Edited for publication

Financial Reporting Council

IN THE MATTER OF

THE EXECUTIVE COUNSEL OF THE FINANCIAL REPORTING COUNCIL

-and-

(1) FORVIS MAZARS LLP

(2) MR DAVID ALLEN

FINAL SETTLEMENT DECISION NOTICE

Pursuant to Rule 108 of the Audit Enforcement Procedure

This Final Settlement Decision Notice is a document prepared by Executive Counsel following an investigation relating to, and admissions made by, the Respondents. It does not make findings against any persons or entities other than the Respondents and it would not be fair to treat any part of this document as constituting or evidencing findings against any other persons or entities since they are not parties to the proceedings.

1. INTRODUCTION

1.1. The Financial Reporting Council (the "**FRC**") is the competent authority for statutory audit in the UK and operates the Audit Enforcement Procedure (the "**AEP**"), revised in June 2023. The AEP sets out the rules and procedure for the investigation, prosecution and sanctioning of breaches of *Relevant Requirements,* as set out in Regulation 5(11) of the Statutory Auditors and Third Country Auditors Regulations 2016 ("**SATCAR**").

1.2. The AEP contains a number of defined terms and, for convenience, those defined terms are also used within this document. Where defined terms are used, they appear in italics.

1.3. This *Final Settlement Decision Notice* also uses the following definitions:

1.3.1. "**FY21**" means the financial year ended 26 March 2021, "**FY21 SRG Consolidated Financial Statements**" means Studio Retail Group plc's ("**SRG**" or the "**Group**") consolidated financial statements for that period, and "**FY21 Audit**" means the statutory audit of the FY21 SRG Consolidated Financial Statements.

1.3.2. "**SRL**" means Studio Retail Limited, which was SRG's main trading company.

1.3.3. **"FY21 Annual Report"** means the annual report for SRG for the financial year ended 26 March 2021

1.3.4. "**Respondents**" means:

1.3.4.1. Forvis Mazars LLP ("**Mazars**" or the "**Firm**") which was the *Statutory Audit Firm* for the FY21 Audit.

1.3.4.2. Mr David Allen ("**Mr Allen**" or the "**Engagement Partner**"), who was the *Statutory Auditor* of SRG for the FY21 Audit and signed off the FY21 Independent Auditor's Report ("**FY21 Audit Report**") on behalf of Mazars.

1.4. In accordance with Rule 102 of the AEP, Executive Counsel entered into settlement discussions with the Respondents.

1.5. A *Proposed Settlement Decision Notice* was issued by Executive Counsel on 17 March 2026 pursuant to Rule 103 of the AEP in relation to the conduct of the Respondents in respect of the FY21 Audit. The Respondents provided written agreement to the *Proposed Settlement Decision Notice*, pursuant to Rule 105 of the AEP, on 17 March 2026. The *Convener* subsequently appointed an *Independent Reviewer*, pursuant to Rule 106 of the AEP, to consider the *Proposed Settlement Decision Notice.*

1.6. On 30 March 2026, the *Independent Reviewer* approved the issuance of this *Final Settlement Decision Notice* pursuant to Rule 107(a) of the AEP.

1.7. This *Final Settlement Decision Notice* sets out:

1.7.1. the breaches of *Relevant Requirement(s)*, with reasons;

1.7.2. the *Sanctions* imposed on the Respondents with reasons;

1.7.3. the amount payable by the Respondents in respect of Executive Counsel's *Costs*; and

1.8. This *Final Settlement Decision Notice* is divided into the following sections:

1.8.1. Section 2: Executive Summary of the breaches of *Relevant Requirements*;

1.8.2. Section 3: Background;

1.8.3. Section 4: *Relevant Requirements* to which the breaches relate;

1.8.4. Section 5: Detail of the breaches of *Relevant Requirements*;

1.8.5. Section 6: *Sanctions*;

1.8.6. Section 7: *Costs*.

2. EXECUTIVE SUMMARY OF THE BREACHES OF *RELEVANT REQUIREMENTS*

2.1. SRG was a digital catalogue retailer which offered a broad range of products with flexible repayment options. SRG was listed on the Main Market of the London Stock Exchange at the time of the FY21 Audit.

2.2. The main trading company of SRG was SRL. SRG also had another subsidiary, [redacted] ("the **Subsidiary**"), which was sold in April 2021 and which was classified as a discontinued operation in SRG's FY21 Annual Report.

2.3. The FY21 SRG Consolidated Financial Statements were prepared on a going concern basis and were signed on 29 June 2021.

2.4. The FY21 Audit Report stated that the Respondents had concluded that the directors' use of the going concern basis of accounting in preparing the financial statements was appropriate; the financial statements had been prepared in accordance with the requirements of the Companies Act 2006 and gave a true and fair view of the state of the Group's affairs and profit; and they had been prepared in accordance with international and UK accounting standards. The FY21 Audit Report was signed by Mr Allen on behalf of Mazars.

2.5. As is set out in this *Final Settlement Decision Notice*, there were numerous and pervasive failures by the Respondents in the manner in which the FY21 Audit was conducted giving rise to breaches of *Relevant Requirements*.

2.6. Section 5 of this *Final Settlement Decision Notice* sets out the detailed breaches of Relevant Requirements. In summary, there were breaches of *Relevant Requirements* in three areas of the audit work:

2.6.1. Expected credit losses ("**ECL**") - There were numerous, serious and pervasive failings across work on SRG's highly material ECL provision, including in respect of the audit work on SRG's ECL model and on the additional overlay provision that was intended to take account of the impact of Covid-19 related conditions. The provision for ECL is a complex accounting estimate, which requires a number of critical judgements to be applied in relation to numerous inputs to the overall calculation of ECL, and SRG's ECL provision was a significant risk and key audit matter in the FY21 Audit.

2.6.2. Going concern - There were serious failings by the Respondents in matters relevant to going concern, specifically in their work on the sensitivities in management's going concern model and the cashflow forecasts. The going concern assumption, which was a significant risk and a key audit matter in the FY21 Audit, is fundamental to the preparation of financial statements and a key consideration for any *Statutory Auditor* to address. It is an important piece of information relied upon by users of financial statements, as it underpins investments and other key decisions. It is therefore essential that the assumption is based on accurate information and takes into account all relevant circumstances that could affect the entity's viability.

2.6.3. Financial services income ("**FSI**") - SRG earned financial services revenue through the provision of credit to customers upon their purchase of products. There were failings in the audit work in this area, namely in the substantive analytical procedures that were carried out by the Respondents and in their consideration of the difference between expected and actual financial services revenue in FY21.

