a "Red" flag status was applied. A copy of this MCS was sent to Mr Howson by email on 5 May 2017.
- 4.147. At the CCS PRM in May 2017, it was reported that the Project Team was estimating a loss of £21 million, with a management adjustment of £15.7 million being applied to support a traded profit to date of £8.4 million as at March 2017. Mr Howson attended this PRM.
- 4.148. On 7 June 2017, the Board held a strategy meeting. At this meeting, Mr Howson presented an "Overview of Key Contract Positions across the Group". In the presentation, MMH was reported as having a forecast end of life margin of £25.2 million (7%). This was expressly stated as including claims in the forecast traded at 100% (i.e. the entirety of the claim values was recognised in the forecast). At the CCS PRM on 22 June 2017 attended by Mr Howson, the Project Team was

estimating a £32.1 million loss and a management adjustment of £20 million to support a traded to date figure of £8.8 million as at April 2017.

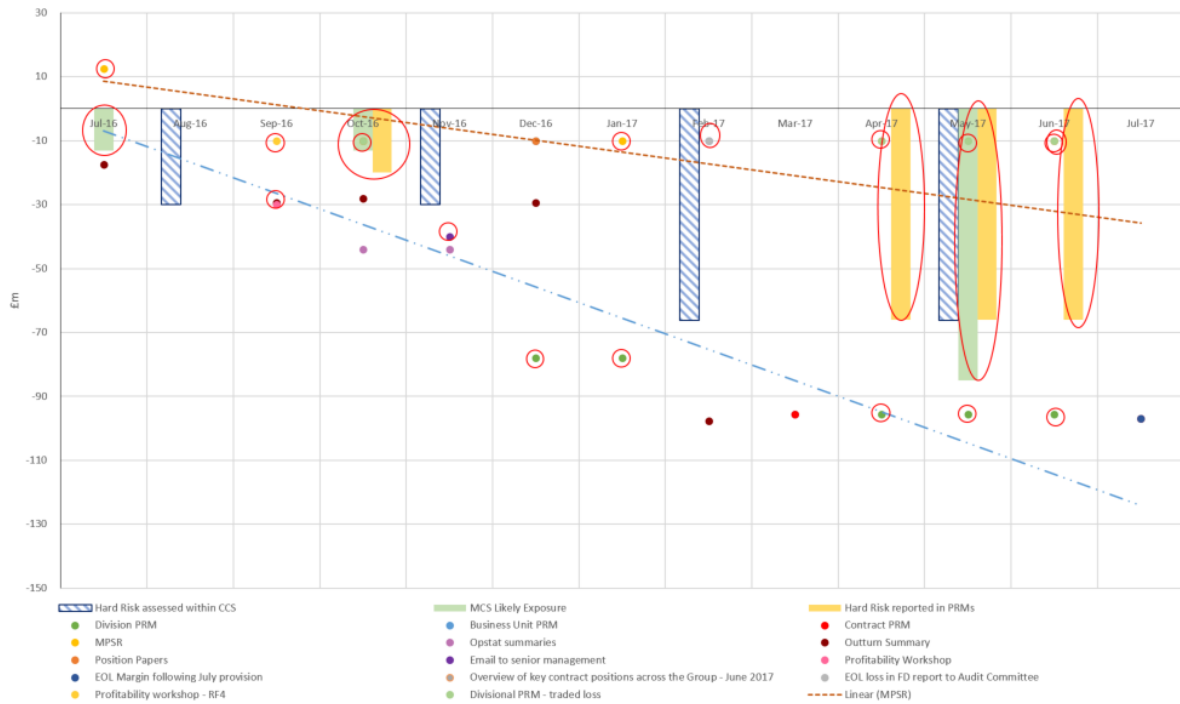
- 4.149. Following the Enhanced Contracts Review, MMH was written down by £48 million. This amount formed part of the contract provision of £845 million announced by Carillion on 10 July 2017.

AWPR

- 4.150. AWPR was a design build finance operate contract² 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.
- 4.151. The tender value for AWPR was £533 million, including costs of around £496 million and a 7% profit margin of £37 million. Carillion's one-third share was £177.8 million, with a margin of £12.4 million.
- 4.152. During 2015 and 2016, AWPR was significantly delayed by poor weather and delays in diverting statutory utilities (such as water pipes, electricity cables, etc).
- 4.153. 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.
- 4.154. By October 2016, Carillion had reduced the forecast end of life margin for AWPR to a loss of £10 million. Despite this downwards revision, there were significant and increasing divergences during the Relevant Period between (on the one hand) Infrastructure's views on AWPR's financial position as reported to Mr Howson 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:

² DBFO 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.

Aberdeen Western Peripheral Route



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

4.155. This divergence between the internal reporting by Infrastructure and CCS to Mr Howson and the reporting to the Board and the Audit Committee during the second half of 2016 is summarised as follows:

Infrastructure and CCS reporting to Mr Howson

- (1) In September 2016, CCS reported in a "profitability workshop" that there was a potential end of life loss of £30 million on AWPR. This was compared in the presentation (seen by Mr Howson) 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 that AWPR was being traded at a £10 million loss and there was no margin or write off forecasted in the budget. The same presentation stated

that hard risk for AWPR amounted to £20 million. Mr Howson attended this PRM.

- (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 Howson received these MCSs.
- (4) On 19 November 2016, an internal Carillion email to (amongst others) Mr Howson addressed the cash position on AWPR and referred to an "estimated end of life loss of £40 million our share (after recovery) or £120 million at a 100% JV level".
- (5) 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 Howson attended this PRM.

Reporting to the Board and the Audit Committee

- (6) 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. It was also inconsistent with the two Group FD's Reports in the Relevant Period which referred to AWPR relying on claims.
- (7) 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.

- (8) 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 Howson was aware) were not reported to the Board or the Audit Committee. Mr Howson 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.

4.156. The Position Paper for AWPR at the 2016 year-end reflected the position as reported in the October 2016 MPSR Executive Summary, with end of life costs estimated at £652.6 million at joint venture level (Carillion's cost being £217.5 million) and a margin loss of £30 million (Carillion's share being a £10 million loss).

4.157. 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.

4.158. The Position Paper submitted to the external auditors for the 2016 year-end accounts recognised £30 million as revenue to be recovered from claims (excluding any additional claim amounts recognised by means of negative accruals). This included a claim for which £23.3 million of revenue was recognised ("Claim 1"). As at the end of December 2016, the progress of Claim 1 was not sufficient to be deemed "*reasonably certain*" (as per Carillion's internal policies) or "*probable*" (as per IAS 11) to be recovered. No revenue should have been recognised in relation to it.

4.159. Infrastructure's estimate of a £78 million loss on AWPR was repeated in a further presentation given at the CCS PRM in January 2017 (attended by Mr Howson). Shortly afterwards, the hard risk for AWPR was increased to £66 million; Mr Howson became aware of this in April 2017. Despite this, the January 2017 MPSR

was unchanged and continued to report an estimated end of life loss for AWPR of £10 million.

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

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

4.164. The MCS in May 2017 identified a likely exposure of £85 million for AWPR, with a "red" flag status. However, the MPSR Executive Summary appended to it indicated that Carillion was continuing to a forecast margin loss of £10 million only. A copy of this MCS was sent to Mr Howson by email on 5 May 2017.

4.165. On 7 June 2017, the Board held a strategy meeting. At this meeting, Mr Howson presented an *"Overview of Key Contract Positions across the Group"*. In the presentation, AWPR was reported as having a forecast end of life margin of a loss of £10 million, with over £121 million of value to be recovered from claims. This was expressly stated as including claims in the forecast traded at 80% (i.e. the majority of the claim values were recognised in the forecast).

