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: **Zafar Khan**

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 Zafar Khan a financial penalty of £154,400 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 Khan for being knowingly concerned in breaches by Carillion plc of:

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(2) Listing Rule 1.3.3R (misleading information must not be published);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

2. SUMMARY OF REASONS

Carillion

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

2.2. On 10 July 2017, Carillion announced (amongst other things) an expected provision of £845 million as at 30 July 2017, of which £375 million was in relation to projects in Carillion Construction Services (CCS). The provision arose from a review following a deterioration in cash flows across several construction projects, including within the UK.

2.3. The nature of the required provision surprised market analysts and Carillion's share price fell by 39% on the day of the announcement and by 70% within three days. Carillion subsequently went into liquidation on 15 January 2018.

2.4. The market's adverse reaction resulted from the unexpected nature and size of the provision, which effectively wiped out Carillion's profits over the previous six years. Carillion's previous announcements, including its 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 Khan

2.6. Mr Khan was Carillion's Group Finance Director from January 2017 up until September 2017. This Notice relates to Mr Khan's conduct as Group FD between 1 January 2017 and 10 July 2017 (the Relevant Period).

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

2.8. Prior to the Relevant Period, Mr Khan worked at Carillion as the Group Financial Controller. He originally assumed this role on a permanent basis in September 2015 and occupied this position throughout 2016. Mr Khan, in his capacity as Group FC, received information which disclosed significant deteriorations in the expected financial performance of various CCS projects in the latter part of 2016. Whilst the Authority does not seek to attach liability to Mr Khan for events that occurred prior to the Relevant Period, as he was not a director, it considers that Mr Khan's knowledge of, and involvement in, matters that occurred in the latter part of 2016 is relevant to his culpability during the Relevant Period.

<u>Overly aggressive contract accounting judgements and internal reporting to Mr Khan</u>

2.9. There was significant pressure on CCS, during the latter part of 2016 and throughout the Relevant Period, to meet very challenging financial targets in the face of clear warning signs that CCS's business was deteriorating significantly. As Group FD, Mr Khan (along with other senior management) maintained these targets during the Relevant Period. 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.

2.10. This gap was bridged, both prior to and 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.

2.11. The financial risks and exposures associated with these judgements were highlighted to Mr Khan and others by CCS management, both prior to and 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 Khan and others as amounting to around £172 million. By April 2017 Mr Khan knew this 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 Khan and others. By May 2017, according to an MCS dated 4 May 2017 received by Mr Khan, 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 Khan 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 Khan and others both prior to and during the Relevant Period:

   a. RLUH: A £21 million loss (assessed by the relevant Project Team) against a budgeted forecast profit of £13.6 million by December 2016, a difference of almost £35 million. This difference increased to £72 million by April 2017 as RLUH's financial performance deteriorated.

   b. Battersea: A £25 million loss (assessed by the relevant Project Team) against a budgeted forecast profit of around £10 million by December 2016, a difference of £35 million. This gap rose to over £43 million by April 2017.

c. MMH: A £15.7 million loss (assessed by the relevant Project Team) against a budgeted forecast profit of £17.7 million by April 2017, a difference of over £33 million.

d. AWPR: A £78 million loss (assessed by the relevant Business Unit within CCS) against a budgeted forecast loss of £10 million by December 2016, a difference of £68 million. This increased to a gap of over £85 million by April 2017.

2.12. 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

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

2.14. The financial risks and exposures reported in 2017, described at paragraph 2.11 above, were not reported by Mr Khan (or otherwise to his knowledge) to the Board or the Audit Committee during the Relevant Period. The key information received by the Board and the Audit Committee in relation to the financial performance of CCS and its major projects during the Relevant Period was in the form of a monthly Overtrade Report and a quarterly Major Project Status Report (MPSR). They were also informed about the level of provisions applied to Carillion's major contracts (which, prior to the £845 million provision announced on 10 July 2017, totalled £50.1 million for the whole of Carillion's business). At half and full year the Group FD, Richard Adam in 2016 and Mr Khan during the Relevant Period, provided a report to the Audit Committee including a summary of financial risks and key judgements associated with major projects.

2.15. As Mr Khan 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 2.11(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 latter part of 2016 and during the Relevant Period up to February 2017, it reported this revenue at between £42 million and £44 million.

2.16. The MPSR was aligned, to Mr Khan's knowledge during the latter part of 2016 and 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 report for the 2016 full year similarly did not identify any material deterioration associated with major projects.

2.17. 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

2.18. The March Results Announcement made positive statements that Carillion's performance was *"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)[1] 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"*.

2.19. 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 stated expectations as described at paragraph 2.11 above. The revenue and profit/margin figures for the Group and Construction Services (excluding the

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

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 described at paragraph 2.11 above.

2.20. 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 2.11 above.

2.21. Mr Khan as Group FD had a central role in preparing and finalising 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 2.11 above that was materially inconsistent with the positive statements made in the Announcements. Mr Khan must have been aware, particularly given his previous role as Group FC and having regard to the nature and cumulative effect of the information and the number of occasions on which it was reported to him, that this information would be highly relevant to the deliberations of the Audit Committee and the Board when they reviewed and approved the Announcements. However, Mr Khan failed to ensure that this information was brought to the attention of the Audit Committee and the Board.

2.22. 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 Khan was knowingly concerned in Carillion's breach of Article 15 of MAR.

2.23. During the Relevant Period, Mr Khan 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 2.11 above. Mr Khan did not take any steps during the Relevant Period to address the material inconsistencies between the proposed PBT figure and financial reporting for RLUH, Battersea and AWPR and other information of which he was aware (see paragraphs 2.15 and 2.16 above). He also failed to bring these matters to the attention of the Audit Committee and the Board.

2.24. In light of the above, and the matters summarised at paragraphs 2.25 to 2.30 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 Khan was knowingly concerned in Carillion's breach of LR 1.3.3R.

Procedures, systems & controls

2.25. 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.

2.26. 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 Khan attended) and in the preparation of Position Papers for major projects (that Mr Khan received). This meant there was no clear record of the assessments being made, approved or reviewed. This contributed to a lack of rigour around these judgements and their approval and review.

2.27. The management information relating to hard risks, MCSs and certain major projects produced and reported by CCS to (amongst others) Mr Khan highlighted large and increasing risks associated with the financial performance of CCS's construction projects during the Relevant Period. This information was inconsistent with other reports (such as Overtrade Reports and MPSRs) that contained much more optimistic assessments of the financial performance of those projects, as reported to the Board and the Audit Committee.

2.28. The Board and the Audit Committee were not made aware of the significant and increasing financial risks during the Relevant Period as described above. This meant they were hampered in providing proper oversight of CCS's financial performance and the overly aggressive contract accounting judgements being applied to its major projects.

2.29. 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.

2.30. As the Group FD with responsibilities for ensuring that Carillion had adequate procedures, systems and controls relating to financial reporting, the Authority considers that during the Relevant Period, Mr Khan was knowingly concerned in Carillion's breach of Listing Principle 1.

2.31. The Authority considers that Mr Khan acted recklessly, during the Relevant Period, in relation to the facts and matters set out at paragraphs 2.9 to 2.29 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 Khan was knowingly concerned in Carillion's breach of Premium Listing Principle 2.

2.32. The Authority has therefore decided to impose a financial penalty on Mr Khan in the amount of £154,400 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 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) Buildings 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 FC" means the Group Financial Controller for Carillion;

"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 January 2017 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 Khan 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 KHAN'S ROLES AND RESPONSIBILITIES

4.6. Mr Khan is a qualified chartered accountant. He joined Carillion, as Finance Director of the MENA Business Division, in March 2011. He was appointed Group Financial Controller on a permanent basis in September 2015. His role as Group FC involved, amongst other things, collating information provided by the Business Units, including information pertaining to the financial performance of various projects within CCS and reporting it to the Chief Executive Officer, Richard Howson, and the then Group Financial Director, Richard Adam.

4.7. Mr Khan became the Group FD of Carillion in January 2017, having been appointed in August 2016. His responsibilities included the following:

(1) Ensuring that Carillion's financial results were reported to the market accurately and in line with applicable accounting standards. This included financial reporting associated with Carillion's construction projects.

(2) Ensuring accurate internal financial reporting to the Board and the Audit Committee to enable them to discharge their functions. This included attending Board and Audit Committee meetings and reporting at these meetings regarding Carillion's financial performance. Pursuant to this, Mr Khan provided a regular Group FD's report to the Board and to the Audit Committee, which typically provided information concerning Carillion's financial performance.

(3) Ensuring that there were adequate systems, controls and procedures around financial reporting to ensure appropriate accounting judgements were being

made, including in relation to the financial performance of Carillion's construction projects.

SECTION C: IAS 11 AND CONTRACT ACCOUNTING JUDGEMENTS

4.8. 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 2016 and the Relevant Period, especially IAS 11.

4.9. 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.

4.10. 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.

4.11. 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*".

4.12. 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).

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

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

SECTION D: CARILLION'S PROCEDURES, SYSTEMS AND CONTROLS

4.15. 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.

4.16. In the latter part of 2016 and during the Relevant Period, the budget and reforecasting challenges issued and maintained by senior management (including by Mr Khan during the Relevant Period) 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

4.17. 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 latter part of 2016 and 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.

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

Application of contract accounting judgements and their reporting within CCS

4.19. 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 Khan). In practice, this meant that the judgements were no longer made in accordance with Carillion's internal policies or on a *"bottom up"* basis as envisaged in the forecasting process, but were aligned to meet the targets set and to maintain the reported profitability of CCS's major projects. These judgements did not reflect the true financial position of the projects or the financial risks associated with them. They did not comply with IAS 11, one of the applicable accounting standards governing the recognition of revenue and costs associated with construction contracts.

4.20. These financial risks and potential exposures arising from these overly aggressive accounting judgements were highlighted by CCS to Mr Khan 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.

4.21. Mr Khan did not respond appropriately to these warning signs during the Relevant Period. He did not adjust CCS's financial targets in response to them. He also did not report them to the Board or the Audit Committee (including in his own reporting to those bodies), even though to his knowledge they were not otherwise being reported, and even though he must have been aware, particularly having regard to the nature and cumulative effect of the warning signs and the number of occasions on which they were reported to him, that they would be highly relevant to the deliberations of the 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.

4.22. There was no single, coherent process within CCS for making contract accounting judgements and obtaining approval of them in accordance with Carillion's policies during the Relevant Period. 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 Khan, Mr Howson 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.

<u>Internal reporting on major projects from Project Team up to Mr Khan</u>

(i) Contract Appraisals

4.23. 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).

4.24. These management adjustments applied in the latter part of 2016 and 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 set for CCS. 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 Khan 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 in response to the pressure placed on CCS to meet very challenging financial targets. This tool was used increasingly during the latter part of 2016 and the Relevant Period in order to maintain the reported profitability of projects, despite the increasing risks. Mr Khan was aware that between January 2016 and November / December 2016, these management adjustments had increased by around £120 million 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

4.25. 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 Khan during the Relevant Period. Mr Khan

also attended Divisional PRMs on a less frequent basis during the latter part of 2016.

4.26. 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

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

4.28. 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.

4.29. 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 Khan) required the Project Teams, Business Units and Business Divisions to work out ways of delivering the revised revenue and profitability targets. During the Relevant Period, this was done within CCS by, amongst other things, using increasingly aggressive 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 4.50 and 4.51 below).

(iv) Hard risk

4.30. The management of CCS and its associated Business Units had significant concerns about the increasing levels of risk associated with these judgements. Those risks were highlighted within CCS and to Mr Khan and others during the latter part of 2016 and the Relevant Period by means of reporting (what was known as) *"hard risk"* and via a management report called the MCS.

4.31. 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 Khan 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.

4.32. As explained below (see paragraphs 4.57 and 4.58), Mr Khan attended CCS PRMs in the latter part of 2016 and 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, the hard risk internally reported in the CCS PRM, in which Mr Khan attended, amounted to around £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

4.33. The MCS was a quarterly report submitted by the Business Divisions to (amongst others) Mr Khan, prior to and 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) in the latter part of 2016 and during the Relevant Period.

4.34. 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.

4.35. The MCS was discussed at Major Contracts Review Meetings typically attended in 2016 and during the Relevant Period by (amongst others) Mr Khan and management from each Business Division.

(vi) Peer review

4.36. 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 latter part of 2016 and 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.

4.37. Mr Khan did not receive peer review reports, although he was aware of the process.

<u>Reporting to the Board and the Audit Committee</u>

4.38. Mr Khan was a member of the Board throughout the Relevant Period. Prior to this, in his capacity as Group FC, Mr Khan had attended a number of Board Meetings in the latter part of 2016. Mr Khan also attended and reported to the Audit Committee in both his role as Group FD and Group FC. Mr Howson was the only other executive director who was a member of the Board during the Relevant Period.

4.39. Mr Khan was responsible in his role as Group FD for ensuring that the Board and in particular the Audit Committee had sufficient information to provide proper oversight of Carillion's financial reporting, including significant contract accounting judgements being applied and their impact on the overall Group results. The Audit Committee's Terms of Reference during the Relevant Period stated, amongst other things, that the Committee would review and where necessary challenge *"whether the Company has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditors"*.

4.40. 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 latter part of 2016 and the Relevant Period. These risks were known to Mr Khan both prior to and 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 Khan 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.

4.41. 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.

4.42. 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 Khan as Group FD during the Relevant Period and by Mr Howson as Group CEO.

4.43. 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 practice had developed in accordance with the previous Group FD's instructions and Mr Khan maintained it. 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 Khan 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.

4.44. 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.

4.45. 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.

4.46. Mr Khan understood the importance of the Overtrade Report and believed that it was supposed to depict where revenue had been recognised in Carillion's financial reports, despite it being contentious. Despite these matters, Mr Khan knew the figures reported in the Overtrade Report did not identify hard risks, the potential exposures reported in the MCS or divergences from budgeted forecast in the financial performance of certain major projects. On 23 February 2017, Mr Khan, the Group FD at the time, acknowledged that "*there was not a consistent practice*" between Business Divisions in relation to revenue traded but not certified, "*a position which had evolved over a number of years*".

4.47. 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.

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

<u>Carillion's financial statements and Position Papers provided to the external auditors</u>

4.49. For each financial reporting period, Position Papers on major projects were prepared by Business Units for the purposes of the external auditors' half and full year audit work. They set out the financial position of selected projects in terms of the estimated end of life and currently traded value, costs and margin. They identified the amounts being recognised in relation to claims, variations and costs, but only provided limited narrative or other explanation as to the judgements being made. They were reviewed at Divisional and Group level, as well as provided to the external auditors. The figures set out in the Position Papers were broadly equivalent to the MPSRs and reflected the amounts recognised for those projects in Carillion's financial statements.

4.50. The Position Papers did not refer to the financial risks associated with hard risks, MCS exposures or divergences between the latest budget or reforecast and the assessment of the Project Team, Business Unit or Business Division. Typically, the

Position Papers would be sent to the Group FC and to the Group FD for consideration before being provided to the external auditors. Mr Khan, as Group FC, initiated the process for preparing Position Papers for the 2016 year-end accounts by instructing members of the Group Finance team to send out a list of selected contracts which would form the subject of the Position Papers. They were reviewed at Divisional and Group level as well as provided to the external auditors. Mr Khan reviewed the Position Papers prepared for the purpose of the 2016 year-end. They were sent to the external auditors in January 2017, when Mr Khan was Group FD. Notwithstanding Mr Khan's role as Group FD and his review of the Position Papers, he did not inform the external auditors of the matters referenced above, namely hard risk, MCS exposures and the divergences between the Project Team's assessments and what was traded.

