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## FINAL NOTICE

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To: Mr David Whistance

Date of Birth: 21 March 1961

Date: 10 April 2007

**TAKE NOTICE: The Financial Services Authority (“the FSA”) of 25, The North Colonnade, Canary Wharf, London E14 5HS gives you a final notice about a requirement to pay a financial penalty:**

### **1. THE PENALTY**

- 1.1 The FSA gave Mr David Whistance a Decision Notice on 10 April 2007 which notified him of the decision of the FSA to impose a financial penalty of £30,000 on Mr Whistance pursuant to section 66 of the Financial Services and Markets Act (“the Act”) in respect of breaches of Principles 6 and 7 of the Statement of Principles for Approved Persons (“APER”).
- 1.2 Mr Whistance confirmed on 14 March 2007 that he will not be referring this matter to the Financial Services and Markets Tribunal.
- 1.3 Accordingly, for the reasons set out below and having agreed with Mr Whistance the facts and matters relied on, the FSA imposes a financial penalty on him in the amount of £30,000.
- 1.4 The FSA considers that Mr Whistance’s failings warranted a financial penalty of £80,000 but this has been reduced as Mr Whistance agreed to settle at an early stage of the FSA’s investigation and therefore qualified for a 30% (stage 1) reduction of the financial penalty under the FSA’s executive settlement procedures. The FSA has also taken into account Mr Whistance’s present financial circumstances.

### **2. REASONS FOR THE ACTION**

- 2.1 The FSA has decided to impose a financial penalty on Mr Whistance for breaches of Principles 6 and 7 of APER in his previous capacity as holder of Controlled Function 1

(Director) (“CF1”) at W Deb MVL Plc, formerly known as Williams de Broe Plc (“the Firm”), during the period 1 December 2001 to 3 May 2005 (“the relevant period”). Mr Whistance held CF1 as the Firm’s Finance Director during the relevant period.

2.2 On 15 January 2007, the FSA issued a Final Notice against the Firm for, amongst other things, failing to adhere to regulatory requirements relating to accounting procedures and records. The responsibility for ensuring that the Firm’s accounting procedures and records complied with regulatory requirements fell to Mr Whistance as the Firm’s Finance Director. The APER breaches identified in this Notice concern his personal culpability as Finance Director for the Firm’s failure to adhere to regulatory requirements relating to accounting procedures and records during the relevant period.

2.3 Mr Whistance breached Principle 6 of APER in that he failed to exercise due skill, care and diligence in managing the affairs of the Firm for which he was responsible. In particular:

- (1) He failed to take reasonable steps to oversee, supervise and organise sufficiently the recording of transactions outside the Firm’s settlement systems and rectify the deficiencies in the systems (see paragraph 6.4).
- (2) He failed to take reasonable steps to ensure the timely investigation and correction of differences in cash balances and stock positions as recorded by the Firm and its counterparties (see paragraph 6.13).
- (3) He failed to take reasonable steps to adequately inform himself and the Board of the Firm as to the potential value of all differences in cash balances and stock positions as recorded by the Firm and its counterparties during the relevant period, and whether such items may have had a material impact on the financial position of the Firm for the financial years ending 2002, 2003 and 2004 (see paragraph 6.16).
- (4) He failed to take reasonable steps to adequately inform himself and the Board of the Firm as to the use and value of the Firm’s borrowings and whether this could materially impact the Firm’s financial position for the financial years ending 2002, 2003 and 2004 (see paragraph 6.24).
- (5) He failed to take reasonable steps to ensure that the Firm provided the external auditors with sufficient accounting records for the purposes of auditing the Firm’s financial statements for the period ending September 2004 (see paragraph 6.33).

2.4 Mr Whistance breached Principle 7 of APER in that he failed to take reasonable steps to ensure that the business of the Firm for which he was responsible complied with the relevant requirements and standards of the regulatory system. In particular:

- (1) He failed to take reasonable steps to ensure that the Firm had appropriate formalised and written procedures relating to the identification, investigation and correction of differences in cash balances and stock positions as recorded by the Firm and its counterparties and the retention of such records for accounting purposes (see paragraph 6.14).