4.166. 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 Howson was:

(1) in respect of all three of the Announcements, 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 all three of the Announcements, knowingly concerned in Carillion's failure to take reasonable care to ensure that its announcements were not misleading, false or deceptive and did not omit anything likely to affect the import of the information (in breach of LR 1.3.3R);

(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 Howson in his capacity as CEO was an officer of Carillion at the time of the December Announcement. As one of its two executive directors he had an important role in preparing and finalising the December Announcement, including

reviewing its content, providing comments on it 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 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 Howson were aware that the following issues had been identified and reported within Carillion:
- (1) The MCS prepared for the quarterly meeting on 3 October 2016, which was sent to Mr Howson by email on that date, identified a likely financial exposure of £566.6 million for the Group and £173.2 million for CCS. Even taking into account any inconsistencies in the production of this report, these figures highlighted very significant likely exposures on major contracts, including within CCS.
 - (2) As part of its 2016 RF3 and 2017 Budget submissions, CCS had reported to Mr Howson (and others) 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 release of the December Announcement, the expected financial performance of certain major contracts was much worse than the budget and reforecasts providing the basis for the December Announcement. Mr Howson was aware of the following facts in this regard:

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

5.10. The Authority considers that Mr Howson 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 Howson, 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 Howson was knowingly concerned in Carillion's breach of Article 15.

5.12. The Authority considers that Mr Howson 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 Howson acted recklessly as a result.

The March Results Announcement

- 5.13. The March Results Announcement reported on Carillion's financial results for the year ended 31 December 2016.
- 5.14. Mr Howson in his capacity as CEO was an officer of Carillion at the time of the March Results Announcement. As one of its two executive directors, he had an important role in preparing and finalising the announcement, including reviewing its content, providing comments on it and approving it as a member of Carillion's Board.
- 5.15. The March Results Announcement and the document published alongside it described Carillion's performance as "*in line with expectations*", with increased revenue of £4,394.9 million and PBT of £178 million for the Group and revenue of £1,520.2 million and operating profit of £41.3 million for "*Construction Services (excluding the Middle East)*". It described strong revenue growth in this segment and confirmed that operating margin profit for this segment "*remains in our target range of 2.5 per cent to 3 per cent*". It referred to its ambition "*to maintain revenue and profit at broadly their current levels*" in 2017. It went on to refer to Carillion as a whole having a "*good platform from which to develop the business in 2017*". These statements were consistent with the expectations set out in the December Announcement.
- 5.16. The revenue and profit / margin figures for the Group and Construction Services (excluding the Middle East) in the March Results Announcement were misstated because they did not accurately reflect the financial performance of the Priority Contracts. In particular, Carillion failed to recognise the costs and revenue associated with these projects in accordance with IAS 11. The revenue and profit / margin figures were materially overstated as a result. This also made false or misleading the references to Carillion's performance being "*in line with*

expectations", with strong revenue growth and operating profit targets being met for the business segment including CCS. While it referred to "*actively managing the positions we have in challenging markets*", this statement was specifically made in relation to markets in the Middle East and Canada and in the context of rebalancing Carillion's business. There was no reference to challenges in the UK market or to the deteriorating financial performance of CCS's construction projects.

5.17. The positive statements in the March Results Announcement about expected performance in 2017 were similar to those contained in the December Announcement. These statements were not justified by the facts and matters known to Carillion (and Mr Howson) as at the date of the announcement on 1 March 2017. In addition to the matters identified at paragraph 5.9 above, far from improving since December 2016 the financial performance of Carillion's construction contracts had continued to deteriorate. Within CCS (and to the knowledge of Mr Howson and another person) it was being reported that:

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

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

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

- 5.20. 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 March Results Announcement, Mr Howson was knowingly concerned in Carillion's breach of Article 15.
- 5.21. The Authority considers that Mr Howson was aware that there was a risk that the March Results Announcement was false or misleading due to the matters at paragraphs 5.14 to 5.17 above. He did not respond appropriately to this risk and failed to take it properly into account when reviewing and approving the March Results 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 March Results 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 Howson acted recklessly as a result.

The May Announcement

- 5.22. The tenor of the May Announcement was that nothing had materially changed since the March Results Announcement. This was reflected in its heading ("*Trading conditions unchanged*") and opening sentence ("*Trading conditions across the Group's markets have remained largely unchanged since we announced our 2016 full-year results*"). This was not an accurate depiction of the Group's trading as at 3 May 2017, which was materially affected by the adverse and deteriorating financial performance of CCS's construction projects leading up to that date. Mr Howson was closely involved in the drafting of this announcement.
- 5.23. The facts and matters described above in relation to the December Announcement and the March Results Announcement indicated a significant deterioration in the financial performance of Carillion and CCS in particular. This deterioration continued, with hard risk within CCS reported to Mr Howson and others as increasing to £310.6 million by March 2017. Significant concerns were raised at the Board meeting on 3 May 2017 attended by Mr Howson about the deterioration

in financial performance of Carillion's major projects. These concerns were consistent with the continued deterioration of CCS's major projects, including (to the knowledge of Mr Howson and another person):

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

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

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

5.26. 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 May Announcement, Mr Howson was knowingly concerned in Carillion's breach of Article 15.

- 5.27. The Authority considers that Mr Howson was aware that there was a risk that the May Announcement was false or misleading due to the matters at paragraphs 5.14 to 5.17 and 5.22 to 5.24 above. He did not respond appropriately to this risk and failed to take it properly into account when reviewing and approving the May 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 May 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 Howson acted recklessly as a result.

Listing Rule 1.3.3R

Carillion's obligations and knowing concern

- 5.28. 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.
- 5.29. 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 breaches and Mr Howson's knowing concern

- 5.30. By failing to take account of the matters at paragraphs 5.7 to 5.9, 5.14 to 5.17 and 5.22 to 5.24 above in its announcements, and by failing to ensure that the matters at paragraphs 5.35 to 5.46 below in relation to Listing Principle 1 were properly addressed, Carillion failed to take reasonable care to ensure that information it notified to a RIS was not misleading, false or deceptive and did not omit anything likely to affect the import of the information, in breach of LR 1.3.3R.

- 5.31. By virtue of his knowledge and involvement in the Announcements as detailed above, and by failing to ensure that the matters at paragraphs 5.33 to 5.46 below in relation to Listing Principle 1 were properly addressed during the Relevant Period, Mr Howson was knowingly concerned in Carillion's breach of LR 1.3.3R with regard to the Announcements.
- 5.32. For the reasons given in paragraphs 5.12, 5.21 and 5.27 above, and in paragraph 5.47 below, the Authority considers that Mr Howson 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

- 5.33. 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.
- 5.34. As a 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

- 5.35. Throughout the Relevant Period, Mr Howson was the CEO of Carillion and his responsibilities included working closely with the Group FD 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.
- 5.36. 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.

5.37. Carillion's procedures, systems and controls did not meet these standards. Mr Howson 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

5.38. Significant pressure was placed on CCS to meet very challenging budgeted and reforecast targets through the budgeting and reforecasting process headed by Carillion's two executive directors, Mr Howson and the Group FD. The targets were maintained even as CCS reported deteriorating financial performance in certain major projects and increasing hard risks and MCS exposures during the Relevant Period. This greatly increased the risk that contract accounting judgements under IAS 11 would be applied too aggressively by CCS in order to meet those targets and would not comply with IAS 11 as a result. In those

circumstances, the control framework around CCS's contract accounting judgements needed to be especially transparent and robust to minimise the risk of non-compliance. It was not, significantly increasing the risk that market announcements in relation to Carillion's financial performance would not be accurate.