4.51. For certain major projects, two versions of Position Papers were produced for the 2016 year-end: a *"clean"* version reflecting the Project Team's assessment of the project's financial position; and an *"adjusted"* version for the external auditors showing a much-improved financial position. The adjusted version was regarded by the Business Unit as more *"audit friendly"* because it did not disclose the overly aggressive nature of the judgements being applied to maintain the budgeted margin and the associated risks to the project's reported financial performance. The external auditors were unaware that a separate, clean version of the Position Paper had been produced reflecting the Project Team's much more conservative assessment. The preparation of *"clean"* and *"adjusted"* Position Papers was one of the tools used within CCS in response to the pressure placed on it to meet very challenging financial targets. Mr Khan only received the "*adjusted*" version, but he was aware that two versions of Position Papers had been produced, in relation to certain major contracts, for the purpose of the 2016 year-end accounts. Notwithstanding this, he did not take any steps during the Relevant Period to alert the external auditors to this.

SECTION E: EVENTS LEADING UP TO THE ANNOUNCEMENTS

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

4.52. 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 Khan, in his capacity as Group FC, and others at that time. Mr Khan must have been aware, particularly having regard to the nature and cumulative effect of the information he received and the number of occasions on which these increases were reported to him, that they would be highly relevant to the deliberations of the Board, the Audit Committee and external auditors. However, they were not reported to the Board, the Audit Committee or the external auditors either before or during the Relevant Period.

July, October and December 2016 MCSs

4.53. 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).

4.54. 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).

4.55. The MCS figures for December 2016 showed *"likely"* exposures of over £550 million for the Group and £157.8 million for CCS. The CCS figure had slightly decreased from October 2016 because it omitted a figure for AWPR. In December 2016, AWPR was separately reporting via the CCS PRM a likely exposure of £68 million against its traded margin (a loss of £10 million). Taking this into account, the *"likely"* exposure for the Group was £618.7 million and for CCS was £225.8 million in December 2016.

4.56. During the latter part of 2016, the MCSs (when taken together with the CCS PRM in December 2016) identified increases of £178.8 million for the Group and £65.9 million for CCS in the level of *"likely"* exposures. Mr Khan attended the MCRMs in July, October and December 2016 and received the MCSs for which they were prepared. Despite the reporting of these exposures, no steps were taken to address them. Whilst responsibility for addressing these exposures did not fall to

Mr Khan until the Relevant Period, he was nevertheless aware of these issues on commencing his role as Group FD. Notwithstanding this, he failed to take any meaningful steps to address them in the Relevant Period.

<u>Hard risk reported in August and October 2016 and January 2017</u>

4.57. 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 Khan on 11 August 2016.

4.58. 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 Khan attended this presentation.

4.59. 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 Khan was in attendance at this PRM.

4.60. As a result, the hard risk forecast reported by CCS increased by £61.8 million between January and August 2016 and by a further £85.7 million between August and December 2016. Mr Khan understood that hard risk represented amounts viewed by CCS as unlikely to be recovered. This was indicated in an email forwarded to him on 6 March 2016 specifically referring to *"what is hard risk vs genuinely collectable"*. Mr Khan did not take any meaningful steps, on becoming Group FD, to understand, assess or address the increasing levels and accumulated values of hard risk reported.

<u>Lack of proper reporting to the Board and the Audit Committee about increasing financial risks and exposures</u>

4.61. The significant increases in likely MCS exposures and high levels of hard risk during the second half of 2016 were not highlighted to the Board or the Audit Committee, or set out in Position Papers sent to the external auditors. Mr Khan was aware of what was being reported to the Audit Committee in the latter part of 2016 as he attended this committee during this period and was responsible for producing most of the first drafts of documents contained in the Audit Committee packs. Mr Khan was also aware of what was being reported to the Board in the latter part of 2016 as he began to attend Board meetings during this period. He was also responsible for reviewing the Group FD's Report and CEO Reports that were included in the Board packs. 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.

4.62. The financial information available to the Board and the Audit Committee about these matters at CCS level during the latter part of 2016 and 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.

4.63. In August 2016, a member of the Audit Committee sent an email to the then Group FD, Mr Adam, which was also forwarded separately to Mr Khan, asking whether contract accounting judgements being made and their linkage to the financial statements could be made clearer because *"trying to assess the judgemental risks/opportunities is difficult"*. As Mr Khan was aware, a member of Group Finance replied stating that this issue would be reviewed going forward. Despite this, no substantive changes were made, prior to or during the Relevant Period, to the level of information being provided to the Audit Committee.

<u>No increase in provisions</u>

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

The December Announcement

4.65. 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 Mr Adam to report to the Board "*The positive news that our overall expectations for Group profit and earnings are broadly in line with our expectations enabled us to keep the consensus forecasts for total underlying profit and earnings broadly unchanged*."

4.66. The trading performance of the Group was discussed at a Board meeting on 6 December 2016, including risks to Carillion's year-end profit forecast. Mr Khan was in attendance at this meeting. Board members emphasised their reliance upon the *"judgment of the executive"* (i.e. the Group FD and CEO) in relation to certain major projects, including AWPR, as well as the need to *"understand whether trading performance of the business had deteriorated".* They were not informed, however, about the increasing exposures in the MCSs or the high levels of hard risk within CCS. No specific consideration was given as to possible changes to the proposed wording of the December Announcement, which was approved for release at this Board meeting.

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

The March Results Announcement

4.68. At the Board meeting on 26 January 2017, concerns were expressed by two Board members about lack of clarity over the Group's trading performance towards the end of 2016 and the need for transparency and clarity *"particularly if the position had deteriorated in the year"*. Mr Khan (now Group FD) noted in response that trading for the last two months of 2016 was in line with forecast. This was broadly consistent with the MPSR Executive Summary for January 2017, which showed no material deterioration in the financial performance of CCS's major projects since the previous quarter.

4.69. 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).

4.70. Mr Khan received the February MCS and was aware that, at around this time, Infrastructure was estimating a loss equivalent to an exposure of £68 million against its traded margin (-£10 million), and RLUH's Project Team was estimating a likely loss of £56.3 million (which equated to an exposure of almost £68 million against its traded margin). The inclusion of these figures in the MCSs would have increased the likely exposure to £664.4 million for the Group and to £285.2 million for CCS. This was an increase in exposures since December of £45.7 million for the Group and of £59.4 million for CCS.

4.71. Final Position Papers for selected contracts had been 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 Major Contract Summaries between July and December 2016, the scale of management adjustments being applied to them, the deterioration in the Project Teams' and Infrastructure's assessment of their financial performance, or variances to peer review recommendations.

4.72. On 23 February 2017, the Audit Committee met to review the draft 2016 Annual Report and Accounts. Mr Khan was in attendance at this meeting. The Group FD's Year-End Report prepared by Mr Khan 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 major projects across the Group (including within CCS) and the claim recoveries and costs savings necessary in order to meet the margins traded for these contracts in Carillion's accounts. The Year-End Report asserted that a total provision of £17 million was appropriate at the year-end for the Construction Services segment (including CCS and Canada). This, when combined with other provisions and contingencies, gave a year-end provision for CCS of £16.9 million.

4.73. 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.

4.74. During the meeting, an Audit Committee member commented that the projects were complex and it was difficult to second-guess management judgements. This emphasised the importance of ensuring that those judgements were appropriately made and disclosed to the Audit Committee. It was also acknowledged by Mr Khan at the meeting that there was not a consistent practice between Business Divisions for completing the Overtrade Report and that a new methodology for reporting uncertified balances would be adopted. This was not implemented by Mr Khan during the Relevant Period.

4.75. The 2016 Annual Report and the March Results Announcement were reviewed by the Audit Committee at its meeting on 23 February 2017, approved at the Board meeting on 28 February 2017 and published on 1 March 2017. There were no material changes in this announcement to the expectations that had been communicated to the market in the December Announcement.

4.76. 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).

4.77. 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 dent), 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".*

4.78. 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.

4.79. Market analyst reports following the March Results Announcement broadly noted that the results were in-line with expectations, with a focus on debts and the performance of projects in support services, the Middle East and Canada. Following the announcement, Carillion's share price fell by 5%.

4.80. Mr Khan, as Group FD, was closely involved in drafting and finalising the March Results Announcement and the 2016 Annual Report. He was listed as the first point of contact on the March Results Announcement. He was responsible for coordinating, overseeing and finalising the content of the March Results Announcement. As a member of the Board, he, along with the rest of the Board, gave final approval before the March Results Announcement and the 2016 Annual Report were published. He signed the statement of responsibility in respect of the

March Results Announcement and Annual Report. This statement asserted that "*The preliminary announcement complies with the Disclosure and Transparency Rules (DTR) of the United Kingdom's Financial Conduct Authority. The preliminary announcement is the responsibility of, and has been approved by, the Directors of Carillion plc ..[…] the financial statements contained in the 2016 Annual Report were prepared in accordance with applicable accounting standards and gave a true and fair view of the assets, liabilities, financial position and profit of the Company […] the 2016 Annual Report and Accounts, taken as a whole, are fair, balanced and understandable, and provide the information necessary for shareholders to assess the Company's financial position, performance, business model and strategy"*.

SECTION F: RECOGNITION OF THE NEED FOR A PROVISION

Events following publication of the 2016 year-end results

4.81. By March 2017, the hard risk for CCS reported to Mr Khan had increased to £310.6 million. This was an increase of £137.9 million since the total 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.

4.82. 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 Khan was aware of this increased level of exposure as he was in receipt of the MCS for May 2017 and was in attendance at the MCRM for which this was prepared.

4.83. In April 2017, Mr Khan 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.

4.84. A significant change in Carillion's debt position was reported to and discussed at a Board meeting on 3 May 2017. Mr Khan was in attendance at 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"*.

4.85. Later that same day, Carillion issued its AGM Statement (the May Announcement) under the headings *"Trading conditions unchanged"* and *"Positive work winning performance"*. The announcement stated that:

"Trading conditions across the Group's markets have remained largely unchanged since we announced our 2016 full-year results in March. Consequently, we continue to focus on the priorities we set out when we announced our 2016 results, namely to accelerate the rebalancing of our business into markets and sectors where we can achieve our objectives for margins and cash flows; and to manage challenging contract positions, particularly in our international markets, as these are key to achieving our objective of reducing average net borrowing."

4.86. 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.

4.87. Mr Khan was closely involved in finalising the May Announcement. He was listed as the first point of contact for the announcement. As with the March Results Announcement, he was responsible for coordinating the preparation of the announcement, reviewing drafts and approving their content before submission to the Board. As a member of the Board, he was also responsible, with the other Board members, for approving the May Announcement before publication.

4.88. Following the May Announcement there was some market commentary relating to challenging contracts in the Middle East, and the share price fell by 5%.

Negative accruals

4.89. 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.

4.90. Negative accruals (as prohibited by Carillion) describes the practice of using the value of claims to reduce costs accounted for on a project, instead of recognising the claim as revenue. This practice can be neutral from an accounting perspective because the profitability of a project should remain the same, whether the claim is recognised as a reduction to cost or an increase to revenue. Within Carillion, however, accounting judgements around claims were reported and assessed internally and to external auditors in the context of revenue recognition, not costs. This enabled negative accruals to be used on certain major projects within CCS to reduce costs by means of overly aggressive judgements on claim recoveries without disclosing that fact in Position Papers seen by the external auditors. For example, a claim for £8 million might have been recognised at the 2016 year-end, of which £5 million was recognised as revenue and £3 million as a negative accrual that reduced costs. The external auditors would only see a value of £5 million for the claim (i.e. the part recognised as revenue), not the additional £3 million recognised by means of the negative accrual. In this way, the profitability on these projects could be maintained without subjecting the overly aggressive accounting judgements being used to appropriate scrutiny.

4.91. 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."

4.92. An internal Carillion investigation into the use of negative accruals was commenced in April 2017, at which point Mr Khan was informed. The investigation reported its initial findings to Mr Khan on 7 May 2017 (four days after the May Announcement). It identified that the majority of negative accruals related to four major contracts (including RLUH, Battersea and AWPR) and amounted to a total of £102 million. It also identified that Business Units had used negative accruals on certain contracts in CCS in response to pressure to *"hold the position [i.e. profit margin]"*. This was a reference to the pressure to meet financial targets imposed on CCS described at paragraph 4.16 above.

4.93. 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 Khan, but he (together with the Board and the Audit Committee) was regularly updated as to the progress of the investigation.

4.94. 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).

4.95. 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 by Mr Khan 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

4.96. 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".

4.97. The Enhanced Contracts Review took place over June and early July 2017. It involved a review of 58 projects across the Group representing £1.58 billion of receivables and 47% of Group revenue for the period ending 31 May 2017. The review considered all aspects of the projects, including the judgements made on each project in relation to variations or claims included in estimated end of life forecasts.

4.98. Mr Khan was involved in structuring the review process, as well as engaging relevant internal and external resource. The review was conducted with assistance from the external auditors, who do not appear to have been provided with details of hard risks, MCS exposures, peer reviews or variances between the figures contained in the "clean" and "adjusted" Position Papers. It concluded that the traded value of a number of projects in Carillion's construction business exceeded the commercial assessment of those positions. It identified a possible exposure of between £378 million and £693 million, and recommended a provision of £695 million. Given the magnitude of the proposed impairment, the external auditors asked Carillion to consider whether any of the proposed provisions required a prior year adjustment to its 2016 results. Carillion's management, including Mr Khan, considered 11 major contract positions to assess whether there was evidence that should have been obtained and considered in preparing the Group's 2016 year-end results ahead of their publication on 1 March 2017. Carillion produced a paper assessing the issues that gave rise to the provision on these projects and considered whether those issues were known as at 31 December 2016. It concluded that the challenges on these projects had crystallised after publication of the 2016 results and no prior year adjustment was required.

4.99. The recommended provision of £695 million was reported to the Audit Committee at its meeting on 9 July 2017. The provision across CCS projects was £375 million. Even with a provision at that level, certain projects retained values being traded that were identified as being at risk. The decision was therefore taken to increase the provision to £845 million to address those risks, which was later allocated to specific projects in September 2017. No prior year adjustment was made.

Trading update on 10 July 2017

4.100. 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.

4.101. Carillion's share price fell 39% that day, and within three days had fallen by a total of 70%.

4.102. In the provision announced by Carillion on 10 July 2017, the four largest provisions within CCS were as follows:

(1) RLUH: £68 million.
(2) Battersea: £38 million.
(3) AWPR: £86 million.
(4) MMH: £48 million.

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

4.103. The facts relating to the above projects and their provisions are addressed below to the extent to which they are relevant to the Authority's findings against Mr Khan as Group FD. This includes facts which either occurred during the Relevant Period or, in instances in which the facts fall outside of this time frame, are relevant to Mr Khan's knowledge during the Relevant Period.

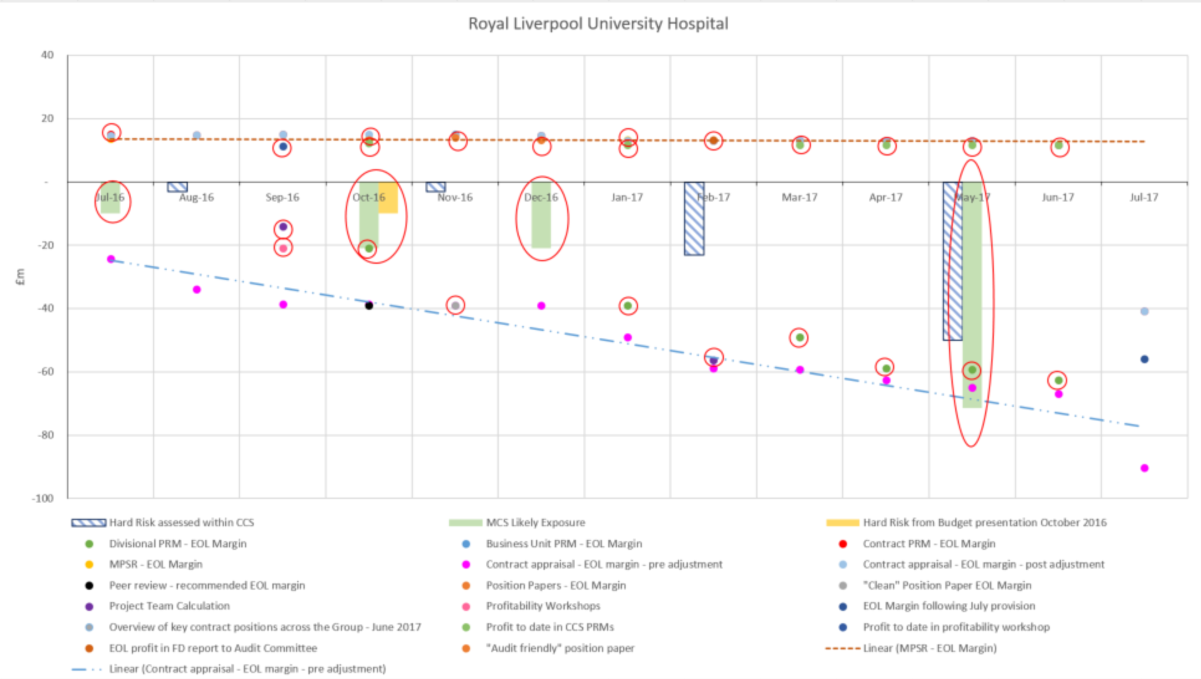
RLUH

4.104. 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.