- (2) He failed to take reasonable steps to ensure that the Firm established and maintained such systems and controls as to the making and retention of readily accessible, adequate, up-to-date and accurate accounting records to determine and monitor the use of the Firm's borrowings, and which enabled particular transactions to be identified at any time and traced through the accounting system of the Firm (see paragraph 6.25).
- (3) He failed to take reasonable steps to establish such systems and controls relating to the making and retention of accounting records that were readily accessible, adequate, up to date, accurate and which enabled particular transactions to be identified at any time and traced through the Firm's accounting system, for the purpose of verifying trade debtors and creditors. In the absence of such records, the Firm made a provision of £49.4 million against net unreconciled debit balances in its accounts for the financial year ending 31 December 2004. In the audited accounts for the financial year ending 31 December 2005, a further provision was made and the combined provision totalled £66.3 million. This raised issues relating to the Firm's potential insolvency leading to its former parent company waiving various loans totalling £58 million to ensure that the Firm was adequately capitalised (see paragraph 6.34).

### *Seriousness of the Findings*

2.5 Mr Whistance's failings are viewed by the FSA as serious in that:

- (1) As Finance Director and holder of CF1, Mr Whistance was a senior member of the Firm's management team, and had responsibility for the areas of the Firm's business in which the failings identified in this Notice occurred. The FSA places a great deal of emphasis on the responsibilities of senior management as it is senior managers who are responsible for the standards and conduct of the businesses they run.
- (2) The failings occurred over a prolonged period and despite a number of warning signals provided by, amongst others, internal and external audit reports produced during the relevant period.
- (3) The deficiencies in the business of the Firm for which he was ultimately responsible during the relevant period were numerous and widespread. They included the continuing failure to ensure timely reconciliation of cash balances and stock positions and the inability to account fully, and on a day-to-day basis, for a credit facility of around £100 million provided by the Firm's former parent company ("the Parent Company").
- (4) The failings resulted in poor accounting procedures and record keeping at the Firm during the relevant period which severely undermined its ability to monitor and substantiate its financial position for the 2004 and 2005 financial years. The combined adjustment of £66.3 million to the Firm's accounts in 2004 and 2005 was off-set by the waiver of various inter-company loans in the sum of £58 million. This waiver arose following concerns that as a consequence of the

adjustment the Firm was potentially insolvent and unable to maintain its FSA authorisation.

- (5) Mr Whistance did not identify all of the failings, including those identified by other parties, and the remedial action instituted to deal with the failings proved ineffective.
- (6) Proper systems and controls relating to financial accounting and record keeping are important safeguards in promoting the FSA's statutory objectives of maintaining market confidence in the regulatory system and securing to consumers the appropriate degree of consumer protection. The penalty imposed on Mr Whistance reflects the importance of senior management ensuring that firms comply with such requirements.

2.6 The FSA notes that Mr Whistance did make some attempts to address and remedy the deficiencies in the Firm during the relevant period.

2.7 In deciding the level of the financial penalty, the FSA has taken account of the following:

- (1) Considerations relating to Mr Whistance's present financial circumstances.
- (2) The FSA does not consider that Mr Whistance deliberately contravened the requirements in APER or that he profited from the failings identified in this Notice.
- (3) Mr Whistance was open and co-operative with the FSA during the course of the investigation.
- (4) Mr Whistance has agreed not to apply for any of the controlled functions specified in Chapter 10.4 of the Supervision Manual of the FSA Handbook.
- (5) There is no evidence that any clients suffered any actual loss as a result of the Firm's failings.

### **3. RELEVANT STATUTORY PROVISIONS AND GUIDANCE**

3.1 Section 66 of the Act provides that:

- (1) The Authority may take action against a person under this section if –*
  - (a) it appears to the Authority that he is guilty of misconduct; and*
  - (b) the Authority is satisfied that it is appropriate in the circumstances to take action against him.*
- (2) A person is guilty of misconduct if, while an approved person -*
  - (a) he has failed to comply with a statement of principle issued under section 64...*

(3) *If the Authority is entitled to take action under this section against any person, it may –*

*(a) impose a penalty on him of such amount as it considers appropriate; or*

*(b) publish a statement of his misconduct.*

3.2 The statements of principle issued under section 64 of the Act are contained in APER. In particular:

*Principle 6 of APER*

*An approved person performing a significant influence function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his controlled function.*

*Principle 7 of APER*

*An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system.*

3.3 The following evidential provisions in APER are also relevant: 4.6.4E(4), 4.6.9E(1), 4.6.10E, 4.6.11G, 4.7.3E, 4.7.4E, 4.7.6E and 4.7.8E.

3.4 When exercising its powers, the FSA seeks to act in a way it considers most appropriate for the purpose of meeting its regulatory objectives, which are set out in section 2(2) of the Act. The FSA considers that imposing a financial penalty of £30,000 on Mr Whistance meets the regulatory objective of market confidence, that is maintaining confidence in the financial system and protection of consumers.