2.7. This *Final Settlement Decision Notice* sets out the following *Sanctions* imposed on the Respondents:

<u>Mazars</u>

2.7.1. a financial sanction of £950,000, discounted by 10% to reflect exceptional cooperation as a mitigating factor, and further discounted for admissions and early disposal by 32.5%, so that the final sanction payable is £577,125;

2.7.2. a published statement in the form of a severe reprimand;

2.7.3. a declaration that the FY21 Audit Report signed on behalf of Mazars did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*; and

2.7.4. an order to take action to reduce the likelihood of recurrence of the breaches, as outlined in section 6 of this *Final Settlement Decision Notice.*

Mr Allen

2.7.5. a financial sanction of £55,000; discounted by 10% to reflect exceptional cooperation as a mitigating factor, and further discounted for admissions and early disposal by 32.5%, so that the final sanction payable is £33,412;

2.7.6. a declaration that the FY21 Audit Report signed by Mr Allen did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*;

2.7.7. a published statement in the form of a severe reprimand; and

2.7.8. an order to undertake training on going concern and ECL relevant to the breaches of *Relevant Requirements*.

3. BACKGROUND

3.1. Mazars was appointed as the auditor to SRG for FY21 on 8 October 2020. The FY21 Audit was the first audit of SRG carried out by the Respondents.

3.2. Mr Allen is a partner of Mazars, with over 20 years of auditing experience. Mr Allen was the Engagement Partner for the FY21 Audit and signed the Audit Report.

3.3. Mr Allen was supported in his role by, among others:

3.3.1. another partner on the FY21 Audit, who was also the Engagement Lead for the Subsidiary and who was responsible for the audit of SRG's retail business (the "**Second Partner**"); and

3.3.2. the Engagement Quality Control Reviewer for the FY21 Audit (the "**EQCR**"), who was required to independently and objectively evaluate the significant judgements made by the Respondents and the conclusions reached in formulating the FY21 Audit Report.

3.4. The Respondents' statutory responsibility was to form an opinion as to whether the FY21 SRG Consolidated Financial Statements showed a true and fair view and had been properly prepared in accordance with the International Financial Reporting Standards ("**IFRS**") and the Companies Act 2006.

3.5. An audit involves obtaining sufficient appropriate audit evidence in respect of the amounts and disclosures in the financial statements in order to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

3.6. Audit evidence is defined in ISA 500 as "*information used by the auditor in arriving at the conclusions on which the auditor's opinion is based*". Audit evidence is primarily obtained from audit procedures performed during the audit.

3.7. For the FY21 Audit, the threshold for financial statement materiality at the Group level was £1.7 million. The equivalent threshold for performance materiality was £1.0 million.

<u>Events after the FY21 Audit</u>

3.8. On 24 February 2022, SRG entered administration. On the same day, SRL and other assets of SRG were sold by the administrators in a pre-packaged sale. SRG's creditors suffered a significant loss in the administration, including the lending banks under SRG's revolving credit facility and unsecured creditors. The administrators considered that there was no prospect of any return to SRG's shareholders and, accordingly, the shareholders lost the entirety of their investment.

3.9. Notwithstanding that the Respondents' audit work regarding the assessment of going concern breached *Relevant Requirements* (as set out further below), Executive Counsel does not suggest that such breaches caused the insolvent administration of SRG.

4. RELEVANT REQUIREMENTS

4.1. Rule 1 of the AEP states that *Relevant Requirements* has the meaning set out in regulation 5(11) of SATCAR. The *Relevant Requirements* include, but are not limited to, the International Standards on Auditing (UK versions) ("**ISAs**"), issued by the FRC and which are based on the standards issued by the International Auditing and Assurance Standards Board.

4.2. The *Relevant Requirements* referred to in this *Final Settlement Decision Notice* are the relevant versions (as specified in Appendix 1) of the following ISAs that were in force at the relevant time:

4.2.1. ISA 200: Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK);

4.2.2. ISA 220: Quality Management for an Audit of Financial Statements;

4.2.3. ISA 230: Audit Documentation;

4.2.4. ISA 330: The Auditor's Responses to Assessed Risks;

4.2.5. ISA 500: Audit Evidence;

4.2.6. ISA 520: Analytical Procedures;

4.2.7. ISA 540: Auditing Accounting Estimates and Related Disclosures;

4.2.8. ISA 570: Going Concern;

4.2.9. ISA 620: Using the Work of an Auditor's Expert; and

4.2.10. ISA 701: Communicating Key Audit Matters in the Independent Auditor's Report.

4.3. Extracts from the ISAs and from the relevant accounting standards setting out those parts which are of particular relevance to the breaches of *Relevant Requirements* are set out in Appendix 1 hereto.

4.4. Two key concepts in the ISAs relevant to this *Final Settlement Decision Notice* are defined as follows:

4.4.1. ISA 315 defines a "*significant risk*" as "*[a]n identified risk of material misstatement: (i) For which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur; or (ii) That is to be treated as a significant risk in accordance with the requirements of other ISAs (UK)*"[1].

4.4.2. ISA 701 defines "*key audit matters*" as "*those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance*"[2].

4.5. As the Senior *Statutory Auditor* responsible for the FY21 Audit, Mr Allen was responsible for the overall quality of the FY21 Audit and the direction, supervision, and performance of the FY21 Audit in compliance with the professional standards and applicable legal and regulatory requirements.

4.6. As the *Statutory Audit Firm* responsible for the Audit, Mazars is responsible for any established breaches of *Relevant Requirements* on the part of its partners or employees.

[1] ISA 315 (Revised July 2020), paragraph 12(l).
[2] ISA 701 (Revised November 2019) (Updated January 2020), paragraph 8.

5. BREACHES OF RELEVANT REQUIREMENTS

A. ECL

Background

5.1. SRG was required to prepare its financial statements in accordance with the IFRS 9 accounting standard (see also Appendix 1 below). Under IFRS 9, entities are required to assess potential losses or impairments across all financial instruments and recognise a provision in their financial statements to reflect the associated risk of expected credit loss, referred to as ECL. Disclosure of ECL provisions is important as it provides users of financial statements with transparency on the amount of future credit losses that the entity is at risk of incurring, which could impact its cash flow and financial stability.