- 5.39. During the Relevant Period, despite knowing the pressure placed on CCS to meet targets maintained by him, and despite his expertise in construction and contract-related matters, Mr Howson 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

- 5.40. 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 Howson was aware that 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 Howson 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.

Inconsistent management information on financial performance

- 5.41. The management information produced and reported by CCS to (amongst others) Mr Howson 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 Howson 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 Howson by means of CCS internally reporting 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 Howson in response.

- (2) The MCSs highlighted likely financial exposures associated with Carillion's contracts, including CCS's construction projects. 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 Howson.
- (3) There were large and increasing divergences during the Relevant Period between the Project Teams' assessments of the financial performance of the Priority Contracts and the much more optimistic forecasts contained in budgets and reforecasts. These divergences were reported to (amongst others) Mr Howson by means of CCS PRMs or in some cases by email. Mr Howson did not make proper enquiries as to the reasons behind these divergences or seek to resolve them.
- (4) The above information provided to Mr Howson 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 typically reflected in budgets and reforecasts. Mr Howson 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

- 5.42. 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 Howson, as described in paragraph 5.41 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”.

- 5.43. Instead, as Mr Howson was aware, reports to the Board (including his CEO Reports) 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 (as approved by Mr Howson during the Relevant Period) 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.
- 5.44. The information provided to the Audit Committee in order to enable them to assess contract accounting judgements was contained in or appended to the Group FD’s Report and the external 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 effectively to assess whether or not the judgements were being applied appropriately.
- 5.45. 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.
- 5.46. By virtue of his knowledge of the matters at paragraphs 5.35 to 5.45 above, and his failure to ensure that they were properly addressed during the Relevant Period, Mr Howson was knowingly concerned in Carillion’s breach of Listing Principle 1.
- 5.47. Further, the Authority considers that Mr Howson was aware in light of the matters at paragraphs 5.35 to 5.44 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 Howson acted recklessly as a result.

Premium Listing Principle 2

- 5.48. Premium Listing Principle 2 requires a listed company to act with integrity towards the holders and potential holders of its premium listed securities.
- 5.49. 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.
- 5.50. As explained in paragraphs 5.12, 5.21, 5.27, 5.32 and 5.47 above, Mr Howson acted recklessly in relation to the facts and matters described above during the Relevant Period. The Authority attributes his state of mind to Carillion in this regard.
- 5.51. 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 Howson 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. In respect of conduct occurring on or after 6 March 2010, the Authority applies a five-step framework to determine the appropriate level of financial penalty. DEPP 6.5B 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 Howson 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.
- 6.6. The period of Mr Howson's breach was 1 July 2016 to 10 July 2017. The Authority considers Mr Howson's relevant income for this period to be £1,326,187. The Authority considers that Mr Howson did not make a direct profit or avoid a loss as a result of his knowing concern in Carillion's breaches 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 Howson's knowing concern in Carillion's breaches:

- (1) Mr Howson 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 Howson'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 Howson was knowingly concerned, continued for a period of over a year and resulted in the misleading Announcements.
- (3) Mr Howson held a senior position within Carillion as its CEO.
- (4) As CEO Mr Howson 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 Howson was an experienced manager 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'. 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 Howson breached a position of trust.
- (4) The breaches were committed recklessly.

6.12. DEPP 6.5B.2G(13) and DEPP 6.5C.2G(16) lists 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 £1,326,187, which equates to £397,856.

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 £397,856.

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 £397,856 represents a sufficient deterrent to Mr Howson and others, and so has not increased the penalty at Step 4.

6.19. Step 4 is therefore £397,856.

Step 5: settlement discount

6.20. Pursuant to DEPP 6.5B.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 £397,800 (rounded down to the nearest £100 in accordance with the Authority's usual practice).

Penalty

6.23. The Authority therefore has decided to impose a financial penalty of £397,800 on Mr Howson.

7. REPRESENTATIONS

7.1. Annex B contains a brief summary of the key representations made by Mr Howson 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 Howson, whether or not set out in Annex B.

8. PROCEDURAL MATTERS

8.1. This Notice is given to Mr Howson 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 Howson 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 Howson 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). 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).

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 10 July 2017 (i.e. the Relevant Period).

1. STATUTORY PROVISIONS

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

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 131AD 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 Rules 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 Howson, and the Authority's conclusions in respect of them (in bold), is set out below.

Knowing concern – the law

2. The case law is clear that knowing concern requires actual involvement in the contravention and actual knowledge of all constitutive facts necessary to establish a contravention by the alleged primary contravenor (i.e. Carillion), yet it is not even alleged that Mr Howson had such knowledge, let alone established.
3. Mr Howson's position on knowing concern is supported by the recent decision by the Court of Appeal in *Ferreira*³. The Court of Appeal considered that policy reasons which the Authority has raised in support of its construction of knowing concern were not persuasive and rejected the suggestion that personal liability could be imposed on directors simply on the basis that they knew of the actions that the company was taking. The Court of Appeal's decision makes it clear that there is intended to be a difference in the test for liability for a primary infringer and a secondary party.
4. **In order for Mr Howson 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, 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"⁴. As explained below in respect of each specific contravention, the Authority disagrees with Mr Howson's view as to what (ii) requires the Authority to establish.**
5. **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 Howson'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 Howson 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

6. In respect of Article 15 of MAR, the constitutive parts of the alleged contravention which it is necessary for Mr Howson to have known are that each Announcement gave or was likely to give false or misleading signals as to the price of Carillion's shares, and that Carillion ought to have known that the information was false or misleading.

³ *FCA v Ferreira* [2022] EWCA Civ 397

⁴ *SIB v Scandex Capital Management A/S* [1998] 1 WLR 712

7. The falsity of the Announcements is clearly a constitutive part of Carillion's alleged breach, and therefore a fact which Mr Howson must be shown to have known. Article 12(1)(c) of MAR is clear that the first requirement to engage the provision is the dissemination of information which gives, or is likely to give, false or misleading signals as to the price of a financial instrument. The secondary question is then whether the person who made the dissemination knew or ought to have known that the information was false or misleading. Carillion cannot have known that an Announcement was false unless it was in fact false; similarly, it cannot be said that Carillion ought to have known that an Announcement was false unless it was in fact false. If the Announcements were entirely true, it could not be alleged that Carillion had committed market manipulation.
8. The Authority's submission that whether information is false or misleading is a legal assessment and therefore not a constitutive fact is not convincing. The Authority is also wrong to submit that the consequence of Mr Howson's interpretation of the law would be that directors of a listed company could remain passive in response to warning signs. A director could be fixed with knowledge by way of wilful blindness or as a matter of evidence. It cannot be right for a person to be exposed to potentially unlimited fines for being "knowingly concerned" in wrongdoing of which they have no knowledge; Mr Howson's interpretation is fair because it means that directors who know that there has been misinformation to investors will be caught by the regime but those who are innocent, like Mr Howson, will not be.
9. **The Authority does not agree with Mr Howson's view as to what is required in order for him to have had knowledge of the facts upon which Carillion's contravention of Article 15 of MAR depends. Instead, the Authority considers that, in respect of each Announcement, it is necessary to show that Mr Howson knew: (i) the information contained in the Announcement; and (ii) sufficient facts to support the conclusion that Carillion ought to have known that the Announcement was false or misleading.**
10. **If Mr Howson's submission was correct, 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 Howson (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 Announcement in question was false or misleading for the purpose of Carillion's primary contravention. Likewise, there is no need to establish that Mr Howson had such knowledge in order for him to be knowingly concerned.**
11. **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 contraventions of Article 15 of MAR are facts concerned with the Announcements and, by contrast, what was said and known within Carillion as to the matters addressed in the Announcements, for example, the financial risks and exposures reported as high risks and likely major contract exposures.**
12. **Further, Mr Howson's approach to the knowingly concerned test would fundamentally undermine the market abuse regime and its objectives, as, notwithstanding Mr Howson's submissions, 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.