3.5 In deciding to take this action, the FSA has had regard to the guidance set out in sections 11.4 and 11.5 of the FSA's Enforcement Manual ("ENF"), which is part of the FSA's Handbook.

3.6 ENF 1.3.1(2)G states that the FSA will seek to exercise its enforcement powers in a manner that is transparent, proportionate and consistent with its publicly stated policies. The criteria for determining whether to take disciplinary action are set out in ENF 11.4.1G and ENF 11.5G. ENF 11.4.1G states that the FSA will consider the full of each case and that the criteria listed are exhaustive. In particular, ENF 11.5.3G states that the FSA will only take disciplinary action against an approved person where there is evidence of personal culpability on his part, which arises where his behaviour, amongst others, fell below that which would be reasonable in all the circumstances.

3.7 Having regard to the matters set out above, the FSA considers it proportionate and appropriate in the circumstances to take disciplinary action against Mr Whistance.

#### **4. FACTS AND MATTERS RELIED ON**

- 4.1 The Firm has been authorised by the FSA since 1 December 2001. During the relevant period, its principal areas of business included the dealing in securities and provision of investment services to institutional and private investors. The Firm was previously regulated by the Securities Association and the Securities and Futures Authority (“the SFA”) from 29 April 1988. During the relevant period the Firm had approximately 4,400 private client accounts.
- 4.2 Mr Whistance was appointed as Finance Director of the Firm in November 1997. His duties included the management and oversight of the Firm’s back office, which comprised the departments responsible for settlement, treasury, IT, the timely and accurate completion of management, statutory and regulatory accounts and financial reporting.
- 4.3 As at 31 December 2001, Mr Whistance held, as Finance Director of the Firm, the position of CF1 under the Act. The areas of the Firm’s business for which he was responsible as CF1 were those he was directing as Finance Director, as described in paragraph 4.2 above.

#### **5. WARNING SIGNALS ABOUT THE FIRM'S RECONCILIATIONS AND ACCOUNTING SYSTEMS AND CONTROLS BEFORE 1 DECEMBER 2001**

##### *Qualified Financial Statements for the Financial Year ending 31 December 1998*

- 5.1 In 1998 the Firm experienced a number of interface problems between SYSTEM A, its primary transaction settlement system used to record all client and proprietary transactions, balances and holdings, and CREST, the UK automated stock exchange settlement system for the sales and purchases of UK registered securities. In particular, SYSTEM A had a weakness in closing down trades and the manual procedures put in place to overcome these problems were insufficient given the increasing volume of trades being processed through SYSTEM A. The internal control to check the CREST system to SYSTEM A was the performance of a reconciliation of the CREST cash control account. However this internal control was not effective given the interface problems of SYSTEM A and led to substantial unreconciled amounts on the CREST cash control account.
- 5.2 In 1998 these unreconciled amounts totalled a net receivable of £3,994,669 and a net payable of £2,517,666. Provisions in excess of £1.5 million were made in the Firm’s financial statements for the financial year ended 31 December 1998 in order to address the risk that all or part of the net debtor balances may not have been recoverable. As the Firm’s external auditor was unable to determine whether such provisions were either required or sufficient, as there were no other satisfactory audit procedures that it could adopt to substantiate these balances, it qualified the audit opinion for the Firm’s financial statements for the financial year ending 31 December 1998.

##### *The First Cut-Over*

- 5.3 In October 1999, as a result of on-going functionality problems with SYSTEM A and the concern that it was not Y2K compliant, the Firm implemented a new system,

SYSTEM B (“the First Cut-Over”). SYSTEM B was a transaction processing system for settlement and accounting for securities trades (equities, bonds and other securities).

5.4 In its management letters for 1998 and 1999, the Firm’s external auditor set out its concerns about the First Cut-Over including significant processing delays at the year-end. The external auditor’s management letter for the year ending 31 December 1999 highlighted the difficulties which included, amongst other things:

- (1) Configuration errors in the automatic postings between key accounts.
- (2) Errors in the standing data, particularly with regard to client settlement details.

#### ***Qualified Financial Statements for the Financial Year ending 31 December 1999***

5.5 As it had in the previous year, the Firm’s external auditor stated in relation to the Firm’s financial statements for the financial year ending 31 December 1999 that the Firm had difficulties reconciling balances with CREST as a result of problems with the systems and processing of CREST as a result of problems with the settlement, combined with high volumes. The external auditor found that there remained a net unreconciled balance on a CREST related control account of £48,000, reduced from the net unreconciled balance of £1,477,000 receivable as at 31 December 1998. The previous year’s £1.5 million provision was brought forward, but was then seen as being unlikely to be required. As there were no other satisfactory audit procedures that the external auditor could adopt to substantiate these balances, the external auditor qualified its audit opinion for the Firm’s financial statements for the year ended 31 December 1999.