5.2. The provision for ECL is a complex accounting estimate, which requires a number of critical judgements to be applied in relation to numerous inputs to the overall calculation. The valuation and recoverability of assets (that included the ECL provision) was identified by the Respondents as a significant risk and a key audit matter.

5.3. An ECL provision is the weighted average of expected credit losses. As to this:

5.3.1. credit loss is the difference between all contractual cash flows that are due to an entity in accordance with the contract, and all the cash flows that the entity expects to receive, both discounted at the original effective interest rate; and

5.3.2. a probability weighting (relating to the probability of credit loss arising) is then applied to each expected credit loss or category of losses.

5.4. When applying IFRS 9 SRG was required to calculate:

5.4.1. lifetime ECLs for receivables for which there had been significant increases in credit risk since initial recognition; and

5.4.2. 12-month ECLs for remaining receivables.

5.5. In determining whether the level of credit risk (i.e. the likelihood of customer default at the accounting year-end) had increased significantly since initial recognition, SRG needed to undertake a comparison of customers' risk of default at the reporting date against the risk of default as was assessed at the time of incurring the initial debt.

<u>SRG's ECL Model</u>

5.6. As the Group had determined there was a significant financing component to SRG's trade receivables, and that they were not individually significant, SRG assessed receivables for impairment by allocating them to one of three stages:

5.6.1. Stage 1: No evidence of significant increase in credit risk since initial recognition;

5.6.2. Stage 2: Evidence of significant increase of risk since initial recognition and no objective evidence of impairment; and

5.6.3. Stage 3: Objective evidence of impairment.

5.7. This staging allocation and estimation of ECL for each stage was performed using a model (the "**ECL Model**") and was said to be based on both quantitative and qualitative information and analysis, including both the Group's historical experience and informed credit assessment, taking into account forward-looking information. In addition, there was a backstop position whereby accounts which were more than 30 and 90 days past due were (respectively) allocated to Stages 2 and 3.

5.8. SRG's IFRS 9 workpaper explained that the ECL Model produced monthly estimates of ECL based on monthly estimates of Probability of Default ("**PD**"), Exposure at Default ("**EAD**") and Loss Given Default (**"LGD**"). The ECL Model then multiplied the PD percentage by the EAD percentage and the LGD percentage and discounted them by the effective interest rate, to arrive at the ECL.

5.9. The FY21 Consolidated Financial Statements explained that SRG's "*impairment model*" (i.e. the ECL Model) was "*not designed to take into account changes to customer payment and default performance arising as a result of the Covid-19 pandemic, and that Covid-19 has inherently impacted the economic inputs of the model*". It then explained that "*[j]udgement has therefore been applied in determining the year-end provision, which has increased it by approximately £13m from the central level derived from the normal forecasting model*". This was a reference to an additional "overlay" provision of £13.1 million added by SRG in FY21, which was intended to take account of the impact of Covid-19 related conditions on the output of the ECL Model (the "**Overlay**").

<u>Statements in the FY21 Audit Report</u>

5.10. For the FY21 Audit, the Respondents identified "*impairment of trade receivables*" (or ECL) as a key audit matter, and also as one of seven significant risks.

5.11. The FY21 Audit Report stated that:

5.11.1. credit risk was "*an inherently judgmental area due to the use of subjective assumptions and a high degree of estimation uncertainty*" in relation to the ability of customers to make future loan repayments;

5.11.2. the calculation of ECL was "*sensitive to assumptions made in the process, particularly the probability of default and changes in credit risk, the timing and amount of cash recoveries and forward-looking information*"; and

5.11.3. the recoverability of trade receivables had "*a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole*" (of £1.7 million) and the on-going Covid-19 pandemic increased the risk associated with the impairment allowance given the impact it *"has had on customer performance, the associated probability of default, payment holidays and the future economic modelling as a result of changing economic conditions caused by the impact of the pandemic*".

5.12. The FY21 Audit Report specifically identified the following areas where the Respondents had identified "*greater levels of management judgement*" in the ECL calculation:

5.12.1. the timeliness of identifying Significant Increases in Credit Risk ("**SICR**") and the impact of this on the "staging" assigned to customer receivables (as described above) and the overall ECL calculation;

5.12.2. key assumptions used to derive the different elements of the ECL provision, especially the EAD and the recoverability of assets, with particular focus on debt sales; and

5.12.3. usage and selection criteria on the key economic drivers used to reflect the range of future economic scenarios.

5.13. The FY21 Audit Report described the audit procedures carried out in relation to the impairment of trade receivables as:

5.13.1. assessing the design and implementation, and testing the operating effectiveness, of the key controls in relation to the impairment and provision model and process (including monitoring of the provisioning model, review controls over key assumptions and data inputs);

5.13.2. assessing SRG's overall methodology against the requirements of IFRS 9, including the method of identifying SICR, including considering Covid-19 payment holidays and deferrals;

5.13.3. performing a combination of control and direct testing over the relevant data elements within the provisioning model to gain comfort over the completeness and accuracy of the source data, which included testing attributes back to source documentation to give comfort over the key inputs including the PD and EAD;

5.13.4. challenging management's forecasting and weighting of key model drivers (macro-economic variables) and expected future debt sale prices (ultimate recoveries) by engaging with Mazars' credit risk specialists and economist; and

5.13.5. using Mazars' credit risk specialists to perform testing of the PD methodology and calculation used by SRG to select the key model drivers for their scenario modelling.

5.14. The FY21 Audit Report concluded in relation to impairment of trade receivables that:

"*Based on the work performed, we found the methodologies and modelled assumptions used to value the trade receivables ECL to be reasonable and in line with the requirements of IFRS 9.*

Control deficiencies in relation to the ECL assumptions were communicated through our audit completion report to the audit committee."

Breach 1 – Failures in respect of the Quants team's year-end report

5.15. For the FY21 Audit, Mazars' Quantitative Solutions ("**Quants**") team performed an assessment of the ECL Model. The Quants team produced two reports of their findings: a half-year report and a year-end report.

The Quants team's year-end report and the financial statements

5.16. There were material discrepancies between the Quants team's year-end report and the FY21 SRG Consolidated Financial Statements, as set out below.

5.17. First, the Quants team's year-end report stated that the total ECL provision was £98.4 million, consisting of: (a) a "*Total Pre-Overlay*" of £90.2 million; and (b) an "*Abnormal Overlay*" of £8.2 million.