Listing Rule 1.3.3R

13. In respect of LR 1.3.3R, the constitutive parts of the alleged contravention which it is necessary for Mr Howson to have known are that the information in the Announcement was misleading, false or deceptive or omitted things likely to affect the import of the information, and that Carillion had failed to take reasonable care to ensure that the Announcement was not misleading, false or deceptive and did not omit things likely to affect the import of the information.
14. The fact that the Announcements were misleading is a constitutive part of the contravention. LR 1.3.3R is in the Handbook under the heading "Misleading information not to be published", so if the published information is not misleading, the rule is not engaged. LR 1.3.3R clearly ties the obligation to take reasonable care to the notification to the RIS or making available through the Authority information that is not false or misleading. Absent such a notification, the rule cannot be breached.
15. It must also be shown that Carillion failed to take reasonable care to ensure that the Announcements were not false or misleading. This is a constitutive fact and therefore a fact which Mr Howson must be shown to have known for knowing concern to be made out. Alternatively, it must at the very least be shown that Mr Howson knew all of the facts upon which such a conclusion is based.
16. It is not sufficient to show that Mr Howson simply knew facts that were inconsistent with the information in the Announcements. That cannot be equated with knowledge that the Announcements were misleading.
17. **The Authority does not agree with Mr Howson'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 Howson submits he requires knowledge of in order to be knowingly concerned are legal conclusions, rather than primary facts.**
18. **Instead, the Authority considers that Mr Howson was knowingly concerned in Carillion's contravention of LR 1.3.3R because he knew the following facts: (i) the information contained in the Announcements; (ii) information (such as that contained in MCSs on potential exposures in the Priority Contracts) which indicated that the statements in the Announcements 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 Announcements were 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 Announcements were accurate).**
19. **The Authority considers that, for the reasons set out in this Notice, the Announcements clearly were misleading, but does not consider it is necessary to show that Mr Howson knew this or that the steps taken by Carillion to ensure that the Announcements were 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

20. In respect of Listing Principle 1, the constitutive parts of the alleged contravention which it is necessary for Mr Howson to have known include that Carillion had not taken

reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations.

21. **The Authority does not agree with Mr Howson's view as to what is required in order for him to have had knowledge of the facts upon which Carillion's contravention of Listing Principle 1 depends. Instead, the Authority considers it is only necessary to establish that Mr Howson 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 Howson knew that those steps fell short of what reasonable care required; that is a legal conclusion and not a primary fact.**

Premium Listing Principle 2

22. In respect of Premium Listing Principle 2, the constitutive facts which it is necessary for Mr Howson to have known are that Carillion acted with a lack of integrity towards the holders and potential holders of its securities.
23. On the facts of this case, it is implicit that a lack of integrity must at least involve knowledge that the Announcements were false or misleading.
24. **Carillion's contravention of Premium Listing Principle 2 is based on attributing the knowledge of Mr Howson (and others) to Carillion. The facts which constitute Carillion's contravention are therefore that Mr Howson (and others) appreciated the risk of Carillion committing breaches of Article 15 of MAR, LR 1.3.3R and Listing Principle 1 and did not respond appropriately to that risk. In order to be knowingly concerned in Carillion's contravention, the Authority must show that Mr Howson had the knowledge that gives rise to Carillion's integrity breach, i.e. that he knew of the risk of breach, and that he did not respond appropriately to that risk. The Authority therefore does not agree that it is necessary to show that Mr Howson knew that the Announcements were false or misleading and that Carillion acted with a lack of integrity.**

Knowing concern - the allegations

25. To the extent that any breach by Carillion depends on additional matters not alleged against Mr Howson, no finding of knowing concern should be made against him.
26. **In respect of all of the breaches, the Authority has reached the view that Mr Howson's knowledge is sufficient to conclude that Carillion was in breach, even where Carillion was also in breach as a result of facts known by others.**

MAR

27. The necessary constitutive facts have not been alleged to make out the knowing concern allegations. Alternatively, Mr Howson denies the factual matters relied on to meet the test for knowing concern.
28. Mr Howson did not know the facts that meant the Announcements contained information giving or likely to give false or misleading signals as to Carillion's share price. It is also denied that he ought to have known that the Announcements were false or misleading.
29. **The Authority considers that Mr Howson was aware of information and warning signs which indicated that the positive statements in the Announcements did not reflect the true financial performance of CCS's construction contracts and that, as a result, he ought to have been aware that the information in the Announcements was false or misleading. As a result of his knowledge and involvement in the Announcements, the Authority considers that Mr Howson was knowingly concerned in Carillion's breaches of Article 15 of MAR.**

Listing Rule 1.3.3R and Listing Principle 1

30. Mr Howson had a large amount of information to support his belief that the Announcements were accurate. He did not know that the control framework was at risk of failing.
31. **The Authority considers that Mr Howson's submission fails to take into account the information and warning signs he received, as a result of which he ought to have known that the information in the Announcements was false or misleading. Further, Mr Howson was aware that the Board and the Audit Committee were not made aware of this information and the warning signs, that inconsistent management information on financial performance was being produced, and that the contract accounting judgements being applied were not properly documented, and so the Authority considers he must have been aware 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.**

Recklessness and lack of integrity

32. Mr Howson did not behave recklessly. He placed reasonable trust in the personnel, processes and procedures, and whenever an issue was raised with him (for example, negative accruals), he sought to address it. Many of the matters referred to were considered by other Board members, and he relied on the systems and procedures in place, the implementation of which was not his responsibility.
33. In any case, it is not accepted that a finding of a lack of integrity necessarily follows on from a finding of recklessness. A finding of a lack of integrity requires something more than recklessness. The Tribunal has stated⁵ 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.*" It cannot be said that Mr Howson is unable to appreciate the distinction between what is honest and dishonest by ordinary standards, but this is what would be required for an allegation of a lack of integrity to be established.
34. **The Authority considers, for the reasons set out in this Notice, that Mr Howson was aware of the risk that the Announcements were false or misleading, and that he acted recklessly by failing to respond appropriately to this risk, by failing to take it into account when reviewing and approving the Announcements and by failing to inform the Board and the Audit Committee of the warning signs of which he was aware. Further, for the reasons set out in this Notice, the Authority considers that Mr Howson was also aware of the risk that Carillion did not have adequate procedures, systems and controls to enable it to comply with its obligations under the Listing Rules, and that he acted recklessly by not responding appropriately to this risk and by failing to take any steps to address the various issues relating to Carillion's procedures, systems and controls. Given Mr Howson's knowledge and responsibilities, the Authority does not consider that it was reasonable for him simply to rely on others to address issues or on Carillion's systems and procedures which were in place.**
35. **The Authority considers that it is well-established that recklessness can constitute a lack of integrity⁶, and that Mr Howson'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 CEO of a listed company as to the accuracy of its market announcements is, objectively, an ethical or moral failing. Shareholders and**

⁵ *Ghanshyam Batra v The Financial Conduct Authority* [2014] UKUT 0214 (TCC)

⁶ See, for example, *Tariq Carrimjee v The Financial Conduct Authority* [2015] UKUT 0079 (TCC)

potential shareholders rely on the accuracy of market announcements. For Mr Howson to sign off on positive market announcements 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 Howson'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 Howson's recklessness in this regard amounts to a lack of integrity.