#### ***Ongoing issues with CREST cash reconciliation post the First Cut-Over***

5.6 As the reconciliation problems were not resolved prior to the First Cut-Over and due to functionality problems arising from SYSTEM B, the problems with the CREST cash reconciliation account continued in 2000. The Firm’s financial statements for the financial year ending 31 December 2000 were not qualified by the external auditor. However, the external auditor noted in its management letter for the year ending 31 December 2000 that the reconciliation for the key CREST cash control account was not performed on a timely basis during the year and the reconciliation of the year-end position took approximately three months to complete.

5.7 The external auditor believed that the existing reconciliation process required further enhancement and observed with regard to the existing reconciliation process that:

- (1) The current procedure was a complex manual process, requiring formatting and visual investigation of spreadsheets, which increased the risk of human error, especially in the event of the absence of the reconciliation clerk.
- (2) There was no formal evidence of independent management review of the work undertaken.
- (3) Exceptions identified as sourced from CREST were investigated and a manual settlement adjustment made to SYSTEM B. The manual adjustment was entered

on to SYSTEM B as a backdated entry – therefore the audit trail of original bargain entry and subsequent adjustment was lost.

#### ***Issues concerning the stock and depot reconciliations***

- 5.8 In its management letter for 1998, the external auditor noted the Firm's failure to perform stock reconciliations between custodians and SYSTEM A.
- 5.9 Similarly, in the management letter for 1999, the external auditor noted the Firm's failure to perform stock reconciliations.
- 5.10 In its management letter for 2000, the external auditor noted that the reconciliations for stock depot accounts were not performed on a timely basis during the year. As a result there remained a large number of reconciling items across various SYSTEM B account balances at the year-end. Furthermore, differences between the Firm's stock records and those of the corresponding depots were not investigated and resolved on a timely basis.

#### ***Issues concerning private client assets***

- 5.11 In its management letter for 1998, the external auditor noted the Firm's failure to perform formal stock reconciliations between SYSTEM P, a portfolio management system used for discretionary clients to provide individual client positions i.e. it tracked money held and paid out on their account, and SYSTEM A. Also during the financial year from April 1997 to April 1998 dividends received on SYSTEM P were not reconciled to SYSTEM A.
- 5.12 In its management letter for 1999, the external auditor noted the Firm's failure to perform reconciliations of private client stock holdings between SYSTEM P and SYSTEM A / SYSTEM B on a regular basis.
- 5.13 In its management letter for 2000, the external auditor noted that reconciliations of private client stock holdings between SYSTEM P and SYSTEM B had not been performed on a regular basis. The auditor also noted that with respect to the SYSTEM P and SYSTEM B reconciliation, the reconciliation was only performed at the year-end and a number of differences identified on the reconciliation had not been fully resolved three months after the year-end.

#### ***General Control Environment before 1 December 2001***

- 5.14 In its management letter for 2000, the external auditor noted the following weaknesses in the Firm's general control environment:
- (1) Procedures Manuals: the Firm was lacking detailed procedures manuals regarding roles, responsibilities and reporting lines.
  - (2) Absence of an Audit Committee: to monitor the controls in place in the business and identify perceived gaps in the control environment.



- (3) Insufficient training on SYSTEM B: key personnel in several areas of the back office expressed concern that they had not received sufficient training on SYSTEM B to be able to take full advantage of its capabilities.

### ***Mr Whistance's awareness of the Warnings Signals***

5.15 The areas of concern highlighted by the Firm's external auditors relating to the functionality problems in SYSTEM A and SYSTEM B, the failure to perform key reconciliations and the poor general control environment were known to Mr Whistance. These areas fell within his responsibility as Finance Director of the Firm following his appointment in November 1997.

5.16 It is the FSA's view that the weaknesses in the Firm's systems and controls identified prior to 1 December 2001 continued from that date and were manifested in the Firm's failure to adhere to the regulatory requirements relating to accounting procedures and records.

## **6. POST 1 DECEMBER 2001: ACCOUNTING SYSTEMS AND CONTROLS**

6.1 The Firm never fully resolved the functionality problems from the First Cut-Over arising from the implementation of SYSTEM B in 1999. This led to accounting systems and controls deficiencies for which Mr Whistance, as Finance Director, was ultimately responsible. For the reasons set out below, the FSA considers that Mr Whistance was personally culpable for these deficiencies and that his conduct fell below the expected regulatory standards for someone in his position. He accordingly failed to comply with Principles 6 and 7 of APER in the respects set out below.