5.18. In contrast, the FY21 SRG Consolidated Financial Statements reported an ECL provision of £106.8 million for FY21. This was also the figure reported to SRG's Audit Committee. SRG's management explained that this consisted of: (a) a "*pure model output*" of £93.6 million from the ECL Model; and (b) a "*post model adjustment*" of £13.1 million (i.e. the Overlay).

5.19. The Quants team did not explain why the ECL provision in their year-end report was different from that reported in the FY21 SRG Consolidated Financial Statements (and to SRG's Audit Committee) and did not reconcile these two figures. Nor did the Quants team explain why they used different methodology to calculate the Overlay (or the Abnormal Overlay), as compared to management's methodology. This was despite: (a) the size of the discrepancy (of £8.4 million) between the Quants team's ECL provision and the reported ECL provision, which was significantly in excess of the £1.7 million threshold for financial statement materiality; (b) the highly material nature of the ECL provision; (c) the fact that the ECL provision was dependent upon significant management judgements; and (d) the considerable reliance that the Respondents placed upon the work performed by the Quants team for the audit of the ECL provision.

5.20. This remained the case even after Mr Allen raised a review note as to the lack of reconciliation between these two figures, and after this review note was cleared by a member of the audit team on 28 June 2021 (see paragraph 5.69 below).

5.21. Second, in relation to the stage allocation of gross trade receivables:

5.21.1. The Quants team's year-end report recorded Stage 1 receivables of £268.2 million. The equivalent figure in the FY21 SRG Consolidated Financial Statements was £265.8 million. This was a difference of £2.4 million.

5.21.2. The Quants team's year-end report recorded Stage 3 receivables of £42.3 million. The equivalent figure in the FY21 SRG Consolidated Financial Statements was £45.3 million. This was a difference of £3.0 million.

5.22. These discrepancies exceeded the threshold for financial statement materiality. Notwithstanding this, these differences were not identified, explained and reconciled in the workpapers.

The Quants team's year-end report and the audit team's workpapers

5.23. The Quants team's year-end report contained a section on LGD, which was described as "*the loss after considering internal recoveries data and when applicable **debt sale***" (emphasis added). The Quants team stated that the debt sale price (i.e. external debt sale recoveries) was 18.1% for both accounts in default and accounts in forbearance (i.e. accounts in which a customer's payments had been temporarily paused, usually to accommodate financial hardship). This was also the debt sale price used in the ECL Model.

5.24. By contrast, in the testing of historical debt sales carried out by the audit team, the percentage recoveries ranged from 24.53% to 24.84%. The Respondents did not identify, explain and reconcile the discrepancy between the historical debt sale price tested by the audit team and the debt sale price set out in the Quants team's year-end report, and as used in the ECL Model. The Respondents also did not assess the reasonableness of the historical debt sale price percentages.

5.25. This was despite: (a) the fact that debt sales were a material component of the ECL Model; (b) the significant effect of these differences on the calculation of estimated recoveries; and (c) the importance of the Quants team's work to the Respondents' assessment of the ECL provision.

Conclusion

5.26. The Respondents failed to identify, explain and/or reconcile the differences between: (a) the ECL recorded in the Quants team's year-end report and in the FY21 SRG Consolidated Financial Statements (and as reported to SRG's Audit Committee); and (b) the debt sale price recorded in the Quants team's year-end report and the historical debt sale price tested by the audit team. The Respondents thereby failed to properly conclude whether sufficient appropriate audit evidence had been obtained following consideration of all relevant audit evidence and were in breach of paragraph 26 of ISA 330.

Breach 2 – Failures in respect of the Macro-Economic Factors Reports

5.27. The FY21 SRG Consolidated Financial Statements stated that:

5.27.1. SRG's management had considered four economic scenarios (upside, baseline, downside and stress) and applied a probability weighting to each of those scenarios (of 5%, 50%, 35% and 10% respectively); and

5.27.2. changes in the "*weighting of the macro-economic scenarios applied to the impairment model could have a significant impact on the carrying value of trade receivables*".

5.28. The FY21 Audit Report stated that the principal audit procedures in relation to the impairment of trade receivables included engaging with Mazars' "*economist*" in relation to the weighting of key model drivers (i.e. macro-economic variables) and expected future debt sale prices. This was a reference to a senior Economist within Mazars (the "**Economist**"), who was classified by the Respondents as an auditor's expert.

5.29. The Respondents did instruct the Economist to provide weightings for each of the four economic scenarios that had been considered by SRG's management. However, and contrary to the statement made in the FY21 Audit Report, the Respondents did not specifically instruct the Economist to consider expected future debt sale prices.

5.30. The SRG and SRL audit files for the FY21 Audit each contained working papers titled the “**Macro-Economic Factors Reports**”, each of which:

5.30.1. recorded that it had been prepared by the Economist on 21 May 2021; and

5.30.2. set out probability weightings for each of the four economic scenarios.

5.31. In addition, the Macro-Economic Factors Reports set out the unemployment rate and average wages for each of the four economic scenarios in each year from 2021 to 2024. The Economist had previously been provided with these figures by email and had described them in an email as being “*very close to my own* [estimates]”.

5.32. However:

5.32.1. contrary to the instructions given to him, the Economist had not in fact provided his opinion (or any commentary) on the probability weightings that were applied in the four economic scenarios used by management in their modelling of impairment losses; and

5.32.2. even though the Macro-Economic Factors Reports were recorded on their face as having been prepared by the Economist, the Economist did not in fact prepare any part of either of the Macro-Economic Factors Reports.

5.33. Instead:

5.33.1. A member of the audit team prepared the Macro-Economic Factors Report in the SRG audit file, and (to the extent that the two working papers were identical) the Macro-Economic Factors Report in the SRL audit file.

5.33.2. The Macro-Economic Factors Report in the SRL audit file included additional commentary (which was not included in the working paper in the SRG audit file) as to the probability weightings and the unemployment rate. Mr Allen considers it likely that he wrote this additional commentary.

5.34. The probability weightings contained in the Macro-Economic Factors Report in the SRL audit file were the same as the weightings set out in the FY21 SRG Consolidated Financial Statements and the Quants team’s year-end report (and as used by SRG in the ECL Model), but were different from those contained in the Macro-Economic Factors Report in the SRG audit file. There was no explanation in the audit file for the different, erroneous probability weightings used in the latter working paper.

5.35. There is no independent evidence on the audit file to support the probability weightings (or commentary on the same) included in the Macro-Economic Factors Reports, and therefore the probability weightings used by SRG’s management in the ECL Model.