Mr Howson's roles and responsibilities

36. Mr Howson was appointed by the Board because it wanted an operationally focused CEO. He had never worked in the Finance function and he was not appointed to make complex contract accounting judgements for large construction projects. He had a heavy workload managing those matters within his remit and was entitled to expect significant issues to be raised with him. In practice, he dealt with a broad range of operational issues on major contracts, whilst the Group FD provided leadership from a finance perspective.
37. The Group FD was responsible for the financial affairs of the Group and for accurately reporting the financial results to the market, ensuring adequate internal financial reporting and ensuring that there were adequate systems, controls and procedures around financial reporting. These were not Mr Howson's responsibilities and he placed trust in Mr Adam and Mr Khan, both of whom were well respected, experienced professionals.
38. Mr Howson did not decide the traded value of contracts and was not responsible for ensuring compliance with IAS 11. Determining the amounts to be traded on Carillion's construction contracts depended on subjective judgements by the Commercial and Finance functions within CCS. Those judgements were subject to a process of review and approval within CCS. Mr Howson did not play a part in making those judgements; that was the responsibility of individuals within CCS and CCS's Finance Director who reported to the Group FD. The Group FD was also responsible for the profit recognition policy. Those responsible for the relevant contract accounting judgements, including the Group FD, were all aware of the alleged warnings of which Mr Howson was aware. Simply having knowledge of a contract would not have equipped Mr Howson to overturn the necessary judgements made, especially given the volume of contracts that Carillion had, and in any event that was not his role.
39. If there were any concerns that the traded positions did not reflect the true contract positions or were not in accordance with IAS 11, it was reasonable for Mr Howson to have expected the CCS Finance Director and/or the Group FD to have dealt with them. He also had every reason to believe that the external auditors and the Audit Committee would have had access to relevant documents.
40. **Mr Howson and the Group FD were the only executive directors at Board level. Carillion's Annual Report for 2016 shows that Mr Howson's responsibilities included working closely with the Group FD to ensure that the Group had in place appropriate risk management and internal control processes and maintained effective relationships and communications with investors. Mr Howson could therefore not reasonably fail to inform the Board and the Audit Committee of the warning signs regarding CCS's financial position of which he was aware.**
41. **Mr Howson received a number of warning signs and knew that the Board and the Audit Committee were unaware of them. He also knew that the Board and the Audit Committee had instead received much more positive information about the financial performance of major contracts. As part of his**

responsibilities regarding Carillion's internal control processes, Mr Howson needed to ensure that not just the Group FD but also the Board and the Audit Committee were informed of the warning signs that he received, so that they could provide effective oversight of Carillion's business and the risks in that business, including those associated with its financial reporting to the market.

42. **The fact that Mr Howson was expected to work closely with the Group FD was particularly important in respect of IAS 11 accounting judgements, as they are underpinned by an assessment of the expected performance of the construction contracts in question. Mr Howson had considerable experience of Carillion's business and also had operational experience around challenging contracts and specific knowledge of the Priority Contracts. He was therefore particularly well-equipped to apply appropriate scrutiny to the commercial assessments which underpinned Carillion's IAS 11 accounting judgements and financial reporting. It was not reasonable for him to rely exclusively on the Finance and audit functions and fail to challenge or make further enquiries in the face of the information and warning signs that he received.**

Carillion's procedures, systems and controls

43. Carillion had extensive systems, controls and procedures around financial reporting, including external auditors, the Audit Committee and an experienced Group FD. Mr Howson was not responsible for ensuring these systems and controls were adequate, and he did not consider them to be inadequate.
44. Mr Howson does not accept that the challenges and targets set gave rise to a clear risk that accounting judgements would not comply with IAS 11 and would misreport the financial performance of major projects. Alternatively, he denies having any knowledge of this.
45. The Authority has accepted that Carillion's financial reporting policies and procedures were adequate, that the pressure put on CCS was not untoward, and that Mr Howson did not set the targets in question. It was not Mr Howson's role to police the control framework, and he had good reasons to consider that there was a robust control framework in place, so the allegation in respect of the pressure put on CCS is not made out.
46. As far as Mr Howson could reasonably have known, the contract accounting judgements were made by the relevant personnel in accordance with Carillion's policies and procedures and were not made arbitrarily. He also took steps to satisfy himself that the contract accounting judgements were being applied appropriately.
47. **The Authority considers that there were serious failings in Carillion's systems and controls during the Relevant Period. In particular, there was inconsistency between the information reported by CCS which highlighted large and increasing risks, and the much more optimistic assessment set out in other reports, such as the Overtrade Reports and MPSRs, that were provided to the Board and the Audit Committee. Mr Howson was aware of these inconsistencies, but he failed to undertake any enquiries to understand why they had arisen or take any steps to resolve them. Given the warning signs known to Mr Howson, he must have appreciated the risk that Carillion's systems and controls were therefore inadequate.**
48. **The Authority considers that the evidence shows that there was significant pressure on CCS to meet very challenging financial targets, 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.**

49. **Mr Howson's submissions that it was not his role to police the control framework, and that others were responsible for the relevant contract accounting judgements, ignore the fact that he had a responsibility to work closely with the Group FD to ensure that the Group had in place appropriate risk management and control processes, and fail to take account of the fact that he was aware of the demanding nature of the targets set and the pressure placed on CCS to meet them during the Relevant Period.**
50. **Mr Howson was present at PRMs in which budgets and forecasts were discussed and he received emails in which the challenging nature of targets set were communicated. He was also aware of the impact of the pressure to meet the targets on the accounting judgements of those within CCS, as reflected in the increasing disparity between the end-of-life forecasts of Project Teams and the traded figures for the Priority Contracts, and the increasing management adjustments applied in order to meet the targets set. This disparity and the management adjustments applied were reported in various CCS PRMs, attended by Mr Howson, during the Relevant Period. In the light of his knowledge and exposure to these matters, and his responsibilities regarding Carillion's risk management and control processes, Mr Howson could not reasonably ignore the risk that contract accounting judgements under IAS 11 would be applied by CCS too aggressively in response to the pressure it was under and he could not reasonably assume without further enquiry and challenge that there was a robust control framework in place.**

Management adjustments

51. Management adjustments were necessary to ensure that the figures were reported accurately. They were a legitimate part of construction contract accounting and provided for under the profit recognition policy. That policy forbade arbitrary management adjustments, not management adjustments *per se*.
52. There is no evidence that Mr Howson was aware of management adjustments being used for an improper purpose. It was reasonable for him to assume that the rationale and reasons for any trading judgements would be in the Position Paper that would be accessed by the external auditors and Finance. He could therefore assume that if any reviewer was not satisfied with a justification, it would be raised with the relevant Business Unit or Business Division, or if material with the Audit Committee.
53. **Mr Howson attended a series of CCS PRMs in 2017 which showed that the Project Teams' forecasts for the Priority Contracts continued to deteriorate, and yet the scale of management adjustments continued to increase, such that the traded figures for the projects remained unaltered. Despite being aware of: the Project Team's estimates for each of the Priority Contracts (and the continued deterioration of those estimates); the large and increasing divergence from the traded figures for each project; and the correspondingly large and increasing management adjustments applied to each project, such that the traded figures remained unaltered, Mr Howson made no enquiries to satisfy himself that such large and increasing management adjustments were warranted. The importance of doing so is clear from the fact that the management adjustments in respect of the Priority Contracts amounted (in each of the CCS PRMs between March and June 2017) to over half of the underlying PBT for the Group for full year 2016, as reported to the market in the March Results Announcement.**
54. **In these circumstances, it was not reasonable for Mr Howson simply to have assumed that the rationale for management adjustments would be explained to, or questioned by, the external auditors, Finance or the Audit Committee and that he needed to do nothing.**