### ***Settlement in SYSTEM B during the Relevant Period***

6.2 As Finance Director, Mr Whistance was ultimately responsible for ensuring the proper functioning of the Firm's systems. The settlement of transactions in SYSTEM B during the relevant period (until its replacement in October 2004) was deficient in that the information generated in SYSTEM B was not consistently accurate or reliable for accounting purposes.

6.3 As a result, SYSTEM B could not function as the Firm's primary source for accurate and reliable data. In particular, there was often no meaningful correlation between the information recorded in SYSTEM B and the information of the Firm's counterparties such as CREST, its custodians and bankers.

6.4 For the reasons set out in paragraphs 6.2. to 6.3 above, the FSA considers that Mr Whistance breached Principle 6 of APER in that he failed to exercise due skill, care and diligence in managing the business of the Firm for which he was responsible. In particular:

- (1) He failed to take reasonable steps to oversee, supervise and organise sufficiently the recording of transactions outside SYSTEM B to ensure that such records were readily accessible, adequate, up to date and accurate and which enabled particular transactions to be identified at any time for accounting purposes.

- (2) He failed to take reasonable steps to ensure that SYSTEM B generated accurate and reliable information by rectifying the deficiencies in SYSTEM B or replacing SYSTEM B.

### *The Clearance of Unreconciled Items*

- 6.5 The performance of key reconciliations fell to the back office for which Mr Whistance was ultimately responsible as Finance Director. The functionality deficiencies in SYSTEM B gave rise to ongoing reconciliation problems with a number of key interfaces post 1 December 2001, namely the CREST cash control account, the SYSTEM P to SYSTEM B reconciliation and stock reconciliations.
- 6.6 As a result, although resources were devoted to addressing the issue, and some progress made, unreconciled items continued to accumulate year-on-year since 1 December 2001. In October 2004, Mr Whistance again reported to the Board of the Firm that the Firm had for the last few years suffered from large numbers of items that needed to be reconciled. He indicated that this was partly due to the failure of SYSTEM A to interface with CREST, and partly due to the problems suffered in the first nine months of SYSTEM B being operational. He reported that 1,800 items remained unreconciled since September 2001, many having their origin in SYSTEM A.
- 6.7 Mr Whistance was warned of the reconciliation problems on a number of occasions. In February 2003, he received a report by the Firm's internal audit function on SYSTEM P administration. The main findings outlined in the executive summary of that report included the following:
  - (1) There was no clearly defined management structure for the SYSTEM P Administration team and roles and responsibilities were not clearly defined.
  - (2) A number of key reconciliations were not performed, or were performed inadequately. These included stock reconciliations, cash reconciliations and dividend reconciliations. Reconciling items were not cleared on a timely basis and errors remained uncorrected.
  - (3) There were no policies or procedures governing work of the SYSTEM P Administration team. There was a lack of consistency in the way that various tasks were performed.
  - (4) There was poor segregation of duties with cashiering duties and reconciliations being performed by the same person.
- 6.8 In response, the Firm agreed that:
  - (1) Dividend reconciliations were not performed adequately between SYSTEM P and SYSTEM B (identified as a 'Medium' risk in the report, which was defined as meaning that these risks were important and management should quickly develop action plans that would ensure timely and permanent resolution of the weaknesses noted).

- (2) There was no stock reconciliation performed between SYSTEM P and SYSTEM B on a regular basis. (The risk attached by internal audit to the absence of this stock reconciliation was 'High' i.e. the risk was so significant to the entity that it required immediate attention of Senior Management and priority to finding a solution). The FSA understands from Mr Whistance that the Firm undertook a manual "daily tick-out" to match transactions. However, the practice of "daily tick-outs" was not guaranteed to identify all instances where SYSTEM P and SYSTEM B did not agree. Further, formal monthly reconciliations which could have identified any such differences were not undertaken.