5.36. These deficiencies in relation to the Macro-Economic Factors Reports were not identified or remedied despite the fact that a senior member of Mazars' Audit Quality Team had raised specific queries as to the Macro-Economic Factors Reports, including by asking where the work purportedly performed by the Economist had been documented. The Respondents did not adequately address the queries raised by the Audit Quality Team (see paragraph 5.70.2 below).

5.37. The Respondents were therefore in breach of the following *Relevant Requirements*:

5.37.1. Paragraph 13 of ISA 701, by failing accurately to describe in the FY21 Audit Report the audit procedures that had been completed in relation to the impairment of trade receivables, in that the Economist did not in fact provide his opinion on the probability weightings or expected future debt sale prices.

5.37.2. Paragraphs 22(a) and 24 of ISA 540, as a result of failing to obtain the Economist's opinion on the probability weightings applied in the four economic scenarios. Specifically, they failed:

5.37.2.1. to obtain sufficient appropriate audit evidence regarding the risk of material misstatement relating to the selection and application of the methods, significant assumptions and data used by management in estimating the ECL provision; and/or

5.37.2.2. to address whether management's significant assumptions were appropriate, gave rise to indicators of possible management bias and/or were consistent with each other.

5.37.3. Paragraph 26 of ISA 330, by failing, in relation to the assessment of and commentary on the appropriateness of the probability weightings applied by SRG in the ECL Model, to properly conclude whether sufficient appropriate audit evidence had been obtained following consideration of all relevant audit evidence. Specifically, the Respondents failed:

5.37.3.1. to ensure that: (a) the Economist had provided all of the information that he had been instructed to provide; (b) the contents of the Macro-Economic Factors Reports accurately reflected the information that he had provided; and/or (c) he had confirmed that he agreed with the contents of the Macro-Economic Factors Reports, which were presented as having been prepared by him; or

5.37.3.2. otherwise, to ensure that there was sufficient appropriate audit evidence to support: (i) the conclusion in the Macro-Economic

Factors Reports that the probability weightings applied by SRG in the ECL Model to the four economic scenarios were appropriate; and (ii) the commentary on the probability weightings set out therein.

5.37.4. Paragraph 12 of ISA 620, by failing to review and evaluate the adequacy of the Economist's work as an auditor's expert.

5.37.5. Paragraphs 8 and 9(b) of ISA 230, by failing to record accurately and/or with sufficient clarity or detail:

5.37.5.1. who performed the work recorded in the Macro-Economic Factors Reports and/or who prepared the Macro-Economic Factors Reports;

5.37.5.2. the nature, extent and scope of the work carried out by the Economist, and by the audit team or Mr Allen respectively, in relation to the matters described in the Macro-Economic Factors Reports; and/or

5.37.5.3. the sources used and the evidence obtained in support of the conclusions and/or commentary set out in the Macro-Economic Factors Reports, including (in particular) by ensuring that the Macro-Economic Factors Reports recorded:

(a) the Economist's conclusion as to the appropriateness of the probability weightings applied by SRG in the ECL Model to the four economic scenarios and the work that had been done and the evidence that had been obtained to support that conclusion; and

(b) the work that had been done and the evidence that had been obtained to support the additional commentary in the Macro-Economic Factors Reports in the SRL audit file (as compared with the report in the SRG audit file).

Breach 3 – Failure to compare current year write-offs with 12-month ECL

5.38. The Respondents' workpapers recorded a planned audit procedure to: compare the current year's annual write-offs for each material portfolio of receivables with the 12-month ECL recognised for that portfolio; and evaluate the variations. When referring to this planned procedure, a reference to workpaper "*WP 17.02*" was cited in the audit file.

5.39. However, no working paper with the reference "WP 17.02" was contained within the audit file, and the Respondents did not in fact compare the current year write-offs for each material portfolio of receivables with the 12-month ECL recognised for that portfolio.

5.40. This was despite the fact that this audit procedure was especially important for the purposes of the FY21 Audit, given that:

5.40.1. the annual write-offs in FY21 (of £45.7 million) were highly material;

5.40.2. the annual write-offs in FY21 were smaller than in the financial year ending in March 2020 ("**FY20**"), as a proportion of sales revenues (9.9% in FY21 and 16.3% in FY20) and gross receivables (11.9% in FY21 and 16.5% in FY20);

5.40.3. the calculation of ECL was sensitive to judgements and assumptions; and

5.40.4. management had mistakenly concluded that the bad debt charge (i.e. the annual write-offs) in FY21 was £8.1 million greater than in FY20. In fact, the FY21 bad debt charge was £8.2 million less than in FY20 (being the difference between the bad debt charge in FY21 and FY20 of, respectively, £45.7 million and £53.9 million).

5.41. The Respondents were therefore in breach of paragraph 14 of ISA 540, by failing to review the outcome of previous accounting estimates made in FY21 (i.e. the 12-month ECLs) against the actual financial performance of the Group to assist in identifying and assessing the risks of material misstatement in the current period.

Breach 4 – Failure to perform a sensitivity analysis on and benchmarking of LGD assumptions in the ECL Model

5.42. The Respondents' workpapers set out various audit procedures in relation to testing management's assumptions in the ECL Model, including: (a) performing sensitivity analysis to understand the effect of movements in LGD and other assumptions relevant to ECL; and (b) benchmarking of LGD assumptions against alternative sources. This benchmarking exercise was also included in the Respondents' audit strategy memorandum as part of the planned response to the risk of impairment allowance on trade receivables in SRL.

5.43. However, the Respondents did not in fact carry out either of these audit procedures. This was even though: (a) these audit procedures would have provided important additional audit evidence as to the appropriateness of management's judgements; and (b) Note 15 to the FY21 SRG Consolidated Financial Statements explained that the sensitivities included therein reflected "*management's assessment of reasonably* *possible changes to key assumptions which could result in a material adjustment to the level of provision within the next financial year*". The Respondents did not record any explanation for their failure to carry out these audit procedures on the audit file.

5.44. The Respondents were therefore in breach of the following *Relevant Requirements*:

5.44.1. Paragraph 24(a) of ISA 540, as explained by paragraph A103 of ISA 540, by failing to perform any sensitivity analysis to understand the effect of movements in LGD and other assumptions relevant to the calculation of the ECL.

5.44.2. Paragraph 26 of ISA 330, by failing to properly conclude whether sufficient appropriate audit evidence had been obtained, where it was apparent that there had been no benchmarking of LGD assumptions against alternative external data sources.