CCS PRMs

55. The detailed decisions as to the judgements made in respect of specific projects were not taken at the level of CCS PRMs. In addition, routine decision-making regarding management adjustments and trading was not made in CCS PRMs, but by way of the process set out in the profit recognition policy. It was reasonable for Mr Howson to rely on those processes and controls.
56. The criticism regarding the lack of minutes or records of CCS PRMs is of limited significance given that discussion of financial performance at the CCS PRMs was by exception only. Further, Mr Howson had good reason to consider the overall process was operating as it should and, if minutes were not taken, that does not mean he knew an appropriate record was not being made of any relevant judgement.
57. Receiving a detailed report does not equate to awareness of the figures in it. Mr Howson was not expected to review the CCS PRM pack in advance of the meeting and could not be expected to interrogate each individual reporting in the CCS PRM as to whether they had covered every item that required his attention.
58. **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. At the CCS PRMs, Mr Howson was informed of the deteriorating estimates by the Project Teams for each of the Priority Contracts, the large and increasing divergence from the traded figures for each project, and the correspondingly large and increasing management adjustments applied to each project, such that the traded figures remained unaltered. It was not reasonable for Mr Howson to receive such information and take the view that, because this information was not provided to him by way of the process set out in the profit recognition policy, there was no need to take appropriate steps to satisfy himself that such large and increasing management adjustments were warranted.**
59. **The lack of minutes taken of PRM discussions, and the lack of record of any detailed review or changes to contract account judgements made or the reasons for them, was a serious inadequacy in Carillion's systems and controls. Mr Howson attended CCS PRMs and must have been aware that these matters were not properly recorded. As CEO, he had a responsibility to work closely with the Group FD to ensure that there were appropriate internal control processes, and it was not reasonable for him to assume that others would make appropriate records.**
60. **The Authority considers that the evidence shows that Mr Howson was not just provided with the CCS PRM packs, but that he attended many CCS PRMs during the Relevant Period at which hard risk and other warning signs were highlighted, including through presentations. Further, such presentations were sometimes specifically sent to him in advance of the meeting. For example, a presentation entitled 'Profit Update Year End & Budget Reporting' was sent to his personal email account, which was reserved for important documents, in advance of the CCS PRM on 19 October 2016. Mr Howson must therefore have been aware of the large and increasing financial risks and potential exposures being reported by CCS.**

Hard risk

61. Mr Howson accepts neither the alleged definition nor the alleged significance of hard risk. The term was used inconsistently across Carillion. Mr Howson did not understand hard risk to mean a sum to be written off. Instead, he understood hard risk to mean a figure which might crystallise in the future if litigation went against Carillion.
62. The use of hard risk was something that Mr Howson had checked with Mr Adam was an appropriate way of planning trading and managing risk. Mr Howson's belief as to

the meaning and significance of hard risk is supported by the fact that others within Carillion, including the Group FDs, did not share the Authority's understanding. It appears that neither the external auditors nor Finance considered that hard risk would be a useful metric and it was not suggested to Mr Howson that hard risk posed a potential threat to the accuracy of the Announcements.

63. It is unclear whether the email sent to Mr Howson on 18 March 2016 that described hard risk as "*not collectible*" meant it was not collectable at all, or that the figure was not collectable at that time.
64. **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*". By receiving the email on 18 March 2016 which referred to sums as "*hard risk/not collectible*", Mr Howson must have appreciated at the very least the risk that sums reported as hard risk were not genuinely collectable. Mr Howson has not identified any contemporaneous document which supports his submission regarding his understanding of hard risk.**
65. **In any case, irrespective of his and others' understanding as to the precise meaning of hard risk, Mr Howson 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 the hard risks reported by CCS were very large: they totalled £171.8 million for CCS in October 2016 and had increased to £310.6 million by March 2017. As Mr Howson must have appreciated, they were large not only in absolute terms, but also relative to Carillion's underlying PBT for 2016, which was £178 million. Further, he was aware that hard risk was reported by CCS as part of the budgeting and reforecasting process, a well-established and important process which formed the basis on which CCS set out its expected financial performance for the year as assessed, amongst other things, against market expectations. In those circumstances, Mr Howson needed to take meaningful steps to understand, assess and address the increasing levels and accumulated values of hard risk being reported to him, but he did not do so.**

The MCS

66. The MCS was not part of the PRM reporting process within Carillion and was not a document which was used in PRMs. The figures did not consistently tie back to any of the metrics relied upon by the business and it is not accepted that the figures were reliable.
67. Mr Howson did not attend any of the MCRMs during the Relevant Period where the MCS was discussed. He did not read the MCS and did not have knowledge of the likely exposure figures. Nobody informed him that an issue had arisen at the October 2016 MCRM which required his attention. Receiving a detailed report does not equate to awareness of the figures. In any case, MCSs were considered to be illustrative only.
68. **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 section for CCS was compiled and submitted by senior directors: its Finance Director and Commercial Director. The MCS records "*exposure to traded amount*" by reference to best, likely and worst outcomes. The "*likely*" exposures for CCS reported in the MCS totalled £159.9 million as at July 2016, increasing to £431.9 million by May 2017. The size of these figures was a clear and obvious warning sign, especially given their size relative to the underlying £178 million PBT for the entire Carillion group for 2016.**
69. **The Authority does not consider it credible that Mr Howson did not read any of the MCS documents during the Relevant Period. In particular, he was sent the MCS in July 2016 and October 2016 to his personal email account, which was filtered by his assistant and reserved for important documents, and he**

was specifically forwarded another MCS by Mr Khan following the MCRM in May 2017. He was also the effective chair of the MCRM and played a significant role in it. The MCS provided an overview of the Group's major projects on a Group and divisional basis. This content would have been of obvious interest to Mr Howson as the CEO, which is consistent with the fact that he chaired the MCRM when available. The Authority therefore considers it is inherently unlikely that he would have ignored MCS documents sent specifically to him at his personal email address.

Negative accruals

70. Mr Howson had no knowledge of negative accruals until April 2017, and he did not know the scale and significance of the problem until well after the May Announcement. He took steps to ensure that the issue was properly investigated, which demonstrates the implausibility of the allegation that he ignored potentially material issues of which he was aware. His review and approval of the May Announcement was reasonably predicated on an understanding that the financial aspects were appropriate given the position taken by, for example, the Group FD. The steps taken included a review by the external auditors, which concluded that no prior year restatement was necessary. This is evidence of the factual position at the time and indicates the reasonableness of his belief in the truth of the Announcements.
71. **The Authority does not agree that any actions taken by Mr Howson in relation to negative accruals supports his submission that he did not act recklessly in the manner set out in this Notice. As explained above, the reasons for the Authority's conclusions that he acted recklessly relate to his failure to respond appropriately to risks that he was aware of that the Announcements were false or misleading and that Carillion did not have adequate procedures, systems and controls to enable it to comply with its obligations under the Listing Rules. Further, the Authority does not consider that the external auditors' conclusion that no prior year adjustment was necessary supports Mr Howson's submissions regarding his belief in the accuracy of the Announcements, given Mr Howson's knowledge, and the external auditors' lack of knowledge, of the warning signs that he received in respect of the deterioration in CCS's financial performance.**