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

4.106. 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 the latter part of 2016 and 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.

4.107. 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 Khan and others; and (on the other hand) those reflected in budgeted forecasts and/or reported to the Board and the Audit Committee during the latter part of 2016 and 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 reported 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 Zafar Khan was aware at that point in time (or subsequently in the case of MPSRs), whether that was by way of being present in meetings or receiving information directly by email.

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

The Project Team's assessments

(1) The Contract Appraisals and other commercial reports prepared by the Project Team from July to December 2016 reported a deteriorating end of life margin loss for RLUH and increasing use of management adjustments to achieve the forecast profit margin of 4.9%. These Appraisals and reports were not seen by Mr Khan. 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 other benefits further reducing it to a £8 million loss. Mr Howson forwarded the email and attached spreadsheet to Mr Khan.

(3) The Project Team's end of life margin forecast for RLUH was reported by CCS at a £21 million loss in a *"profitability workshop"* in September 2016. The same figure was highlighted in a CCS PRM in October 2016. Mr Khan 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 Khan was aware of this Contract Appraisal or peer review prior to or during the Relevant Period.

CCS's reporting to Mr Khan

(5) CCS reported the Project Team's views internally as described above. At the profitability workshop in September 2016 attended by Mr Khan, CCS

reported that for RLUH a 4.7% margin (equivalent to an £11.3 million profit) had been traded to date (i.e. recognised in Carillion's financial reporting) compared to the £21 million loss assessed by the Project Team. The presentation indicated that the Project Team had been challenged to achieve *"breakeven"* (i.e. no profit or loss).

(6) At the CCS PRM in October 2016 attended by Mr Khan, the margin traded for RLUH to date was reported by CCS as being £12.2 million compared to the Project Team's assessment of a £21 million loss (a difference of £33.2 million). The presentation highlighted hard risk of £10 million against RLUH, having previously been assessed at £3 million in April 2016 and £7 million in August 2016. Shortly after the year-end, this was further increased to £23 million.

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

Reporting to the Board and the Audit Committee

(8) The MPSR Executive Summaries, Overtrade Reports, CEO and Group FD's reports to the Board and/or the Audit Committee did not reflect the Project Team's assessments or peer review recommendation as to the financial performance of RLUH. They also did not highlight the financial risks associated with RLUH, including the level of management adjustments being applied or the hard risks and MCS exposures internally reported by CCS. To that extent, they omitted highly material and relevant information concerning RLUH's financial performance during the Relevant Period. Instead, the MPSR Executive Summaries, in particular, 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.

4.109. Mr Khan was in receipt of the MPSR Executive Summaries for July and October 2016. He attended Board meetings and sat on the Audit Committee in the latter part of 2016 and therefore saw the Overtrade Reports submitted to them during this period. 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.

4.110. 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 preparing Carillion's 2016 Annual Report and Accounts as announced on 1 March 2017; the external auditors were not provided with the *"clean"* version of the Position Paper.

4.111. Mr Khan was aware of the existence of two versions of Position Papers for RLUH. He received an email in November 2016 attaching various Position Papers and a document titled *"Carillion Building Position Paper Summary"*. This document set out *"original"* and *"adjusted"* figures for RLUH. Despite Mr Khan's awareness of the existence of two versions of Position Papers, he took no steps to ensure that external auditors were aware of the *"clean"* and/or *"original"* figures for RLUH for the purpose of the audit of Carillion's 2016 Annual Report and Accounts, which were finalised during the Relevant Period.

4.112. 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. This was seen and reviewed by Mr Khan. 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.

4.113. 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 Khan, who by this time was the Group FD of Carilion, attended this PRM.

4.114. The February 2017 MCS excluded any figures for RLUH and it was given a *"Red"* flag status. Mr Khan received this MCS and attended the MCRM at which it was discussed.

4.115. On 8 February 2017, the Project Team sent a briefing on RLUH to senior management and certain Business Unit and Divisional management ahead of a RLUH presentation at a CCS PRM on 10 February 2017. This PRM was attended by Mr Khan. It 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.

4.116. This information was not communicated to the Board or the Audit Committee by Mr Khan 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, prepared by Mr Khan, 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.

4.117. 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.

4.118. 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 Khan attended both of these PRMs. The MCS in May 2017 identified a likely exposure of £71.5 million for RLUH. Mr Khan attended the MCRM for which the MCS was prepared. He was also in receipt of the May 2017 MCS. Despite this, the Board and the Audit Committee were not made aware by him, or to his knowledge anyone else, of the Project Team's forecast or reported exposures for RLUH.

4.119. The size of the MCS exposure of £71.5 million was reflected in CCS's reporting at a PRM attended by Mr Khan on 19 May 2017, which referred to the Project Team estimating a loss of £59.3 million, with a management adjustment of £67 million to help support a traded to date profit of £11.7 million as at March 2017.

4.120. On 7 June 2017, the Board held a strategy meeting attended by Mr Khan. At this meeting, Mr Howson presented an *"Overview of Key Contract Positions across the Group"*. In the presentation, RLUH was reported as having a forecast end of life margin of £11.7 million (3%). This was expressly stated as including claims in the forecast traded at 100% (i.e. the entirety of the claim values was recognised in the forecast). At the CCS PRM on 22 June 2017 attended by Mr Khan, the Project Team's estimated loss was reported as being £62.6 million, with a management adjustment of £74 million to help achieve a traded to date profit figure of £11.7 million as at April 2017.

4.121. 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

4.122. 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.

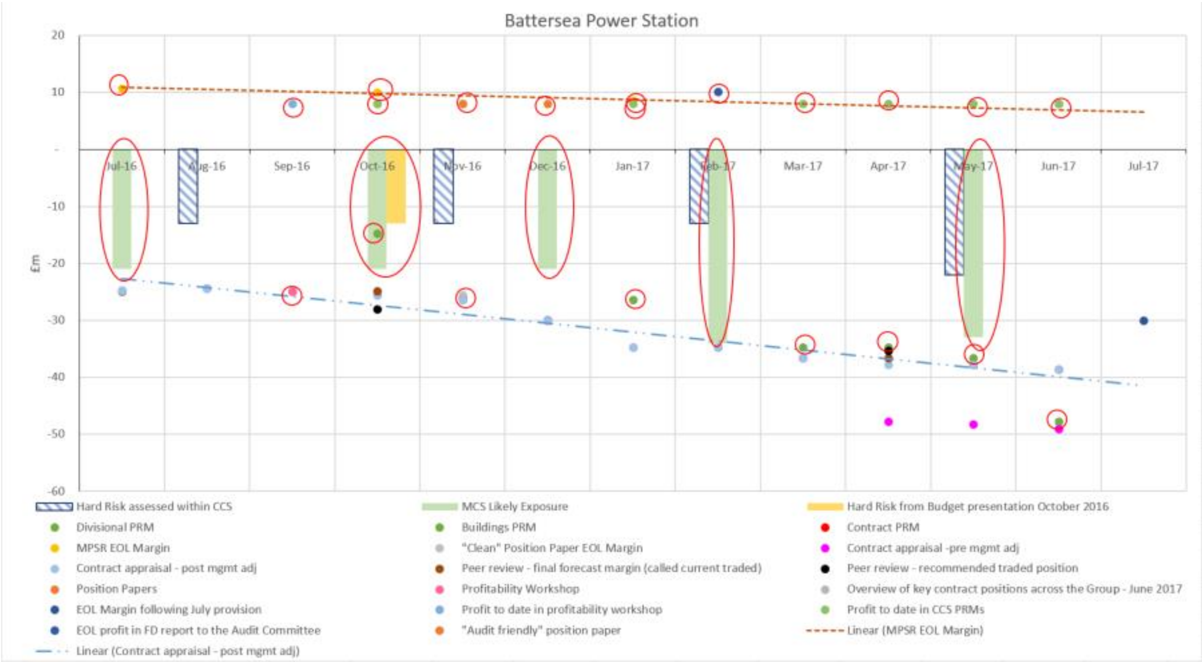
4.123. The contract was tendered at a value of £443.7 million with a 0% profit margin.

4.124. 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.

4.125. 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.

4.126. 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 £24.7m (-5%) in July 2016. This gap continued to increase during the latter part of 2016 and the Relevant Period and was bridged by means of large management adjustments, rising from a management adjustment of £28.6 million in July 2016 to around £34 million in December. The Board and the Audit Committee were unaware of the scale of 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.

4.127. 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 Khan and others; and (on the other hand) those reflecting budgeted forecasts and/or reported to the Board and the Audit Committee during the latter part of 2016 and during the Relevant Period. These are illustrated by the following graph:



Graph 2 - Each point on the graph shows the end of life (EOL) margin and/or traded to date 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 show the increasing divergence of views between the position reported 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 Khan 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.

4.128. 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 Teams 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 Khan but he was aware of the Project Team's assessments by alternative means as set out below.

CCS's reporting to Mr Khan

(3) CCS reported the Project Team's views internally as described above. At the profitability workshop in September 2016, attended by Mr Khan, CCS reported that Battersea had a traded margin of 2.1% to date (equivalent to just over £8 million) compared to the Project Team's projected end of life loss of £25 million, and that the Project Team had been challenged to achieve *"breakeven"* (i.e. no profit or loss).

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

(5) The July, October and December 2016 MCSs reported a *"likely"* exposure of £21 million for Battersea and assigned a *"Red"* flag status to the project. This exposure represented 53% of the contentious amounts of £39.9 million identified in the MCSs as due on Battersea. Mr Khan received the July, October and December 2016 MCSs, as well as attending the MCRMs at which these MCSs were discussed.

Reporting to the Board and the Audit Committee

(6) The MPSR Executive Summaries, Overtrade Reports, CEO and Group FD's reports presented to the Board and the Audit Committee did not reflect the Project Team's views or peer review recommendation as to Battersea's financial performance. They also did not highlight the financial risks associated with Battersea, including the level of management adjustments being applied or the hard risks and MCS exposures reported by CCS. To that extent, they omitted highly material and relevant information

concerning Battersea's financial performance during the latter part of 2016 and the Relevant Period.

(7) Instead, during the latter part of 2016 and 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 Khan was in receipt of the MPSR Executive Summaries for July and October 2016 and January 2017. He attended Board meetings and sat on the Audit Committee in the latter part of 2016 and therefore saw the Overtrade Reports submitted to them during this period. 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.

4.129. At the 2016 year-end, two sets of figures were produced when drafting the Position Papers for the external auditors as described at paragraph 4.51 above, including for Battersea. The *"clean"* Position Paper for Battersea reported a forecast end of life loss of £25.6 million; the *"audit friendly"* version incorporated adjustments to maintain a positive end of life margin of £8 million, a difference of £33.6 million.

4.130. The final version of the Position Paper for Battersea submitted to the external auditors for the 2016 year-end accounts reflected the *"audit friendly"* version. This was seen and reviewed by Mr Khan. It recognised £28.6 million of revenue by means of claims, an increase of over £21 million compared to the amount of £7 million for claims recognised in the *"clean"* Position Paper. The claim figure of £28.6 million appears to reflect sums associated with Contract Reset 2. On 31 December 2016, it was not "probable" that Contract Reset 2 would be approved nor was it supported by "*a client written instruction*" (as per IAS 11 and Carillion's own policies). Therefore, no revenue should have been recognised in relation to Contract Reset 2. The Position Paper for Battersea reported end of life costs of £516.4 million, £18.3 million lower than the Project Team's view at this time.

4.131. Mr Khan was aware of the existence of two versions of Position Papers for Battersea. He received an email in November 2016 attaching various Position Papers as well as a document titled *"Carillion Building Position Paper Summary*". This set out *"original"* and *"adjusted"* figures for Battersea. Despite Mr Khan's awareness of the existence of two versions of Position Papers, he took no steps to ensure that the external auditors were aware of the *"clean"* and/or *"original"* figures for Battersea for the purpose of the audit of Carillion's 2016 Annual Report and Accounts, which were finalised during the Relevant Period.

4.132. At the January CCS PRM on 18 January 2017, the Business Unit reported the Project Team's estimated loss of £26.3 million loss (-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 Khan, who by this time was the Group FD, attended this PRM.

4.133. The February 2017 MCS showed a "likely" exposure to traded amount of £34 million (an increase of £13 million from December 2016) and a *"Red"* flag status was indicated. Mr Khan received this MCS and attended the MCRM at which it was discussed.

4.134. The Group FD's Report, prepared by Mr Khan, submitted to the Audit Committee meeting on 23 February 2017 referred to the need to achieve £28.6 million recoveries in relation to claims, which they expected to deliver through a contract reset to achieve the forecast end of life margin of 2.0% (equivalent to £10.1 million). In their Audit Memorandum presented to the meeting, the external auditors noted that *"Carillion no longer need to achieve £19.3 million in future cost savings, instead management is targeting an additional £28.6 million recovery from the client through a second reset."* No reference was made to the Project Team's assessment of a significant loss, the scale of management adjustments being applied, hard risks or MCS exposures, about which the Audit Committee and external auditors remained unaware.

4.135. 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 of 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.

4.136. 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 as of February 2017. 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 Khan attended both of these PRMs.

4.137. The MCS in May 2017 identified a likely exposure of £33 million for Battersea. Mr Khan was aware of the reported exposures for Battersea, as he received the May 2017 MCS and attended the MCRM for which it was prepared.

4.138. At the CCS PRM in May 2017 attended by Mr Khan, the Project Team's reported estimates had worsened to a forecast loss of £36.6 million, with a £41.5 million management adjustment being applied to support a traded profit to date of £8 million as at March 2017.

4.139. On 7 June 2017, the Board held a strategy meeting attended by Mr Khan. At this meeting, Mr Howson presented an *"Overview of Key Contract Positions across the Group"*. In the presentation, Battersea was reported as having a forecast end of life margin of £8 million (1.5%). This was expressly stated as including claims in the forecast traded at 100% (i.e. the entirety of the claim values was recognised in the forecast). At the CCS PRM on 22 June 2017 attended by Mr Khan, the Project Team was estimating a £47.8 million loss, with a management adjustment of £42.7 million helping to support a traded to date figure of £8 million as at April 2017.

4.140. 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

4.141. 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.

4.142. The contract was tendered at a value of £296.7 million at a 5.97% margin (or £17.7 million).

4.143. The period between Carillion bidding for MMH and financial close on 11 December 2015 was the shortest in Carillion's history.