Breach 5 – Failure to perform adequate data input testing

5.45. The Respondents' workpapers recorded various planned audit procedures in relation to the testing of data inputs in the ECL Model, so as to ensure that these data inputs were complete and accurate. The Respondents expressed the conclusion that "*the variable inputs and exposure inputs into the client's ECL Model are reasonable and justified*".

5.46. However, the Respondents did not adequately test the data inputs in the ECL Model. In particular:

5.46.1. The ECL Model assumed that a SICR had occurred if an account met the relevant quantitative, qualitative or backstop criteria. These were freestanding and alternative criteria, such that (e.g.) an account could meet the quantitative criteria for a SICR (in terms of the relative increase in PD since origination) even though the account did not breach the backstop criteria. However, the Respondents' testing of the SICR assumption did not provide audit evidence as to the appropriateness of the application of the quantitative SICR criteria in the ECL Model.

5.46.2. The Respondents did not test the EAD assumption.

5.46.3. The Respondents did not adequately test and/or evaluate the appropriateness of the "*LGD*", "*Discount rate*" and "*Base PD*" assumptions (each as described in the workpapers).

5.46.4. The Respondents did not identify, explain and/or follow up on differences between (on the one hand) the inputs obtained or tested by the Respondents, and (on the other hand) the inputs in the ECL Model, namely differences between each of: (a) the "*Experian rating*" obtained by the Respondents and the "*Score*" (i.e. credit score) in the ECL Model; and (b) the historical debt sale price tested by the Respondents and the debt sale price used in the ECL Model (see also paragraphs 5.23 to 5.25 above).

5.47. The Respondents were therefore in breach of the following *Relevant Requirements*:

5.47.1. Paragraph 22(a) of ISA 540, by failing to obtain sufficient appropriate audit evidence regarding the risk of material misstatement relating to the selection and application of significant assumptions in the ECL Model and the data used by management in the ECL Model.

5.47.2. Paragraph 25(c) of ISA 540, by failing to obtain sufficient appropriate audit evidence in relation to the ECL provision as reported in the FY21 SRG Consolidated Financial Statements (and, in particular, the data inputs in the ECL Model) in order to reduce the audit risk to an acceptably low level.

Breach 6 – Failure to perform adequate audit procedures in relation to the Overlay

5.48. As explained above, SRG added the Overlay (of £13.1 million) to the output of the ECL Model (of £93.6 million) to arrive at its ECL provision (of £106.8 million). The Overlay was intended to take account of the impact of Covid-19 related conditions.

5.49. However, the Respondents did not properly assess and challenge management's methodology for calculating the Overlay. Such a challenge was especially important, in light of: (a) the size of the Overlay; and (b) the impact of assumptions and judgements made by management in calculating the Overlay.

5.50. The Respondents' workpapers did set out various audit procedures in relation to the Overlay, which was described as an area of "*key audit focus*". However, the Respondents' response to each of these planned audit procedures was to refer to an "*overlay summary work paper*", when no such workpaper was in fact produced.

5.51. The EQCR's review of the draft FY21 Audit Report also proceeded on the basis that the Respondents had carried out a "*standback review*" of the Overlay. However, the Respondents performed no such standback review or other assessment of their audit procedures in relation to the Overlay.

5.52. The audit file for the FY21 Audit did not contain sufficient appropriate audit evidence that the Overlay was not materially misstated. The Respondents also did not seek to narrow the range of reasonable management judgements on the Overlay, even though this had been identified as an "*action point*" for the Respondents.

5.53. The Respondents were therefore in breach of paragraph 23(d)(ii) of ISA 540 by failing to carry out adequate audit procedures in order to obtain sufficient audit evidence as to the appropriateness of a key adjustment made to the ECL provision (i.e. the Overlay), including by reason of their failure to:

5.53.1. record the composition of the Overlay; and

5.53.2. assess management's assumptions and judgements in calculating the Overlay.

5.54. By reason of the same facts and matters, the Respondents were also in breach of paragraph 16 of ISA 200 by failing to use professional judgement in performing the audit in relation to the Overlay.

<u>Breach 7 – Failure to carry out a proper overall evaluation of the audit work on ECL</u>

5.55. The audit workpapers stated that when designing audit procedures to "*address assertion risks pertaining to financial assets and financial liabilities*", the Respondents should perform a "*standback assessment*" to consider the adequacy and appropriateness of the planned procedures. This step was recorded as having been completed by the audit team.

5.56. However, the Respondents did not perform a "*standback assessment*" of the audit procedures, including by preparing an overall summary of the work done on ECL by each of the audit team and the Quants team. This would have assisted the Respondents in ensuring that no relevant matters were overlooked or omitted, and that the testing, work and conclusions of the Respondents (including that of the audit team and the Quants team) were complete and sufficient for the purposes of the FY21 Audit.

5.57. The Respondents were in breach of paragraph 26 of ISA 330 by failing to carry out a proper overall evaluation of the audit work that had been performed in relation to ECL, and thereby failed to evaluate whether sufficient appropriate audit evidence had been obtained for the ECL provision and (as a result) to properly address the risk of material misstatement in respect of ECL in the FY21 SRG Consolidated Financial Statements.

<u>Breach 8 – Failure to document why certain tests and procedures set out in Mazars' IFRS 9 Work Programme were not carried out</u>

5.58. The SRG audit file for the FY21 Audit included a non-client specific internal template paper which set out Mazars' approach to, and audit procedures in relation to, the audit of ECL models.

5.59. The audit team recorded in this template paper various planned audit procedures in relation to the audit of the ECL Model for the FY21 Audit ("**Mazars' IFRS 9 Work**

Programme"). However, the Respondents did not carry out certain of these tests and procedures, even though: (a) they were planned and recorded as having been performed; and (b) certain of these audit procedures were important for the purposes of the FY21 Audit (including in relation to Breaches 3, 4, 5 and 6 above, and Breach 9 below). There is no evidence or documentation in the workpapers explaining why certain work had not been completed and/or was not considered to be required.

5.60. By way of example, in Mazars' IFRS 9 Work Programme:

5.60.1. As to assumptions in the ECL approach and the use of judgement, the Respondents recorded a procedure to *"[c]hallenge key judgements*" and referred, in this context, to "*our summary memo filed on 17.02*". In fact, the Respondents did not produce any summary memo or otherwise carry out this audit procedure. No explanation for this omission was recorded in the audit file.