Reporting to the Board and the Audit Committee

72. If there was inconsistency between the information and figures being presented to the Board and the Audit Committee, and that presented to others at Carillion, Mr Howson was not aware of it. It was the Group FD who reported on financial performance; it was not Mr Howson's responsibility and he was not responsible for deciding which papers were provided to the Board.
73. Mr Howson reasonably considered that the Board was properly informed in light of the procedures, systems and controls in place. As far as he was aware, the matters reported to him and the Board in the Group FD's Finance Report were the conclusion of a well-constructed policy which included bottom-up reporting from the projects, with reviews being undertaken according to the profit recognition policy. The Board had three chartered accountants sitting on it at all times and could have requested other information if it thought that was required.
74. The Audit Committee was meant to ensure that Carillion had proper internal controls and an effective control environment, and to review the integrity of the financial statements. It was chaired by a Non-Executive Director who was an accountant. Whilst Mr Howson attended Audit Committee meetings, the Audit Committee would meet the Group FD and separately the external auditors without Mr Howson being present. Mr Howson was not responsible for what was reported to the Audit Committee.
75. The roles of the Audit Committee and the external auditors shows that there were substantial checks, controls and validation processes in place for the judgements that

were made. If the Audit Committee considered that there was important information that it had not received, it would have requested it.

76. **Mr Howson received the management information produced and reported by CCS which highlighted large and increasing risks associated with the reported financial performance of CCS's construction projects during the Relevant Period, as well as the reports which went to the Board and the Audit Committee which contained much more optimistic assessments of the financial performance of those projects. Accordingly, Mr Howson must have been aware of the inconsistency between the figures in these different reports. Mr Howson's responsibilities as CEO included working closely with the Group FD to ensure that Carillion communicated effectively with investors and had appropriate internal control processes. Given the warning signs of which he was aware, it was not reasonable for Mr Howson to fail to bring them to the attention of the Board and the Audit Committee, in circumstances where they were not mentioned in the papers provided to them. Mr Howson's failure to do so meant that the Board and the Audit Committee were seriously hampered in providing effective oversight of CCS's financial performance and the contract accounting judgements being applied to its major projects.**
77. **Although the Board and the Audit Committee could have asked for further information, the materials before them did not disclose the hard risks, MCS reports and other warning signs of which Mr Howson was aware. It was not reasonable for such information to be held only at executive director level, which meant that the Board and the Audit Committee were not in the position to ask questions about such matters.**

MPSRs and Overtrade Reports

78. Mr Howson believed that the source of the financial information in the MPSRs was derived from a combination of the Contract Appraisals and any agreed management adjustments, which followed the profit recognition policy and reflected the accounting judgements reached as to the traded positions. He reviewed and approved the MPSRs on the basis that other senior management (including the Group FD) were content with the figures. As CEO it was not his responsibility to conduct a detailed review and comparison of the underlying supporting documents.
79. Mr Howson does not accept that receiving the Overtrade Report meant that he knew any necessary constitutive fact of any alleged contravention.
80. **MPSRs and Overtrade Reports were two key reports received by the Board dealing with the financial performance of CCS's projects. 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.**
81. **Mr Howson was aware that the financial information in the MPSRs was inconsistent with the hard risk and MCS figures and with the Project Teams' assessments of the financial performance of the Priority Contracts. In those circumstances, it was not appropriate for him to review the MPSRs, and approve the figures in them, on the basis that other members of senior management were content with the figures. Instead, he should have made enquiries about the inconsistencies and brought them to the attention of the Board and the Audit Committee.**
82. **Mr Howson understood that 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. He knew the figures**

reported in the Overtrade Report did not identify hard risks, exposures reported in the MCS or divergences from budgeted forecasts in the financial performance of certain major projects, and therefore that the Board was not informed of information that was highly relevant to its deliberations.

The role of the external auditors

83. External auditors were retained by Carillion to identify (among other things) that the internal controls, including reporting procedures, were working properly, and that the financial statements as a whole were free from material misstatement.
84. The external auditors' role, knowledge and power to obtain documents and information, combined with their opinion that the financial statements gave a true and fair view of the state of Carillion's affairs for the purposes of the December Announcement, were objective facts which are relevant to whether the documents relied upon establish Mr Howson's knowledge of the alleged breaches.
85. The fact that the external auditors did not identify any of the issues relied on means the Authority should be cautious in concluding that Mr Howson, who is not an accountant, had in fact identified such matters or that he was reckless in not doing so.
86. **The external auditors' role in respect of the financial statements does not negate Mr Howson's own primary responsibilities, as a director, for the preparation and approval of the financial statements and ensuring that they were 'true and fair'. 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. Having received warning signs regarding CCS's financial position, Mr Howson needed to take action to discharge his responsibilities. He could not reasonably disregard these warning signs on the ground that he expected the external auditors to uncover the same matters, in particular in circumstances where he was aware that the Audit Committee was not informed of any of them.**

The Priority Contracts

87. Mr Howson did not know facts which indicated that the financial performance of the Priority Contracts in CCS was deteriorating more than the figures presented to the Board and the Audit Committee would suggest. The case against him is based on figures cherry-picked from about 10 documents across a year, amongst a large volume of other material that Mr Howson received. He did not even see some of those figures and did not understand the meaning or significance ascribed to any of the figures. He relied on the expertise and judgements made by others, and nobody ever identified to him that the figures meant that there should be an adjustment to the traded figures.
88. The Priority Contracts were four out of 40 or 50 major projects in CCS. Mr Howson could not be expected to "know" all the information he was sent, especially if it related to a sphere of operation that was not his responsibility. He received a large amount of material and the allegedly divergent figures that he did receive were contained within a mass of other information and/or not identified as requiring his attention and/or related to a discussion at a meeting that he did not attend. Given Carillion's size and complexity, he could not have been reasonably expected to know all material facts about each of Carillion's various contracts.
89. In respect of the deterioration in the financial performance of the Priority Contracts, the management adjustments that were being applied and how the matters were treated in the accounts were not decisions for Mr Howson. The fact that the management adjustments had increased does not mean the adjustments were improper. If adjustments were being applied to maintain an unjustified forecast profit margin improperly, Mr Howson was not aware of that practice.
90. The alleged divergence in the figures in the graphs for the Priority Contracts in Section G of the Notice is unfair, as the comparison that is being made is not between like-for-

like figures. The negative figures that are being compared in the graphs are not the considered site view post-management adjustments. They were either site view figures prior to the management adjustment or a different metric that was not intended to represent the post management adjustment figure. Overall, the graphs do not show that Mr Howson was aware that the figures being presented to the Board and/or the Audit Committee were wrong.