4.144. The progress of MMH was disrupted at an early stage by two main issues:

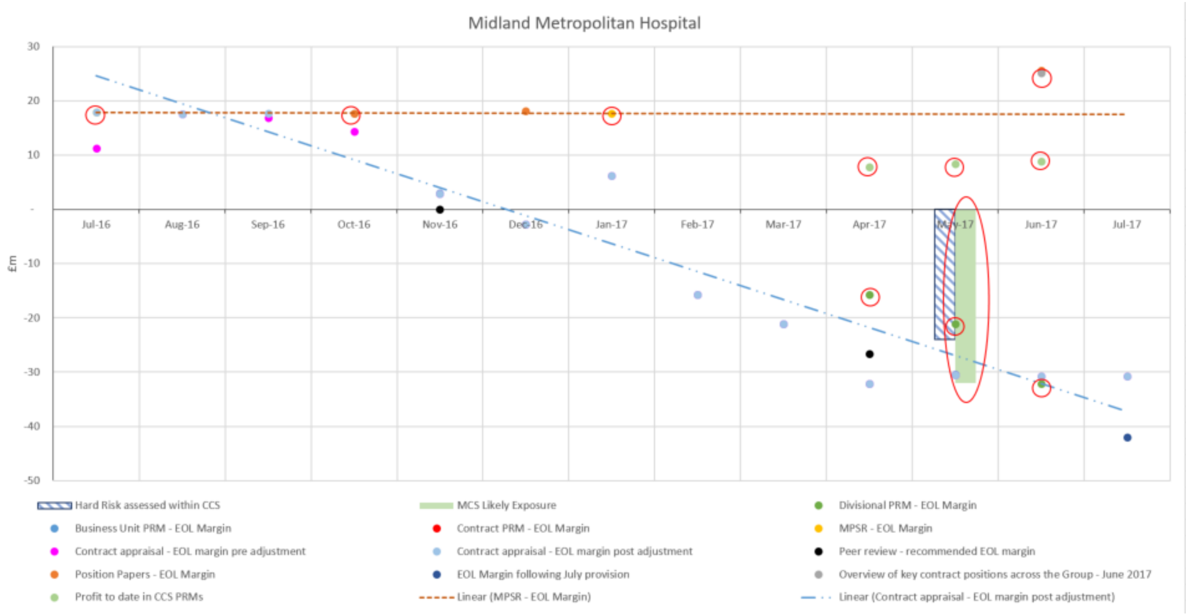
(1) Problems with the design and procurement processes arising from a short bid period; and

(2) Adverse weather, with heavy rainfall flooding parts of the building under construction, impacting on productivity.

4.145. As of July 2016, MMH was nine weeks behind the target construction programme as a result of the issues referenced above.

4.146. 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.

4.147. During the latter part of 2016 and the Relevant Period, there were significant and increasing divergences between (on the one hand) the Project Team's views on MMH's financial position and the financial risks internally reported by CCS to Mr Khan and others; and (on the other hand) those reflecting budgeted forecasts and/or reported to the Board and 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 Khan 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.

4.148. 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. The Authority has not seen any evidence indicating that Mr Khan was aware of the facts and matters referenced at sub-paragraphs 4.131(1) to 4.131(3), 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 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 £17.7 million (6%) for MMH, as Mr Khan was aware.

4.149. The *clean"* and *"audit friendly"* versions of the Position Paper for MMH were the same and did not contain similar adjustments to those for RLUH and Battersea (see paragraph 4.51 above). Mr Khan was aware of the existence of two versions of Position Papers for MMH through an email, sent in November 2016, attaching a document titled *"Carillion Building Position Paper Summary*" setting out figures for each version of the MMH Position Paper. Both versions showed an end of life margin of £17.7 million (6%), with costs of £280.3 million and revenue of £298 million.

4.150. The final version of the Position Paper for MMH submitted to the external auditors for the 2016 year-end accounts was materially the same as the "clean" and "audit friendly" versions, with a small increase in costs (to £284 million), revenue (to £302 million) and forecast end of life margin (to £18.1 million). It was seen and reviewed by Mr Khan. The true costs were, however, closer to £304.8 million as reported by the Project Team (i.e. almost £21 million more than reported in the Position Paper). This meant that the profit recognised on MMH at the 2016 year-end was not in accordance with IAS 11 and was materially misstated.

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

4.152. 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

4.153. 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 and IAS 11. The Authority has not seen any evidence that Mr Khan was aware of this understatement as at 1 March 2017.

4.154. The internal reporting about the financial performance of MMH continued to diverge in the second quarter of 207. 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%).

4.155. In April 2017, Mr Khan 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 forecast profit margin of £7.8 million (consistent with an end of life margin of over £17.7 million).

4.156. 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. Mr Khan was aware of the reported exposures for MMH, as he received the May 2017 MCS and attended the MCRM for which it was prepared. Despite this, he did not report these exposures to, or take any other steps to ensure they were brought to the attention of, the Board or the Audit Committee.

4.157. 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 Khan attended this PRM.

4.158. On 7 June 2017, the Board held a strategy meeting attended by Mr Khan. At this meeting, Mr Howson presented an *"Overview of Key Contract Positions across the Group"*. In the presentation, MMH was reported as having a forecast end of life margin of £25.2 million (7%). This was expressly stated as including claims in the forecast traded at 100% (i.e. the entirety of the claim values was recognised in the forecast). At the CCS PRM on 22 June 2017 attended by Mr Khan, the Project Team was estimating a £32.1 million loss and a management adjustment of £20 million to support a traded to date figure of £8.8 million as at April 2017.

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

AWPR

4.160. AWPR was a design build finance operate contract[2] for the construction of a 58km ring road around Aberdeen. It was structured as a joint venture ("AWPR JV") with two other partners. The project started in January 2015. Within Carillion, it was managed by the Infrastructure Business Unit of CCS.

4.161. 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.

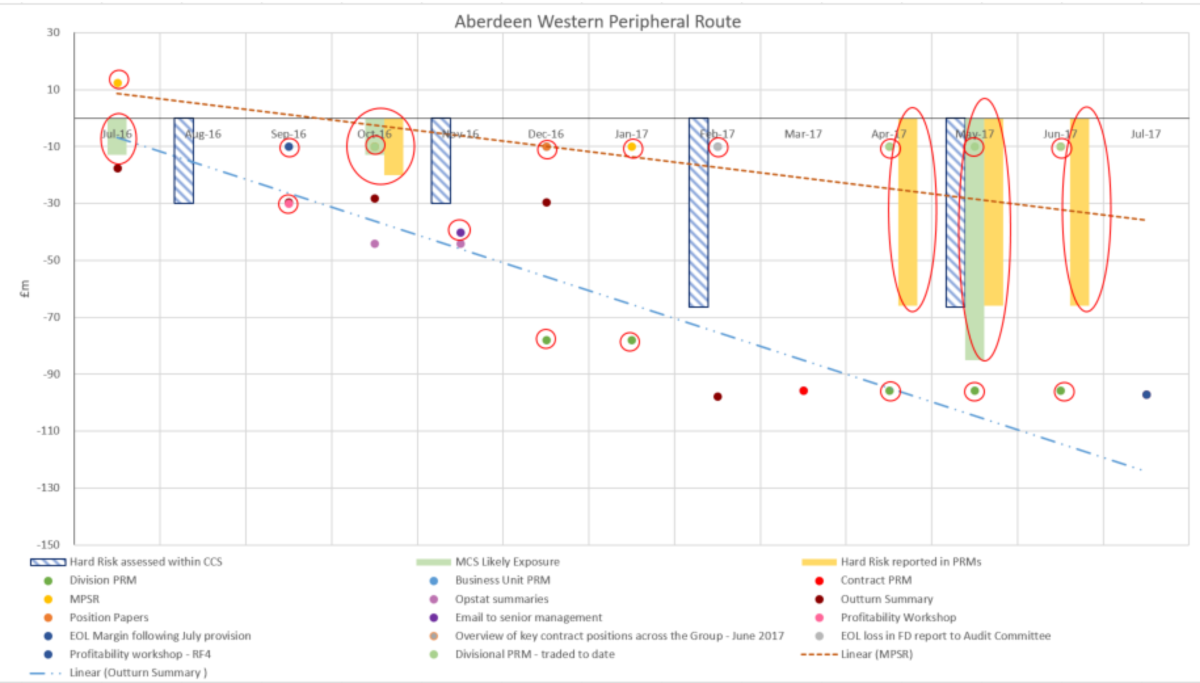
4.162. During 2015 and 2016, AWPR was significantly delayed by poor weather and delays in diverting statutory utilities (such as water pipes, electricity cables, etc).

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

4.163. 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.

4.164. By October 2016, Carillion had reduced the forecast end of life margin for AWPR to a loss of £10 million. Mr Khan was aware of this movement in forecast, through his receipt and review of MPSRs in 2016.

4.165. Despite this downwards revision, there was an increasing divergence, in the latter part of 2016 and during the Relevant Period, between (on the one hand) Infrastructure's views on AWPR's financial position as reported to Mr Khan 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 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 Khan 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.*

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

Infrastructure and CCS reporting to Mr Khan

(1) In September 2016, CCS reported in a *"profitability workshop"* attended by Mr Khan that there was a potential end of life loss of £30 million on AWPR. This was compared in the presentation to a £10 million loss forecast within RF4 at around that date.

(2) In October 2016, CCS reported at the CCS PRM Profit Update Year End & Budget attended by Mr Khan 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 (seen by Mr Khan) stated that hard risk for AWPR amounted to £20 million.

(3) In the MCSs for July and October 2016, AWPR was identified as having a *"likely"* exposure of £13.1m, with a *"Red"* flag status. This represented 44% of the total contentious amount of £30 million identified in these MCSs as due on the project. Mr Khan received these MCSs and attended the MCRMs at which they were discussed.

(4) On 19 November 2016, an internal Carillion email to (amongst others) Mr Khan addressed the cash position on AWPR and referred to an *"estimated end of life loss of £40m our share (after recovery) or £120m at a 100% JV level"*.

(5) In the MCS for December 2016, AWPR retained its red flag status, but was reported without any figures and with the commentary that it was *"To be discussed"*. Mr Khan attended the MCRM at which this MCS was discussed.

(6) On 16 December 2016, Infrastructure gave a presentation to the CCS PRM with an estimated *"most likely"* end of life margin loss for Carillion of £78 million on AWPR, with end of life costs estimated by the joint venture Project Team at £900 million (joint venture level) (Carillion share £300 million). Mr Khan attended this PRM.

Reporting to the Board and the Audit Committee

(7) The MPSR Executive Summaries, Overtrade Reports, CEO and Group FD's reports to the Board and/or the Audit Committee during the latter part of 2016 and the Relevant Period did not reflect the above matters. As noted above, the profit margin for AWPR in the October 2016 MPSR Executive Summary was revised downwards to a £10 million loss and this was subsequently maintained in the January 2017 MPSR Executive Summary for AWPR. The Overtrade Report showed AWPR as having no revenue traded not certified (i.e. it suggested that there was no client revenue recognised in Carillion's management accounts that was "at risk"). This was incorrect because Infrastructure was relying upon claims of over £33 million even to achieve its forecast £78 million loss for AWPR. This was also inconsistent with the two Group FD's Reports in the second half of 2016 and during the Relevant Period which referred to AWPR relying on claims.

(8) On 9 November 2016, the Board was informed of *"an unexpected increase in the end out cost of the contract. The extent of the increase is not yet fully understood and further work is being undertaken to evaluate, control and, where possible, reduce/mitigate these costs"*. AWPR was also discussed at a Board meeting on 6 December 2016 as one of the potential risks to achieving Carillion's year-end profit forecast of £178 million. It was noted in the minutes that the Board was reliant on the judgement of the executives around AWPR as well as another project. Mr Khan attended these Board meetings.

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

4.167. The Position Paper for AWPR at the 2016 year-end reflected the position as reported in the October 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). Mr Khan reviewed this Position Paper.

4.168. 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 external auditors.

4.169. 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.

4.170. Infrastructure's estimate of a £78 million loss on AWPR was repeated in a further presentation given at the CCS PRM (attended by Mr Khan, who by this time was the Group FD of Carillion) in January 2017. Shortly afterwards, the hard risk for AWPR was increased to £66 million; Mr Khan became aware of this in April 2017. The subsequent January 2017 MPSR was unchanged and continued to report an estimated end of life loss for AWPR of £10 million.

4.171. The February 2017 MCS excluded any figures for AWPR and it was given a *"Red"* flag status. Mr Khan received this MCS and attended the MCRM at which it was discussed.

4.172. The Group FD's Report, prepared by Mr Khan, submitted to the Audit Committee for its 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 the 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 external auditors remained unaware.

4.173. On 21 February 2017, a member of the Audit Committee emailed Mr Khan (amongst 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, Mr Khan did not inform 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 instead described the position on AWPR as "*somewhat fluid*".

4.174. 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.

4.175. 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 Khan, 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 Khan, as was the hard risk figure of £66 million for AWPR.

4.176. 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 forecast a margin loss of £10 million only. Mr Khan was aware of the reported exposures for AWPR, as he received the May 2017 MCS and attended the MCRM for which it was prepared. He was also aware of the disparity between this and what was reported in the MPSR Executive Summary as he received and reviewed them during the Relevant Period. Notwithstanding this, Mr Khan did not report this exposure, or take any steps to ensure it was reported, to the Board, the Audit Committee or the external auditors.

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

4.178. 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 Khan was:

(1) in respect of both 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 both 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 during the Relevant Period 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 March Results Announcement

5.7. Mr Khan, in his capacity as Group FD, was an officer of Carillion at the time of the March Results Announcement. He had a central role in preparing and finalising this announcement, including reviewing its content, tabling it in draft at the Audit Committee meeting on 23 February 2017 and the Board meeting on 28 February 2017 and approving it as a member of Carillion's Board. He signed the statement of responsibility in respect of the March Results Announcement and the Annual Report. This statement asserted that:

"*The preliminary announcement complies with the Disclosure and Transparency Rules (DTR) of the United Kingdom's Financial Conduct Authority. The preliminary* *announcement is the responsibility of, and has been approved by, the Directors of Carillion plc ..[…] the financial statements contained in the 2016 Annual Report were prepared in accordance with applicable accounting standards and gave a true and fair view of the assets, liabilities, financial position and profit of the Company […] the 2016 Annual Report and Accounts, taken as a whole, are fair, balanced and understandable, and provide the information necessary for shareholders to assess the Company's financial position, performance, business model and strategy".*

5.8. The March Results Announcement and the document published alongside it described Carillion's performance as *"in line with expectations"*, with increased revenue of £4,394.9 million and PBT of £178 million for the Group and revenue of £1,520.2 million and operating profit of £41.3 million for *"Construction Services (excluding the Middle East)"*. It described strong revenue growth in this segment and confirmed that operating margin for this segment *"remains in our target range of 2.5 per cent to 3 per cent"*. It referred to its ambition *"to maintain revenue and profit at broadly their current levels"* in 2017. It went on to refer to Carillion as a whole having a *"good platform from which to develop the business in 2017"*.

5.9. The revenue and profit / margin figures for the Group and Construction Services (excluding the Middle East) in the March Results Announcement were misstated because they did not accurately reflect the financial performance of the Priority Contracts. In particular, Carillion failed to recognise the costs and revenue associated with these projects in accordance with IAS 11. The revenue and profit / margin figures were materially overstated as a result. This also made false and misleading 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.

5.10. The positive statements and revenue and profit / margin figures contained in the March Results Announcement regarding Carillion's expected financial performance in 2017 were not justified by the facts and matters known to Carillion and Mr Khan as at the date of the March Results Announcement, on the basis that:

(1) In the second half of 2016 the following issues had been identified and reported within Carillion of which Mr Khan was aware:

(a) The MCS prepared for the quarterly meeting on 5 December 2016 attended by Mr Khan identified a likely financial exposure of over £550 million for the Group and £157.8 million for CCS. Even taking into account any inconsistencies in the production of this report, these figures highlighted very significant likely exposures and excluded a further major loss-making project (AWPR), which would (if included) have further increased the amount of the likely exposures.