- 6.9 Mr Whistance was also aware of concerns highlighted by the Firm's external auditor's report to the FSA for the year ending 31 December 2002 which stated that:

*"Progress reported last year in that balances and positions with custodians, banks and intermediate brokers were now being reconciled had been continued. During the year they were reconciled within the required timeframe, although a number of old reconciling items have still not been cleared as required by FSA Rules 10-11(1-3)*

*...whilst reconciled at the year end, a number of control and wash accounts were not reconciled regularly during the year, as required by FSA Rules 10-11(1-3). In addition, while efforts were made to reconcile the [SYSTEM P] Private Clients systems to the main settlement system on a monthly basis, not all the reconciling differences were explained or cleared on a timely manner. We note that the reconciliation process was strengthened during the year and the number of such unexplained differences has significantly reduced. However, there are still a number of old outstanding items that have yet to be explained and cleared, as required by FSA Rules 10-11(1-3)."*

- 6.10 The external auditor's report to the FSA for the year ending December 2003 expressed similar concerns:

*"Balances in two non-trading bank accounts were not reconciled during the year within the required timeframe as set out in FSA Rule 10-11(3);*

*Other than the accounts noted in (1), during the year balances and positions with custodians, banks and intermediate brokers were reconciled within the required timeframe, although a number of old reconciling items have still not been cleared as required by FSA Rules 10-11(1-3);*

*As noted last year, whilst reconciled at the year end, a number of control and wash accounts were not reconciled regularly during the year, as required by FSA Rules 10-11(1-3). In addition, while the monthly process of reconciling the [SYSTEM P] Private Clients system to the main settlement system has been strengthened, we note that not all the reconciling differences were explained or cleared in a timely manner. Although the number of such unexplained differences have significantly reduced, there are still a number of old outstanding items that have yet to be explained and cleared, as required by FSA Rules 10-11(1-3)."*

- 6.11 One consequence of the continuing failure to perform the CREST cash control account reconciliation in a timely and effective manner was that the Firm did not detect that it had erroneously paid approximately £14.5 million in stamp duty which it had in fact been exempt from (as a market maker), since 1998. This error remained undetected until 2003.
- 6.12 During the relevant period, the Firm had limited written procedures relating to the identification, investigation and correction of differences in cash balances and stock positions as recorded by the Firm and its counterparties and the retention of such records for accounting purposes.
- 6.13 For the reasons set out in paragraphs 6.5 to 6.11, the FSA considers that Mr Whistance breached Principle 6 of APER in that he failed to exercise due skill, care and diligence in managing the business of the Firm for which he was responsible. In particular, he failed to take reasonable steps to ensure the timely investigation and correction of differences in cash balances and stock positions as recorded by the Firm and its counterparties, including differences between CREST and SYSTEM B and differences between SYSTEM B and SYSTEM P during the relevant period. Mr Whistance's failure impaired the Firm's ability to maintain and retain accounting records that are readily accessible, adequate, up to date and accurate and which enabled particular transactions to be identified at any time and traced through the accounting system of the Firm.
- 6.14 For the reasons set out in paragraphs 6.5 to 6.12, the FSA considers that Mr Whistance breached Principle 7 of APER in that he failed to take reasonable steps to ensure that the business of the Firm for which he was responsible complied with the relevant requirements and standards of the regulatory system. In particular, he failed to take reasonable steps to ensure that the Firm had sufficient written procedures relating to the identification, investigation and correction of differences in cash balances and stock positions as recorded by the Firm and its counterparties and the retention of such records for accounting purposes.

#### ***Valuation of unreconciled transactions***

- 6.15 During the relevant period, Mr Whistance reported to the Board of the Firm on the number of outstanding transactions that needed to be reconciled. This did not include an assessment of the total value of the items that needed to be reconciled. Despite the nature and volume of transactions that remained unreconciled during the relevant period, Mr Whistance did not consider such an assessment to be necessary as he believed that the value of these transactions would not be material so as to justify a provision by the Firm. As a result, the Firm did not properly consider whether these items had a material impact on the financial position of the Firm and the accuracy of statutory and regulatory accounts submitted by the Firm for the financial years ending 2002, 2003 and 2004.
- 6.16 For the reasons set out in paragraphs 6.5 to 6.10 and 6.15, the FSA considers that Mr Whistance breached Principle 6 of APER in that he failed to exercise due skill, care and diligence in managing the business of the Firm for which he was responsible. In particular, he failed to take reasonable steps to adequately inform himself and the Board of the Firm as to the potential value of all differences in cash balances and stock

positions as recorded by the Firm and its counterparties, and whether such items may have had a material impact on the financial position of the Firm for the financial years ending 2002, 2003 and 2004. This undermined the Firm's ability to monitor its compliance with financial resources requirements under the Act.