5.60.2. As to data inputs and validation, the Respondents stated that they "*tested underlying data by performing a combination of procedures around controls (both IT and Manual) and some substantive testing (such as days past due calculation, validation of data against source contracts, etc.)*". The issues surrounding controls testing are further addressed in relation to Breach 9 below. The substantive testing carried out by the Respondents in relation to data input testing is further addressed in relation to Breach 5 above.

5.60.3. As to PD, the Respondents stated that they would perform procedures designed to: (a) assess the appropriateness of assumptions; (b) consider benchmarking to alternative sources; and (c) consider stress testing of assumptions. However, the Respondents did not carry out these procedures and the audit file did not record an explanation for the failure to do so.

5.60.4. As to LGD, the Respondents referred to "*sensitivity in 17.02 ('LGD Sensitivity – All results')*" in relation to the performance of sensitivity analysis on LGDs when assessing the appropriateness of values applied by management. However, no such workpaper was produced (see Breach 4 above).

5.60.5. As to management overlays, the Respondents referred to an "*overlay summary work paper*" in relation to the three audit procedures in this area. This workpaper was not produced (see Breach 6 above).

5.61. The Respondents were therefore in breach of paragraph 8 of ISA 230, by failing to record an explanation for why certain of the tests and procedures set out in Mazars' IFRS 9 Work Programme had not been completed and/or were not considered to be required. This is in addition to the matters set out in the Breaches above and below (see Breaches 3, 4, 5, 6 and 9).

<u>Breach 9 – Failure to accurately report on controls testing</u>

5.62. The management of SRG and/or SRL had in place various ECL-related internal controls.

5.63. The Respondents identified in a workpaper two management review controls that were described as "*key controls*", namely: (a) review of data inputs and period end impairment; and (b) review of the macroeconomic scenarios, including computation and data inputs (each performed by the Impairment Committee).

5.64. When reviewing the design and implementation of these controls, the Respondents assessed that they were not sufficiently granular and therefore were not appropriately designed. The Respondents therefore did not test the operating effectiveness of the controls. The Respondents nevertheless concluded, in relation to key controls: "*Audit testing over the ECL model output has been fully substantive in anture* [sic] *and therefore no impact on the audit approach*".

5.65. The FY21 Audit Report continued to refer, as one of the principal audit procedures in relation to ECL, to "*testing the operating effectiveness, of the key controls in relation to the impairment and provision model and process*".

5.66. The Respondents were therefore in breach of paragraph 13 of ISA 701, in that they referred in the FY21 Audit Report to controls testing that was not in fact undertaken, and thereby failed to describe accurately in the FY21 Audit Report the audit procedures that had been completed in relation to the impairment of trade receivables.

<u>Breach 10 – Failures in quality control</u>

5.67. The workpapers prepared by the Respondents for the FY21 Audit contained various errors, incomplete work and unresolved review notes in relation to the audit of ECL, which were not identified by Mr Allen. These are set out further below.

5.68. <u>First</u>, the Respondents did not resolve or address review notes in workpapers relating to the financial statement area of "*Debtors*" in the FY21 SRG Consolidated Financial Statements. For example, the Second Partner raised a review note in one of the workpapers, stating that ECL on trade receivables was a "*significant risk*" that warranted a separate file note containing substantially more detail on ECL. The Respondents did not resolve or address this (and other) review notes in these workpapers.

5.69. Second, Mr Allen raised Review Note 435 on 23 June 2021, in which he asked where the following audit work was in the audit file, namely: (a) the Quants team's working papers; (b) the Respondents' testing on SICR (see Breach 5 above); and (c) the Respondents' work on the Overlay (see Breach 6 above). Mr Allen also sought an explanation for the discrepancy between the ECL in the Quants team's year-end report and in the FY21 SRG Consolidated Financial Statements (see Breach 1 above). However, and as explained above, the points raised in Review Note 435 were not adequately resolved or addressed by the Respondents. Review Note 435 was nevertheless signed off by Mr Allen as having been "*answered to* [his] *satisfaction*" on 6 August 2021, i.e. more than a month after he had signed the FY21 Audit Report.

5.70. Third, the Respondents also did not adequately resolve or address review notes raised by the EQCR and by a senior member of Mazars' Audit Quality Team, including on the draft FY21 Audit Report. In particular:

5.70.1. The EQCR asked the Respondents to "*simplify our approach and summary more clearly on file*", and also (in the draft FY21 Audit Report) referred to "*our standback review of the £13m overlay*" (see Breach 6 above). However, the Respondents did not adequately respond to these comments.

5.70.2. A senior member of Mazars' Audit Quality Team raised review notes in the draft FY21 Audit Report as to the following audit procedures as set out therein: "*We challenged management's forecasting and weighting of key model drivers (macro-economic variables and expected future debt sale prices… We performed a stand back assessment when considering the expected future debt sales…*".[3] In particular, the review notes: (a) asked where the work performed by the Economist had been documented; (b) advised that the audit team should not use the word "*challenge*" unless there was robust supporting evidence and documentation; and (c) requested a reference to the workpaper(s) in which the Respondents had carried out a "*stand back assessment*" (see Breach 7 above).

5.70.3. In the event, the FY21 Audit Report inaccurately described the work performed by the Economist (see Breach 2 above) and also referred to challenge of future debt sale prices when no such challenge had been carried out.

5.71. Fourth, the Respondents prepared two workpapers (referred to herein as the "**ECL Assumptions Assessment Workpapers**") included in the SRG and SRL audit files

[3] The final FY21 Audit Report did not refer to any "*stand back assessment*".

for the FY21 Audit. However, the contents of the workpapers were different between the two audit files, as the versions included in the SRL audit file contained an updated version of the audit work performed.

5.72. Both of these workpapers were signed off as having been reviewed by Mr Allen. This was even though:

5.72.1. the workpaper in the SRG audit file (reviewed on 28 June 2021) was unfinished and largely incomplete: and

5.72.2. the workpaper in the SRL audit file (reviewed on 25 June 2021) was: (a) still incomplete when Mr Allen signed it off; (b) updated thereafter; and (c) updated again after Mr Allen had signed the FY21 Audit Report (on 29 June 2021). The nature and content of these updates were not recorded or explained in the audit file, and the updates were not carried across to the SRG audit file.

5.73. The Respondents were therefore in breach of the following *Relevant Requirements*:

5.73.1. Paragraph 17 of ISA 220, in that Mr Allen failed to ensure that all the review notes were adequately resolved by the Respondents. Mr Allen thereby failed, through a review of the audit documentation and discussion with the engagement team, to satisfy himself that sufficient appropriate audit evidence had been obtained to support the conclusions reached and for the auditor's report to be issued.