(b) As part of its 2016 RF3 and 2017 Budget submissions, Mr Khan was aware that CCS had reported that hard risk was forecast to amount to £171.8 million by the end of 2016 and £149.6 million by the end of 2017 respectively. These were amounts that were not likely to be recovered, a significant proportion of which should have been written off in accordance with IAS 11.

(c) The expected financial performance of certain major contracts was much worse than the budget and reforecasts providing the basis for the December Announcement. Mr Khan was aware of the following facts in this regard:

(i) For RLUH, the Project Team had internally reported an expected loss of between £14 million and £21 million, not the profit of £13.6 million forecast in the July and October 2016 MPSRs. A likely financial exposure of £21 million for RLUH in the October and December 2016 MCSs and hard risk of £10 million had been internally reported by CCS.

(ii) For Battersea, the Project Team had internally reported an expected loss of between £14 million and £25 million, compared to the forecast profit of around £10 million in the July and October 2016 MPSRs. A likely financial exposure of £21 million in the October and December 2016 MCSs and hard risk of £13 million had been internally reported by CCS.

(iii) For AWPR, the Board 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 Khan), 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 Khan (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. The MCS in December 2016 excluded any figures for AWPR but it was still shown with a red flag status.

(d) There had been discussions around a possible deterioration in the trading performance of the business at the Board meeting the day before the December Announcement and the 2017 Budget had been described as *"challenging"*.

(2) In addition to the matters identified above of which Mr Khan was aware, far from improving since the second half of 2016 the financial performance of Carillion's construction contracts had continued to deteriorate during the Relevant Period. The MCS for February 2017 identified significantly increased likely exposures at Group and CCS-level. Within CCS (and to the knowledge of Mr Khan and another person) it was being reported that:

(a) hard risk had increased to £258.4 million by the end of December 2016;

(b) for RLUH, the Project Team had 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);

(c) 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);

(d) for AWPR, Infrastructure had internally reported a likely end of life loss of £78 million against a forecast loss of £10 million.

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

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

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

5.13. 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 Khan was knowingly concerned in Carillion's breach of Article 15.

5.14. The Authority considers that Mr Khan was aware that there was a risk that the March Results Announcement was false or misleading due to the matters at paragraphs 5.7 to 5.10 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 Khan acted recklessly as a result.

The May Announcement

5.15. The tenor of the May Announcement, on 3 May 2017, 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 Khan was closely involved in preparing the May Announcement.

5.16. The facts and matters described above in relation to 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 Khan and others as increasing to £310.6 million by March 2017. Significant concerns were raised at the Board meeting attended by Mr Khan on 3 May 2017 about the deterioration in financial performance of Carillion's major projects. These concerns were consistent with the continued deterioration of CCS's major projects, including (to the knowledge of Mr Khan 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 being 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.

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

5.18. The Authority considers that Mr Khan 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 Khan and another person to Carillion for its finding in this regard.

5.19. 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 Khan was knowingly concerned in Carillion's breach of Article 15.

5.20. The Authority considers that Mr Khan was aware that there was a risk that the May Announcement was false or misleading due to the matters at paragraphs 5.7 to 5.10 and 5.15 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 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 Khan acted recklessly as a result.

Listing Rule 1.3.3R

Carillion's obligations and knowing concern

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

5.22. 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 Khan's knowing concern

5.23. By failing to take account of the matters at paragraphs 5.7 to 5.10 and 5.15 to 5.17 above in its announcements, and by failing to ensure that the matters at paragraphs 5.26 to 5.38 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.

5.24. By virtue of his knowledge and involvement in the Announcements as detailed above, and by failing to ensure that the matters at paragraphs 5.26 to 5.38 below in relation to Listing Principle 1 were properly addressed during the Relevant Period, Mr Khan was knowingly concerned in Carillion's breach of LR 1.3.3R with regard to the Announcements.

5.25. For the reasons given in paragraphs 5.14 and 5.20 above, and in paragraph 5.40 below, the Authority considers that Mr Khan 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

5.26. 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.

5.27. 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

5.28. Throughout the Relevant Period, Mr Khan was the Group FD of Carillion and thus the director with primary responsibility for ensuring financial information disseminated to the market was accurate and not misleading. He was also responsible for ensuring that Carillion had adequate procedures, systems and controls in place relating to financial reporting. 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.

5.29. 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 Audit Committee to enable them properly to consider the financial performance of construction projects and assess material risks associated with their financial reporting.

5.30. Carillion's procedures, systems and controls did not meet these standards. Mr Khan 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

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

5.32. During the Relevant Period, despite knowing the pressure placed on CCS to meet targets maintained by him, and despite his knowledge of the Group's accounting policies and the requirements of IAS 11, Mr Khan 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

5.33. The contract accounting judgements being applied were not properly documented, which meant there was no clear record of the assessments being made, approved or reviewed. This contributed to a lack of rigour around contract accounting judgements and their approval and review. Mr Khan was aware of the following inadequacies in this regard:

(1) The PRM process was a key forum at which the financial performance of projects was discussed and reviewed at different levels within CCS, often in the context of Carillion's budgeting and reforecasting process. Mr Khan

attended the CCS PRMs both in the latter part of 2016 and during the Relevant Period, but there were no minutes taken of PRM discussions and no record of any detailed review or changes to contract account judgements made or the reasons for them.

(2) Position Papers reflected the contract accounting judgements made, but absent any other records, did not provide adequate explanation or support for them. Having received and reviewed the Position Papers for the purpose of the 2016 year-end accounts, Mr Khan was aware of this omission during the Relevant Period. Even putting to one side his knowledge that *"audit friendly"* Position Papers were being produced, in relation to certain major contracts, for the purpose of the 2016 year-end accounts, the judgements applied in the Position Papers were often inconsistent with other management information being reported by those responsible for making contract judgements, as reflected in MCS exposures, hard risk and Project Team's forecasts reported in CCS PRMs. Mr Khan did not take any steps to resolve these inconsistencies, or to ensure that they were explained or otherwise addressed in the Position Papers.

<u>Inconsistent management information on financial performance</u>

5.34. The management information produced and reported by CCS to (amongst others) Mr Khan highlighted large and increasing risks associated with the reported financial performance of CCS's construction projects both during and prior to 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 Khan was aware of the following matters during the Relevant Period:

(3) 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 Khan by means of CCS reporting internally on hard risk. This was seen by those making the judgements as an increasingly important means of highlighting those risks to enable appropriate action to be taken, for example by means of write-offs, provisions or changes to budgets and reforecasts. Despite this, no meaningful action was taken by Mr Khan, during the Relevant Period, in response.

(4) The MCSs highlighted likely financial exposures associated with Carillion's contracts, including CCS's construction projects. To Mr Khan's knowledge, no guidance was given to those preparing the MCS and the figures reported in it were inconsistent. It was nonetheless another means by which Business Divisions (including CCS) reported large exposures that significantly increased in the latter part of 2016 and during the Relevant Period. The increasingly large exposures reported in it were not addressed by Mr Khan during the Relevant Period.

(5) There were large and increasing divergences in the latter part of 2016 and 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 Khan by means of CCS PRMs or in some cases by email. Mr Khan did not make proper enquiries as to the reasons behind these divergences or seek to resolve them during the Relevant Period.

(6) The above information provided to Mr Khan was inconsistent with the figures reported to the Board and the Audit Committee in the MPSR Executive Summaries and Overtrade Reports. It was also inconsistent with the financial position of CCS's construction projects, as contained in Position Papers and typically reflected in budgets and reforecasts. Mr Khan failed to undertake any enquiries to understand why these inconsistencies had arisen and failed to take steps to resolve them.

<u>Failure to inform the Board and the Audit Committee</u>

5.35. 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 Khan, as described in paragraph 5.34 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"*.

5.36. Instead, as Mr Khan was aware, reports to the Board and discussions at Board meetings tended to focus on operational issues associated with individual projects, not their financial impact. Financial reporting to the Board in relation to financial risks associated with Carillion's construction contracts mainly consisted of the MPSR Executive Summaries and Overtrade Reports. They did not reflect the financial risks identified and highlighted by CCS by means of, for example, hard risks, MCS exposures, CCS PRMs or otherwise.

5.37. 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 (prepared by Mr Khan in February 2017) 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, 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.

5.38. 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.

5.39. By virtue of his knowledge of the matters at paragraphs 5.30 to 5.37 above, and his failure to ensure that they were properly addressed during the Relevant Period, Mr Khan was knowingly concerned in Carillion's breach of Listing Principle 1.

5.40. Further, the Authority considers that Mr Khan was aware in light of the matters at paragraphs 5.28 to 5.37 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 Khan acted recklessly as a result.

Premium Listing Principle 2

5.41. Premium Listing Principle 2 requires a listed company to act with integrity towards the holders and potential holders of its premium listed securities.

5.42. 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.

5.43. As explained in paragraphs 5.14, 5.20, 5.25 and 5.40 above, Mr Khan acted recklessly in relation to the facts and matters described above during the Relevant Period. The Authority attributes Mr Khan's state of mind to Carillion in this regard.

5.44. 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 and Mr Khan 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.

<u>Step 1: disgorgement</u>

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 Khan derived directly from the breach.

6.4. Step 1 is therefore £0.

Step 2: the seriousness of the breach

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

6.6. The period of Mr Khan's breach was from 1 January 2017 until 10 July 2017, so Mr Khan's relevant income is that which he earned between 11 July 2016 and 10 July 2017. The Authority considers the relevant income for this period to be £514,750. The Authority considers that Mr Khan 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 6.5B2G(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 Khan's knowing concern in Carillion's breaches:

(1) Mr Khan 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 Khan'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 Khan was knowingly concerned, were for a sustained period and resulted in the misleading Announcements.

(3) Mr Khan held a senior position within Carillion as its Group FD.

(4) As Group FD Mr Khan 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 Khan was an experienced accountant in the construction services sector.

6.11. DEPP 6.5B.2G(12) and DEPP 6.5C.2G(15) set out factors which are likely to be considered 'level 4 factors' or 'level 5 factors'. 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 Khan breached a position of trust.

(4) The breaches were committed recklessly.

6.12. DEPP 6.5B.2G(13) and DEPP 6.5C.2G(16) list factors likely to be considered 'level 1, 2 or 3 factors'. Of these, the Authority considers the following factor to be relevant to the breaches:

(1) No profits were made or losses avoided by Carillion because 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 £514,750, which equates to £154,425.

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 £154,425.

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 £154,425 represents a sufficient deterrent to Mr Khan and others, and so has not increased the penalty at Step 4.

6.19. Step 4 is therefore £154,425.

Step 5: Settlement discount

6.20. Pursuant to DEPP 6.5B.5G and DEPP 6.5C.5G, if the Authority and the individual on whom a penalty is to be imposed agree the amount of the financial penalty and other terms, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the Authority and the individual reached agreement. The settlement discount does not apply to the disgorgement of any benefit calculated at Step 1.

6.21. No settlement discount applies.

6.22. Step 5 is therefore £154,400 (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 £154,400 on Mr Khan.

7. REPRESENTATIONS

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

8. PROCEDURAL MATTERS

8.1. This Notice is given to Mr Khan 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 Khan 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 Khan 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 January 2017 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

Penalties for Breach of Listing Rules

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 FCA 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 Khan, and the Authority's conclusions in respect of them (in bold), is set out below.

Knowing concern – the legal position

2. In order to be knowingly concerned in a contravention, the person must have been actually involved in the contravention and must have knowledge of the facts on which the contravention depends. Mr Khan cannot have been knowingly concerned without knowing the facts constituting the breach. The key legal question in respect of each alleged breach is therefore what are the facts that make the acts complained about a contravention?

3. Mr Khan's position on knowing concern is supported by the recent decision by the Court of Appeal in *Ferreira*[3]. The Court of Appeal rejected the policy reasons which the Authority has raised in support of its construction of knowing concern and made it clear that there is intended to be a difference in the test for liability for a primary infringer and a secondary party.

4. Even if it was established that Mr Khan was reckless as to certain matters, that does not establish that he had knowledge of those matters.

5. **The Authority agrees that, in order for Mr Khan 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 Khan's view as to what (ii) requires the Authority to establish.**

6. **The Court of Appeal's decision in *Ferreira* is not inconsistent with the Authority's analysis of the knowingly concerned test. In *Ferreira*, the Court of Appeal was considering a contravention which included a disapplication provision (i.e. a provision identifying the circumstances in which the contravention does not apply) and a factual element relating to that disapplication provision, but no equivalent disapplication provision or factual element exists in relation to the contraventions in this case. As *Ferreira* was concerned with knowledge of a purely factual question, it does not support Mr Khan'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 Khan 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.**

7. **The Authority agrees that the test for recklessness is different to the test for knowing concern. For the reasons given in this Notice, the Authority considers that Mr Khan both was knowingly concerned in Carillion's contraventions and acted recklessly.**

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

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

MAR

8. For Mr Khan to be knowingly concerned in a breach by Carillion of Article 15 of MAR, it must be established that the Announcements were false or misleading and that he knew both that the Announcements were false or misleading and that Carillion ought to have known this. However, it is not even alleged that he knew that the Announcements were false or misleading and so the allegation that he was knowingly concerned must fail.

9. It cannot be right for the test just to be that Mr Khan ought to have known that the Announcements were, or were likely to be, false and misleading, as then mere inadvertence would satisfy the knowing concern test. While a company might be liable for market abuse if it ought to have known that an announcement was false, the same is not true of an individual involved with the company's decision to make the announcement. As is clear from the Court of Appeal's decision in *Ferreira*, it is not illogical for the test to be such that the primary actor is liable but the secondary actor is not.

10. Mr Khan's interpretation of the "knowingly concerned" test would not undermine the objectives of the MAR regime as this was the test chosen by Parliament for accessory liability for market abuse. In addition, this interpretation should not affect directors' behaviour as they cannot escape liability by turning a blind eye to warning signs.

11. Mr Khan honestly believed that the information contained in the Announcements was correct. He did not know that they were false or that Carillion ought to have known that they were false. Therefore, he cannot be knowingly concerned in a breach of Article 15 of MAR by Carillion. This conclusion is consistent with Australian case law.

12. Further, Mr Khan cannot be knowingly concerned if he did not know facts attributed to Carillion as a result of the knowledge of other persons (for example, Mr Howson or Mr Adam).

13. **The Authority does not agree with Mr Khan'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 Khan 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.**

14. **If Mr Khan'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 Khan (and another person) 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 Khan had such knowledge in order for him to be knowingly concerned.**

15. **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.**

16. **Further, Mr Khan's approach to the knowingly concerned test would fundamentally undermine the market abuse regime and its objectives, as the**

implication would be that a director could remain passive (which, unlike turning a blind eye, does not require a deliberate act) 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.

17. **The Authority considers that Australian case law does not support Mr Khan's position because there are judgments in Australian cases which are both consistent and inconsistent with his position, and the fact that there are two differing lines of authority does not appear to have been resolved. Further, the Authority considers that little weight should be placed on Australian case law, as it is directed to the specific statutory provisions which were in issue in those cases.**

18. **The Authority considers that Mr Khan did not need to know of every fact on which Carillion's contravention is based; rather, he needed to know of sufficient facts to support the conclusion that Carillion ought to have known that the Announcements were false or misleading. The Authority has reached the view that Mr Khan's knowledge is sufficient to conclude that Carillion was in breach of Article 15 of MAR, even where Carillion was also in breach as a result of facts known by others.**

Listing Rule 1.3.3R

19. To be knowingly concerned in a breach of LR 1.3.3R, it would need to be established that Mr Khan knew that Carillion had failed to ensure that the information notified to a RIS or made available through the Authority was not misleading, false or deceptive or omitted things likely to affect the import of the information, and that he knew that Carilion had failed to take reasonable care to ensure this, or at least that he knew that the procedures that were in place had inadequacies. However, it is not alleged that he had such knowledge. The contention that Mr Khan was aware of the risks that the Announcements were false or misleading and that Carillion did not have adequate procedures does not support an allegation that he was knowingly concerned in Carillion's alleged breach of LR 1.3.3R.