### ***Treasury Management***

- 6.17 During the relevant period, the Firm had access to a £100 million inter-group credit facility. The use and management of the credit facility fell to the Firm's Treasury Department for which Mr Whistance was ultimately responsible. In November 2002, the Parent Company actively sought to fully ascertain the use to which the credit facility was being put. Mr Whistance informed the Parent Company that the majority of the credit facility was used to fund the international arbitrage business of the Firm.
- 6.18 In June 2003, the Firm's internal audit function issued a report on the Firm's treasury management ("the 2003 Treasury Report"), including controls relating to the credit facility. The main findings of the report are stated as:

*"The audit opinion regarding the adequacy of internal control related to [the Firm's] treasury management is weak. This results from [the Firm's] inability to properly justify one main component of the daily borrowing i.e. the "stock on water" component, and from the lack of procedures, transparency and monitoring of the treasury management activity.*

*Our main audit concerns are ...(no clear-cut traceable justification for the "stock on water" calculation) and ...(no daily monitoring of funding)."*

- 6.19 It is the FSA's understanding that "stock on the water" refers to stock in transit between stock depots. The audit rating assigned to the 2003 Treasury Report was "weak", (the definition of which was that, "the operations are assessed to have an inadequate system of internal controls and procedures in certain areas, or be inadequate in at least one area of significant importance' with the impact of the weakness(es) identified in those areas of the control environment exposing the business to a serious level of risk").
- 6.20 Mr Whistance disagreed with the findings of the 2003 Treasury Report which in his view overstated the risk the Firm was exposed to. On 9 May 2003, he communicated to the Firm's Parent Company that the Firm would have a full department breakdown of the use of funds before the end of the summer of 2003. In July 2003, Mr Whistance established a team to investigate the Firm's level of borrowings. On 30 October 2003, he communicated to the management of the Firm that he was able to explain 95% of the Firm's borrowing on a daily basis.
- 6.21 In February 2004, the Firm's internal audit function issued a follow up report on treasury management ("the 2004 Treasury Report"). The audit concluded that:

*"Despite [the Firm's] main achievements regarding funding monitoring, the audit opinion regarding the adequacy of internal control related to treasury management can't be yet regarded as satisfactory and therefore remains weak."*

6.22 The 2004 Report found that the Firm's internal controls relating to treasury management remained weak because:

- (1) An estimated £14.5 million stamp duty paid by mistake to the Inland Revenue since 1998.
- (2) £2.3 million of missing firm stock with another £2.5 million of potentially missing firm stock.
- (3) A residual inability to trace all of the borrowings uses, especially those not assessed in the daily analysis of the borrowings.
- (4) A continued inability to account for any more than 70-90% of the daily borrowings on a daily basis with the simultaneous criticism that the process used to account even for these levels was not documented.
- (5) There was also the restated concern that as borrowing remained at the £100 million level, this demonstrated that funding monitoring was not effective which in turn bore the risk that the firm could hit its borrowing limit.

6.23 On 28 June 2004, Mr Whistance informed the Board of the Firm that he expected automated borrowings within weeks and that he hoped to explain borrowings as close to 100% as possible. However, this was not achieved and on 25 October 2004, he informed the Board that the resolution of the borrowings issue would not be possible until the replacement of SYSTEM B with SYSTEM C in October 2004. On 18 April 2005, Mr Whistance reported to the Board of the Firm that borrowings of £5.8 million remained unexplained. By the time of his suspension from office in May 2005, the Firm was still unable to fully account for all of its borrowings.

6.24 For the reasons set out in paragraphs 6.17 to 6.23, the FSA considers that Mr Whistance breached Principle 6 of APER in that he failed to exercise due skill, care and diligence in managing the business of the Firm for which he was responsible. In particular, he failed to take reasonable steps to adequately inform himself and the Board of the Firm as to the use and value of the Firm's borrowings and whether these materially impacted the Firm's financial position for the financial years ending 2002, 2003 and 2004. This undermined the Firm's ability to monitor its compliance with financial resource requirements under the Act.

6.25 For the reasons set out in paragraphs 6.17 to 6.22, the FSA considers that Mr Whistance breached Principle 7 of APER in that he failed to take reasonable steps to ensure that the business of the Firm for which he was responsible complied with the relevant requirements and standards of the regulatory system. In particular, he failed to take reasonable steps to ensure that the Firm established and maintained such systems and controls relating to the making and retention of readily accessible, adequate, up to date and accurate accounting records to fully determine and monitor the use of the Firm's borrowings on a day-to-day basis, and which enabled particular transactions to be identified at any time and traced through the accounting system of the Firm.