91. **Mr Howson was informed by a variety of means of large and increasing 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. The information he received included being told of: very large disparities between the end of life estimates provided by experienced CCS personnel and the much more positive assessments reflected in Carillion's budgeted forecasts; assessments from within CCS which explicitly set out itemised recovery plans running to tens of millions of pounds, and even after the application of those proposed recoveries still concluded that the contracts in question were severely loss-making; and assessments not just from Project Teams but also from CCS management and director level, which could not just be considered to be site view estimates. RLUH, Battersea and MMH were reported to the Board as profit-making contracts throughout the Relevant Period. As Mr Howson was aware, if they were actually loss-making contracts, the full extent of the loss needed to be recognised immediately in the accounts by way of an appropriate write down under IAS 11. In those circumstances, Mr Howson should have treated the information he received indicating that the contracts were loss-making with the utmost seriousness, due to the significant impact of the losses having to be recognised in full immediately.**
92. **AWPR was 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. Mr Howson was repeatedly informed that the best end of life assessment for AWPR was a far greater loss. These warning signs concerning AWPR were extremely serious given the loss-making nature of the contract: the full extent of the loss needed to be recognised in the accounts immediately under IAS 11, with a correspondingly significant impact on Carillion's accounts for 2016.**
93. **The scale of the divergences highlighted to Mr Howson was considerable and the Authority considers that they are fairly illustrated by the graphs contained in Section G of this Notice. Carillion's financial results for 2016 were based on an underlying PBT figure of £178 million for the entire Group, yet the divergences highlighted to Mr Howson, even in respect of a single project, consistently ran into tens of millions of pounds, and equated to a very substantial proportion of the underlying PBT for the whole Group. In those circumstances, it was imperative that Mr Howson treated the figures with the utmost seriousness, and so the Authority does not accept that it was reasonable for him not to pay due attention to the Priority Contracts on account of all the other information he received.**
94. **The management adjustments were so large that Mr Howson could not simply trust that they were appropriate. However, he did not make any enquiries to satisfy himself that management adjustments of such scale were warranted. He also did not inform the Board or the Audit Committee of any of the warning signs he received, notwithstanding that the Board emphasised at the December 2016 Board meeting that it was relying on the judgement of the executive and that it was "important to understand whether the trading performance of the business had deteriorated".**

The Announcements

95. Mr Howson was not aware there was a risk that the Announcements were false or misleading and he did not consider them to be false or misleading. He reviewed and approved the Announcements from his perspective as CEO. He did not draft them and it formed no part of his role to make any relevant accounting judgements. The Group FD was responsible for the drafting process and, if there was an issue with the figures, he should have raised it. That is also the case in respect of anyone from CCS who thought that there was an issue.
96. Mr Howson had good reasons to consider that the Announcements were true. These included that the financial aspects were the culmination of a process that carried with it the express or implied endorsements of various well-qualified persons who Mr Howson trusted: those responsible for making, reviewing and approving the judgements within CCS; the Finance function; the Group FD; the Audit Committee; and the external auditors.
97. The reference in the May Announcement to "*particularly in our international markets*" did not mean exclusively restricted to those markets.
- 98. Mr Howson played an integral role in the preparation of the Announcements and approved them as a Board member. He therefore had important personal responsibilities in respect of the Announcements, but he did not take appropriate action to address the warning signs that he received or bring them to the Board's or the Audit Committee's attention. In the face of these warning signs, and given his responsibilities, Mr Howson should not have relied on others to raise concerns with the figures and should have taken all reasonable steps to satisfy himself that the Announcements were accurate and not misleading.**
- 99. Mr Howson was aware that the Announcements made positive statements about Carillion's performance generally and in relation to CCS's construction business segment in particular. He was also aware that these positive statements were inconsistent with significant financial risks and exposures which had been brought to his attention through numerous warning signs, and which he was aware had not been addressed or brought to the attention of the Board or the Audit Committee. In these circumstances, the Authority considers that Mr Howson was aware that there was a risk that the Announcements were false or misleading.**
- 100. The comment in the May Announcement regarding managing challenging contract positions was explicitly linked to international markets and did not refer to the UK, so was not sufficient to provide an accurate depiction of the Group's trading as at the date of the May Announcement. The comment was expressly linked to the similar statement made in the March Results Announcement, which was specific to the Middle East and Canada, and did not convey significant problems within Carillion's UK construction business (i.e. CCS).**

Limitation

101. The Authority is not permitted to impose a financial penalty in respect of Mr Howson'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.
102. 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. Annex 1 to the Investigation Recommendation stated that

Mr Howson was under consideration for investigation and potentially implicated in the misconduct. The Authority therefore had sufficient knowledge to justify an investigation prior to 18 September 2017, and so, having regard to the Tribunal's decision in the case of *Jeffery*⁷, the Authority is time-barred from imposing a financial penalty on Mr Howson in respect of those alleged breaches.

103. **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*, 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."**
104. **In summary, the particular misconduct alleged against Mr Howson, 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, 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 Announcements 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 Howson's failure to respond appropriately to them. Accordingly, the Authority did not have information from which Mr Howson's breaches could reasonably be inferred.**
105. **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 Mr Howson as an individual. Notwithstanding that Annex 1 mentioned Mr Howson as an individual under consideration for investigation, 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".**

Financial penalty

106. Mr Howson's primary position is that he was not in breach and so no financial penalty should be imposed. Notwithstanding his primary position, at Step 2 of the financial penalty calculation, the assessment of the seriousness level should take into account that steps were taken to ensure compliance, that Mr Howson acted promptly when alerted to issues, and that he was entitled to place some reliance on Finance and the external auditors.
107. In respect of the calculation of the income figure, Mr Howson does not agree the benefits figure because it includes allowances related to his work which should not form part of the salary calculation. He also does not agree the pension figure, which is too high. In addition, he disputes the calculation of the long-term incentives "LEAP" award shares; it should be zero as the shares were received outside the Relevant Period (in October 2017), or an amount which reflects the lower value of the shares at the time of receipt.

⁷ *Andrew Jeffery v the Financial Conduct Authority*: FS/2010/0039

108. **For the reasons given in this Notice, the Authority considers that Mr Howson was knowingly concerned in breaches by Carillion and that he acted recklessly. The Authority considers it appropriate to impose a financial penalty on Mr Howson in respect of his misconduct.**
109. **The factors that the Authority considers relevant to the seriousness level at Step 2 of the penalty calculation are set out in paragraphs 6.9 to 6.12 of this Notice. The Authority considers that the factors mentioned by Mr Howson do not take account of his responsibilities, including in relation to Carillion's risk management and internal control processes, and his integral role in approving the Announcements, and do not affect the seriousness level.**
110. **The Authority has used the information provided in the Remuneration Report in Carillion's 2016 Annual Report and Accounts, extrapolated into 2017, as the basis for the calculation of Mr Howson's income figure, including the benefits and pension figures. The Authority considers this is the fairest approach, in the absence of any documentary evidence to the contrary. The Authority has also used the Remuneration Report to determine the LEAP award figure. The Authority considers this to be appropriate as the award is treated in the Remuneration Report as being earned in 2016.**

The Authority's investigation

111. The Authority's Enforcement division failed in its investigation to interview key personnel and to obtain relevant information, including documentation used by the external auditors for the purposes of their audit. It also preferred the interview evidence of certain employees over others for no good reason and failed to press interviewees in questioning on certain important matters.
112. It was also procedurally unfair for the Authority's Enforcement division to introduce new evidence after the issue of the Warning Notice. The Authority should not make any adverse findings against Mr Howson on the basis of the new material.
113. **The Authority does not accept that the Enforcement division should have carried out more interviews. In respect of the individuals mentioned by Mr Howson, the Enforcement division obtained and reviewed evidence of interviews carried out by other regulators. The Authority has also paid due regard to all the evidence before it in reaching its decision.**
114. **The Authority does not consider it was necessary or appropriate for the Enforcement division to investigate the adequacy of the audit carried out by the external auditors in order to reach conclusions regarding the appropriateness of Mr Howson's conduct, in particular given Mr Howson's responsibilities, role in the Announcements and awareness of warning signs that the external auditors were not aware of. Further, the Enforcement division did obtain relevant documents from the external auditors for the purposes of its investigation and, in the light of Mr Howson's representations, identified and disclosed further relevant documents.**
115. **Mr Howson was given the opportunity to make, and did make, further written representations in respect of the new material produced by the Enforcement division following the issue of the Warning Notice. He also made oral representations following the disclosure of the new material. In the circumstances, the Authority considers that Mr Howson has been given a 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.**