20. **The Authority does not agree with Mr Khan'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 Khan submits he requires knowledge of in order to be knowingly concerned are legal conclusions, rather than primary facts.**

21. **Instead, the Authority considers that Mr Khan 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).**

22. **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 Khan 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

23. Similarly to LR 1.3.3R, to be knowingly concerned in a breach of Listing Principle 1, it would need to be established that Mr Khan knew that Carillion had failed to take reasonable steps to establish and maintain adequate procedures, systems and controls, but this is not alleged. Awareness of the risk that Carillion did not have adequate procedures, systems and controls is not sufficient for Mr Khan to be knowingly concerned.

24. **The Authority does not agree with Mr Khan'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 Khan 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 Khan 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

25. Mr Khan does not accept that he was reckless or acted with a lack of integrity, and he did not know the alleged risks or that Carillion acted with a lack of integrity, so he cannot have been knowingly concerned in a breach of Premium Listing Principle 2 by Carillion.

26. **Carillion's contravention of Premium Listing Principle 2 is based on attributing the knowledge of Mr Khan (and another person) to Carillion. The facts which constitute Carillion's contravention are therefore that Mr Khan (and another person) 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 Khan 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 Khan knew that Carillion acted with a lack of integrity.**

27. **As explained below, the Authority considers that Mr Khan acted recklessly and with a lack of integrity, and was aware of the said risks.**

Recklessness and lack of integrity

28. There is no basis for a finding that Mr Khan was reckless as he was not aware of, and did not ignore, the alleged risks that the Announcements were false or misleading, that reasonable care had not been taken to ensure that the Announcements were not false or misleading, and that Carillion had inadequate procedures, systems and controls to enable it to comply with its obligations under the Listing Rules. In particular, he was not aware of a risk that: (i) overly aggressive accounting judgements were being made at the level of Carillion's Business Divisions in order to maintain CCS's reported revenues and profitability; or (ii) accounting judgements were being made at the level of the Business Divisions which did not reflect the divisional managers' best understanding of the true financial position of the Projects or the financial risks

associated with them. Mr Khan honestly believed that accounting judgements were being made properly by those at the level of the Business Divisions.

29. Although Mr Khan accepts he had knowledge of many of the documents and emails referred to in this Notice, he did not know that they evidenced a risk that the Announcements were false or misleading or that Carillion had failed to comply with its regulatory obligations.

30. Even if it was concluded that Mr Khan's conduct was reckless, it was at the very lowest end of the broad spectrum of conduct that can be described as reckless and did not indicate a lack of integrity on the part of Carillion. A finding of a lack of integrity does not automatically follow from a finding that an individual acted recklessly. The Tribunal has stated[5] 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.*" Whilst in an appropriate case reckless conduct can indicate a lack of integrity, in this case the alleged reckless conduct – i.e. that he failed to identify that a number of emails and documents that he saw contained 'red flags' - does not suggest any moral failing, lack of rectitude or breach of an ethical code and so it does not indicate a lack of integrity.

31. **As Group FD, Mr Khan had a central role in preparing and finalising the Announcements and approving them as a Board member. He did so in the knowledge of information about Carillion's financial position that was inconsistent with the positive statements made in the Announcements. Mr Khan was also aware that this information had not been brought to the attention of the Board or the Audit Committee and had not been taken into account by the Board in approving the Announcements. As a result, the Authority considers that Mr Khan was aware of the said risks.**

32. **The Authority considers that Mr Khan acted recklessly by failing to respond appropriately to the risks relating to the Announcements, by failing to take them into account when reviewing and approving the Announcements and by failing to ensure the Board and the Audit Committee were informed of the warning signs of which he was aware. Further, the Authority considers that Mr Khan acted recklessly by not responding appropriately to the risk that Carillion's procedures, systems and controls were inadequate and by failing to take any steps to address that risk.**

33. **The Authority considers that Mr Khan'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 finance director of a listed company as to the accuracy of its market announcements is, objectively, an ethical or moral failing. Shareholders and potential shareholders rely on the accuracy of market announcements. For Mr Khan 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 Khan'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 the Board and the Audit Committee. The Authority considers that Mr Khan's recklessness in this regard amounts to a lack of integrity.**

Evidence and likelihood of wrongdoing

34. Given the seriousness of the allegations, and their inherent improbabilities, there must be strong evidence of wrongdoing in order to find that Mr Khan committed the alleged

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

misconduct. However, there is no such strong evidence. The Authority relies on only a small number of documents, and there is no direct evidence supporting its case.

35. At the heart of the Authority's case is a scheme (not involving Mr Khan) to pass misleading 'formal' financial reports to the Group, in a context where the same people were, at the same time, passing other documents to the Group that were intended to give a 'fairer' assessment of the financial position. The alleged scheme apparently involved numerous individuals and was widely known, yet was not discovered by the Board, the Audit Committee or the external auditors. Such a scheme is inherently improbable and it is equally improbable that Mr Khan would acquiesce to such wrongdoing.

36. **The Authority considers that there is compelling evidence in support of its conclusion that Mr Khan was knowingly involved in Carillion's contraventions and acted recklessly. As well as the hard risk and MCS figures, Mr Khan received information by a variety of means and from a number of highly experienced individuals within CCS, showing large and increasing divergences between the assessments of financial performance by the project and/or management teams within CCS and the financial performance as reflected in Carillion's budgeted forecasts.**

37. **The Authority disagrees with Mr Khan's characterisation of its case. Instead, at the centre of its case are the numerous warning signs of which Mr Khan was aware, which highlighted the financial risks and exposures associated with contract accounting judgements made within CCS. Mr Khan did not take appropriate steps to address these warning signs or satisfy himself that contract accounting judgements were being applied appropriately, and did not inform the Board or the Audit Committee of the warning signs, despite the fact that he must have been aware, particularly having regard to the nature and cumulative effect of the warning signs, that they would be highly relevant to their deliberations.**

<u>Mr Khan's motivation</u>

38. From the outset of becoming Group FD on 1 January 2017, Mr Khan was prepared to break bad news to his colleagues and to the market. For example, on 22 January 2017 he recommended that Carillion suspend or significantly reduce the 2016 full year dividend. A write-down in the 2016 financial statements would have attracted less negative coverage than the cancellation of the dividend. It makes no sense for Mr Khan to have chosen to report some serious matters to the Board, yet not report concerns about financial reporting. His actual behaviour was therefore inconsistent with that of a person who would knowingly, or recklessly, mislead the market and/or allow Carillion to operate procedures and processes which he knew or suspected to be inadequate.

39. Mr Khan was not responsible as Group FD for the financial statements for 2016, so he had no motivation to conceal any inaccuracy or suspicion of inaccuracy. It is also not plausible that he would take on the role of Group FD knowing or suspecting that the financial statements were about to be misstated.

40. **As set out above, the Authority considers that Mr Khan was aware of the risks that the Announcements were misleading, that reasonable care had not been taken to ensure that the Announcements were not 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. Mr Khan did not respond appropriately to these risks. He did not take them into account in reviewing the Announcements and did not take any steps to address the risk regarding Carillion's procedures, systems and controls. The Authority does not consider that Mr Khan's submissions regarding his actual behaviour and motivation undermine these conclusions. The Authority's conclusions are**

based on assessing the information known to Mr Khan at the relevant times and the actions he took. As a result, the Authority does not need to reach, nor has it reached, a conclusion with respect to Mr Khan's motives, in order to be satisfied that the evidence demonstrates that he acted recklessly.

<u>Mr Khan's role as the Group FD</u>

41. The Priority Contracts were important contracts, but CCS was just one of several Business Divisions, and Mr Khan received a great deal of information from all of them and he also had a number of responsibilities. A Group FD cannot reasonably be expected to question every piece of information that passes across their desk. As the Group FD in a group of the size and complexity of Carillion, Mr Khan had to be extremely discerning in relation to the information to which he paid particularly close regard and the information on which he relied. That made it all the more important that any issues and their potential significance were brought unambiguously to his attention, but that did not happen in relation to the alleged 'red flags'.

42. The information flowing up to the Group from the Business Units and Business Divisions started off as raw data generated on site and judgements made on that data by the Business Units and Business Divisions. The data and judgements flowed through a number of layers of management and needed to be reduced to a manageable size so that they could be digested by, among others, the Group's Finance team, including Mr Khan. The executives at Group level, including Mr Khan, expected key commercial issues to be brought to their attention by the Business Divisions.

43. **As Group FD, Mr Khan had primary responsibility for ensuring that the financial results of the Group were accurately reported. This responsibility required him, at the very least, to take all reasonable steps to satisfy himself, in the light of the information that he received, that the financial performance of Carillion's construction contracts was being accurately reported in compliance with financial reporting requirements, including IAS 11.**

44. **Mr Khan was aware that significant financial risks and exposures were being reported internally by CCS, as he received papers showing hard risk figures, MCSs and reports from project and/or management teams of large and increasing divergences in financial performance in relation to the Priority Contracts. Given the nature and cumulative effect of the warning signs, it was incumbent upon Mr Khan to address them and to ensure that they were brought to the attention of the Board and the Audit Committee. Given his personal responsibilities, as the Group FD, in relation to: (i) the financial affairs of Carillion as a whole, including its financial reporting to the market; (ii) the preparation of the Announcements (in which he played an integral role); (iii) his approval of the Announcements as a director of the Board; (iv) the adequacy of Carillion's systems and controls with respect to financial reporting; (v) the overall adequacy of Carillion's provisions; and (vi) providing the Audit Committee with assurance that the level of provisions made for risks in connection with Carillion's major contracts was appropriate, Mr Khan should have paid regard to all the information he received, not just that contained in the reports prepared for the Board. Further, the evidence shows that Mr Khan had a detailed level of involvement in the information which flowed up to him, which is inconsistent with Mr Khan's assertion that the 'red flags' were not brought to his attention.**

<u>IAS 11 and contract accounting judgements</u>

45. When Mr Khan became Group FD, he reasonably relied upon the processes and controls of the business, and on the professional judgement of senior professionals in management levels beneath him, as ensuring sufficient and appropriate rigour was applied to judgements and estimates made in respect of the various contract positions. Mr Khan reasonably believed that appropriate rigour was being applied. Management

teams at the Business Unit and Business Division levels were suitably qualified and experienced and were best placed to make judgements around IAS 11, which can only be made by professionals on the ground with day-to-day experience and knowledge of the particular contract. They are not judgements that can be taken by accountants at Group level, including the Group FD, with no direct involvement in the contracts.

46. **The nature of IAS 11 judgements and their significance to Carillion's business meant that it was particularly important for Mr Kahn to take all reasonable steps to address the warning signs of which he was aware. 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 recoverability of value associated with claims and variations. This made the proper application of IAS 11 in particular of fundamental importance to Carillion. As Group FD, Mr Khan had primary responsibility for ensuring that the financial results for the Group were accurately reported, so he could not simply rely on the processes in place and the judgements of others, notwithstanding their qualifications and experience, in particular given his awareness of the warning signs.**

<u>Carillion's control framework</u>

47. It has not been demonstrated that Carillion failed to take reasonable steps to establish and maintain adequate procedures, systems and controls. Carillion had a clear, well-established reporting system. If individuals chose to misuse the reporting system, it does not follow that the system was inadequate.

48. Mr Khan was not aware and did not suspect that Carillion had not taken reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations. Even if there was confusion within CCS as to the status and meaning of the information contained within the hard risk schedules or the MCSs, such confusion did not impair Carillion's systems and controls, because those systems and controls around financial reporting were not based on those documents.

49. Whilst Mr Khan was, from an overarching perspective, responsible for the procedures, systems and controls within Carillion as they related to accounting, it is not reasonable to: (i) conclude that he was aware that there was a lack of documentation supporting the decisions that were being made around management adjustments; or (ii) criticise him for not changing or undertaking a wholesale review of the systems and controls around financial reporting, given the short period he was Group FD and the number of pressing challenges on which he was necessarily and reasonably focused during his tenure. Nevertheless, as Group FD, Mr Khan did seek to make improvements to how information flowed within Carillion, as is indicated by an email from a Board member in February 2017 congratulating him on the steps he had taken to improve the contents of his Board reports.

50. **The Authority considers that there were serious failings in Carillion's procedures, systems and controls during the Relevant Period. These are evident from the fact that Carillion's systems and controls did not prevent or address the inconsistency between (i) the management information relating to hard risks, MCSs and certain major projects reported by CCS, which highlighted large and increasing risks associated with the financial performance of CCS's construction projects, and (ii) the information contained in 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. Further, the fact that the Board and the Audit Committee were not made aware of the more pessimistic assessments in the management information referred to above also demonstrates that Carillion's procedures, systems and controls were inadequate.**

51. **Mr Khan was aware of these inconsistencies and also that they were not being reported to the Board and the Audit Committee. Given the scale of the financial risks reported in the hard risk schedules and MCSs, it was not reasonable for Carillion's systems and controls to ignore these important sources of information. As this information was not being taken into account in the papers going to the Board and to the Audit Committee, Mr Khan must have been aware 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.**

52. **Mr Khan had been Group FC prior to becoming Group FD, and as Group FC had also been aware of the inconsistencies and that they were not being reported to the Board or to the Audit Committee. Therefore, upon becoming Group FD, he must have been aware of the risk that Carillion's systems and controls were inadequate, and so the Authority does not consider that he can reasonably rely upon his short tenure as Group FD to excuse his failure to take steps to address this risk. The email from the Board member in February 2017 congratulating him on the improvements to the contents of the Board reports does not demonstrate that Mr Khan took adequate steps to address the failings in Carillion's systems and controls, given that the Board reports still did not reflect the financial risks identified and highlighted by CCS to Mr Khan and others. Instead, the Authority considers that Mr Khan failed to undertake any enquiries to understand why the inconsistencies had arisen and failed to take any steps to resolve them.**

<u>Pressure to meet targets</u>

53. Mr Khan's personal experience from being a finance director at the Business Division level was that finance directors were not put under any pressure to submit inappropriate numbers in order to meet targets.

54. There is no substantive evidence that pressure was applied to CCS during the latter part of 2016 or when Mr Khan was Group FD to meet challenging financial targets in order to maintain CCS's traded figures. Target-setting is not an excuse for submitting inaccurate financial reports.

55. Mr Khan does not consider that Carillion's systems and controls were inadequate to counter the risk that, as a result of the alleged pressure which was exerted, overly aggressive accounting judgements would be applied in order to maintain Carillion's financial performance.

56. **Notwithstanding Mr Khan's submission regarding his personal experience, the Authority considers that the documentary and interview evidence shows that there was significant pressure on CCS to meet very challenging financial targets. During the Relevant Period, Mr Khan (and others) maintained these targets despite being aware of concerns raised at CCS level regarding the achievability of targets set and that CCS was reporting deteriorating financial performance in respect of the Priority Contracts and increasing hard risks and MCS exposures. This greatly increased the risk that contract accounting judgements under IAS 11 would be applied overly aggressively by CCS in order to meet those targets and would not comply with IAS 11 as a result.**

57. **In these circumstances, the Authority considers that the control framework around CCS's contract accounting judgements needed to be sufficiently transparent and robust to ensure compliance with IAS 11. However, it was not, and during the Relevant Period the level of management adjustments applied in order to maintain CCS's traded margins continued to grow. Mr Khan was aware of this but did not take appropriate 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.

Position Papers

58. The most critical documents for the purposes of financial reporting were the Position Papers, which were intended to contain a fair assessment of the financial position of each of Carillion's contracts and were assumed to be based on the divisional contract appraisals. Position Papers contained the Business Division's best judgements as to value for the purposes of IAS 11 and thus the numbers which would form the basis of Carillion's financial reporting. The divisional Contract Appraisal documents were not accessible to Group Finance or Mr Khan. Mr Khan sought to understand what the data he received meant for cash management, budgeting and financial reporting purposes, but he was not in a position to amend the Position Papers and did not do so.