### *Adjustment to the balance sheet as at 30 September 2004*

- 6.26 As Finance Director, Mr Whistance was ultimately responsible for the timely preparation and submission of the Firm's financial statements for statutory and regulatory accounting purposes.
- 6.27 Due to the ongoing problems with the Firm's accounting systems, by 2004 the Parent Company was of the view that the Firm was unable to produce annual financial statements with an adequate audit trail within the time-frame stipulated for group reporting purposes. It was decided at group level to subject the Firm's financial statements as at 30 September 2004 to an audit for group reporting purposes, with the intention of using the resulting audit opinion for the group financial statements as at 31 December 2004.
- 6.28 Mr Whistance had overall responsibility for the provision of the above information to the external auditors, but despite repeated requests this was not fulfilled to the satisfaction of the Parent Company or the external auditors.
- 6.29 The Parent Company therefore decided to take a different approach to the preparation of the financial statements, and the resulting accounts prepared as at 30 September 2004 made full provision against any amounts that could not be supported by adequate documentation. These accounts were audited by the Firm's internal audit function and the balance sheet was the subject of a specific scope review by the external auditors dated 15 August 2005 ("the Review").
- 6.30 The provision made in the accounts subject to the Review amounted to £51.7 million comprising, amongst other things, a net provision against unverified trade debtors and creditors of £39.7 million and a provision against bank reconciling items outstanding over 30 days of £4.6 million. Subsequently the Firm confirmed to the FSA that an adjustment of £58 million was made to the Firm's accounts as at 30 September 2004. The difference of £6.4 million is attributable to a number of miscellaneous provisions.
- 6.31 The adjustment of £58 million to the Firm's balance sheet as at 30 September 2004 was offset by the write-off of an equivalent amount against an inter-company loan owed to the Parent Company by the Firm. This was achieved by means of a recapitalisation agreement. This agreement was reached following the concerns of the Firm and its former parent that as a consequence of the adjustment, the Firm was potentially insolvent and unable to maintain its FSA authorisation.
- 6.32 The Firm's financial accounts for the year ending 31 December 2004 were completed in August 2006 and the Firm's financial accounts for the year ending 31 December 2005 were completed in November 2006. These accounts reveal that the Firm made a provision for net reconciled receivable balances of £49,416,734 million in its accounts for the year ended 31 December 2004 and a provision for net reconciled receivable balances of £16,905,729 million in its accounts for the year ended 31 December 2005.
- 6.33 For the reasons set out in paragraphs 6.26 to 6.28, the FSA considers that Mr Whistance breached Principle 6 of APER in that he failed to exercise due, skill, care and diligence in managing the business of the Firm for which he was responsible. In particular, he failed to take reasonable steps to ensure that the Firm provided the external auditors

with sufficient accounting records for the purposes of auditing the Firm's financial statements for the period ending September 2004.

- 6.34 For the reasons set out in paragraphs 6.26 to 6.32, the FSA considers that Mr Whistance breached Principle 7 of APER in that he failed to take reasonable steps to ensure that the Firm established and maintained appropriate systems and controls to make and retain readily accessible, adequate, up to date and accurate records and which enabled particular transactions to be identified at any time and traced through the accounting system, for the purpose of verifying its trade debtors and creditors. As a result, the Firm made a provision of £49.4 million against net unreconciled debit balances in its accounts for the year ended 31 December 2004. In the audited accounts for the year to 31 December 2005, a further provision was made and combined provision totalled £66.3 million.

## **7. CONCLUSION**

- 7.1 Taking into account the seriousness of the breaches and the risk they posed to the FSA's statutory objectives, the FSA has decided to impose a financial penalty of £30,000 on Mr Whistance.

## **8. DECISION MAKERS**

- 8.1 The decision which gave rise to the obligation to give this notice was made by the Executive Settlement Decision Makers on behalf of the FSA.

## **9. IMPORTANT**

- 9.1 This Final Notice is given to Mr Whistance in accordance with section 390 of the Act.

### ***Manner and time for Payment***

- 9.2 The financial penalty must be paid in accordance with the terms agreed under the FSA's executive settlement procedure.

### ***If the financial penalty is not paid***

- 9.3 If all or any of the financial penalty is not paid in accordance with the terms agreed under the FSA's executive settlement procedure, the FSA may recover the outstanding amount as a debt owed by Mr Whistance and due to the FSA.

### ***Confidentiality and publicity***

- 9.4 Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under these provisions, the FSA must publish such information about the matter to which this notice relates as the FSA considers appropriate. The information may be published in such manner as the FSA considers appropriate. However, the FSA may not publish information if such publication would, in the opinion of the FSA, be unfair to you or prejudicial to the interest of consumers.



9.5 The FSA intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

**FSA contacts**

9.6 For more information concerning this matter generally, you should contact Liz Ludlow at the FSA (direct line: 020 7066 1474 /fax: 020 7066 9720).

**Georgina Philippou**  
**For and on behalf of the FSA**