59. The preparation of the Position Papers was an iterative process, with discussions taking place within the Business Divisions and Business Units. To the extent that different iterations of those Position Papers were presented to Group management, Mr Khan only relied on the final versions.

60. **As Mr Khan was aware, the Position Papers did not refer to the financial risks associated with hard risks, MCS exposures or divergences between the latest budget or reforecast and the assessment of the Project Team, Business Unit or Business Division. It was therefore not reasonable for Mr Khan to place such reliance upon the Position Papers for the purposes of financial reporting. He also failed to ensure that the inconsistencies were explained or otherwise addressed in the Position Papers.**

61. **In addition, Mr Khan was aware that the external auditors, who received the Position Papers, were being given information regarding CCS's financial position which did not correspond with CCS's actual assessments. In these circumstances, Mr Khan should have taken steps to ensure that the external auditors were informed of these additional matters.**

Management adjustments

62. There is no evidence to suggest that Mr Khan was aware of any improper use of management adjustments or that he personally directed any individual to use management adjustments to deliver certain positions which in reality were unattainable. Mr Khan relied upon the judgement of those on the ground and the robustness of Carillion's reporting systems, and so did not doubt the appropriateness of any management adjustments. He necessarily relied on senior management in the Business Divisions to ensure that the management adjustments they were applying were appropriate and in accordance with Carillion's written policies. He was never told and never suspected that the contract appraisals adopted by the Business Units and Business Divisions did not reflect their best judgements.

63. Mr Khan was not responsible for commercial issues arising on the Priority Contracts and he could not be responsible for determining the appropriate level of provision for them. The management adjustments applied to the Priority Contracts were determined at the level of the appropriate Business Unit and Business Divisions and those adjustments were reflected in the management accounts of those Business Divisions. The Group Finance team and Mr Khan were in no position to re-write the Business Divisions' accounts.

64. If the Project Teams were using management adjustments to plug the difference between the true values and the budget, regardless of their true judgement as to sums likely to be recovered, they were acting contrary to Carillion's profit recognition policy.

65. **During the Relevant Period, Mr Khan attended a series of CCS PRMs which showed that the Project Teams' end of life forecasts for the Priority Contracts continued to deteriorate, and that the scale of management adjustments**

continued to increase, such that the traded figures for the projects remained unaltered. Despite being aware of: the respective 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 Khan 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 the full year 2016, as reported to the market in the March Results Announcement.

66. **It was not appropriate for Mr Khan simply to rely on Carillion's policies and senior management to ensure that the management adjustments were appropriate given: (i) the information he was provided on hard risks, MCS exposures, the deteriorating performance of the Priority Contracts and the high and increasing level of management adjustments being applied; and (ii) his own responsibilities for Carillion's financial affairs, including the overall adequacy of Carillion's provisions.**

<u>PRMs</u>

67. Given the volume of detailed information in each PRM pack, which was usually around 100 pages long, it generally was not practicable for Mr Khan to review them in detail.

68. PRMs were a reporting forum for the Business Divisions and it was not intended that accounting judgements would be made in that forum, nor were they. The main focus of the PRMs was on core operational and commercial concerns. The meetings did not address detailed contract-specific information to allow anyone to form fresh views as to the contract accounting estimates. The ultimate decisions on margins and traded positions were taken by management within the Business Divisions.

69. Within CCS alone there were more than 300 contracts in this period. Whilst the bigger contracts, including the Priority Contracts, would at least be discussed briefly at each monthly PRM, their gross value was less than 5% of Carillion's total revenue of £5 billion, so their importance and the focus Mr Khan could properly apply to them should not be overstated.

70. **Notwithstanding the size of the PRM pack, the information regarding the financial position was presented in such a way that Mr Khan would have been aware that the views within CCS contrasted with that being reported in papers to the Board and the Audit Committee. For example, in respect of the CCS PRM in January 2017, the PRM pack included a 'dashboard' summary which showed: (i) for RLUH, a Project Team estimate of a £39 million loss (-13%), with a management adjustment of £53.9 million applied to help achieve a traded-to-date margin of 4.7% (£11.7 million); (ii) for Battersea, a Project Team estimate of a £26.3 million loss (-5.2%), with a management adjustment of £31.2 million to help achieve a traded-to-date margin of 1.9% (£8 million); (iii) an increase in Building management adjustments from around £75 million in January 2016 to just under £150 million in July 2016 to just under £200 million in November 2016; and (iv) an increase in Infrastructure management adjustments of just over £45 million in January 2016 to just under £60 million at July 2016 and around £45 million in December 2016.**

71. **The PRM process was an important forum at which the financial performance of projects was discussed and reviewed at different levels with CCS, often in the context of Carillion's budgeting and reforecasting process. These discussions included discussions of claims, variations and costs on different**

projects, and the challenges or opportunities associated with them, including their recovery strategy. The CCS PRMs included reporting of hard risk and MCS figures, and also showed that the Project Teams considered that the financial performance of the Priority Contracts was deteriorating and that large and increasing management adjustments were being applied. In these circumstances, Mr Khan could not reasonably fail to take into account such information when considering whether contract accounting judgements were being applied appropriately.

72. **Although the value of the Priority Contracts might have been relatively small in comparison to Carillion's total revenue, the scale of the potential losses for them, which consistently ran into the tens of millions of pounds for each project, was extremely significant relative to the underlying PBT for the whole Group of £178 million for the full year 2016. Mr Khan was aware of this and so must have been aware of their importance and the need for him to give them appropriate attention.**

Red flags

73. Mr Khan did not understand the hard risk figures or MCSs produced by CCS to be 'red flags' which suggested that the financial performance of the projects reported by CCS through Carillion's "core" accounting system was incorrect.

74. Mr Khan's understanding is that the hard risk figures and the MCSs were intended to address commercial issues outside the framework of statutory financial reporting and involving assessments made on a different basis. The fact that they formed part of Carillion's processes does not mean that they formed part of Carillion's financial reporting processes. Whatever the intentions of those preparing the documents, Mr Khan did not understand or suspect that the values in the documents were intended to reflect more accurate judgements than those in the contract appraisals. If this had been suggested to him, he would have investigated the matter because it would have been a clear breach of Carillion's control framework.

75. Mr Khan understood that the hard risk and MCS reports had commercial uses, but also that they did not displace information that was provided to Group management through the "core" reporting channels. He should not be held responsible if individuals at Business Unit and Business Division level chose not to report the correct numbers through the proper financial reporting channels, but instead chose to record the correct numbers through a parallel informal channel which formed no part of the financial reporting framework.

76. Other alleged 'red flags' – consisting of a few isolated emails predating his time as Group FD and some PRM packs – did not give Mr Khan cause for concern about either the financial reporting or Carillion's controls. None of the emails sought to inform Mr Khan that the figures reported in the Position Papers were wrong and reasonably he would not have paid close attention to them.

77. The Authority, in particular, relies on three emails. The first of these emails was sent in September 2016 by the RLUH Project Team to Mr Howson (and others), which Mr Howson forwarded to Mr Khan (and others). The spreadsheet attached to this email appears to predict an end of life margin loss of £50 million on the project, reduced to a £14 million loss by realistic recoveries and reduced further to an £8 million loss by other potential benefits. This email is evidence of those with responsibility for assessing, approving and reviewing accounting judgements considering the RLUH contract carefully. It is also unrealistic to expect the Group FD of a major listed company to pay careful attention to each and every attachment to the thousands of emails he received.

78. The second email was sent to Mr Khan (and others) on 19 November 2016, regarding the cash position on AWPR. There were considerable uncertainties at the time in relation to confidence around the cost to complete AWPR and the value of claims.

Although the position for AWPR would have been discussed at the December 2016 PRM, Mr Khan was Group FC at the time and would have had only limited involvement in those discussions.

79. The third email is an internal email between senior CCS individuals dated 24 November 2016 which was forwarded to Mr Khan the same day, which attached Building Position Papers and a summary of adjustments made to make them "*audit friendly*". The preparation of the Position Papers was an iterative process and Mr Khan only relied on the final versions. As he did not have a detailed knowledge of the contracts and was not involved in making management adjustments, it is not surprising that he would not have paid close attention to the attachments. Further, he cannot recall reading the substance of the forwarded email and a reasonable reading of it is that the Position Papers had been prepared and they were ready to send to the external auditors.

80. In the light of the alleged 'red flags', there was no reason why Mr Khan should have reported differently to the Board and the Audit Committee and included in his reporting details of the hard risk numbers and the MCS.

81. **It was not appropriate for Mr Khan to proceed on the basis that, because the hard risk and MCS figures were not part of what he describes as the "core" reporting channels, they should not have been taken into account in Carillion's financial reporting processes. The magnitude of the risks revealed by these figures meant it was imperative that Mr Khan, given his responsibilities as Group FD, take reasonable steps to satisfy himself that Carillion's financial reporting was accurate. However, he failed to do so.**

82. **Besides hard risk and MCS reporting, Mr Khan was informed by a variety of means of the large and increasing divergences between: (i) the assessments of financial performance by the project and/or management teams within CCS; and (ii) the financial performance as reflected in Carillion's budgeted forecasts. The Authority considers that this information amounts to an independent source of significant warning signs from a number of highly experienced senior employees within CCS. For example, Mr Khan was informed of: (i) 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; (ii) assessments from within CCS which explicitly set out itemised recovery plans running to tens of millions of pounds, and which concluded that the contracts in question were severely loss-making even after the application of those proposed recoveries; (iii) assessments not just from Project Team level but also from CCS management and director level, which could not be considered just raw site team estimates; and (iv) CCS's provision of "audit friendly" Position Papers to the external auditors, which did not reflect CCS's best estimate of the position of the contracts. Mr Khan was aware of these warning signs by the time he became Group FD, and they should have given him cause for concern about Carillion's financial reporting and controls, in particular when considered cumulatively with the hard risk and MCS figures. As a result, he should have taken appropriate steps to address these warning signs (including the hard risk and MCS figures) and to ensure that they were brought to the attention of the Board and the Audit Committee, but he failed to do so.**

83. **Mr Khan was sent the September 2016 email with a specific invitation to discuss, so the Authority considers that he was aware of the information contained in it. The email was sent by an experienced contractor on the RLUH project and needed to be taken seriously. His assessment was supported by an itemised loss of proposed recoveries amounting to £42 million, but even taking these into account the RLUH Project was still considered to be loss-making, which would then have triggered the immediate recognition of the**

full extent of the expected loss. Mr Khan therefore had good reason to consider whether any further alteration to his estimate by way of management adjustment was in fact justified or at least to take steps to understand the basis for such an adjustment. However, he did not take such steps or inform the Board or the Audit Committee of this assessment.

84. **The email of 19 November 2016 was sent by a senior CCS individual. It referred to an end of life loss for Carillion in respect of AWPR of £40 million. Although the email made clear that costs to complete on the AWPR project were uncertain, this does not assist Mr Khan's position, given that the outcome of the revised cost-to-complete exercise was actually an even worse end of life assessment, namely the £78 million projected loss mentioned in the report presented at the CCS PRM on 16 December 2016 which Mr Khan attended. Mr Khan was therefore aware of this projected loss, when he became Group FD, but he failed to take it properly into account when reviewing and approving the March Results Announcement and failed to bring it to the attention of the Board and the Audit Committee.**

85. **The email dated 24 November 2016 forwarded to Mr Khan stated: "*Please find attached the latest Building position papers together with a summary of the adjustments we have had to make to make them audit friendly.*" The fact that changes had to be made to make the Position Papers "*audit friendly*" should have been a clear cause for concern for Mr Khan. The spreadsheet attached to the email states, for each project that it addresses, the 'original' and 'adjusted' end of life forecasts and calculates the movement between those figures. For RLUH, the 'original' end of life forecast was adjusted from a £38.67 million loss to a £14.05 million profit, being a movement of £52.72 million, and for Battersea, the 'original' end of life forecast was adjusted from a £28.56 million loss to a £8.03 million profit, being a movement of £33.59 million. The spreadsheet also includes a table showing the corresponding adjustments made to the 'recovery strategy' for the projects. It was therefore brought to Mr Khan's attention that the external auditors were being presented with an 'adjusted' view which did not correspond with CCS's actual assessment of the position. Mr Khan was specifically sent this email to review the Position Papers, yet he did not take action to satisfy himself that the adjustments were warranted, including once he became Group FD. Given the magnitude of the adjustments, it was not appropriate for him simply to rely on the adjusted figures.**

<u>Hard risk</u>

86. CCS was the only Business Division which reported hard risk when Mr Khan was Group FD, but this did not happen in a structured or regular manner across CCS Business Units. Mr Khan did not understand hard risk to refer to values that needed to be written off. Amounts described as hard risk were not described as irrecoverable, but rather as items to which a degree of risk attached or which required additional focus in terms of recovery strategies. CCS management did not make any requests to Group Finance for a write-off or for provision to be made against these balances.

87. Hard risk was used by different individuals, in different contexts, for different purposes, and there was a lack of common understanding as to its meaning and how it should be reported. This supports Mr Khan's submission that he acted reasonably in relying on the formal reporting of positions through, for example, the Position Papers.

88. Hard risk schedules were submitted as part of the budgeting and forecasting process, and were not submitted as part of any monthly, quarterly, half year or year-end reporting. CCS only updated the hard risk schedules as part of the target setting process and included a summary table in the PRM packs. Mr Khan did not review the hard risk schedules and was not asked to do so. He also understood that the external auditors had been presented with hard risk schedules in the past and had indicated

that they were neither helpful nor reliable. Hard risk was not highlighted or discussed in the managing director's or commercial director's summaries in the PRM pack, to which the external auditors had access, and hard risk was not raised or routinely discussed during PRMs.

89. Hard risk relief was a relief that was granted as part of the budgeting process; it played no part in the numbers reported in the Position Papers, which ultimately formed part of the external financial reporting. The numbers set out in the Position Papers reflected the actual reported numbers, determined solely by CCS (as was appropriate), reflecting an assessment of contracts at a point in time by the Business Division and Business Units.

90. Mr Khan has no recollection of receiving the 6 March 2016 email referring to "*hard risk vs. genuinely collectable*" and he did not understand as a result of this email that hard risk represented amounts viewed by CCS as unlikely to be recovered. It is clear from its context that it was being sent for the purposes of a cash call taking place that day. Mr Khan understands the email to be comparing what is hard risk with what is genuinely collectable now.

91. **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*". In any case, irrespective of his and others' understanding as to the precise meaning of hard risk, Mr Khan was aware that it 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. As Mr Khan was aware, they totalled £171.8 million for CCS as at October 2016, and increased to £310.6 million as at March 2017, by which time Mr Khan was Group FD. They were not only large in absolute terms, but also relative to Carillion's underlying PBT for the full year 2016, which was £178 million.**

92. **Further, Mr Khan was aware that hard risk was reported by CCS as part of Carillion's quarterly 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. Mr Khan was frequently and regularly informed of hard risk as part of this process. In those circumstances, it was not reasonable for Mr Khan simply to rely on the formal reporting of risks through, for example, the Position Papers, when the formal reporting was inconsistent with the hard risk figures. Instead, Mr Khan needed to take meaningful steps to address the increasing levels and accumulated values of hard risk being reported to him, but he did not do so.**

93. **The Authority considers that the evidence does not support Mr Khan's submission that the external auditors had been presented with hard risk schedules in the past and had indicated that they were neither helpful nor reliable.**

94. **CCS reported hard risk figures in order to highlight financial risks and exposures and to enable Group management to take a view on whether, and if so how, to deploy central provisions and contingencies at Group level, by means of 'hard risk relief' or otherwise. The amount of hard risk relief allocated to CCS represented an amount by which CCS was permitted to adjust its overall profit forecast downwards to take account of hard risk. During the Relevant Period, Mr Khan, as the Group FD, had responsibility for determining how much hard risk relief should be allocated to CCS. The Position Papers sent to the external auditors displayed the position after the application of hard risk relief. The application of hard risk relief thereby altered the values ascribed to particular projects for the purposes of preparing Carillion's published accounts.**

95. **Mr Khan's submission that he understood "*genuinely collectable*" to mean "*genuinely collectable now*" is not what the 6 March 2016 email said and is inconsistent with the supporting analysis attached to the email. Mr Khan has failed to identify any contemporaneous documents which support his asserted understanding of hard risk.**

MCS

96. MCSs were instigated at Mr Adam's request when Mr Khan was the Group FC and were loosely used as an agenda for each MCRM in order to identify those contracts which required particular attention. The MCS was not a document that was intended to capture risks that needed to be written-off. The "*best*", "*likely*" and "*worst*" figures set out in the MCS were never discussed or raised at the MCRMs, and Mr Khan understood them to be ranges of outcomes if Carillion agreed to settle various claims for cash with no further actions. Neither the MCS nor the MCS figures were ever discussed in detail at the MCRMs. Mr Khan understood the MCS to be an illustrative commercial tool, with no prescribed methodology underlying the reported ranges, no standardised approach to their use between different Business Units, and no external validation applied to their preparation at any level before reaching Group management. He therefore did not consider the MCS to be useful to him for financial reporting purposes.

97. **The Authority considers that the evidence shows that Mr Khan was involved in the creation of the MCS in March and April 2014. The MCS was a report prepared for the purpose of a quarterly MCRM between senior management at Divisional and Group level within Carillion. It was intended to be a central summary capturing all of the major contract exposures across the Group. Given the size of the "*likely*" outcomes recorded in the MCSs during the Relevant Period, and the purpose for which the MCS was created, the Authority does not consider Mr Khan's submission that the MCS was not significant for Carillion's financial reporting to be credible.**

98. **Mr Khan's assertion that he understood the MCS to be a commercial document, not a financial reporting tool, is contradicted by the documentary evidence. He has also not identified any basis for believing that the MCS report conveyed anything other than the natural and ordinary meaning of a "*likely*" exposure. In light of the size of the figures reported, which identified significant losses even on the "*best*" case scenario, Mr Khan unreasonably failed to take any steps to address the inconsistency between the MCS reporting and other management and financial information within Carillion, and unreasonably failed to inform the Board and the Audit Committee of the MCS reporting.**

Peer reviews

99. The peer review process was not significant to Carillion's control framework. It was designed to share best practice and ideas to enhance process improvements, rather than to scrutinise the reporting of a commercial position. Mr Khan regarded the peer review process as a useful control. However, the numbers used did not reflect management adjustments that would be made by management at Business Unit and Business Division level, and therefore the figures that would flow through the recognised core reporting process, and so there was no need for the peer review numbers for individual contracts to be provided to the Board or to the Audit Committee.

100. **Peer reviews of major projects by experienced contract managers included consideration of the financial position of the relevant projects and the contract accounting judgements applied to them. During the latter part of 2016 and the Relevant Period, the peer review recommendations on certain major projects identified significantly worse financial performance than the budgeted forecasts. Although Mr Khan did not receive peer review reports, he was aware that there was no formal process to ensure that a peer**

reviewer's recommendations were taken into account. In fact, no meaningful action was taken in response to the conclusions of the peer reviews and the peer review recommendations were not taken into account in the reports to the Board and the Audit Committee of the financial performance of CCS's projects. As a result, this was another source of information, along with the increasing managements adjustments, hard risks, MCS exposures and divergences from budget forecasts for major projects, that the Board and the Audit Committee were not aware of and did not take into consideration in approving the Announcements.

Reporting to the Board and the Audit Committee

101. Mr Khan does not accept that he failed to inform the Board and the Audit Committee about matters relevant to their review and approval of the Announcements, or that the Board and the Audit Committee were not provided with sufficient information to enable them to fulfil their duties in overseeing Carillion's financial performance.

102. The Board was provided with more robust and consistent data than the Overtrade Reports, which enabled it to understand the status of the Projects and the judgements made. Similarly, the Audit Committee was provided with sufficient information, including the reports of the external auditors and the Group FD's report, to enable it to assess the financial reporting decisions. The information received by the Board and the Audit Committee could have prompted further questions about CCS's financial performance and that of the Priority Contracts. Senior members of CCS addressed the Board and the Audit Committee directly in relation to the Priority Contracts and were best placed to inform them of any matters concerning CCS about which they needed to be aware.

103. Mr Khan's approach was cautious, prudent and focused on providing clear and complete financial data to the Board. His actions are not consistent with an individual who was seeking to hide information from the Board or, ultimately, shareholders.

104. **The Authority does not agree that the Board and the Audit Committee were provided with sufficient information to enable them to understand the status of the Priority Contracts and the contract accounting judgements made. None of the materials provided to them referred to hard risk, the likely exposures reported in the MCS, or the significant and increasing divergence between the information provided to them and the CCS Project Teams' and management teams' assessments of contract performance. Mr Khan was aware of these warning signs and must have been aware that they were matters which needed to be brought to the attention of the Board and the Audit Committee.**

105. **Mr Khan's submission that senior members of CCS were best placed to inform the Board and the Audit Committee of any matters concerning CCS about which they needed to be aware fails to have regard to the responsibilities that Mr Khan himself owed as Group FD, and in any case does not excuse his own failure to inform them.**

106. **The fact that the Board and the Audit Committee could have asked for further information fails to take into account that the warning signs were not mentioned in the materials provided to them, and so it could not be expected that they would ask questions about them. Given Mr Khan's awareness of the warning signs and that the Board and the Audit Committee were not aware of them, the Authority considers that Mr Khan acted recklessly in not ensuring that these were brought to their attention.**

The Priority Contracts

107. The case against Mr Khan is based on just a few of the thousands of documents that would have been available to him. They were not part of the processes and

controls for financial reporting, and undue and inappropriate prominence and weight have been attached to them.

108. There is no evidence that Mr Khan understood or suspected that the numbers reported to him in respect of the Priority Contracts, and by him to the Board, were incorrect; or that hard risk and MCS figures better reflected the IAS 11 judgement of the managers and directors of CCS in relation to the Priority Contracts; or that there was any discussion or questioning within Carillion as to the misstatement of values in relation to the Priority Contracts.

109. **Mr Khan's recklessness and knowing concern in Carillion's breaches is based on documents which show that he was aware of warning signs and failed to take appropriate steps to address them and to bring them to the attention of the Board and the Audit Committee. These warning signs were brought to his attention on a number of occasions, by a variety of means and through important processes within Carillion, including through CCS PRMs and through the budgeting and reforecasting process. Given the nature and cumulative effect of the warning signs, Mr Khan must have appreciated that this information would be highly relevant to the deliberations of the Board and the Audit Committee, and the risk that Carillion's systems and controls would be inadequate, if due consideration was not given to such information.**

110. **Mr Khan must have been aware, as a result of receiving the hard risk and MCS figures, and figures showing the divergences between the assessments of financial performance by CCS's Project and management teams and the financial performance as reflected in Carillion's budgeted forecasts, that there was a risk that the figures reported to the Board were incorrect. However, he did not make enquiries to satisfy himself that the figures reported to the Board were appropriate.**

<u>The Announcements</u>

111. The assertion that Carillion's 2016 financial statements were misstated is unsubstantiated. Carillion's external auditors were asked to undertake a specific review to identify whether there had been a material misstatement of the financial position as at the 2016 year end, and concluded that a prior year adjustment was not necessary and thus that the conditions justifying the write-down arose in 2017. No evidence has been put forward to demonstrate that this conclusion was wrong. In any event, Mr Khan did not know or suspect that the financial statements were misstated at the time of the Announcements.

112. The wording of the March Results Announcement reflected the fact that some of the business's contracts were in markets that were challenging and that a degree of rebalancing was necessary. The overall sentiment of the announcement was that Carillion was operating in difficult markets with some difficult contracts and 2017 was going to be a period of retrenchment. Mr Khan considered that the wording was appropriate, given his understanding of the financial position at the relevant time. The issues which subsequently emerged in relation to the Priority Contracts and which informed the July 2017 write-downs were not apparent at the time of the March Results Announcement.

113. At the time of the preparation of the May Announcement, no individuals in CCS had raised with Mr Khan that the reported numbers in relation to the Priority Contracts, on which the Announcement was based, were incorrect. He therefore had no reasons to doubt the reported numbers.

114. Mr Khan's update to the Board for its meeting on 3 May 2017 was considered to be a pessimistic assessment of the position, but that and the discussions at the meeting led to a redrafting of the AGM statement to add the words "*challenging contract positions*". Mr Khan was satisfied that the May Announcement, as re-drafted following the 3 May 2017 Board meeting, was accurate. The May Announcement did not suggest

that the challenge arose only in international markets; the phrase "*particularly in*", in reference to overseas markets, cannot be read as excluding everything beyond those markets. It was not considered necessary at that time to make express reference to the CCS contracts in the May Announcement, as the executive directors and the Board did not understand the financial position to have deteriorated significantly.

115. **The Authority considers that the evidence shows that Carillion's 2016 financial statements were misstated. 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. 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 facts and matters known to Carillion and Mr Khan regarding CCS's financial position by the date of the announcement.**

116. **The Authority does not agree that the overall sentiment of the March Results Announcement was that Carillion was operating in difficult markets and that 2017 was going to be a period of retrenchment. Rather, the announcement described Carillion's performance as "*in line with expectations*", with the document published alongside it stating that "*Revenue grew strongly by 21 per cent*" in Construction Services (excluding the Middle East) and confirming that the operating margin for this segment "*remains within our target range of 2.5 per cent to 3.0 per cent*". It described the ambition for this segment in 2017 as being to "*maintain revenue and profit broadly at their current levels*" and referred to Carillion having a "*good platform from which to develop the business in 2017*". Given his knowledge of the warning signs, Mr Khan must have appreciated the risk that these statements were inaccurate.**

117. **The tenor of the May Announcement was that nothing had materially changed since the March Results Announcement. 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 the Priority Contracts.**

118. **The Authority considers that the comment in the May Announcement regarding managing challenging contract positions, was not sufficient to provide an accurate depiction of the Group's trading as at the date of the announcement, since it was explicitly linked to international markets and did not refer to the UK. The comment was expressly linked to the similar statement made in the March Results Announcement, which was specific to the Middle East and Canada. It did not convey significant problems within Carillion's UK construction business (CCS).**

119. **The Authority does not consider that the external auditors' conclusion that no prior year adjustment was necessary demonstrates that the financial statements were not misstated. In reaching their conclusion, the external auditors were provided with inaccurate information and material information was withheld from them, including the clean Position Papers and details of hard risks and MCS exposures.**

<u>Limitation</u>

120. The Authority is not permitted to impose a financial penalty in respect of Mr Khan'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.

121. Mr Khan was specifically named in the document referring the matter to the Authority's Enforcement division on around 25 September 2017, which was based on information held by the Authority over three years before 18 September 2020, the date the Warning Notice was issued. The referral stated that there were circumstances suggesting contraventions by Carillion because of inadequate systems and controls, contraventions that Mr Khan is now alleged to have been knowingly concerned with. In the circumstances, the Warning Notice issued on 18 September 2020 is time-barred.

122. **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*[6], 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.*"**

123. **In summary, the particular misconduct alleged against Mr Khan, 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 when the Warning Notice was issued), the Authority did not have information concerning any of the warning signs identified in the Warning Notice or Mr Khan's failure to respond appropriately to them. Accordingly, the Authority did not have information from which Mr Khan's breaches could reasonably be inferred.**

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

<u>The proposed sanction</u>

125. Without prejudice to Mr Khan's primary position that he was not knowingly concerned in breaches by Carillion, should the Authority consider it appropriate to impose a financial penalty on Mr Khan, it should be lower than that proposed and should be no greater than £41,693.

126. The Relevant Period should end at the latest on the date of the May Announcement, namely 3 May 2017. Mr Khan's income for the purposes of calculating relevant income should therefore be £490,500.

127. Even if the Relevant Period ends on 10 July 2017, the relevant income should be £501,000 because it should not include a payment to Mr Khan in respect of holiday that he did not take. He received this payment because his employment was terminated early in September 2017 and so, at the time of termination, he was unable

[6] *Andrew Jeffery v the Financial Conduct Authority*: FS/2010/0039

to enjoy a period of paid leave. His income throughout the Relevant Period was the same, whether or not he took leave. Accordingly, it is not appropriate for this payment to be included in the calculation of his earnings between July 2016 and July 2017.

128. The seriousness of Mr Khan's breaches should be assessed as level 2 rather than level 4. Carillion's liquidation was not a consequence of the alleged breaches, but was the result of other distinct issues, so should not be taken into consideration in assessing the impact of the breaches. Systemic weaknesses in Carillion's procedures should also not be taken into account, as they were in place long before he became Group FD and he was not in position long enough to change those systems. In addition, if Mr Khan was knowingly concerned, it was inadvertently, rather than recklessly.

129. Various mitigating factors have not been taken into account in the penalty calculation. Mr Khan was only the Group FD for a short period, had no previous disciplinary record and fully cooperated with the Authority's investigation and with investigations by other agencies. He also took steps to improve the level of reporting to the Board when Group FD, and there was little time for him to remediate any systemic failure as it existed before he took up his position as Group FD. These mitigating factors merit a 15% reduction.

130. **The Authority considers that it is appropriate to impose a financial penalty of £154,400 in respect of Mr Khan's knowing concern in Carillion's contraventions of Article 15 of MAR, LR 1.3.3R, Listing Principle 1 and Premium Listing Principle 2.**

131. **The Authority considers that the appropriate end date for the Relevant Period is 10 July 2017, the date that Carillion announced the contract provision of £845 million and thereby corrected the misleading information in the Announcements.**

132. **The Authority considers it is appropriate to include Mr Khan's unused holiday entitlement as part of his relevant income as, by not taking holiday, Mr Khan was in effect earning income which was then paid out on his departure.**

133. **The Authority has concluded that Mr Khan's breaches were reckless and that, having regard to all relevant factors, in particular those set out in paragraphs 6.11 and 6.12 of this Notice, it is appropriate to assess them as seriousness level 4.**

134. **The Authority is not alleging that the breaches by Carillion and Mr Khan resulted in Carillion's liquidation. However, the public nature of Carillion's business, the size and scope of the business, and Carillion's subsequent liquidation have undermined confidence in the financial reporting regime.**

135. **The weaknesses in Carillion's procedures, systems and controls were present when Mr Khan was the Group FC and continued during his time as Group FD, and so the Authority does not agree that he did not have the opportunity to address them.**

136. **The Authority acknowledges that Mr Khan only became Group FD six months prior to the announcement in July, but does not consider this to be a mitigating factor in circumstances where he was the Group FC beforehand and was aware of certain of the warning signs and the procedures in place at Carillion in that role. The Authority does not consider that any improvements that Mr Khan made to the reporting to the Board amount to a mitigating factor, given that he was aware that the warning signs were not being brought to the Board's attention.**

137. **The Authority acknowledges that Mr Khan attended a voluntary interview, but considers that he did not show any exceptional cooperation during his investigation which merits a Step 3 mitigation discount. Similarly, the**

Authority acknowledges that Mr Khan has no prior disciplinary history with the Authority, but does not consider that this merits a reduction in the financial penalty.

Introduction of new material following issue of the Warning Notice

138. It was inappropriate for the Authority to introduce new material into the proceedings after the Warning Notice was issued.

139. **Mr Khan was given the opportunity to make, and did make, further written representations in respect of the new material produced by the Authority 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 Khan has been given a fair and reasonable opportunity to make representations in respect of this new material and that it is not unfair for the Authority to have regard to this material in reaching its decision.**