5.73.2. Paragraph 26 of ISA 330, in that Mr Allen failed to properly conclude whether sufficient appropriate audit evidence had been obtained following consideration of all relevant audit evidence, in that he did not review the ECL Assumptions Assessment Workpapers before signing it off. Specifically, he failed:

5.73.2.1. to ensure that any subsequent changes to the ECL Assumptions Assessment Workpapers were recorded and explained; and

5.73.2.2. to ensure that the ECL Assumptions Assessment Workpapers had been completed by the time the FY21 Audit Report was signed on 29 June 2021.

B. <u>GOING CONCERN</u>

<u>Background</u>

5.74. SRG was required to prepare its financial statements in accordance with the International Accounting Standard ("**IAS**") 1 (Presentation of Financial Statements) (see also Appendix 1 below).

5.75. IAS 1 requires management to make an assessment of an entity's ability to continue as a going concern. It also states that an entity shall prepare its financial statements on a going concern basis unless management intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. This requirement applies even when there are uncertainties about events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern in the future. Such uncertainties are required to be disclosed in the financial statements when they are material.

5.76. In considering whether a company/group is a going concern, the key test is therefore whether the company/group can pay its debts as they fall due for a period of not less than twelve months from the date the financial statements are approved. If the going concern assumption is not appropriate, the company/group prepares its accounts on a break-up basis, with assets valued on the basis of expected realisation from a forced sale.

5.77. Sensitivity testing, stress testing and scenario analysis are mechanisms used to assess the risks facing a business and the potential impacts if those risks were to materialise. The purpose is to analyse the effect of changes to the assumptions incorporated in a financial model. For example, in a going concern context, the risk being considered could be a decline in demand for a company's products. Sensitivity testing might focus on the sales assumptions about sales volumes and/or values, and assessing the variations in headroom against changes in those assumptions.

SRG's performance in FY21

5.78. SRG enjoyed significant increases in revenue, gross profit and profit before tax in FY21, as compared to FY20. This was largely a consequence of Covid-19 lockdowns, during which consumers switched to online retail while physical retailers were closed and some consumers benefited from government support packages.

5.79. SRG's management expressly recognised that FY21 was a "*record*" year for the Group and stated that FY21 "*represented a step-change in the level of performance for* [SRG]". Management expressly linked SRG's performance in FY21 to the Covid-19 pandemic and related lockdowns, which had (amongst other things) increased SRG's active customer base as "*customers… found Studio for the first time during the pandemic when the high-street alternatives were closed*". By way of example, product revenue increased by 43% from FY20 to FY21; in comparison, product revenue had increased by just 2.5% from the financial year ending in March 2019 ("**FY19**") to FY20.

Management's forecasts for FY22 to FY25

5.80. SRG's management explained in the FY21 Annual Report that they expected the transition from shopping on the high street to shopping online that had been seen during FY21 to continue after the Covid-19 pandemic, and that there was "*every reason to believe*" that new credit customers would carry on shopping with SRG in the financial year ending in March 2022 ("**FY22**").

5.81. The FY22 budget (i.e. the base case or "business as usual" forecast) produced by management therefore projected similar performance as compared to the "*exceptional*" performance reflected in the FY21 results. The base case forecasts for future financial years ending in March 2023 – 2025 ("**FY23 to FY25**") also projected performance in line with, or exceeding, the FY21 results. These comparisons were based on SRG's FY21 results once the Subsidiary's results are excluded, since the Subsidiary was treated as a discontinued operation in FY21 (see paragraph 2.2 above).

Management's sensitivity analysis

5.82. SRG's management carried out their sensitivity analysis by applying sensitivities to the base case forecast in the form of scenario analysis, namely by considering what were said to be "*severe but plausible downsides arising as a result of Covid-19*" and which addressed the impact of economic factors (particularly unemployment rates) on SRG's business. The going concern statement in the FY21 Audit Report explained that the going concern basis had been adopted in preparing the FY21 SRG Consolidated Financial Statements after assessing the principal risks (see paragraph 5.85 below) and modelling the downside scenarios.

5.83. There were eight scenarios developed under the scenario analysis ("**Scenarios 1 - 8**"). In particular, Scenario 8 was put forward as the "worst case" scenario and consisted of the combination of Scenarios 1 to 7. Under Scenario 8, total revenue, gross profit and earnings before income, taxes, depreciation and amortisation ("**EBITDA**") were (respectively) £64.8 million (or 11.2%), £36.5 million (or 14.3%) and £26.4 million (or 39.9%) less than under the base case forecast.

Significance of Going Concern Assessment

5.84. The Respondents correctly identified going concern as a key audit matter for the FY21 Audit, and as one of seven significant audit risks identified at the planning stage in relation to the FY21 Audit.

5.85. In the course of the FY21 Audit, the Respondents obtained management's assessment of going concern which set out six principal risks and uncertainties for SRG, including economic uncertainty, supply chain issues and liquidity management. These were also identified as principal risks and uncertainties in SRG's FY21 Annual Report.

5.86. The FY21 Audit Report also identified, as "*significant risks*" in relation to going concern:

5.86.1. Covid-19 pandemic-related uncertainty regarding SRG's ability to forecast the cash flows that were expected to be recovered from customer credit trade receivables; and

5.86.2. uncertainty over forecasting future trading cash flows in light of: (a) record levels of trading in FY21 as SRG benefited from consumer spending shifts during the Covid-19 pandemic; and (b) uncertainty over how consumer spending habits would change following the UK's emergence from lockdown measures and the cessation of government support packages.

5.87. The Respondents therefore identified that notwithstanding SRG's record performance in FY21, there were significant risks and uncertainties relating to going concern, in particular economic uncertainty (to which the exceptional and unprecedented circumstances created by the Covid-19 pandemic contributed), and potential supply chain issues and cash flow (or liquidity) issues. The specific risks identified were also consistent with the principal risks and uncertainties that SRG's management had recognised.

5.88. The FY21 Audit Report concluded in relation to going concern that:

"*Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the group's and the parent company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.*"

Breach 11 – Failure to adequately evaluate and challenge management's sensitivity analysis

The planned audit procedures

5.89. The Respondents designed procedures that were intended to evaluate the effect of the identified risks, which included Covid-19 pandemic-related uncertainty, on SRG's ability to continue as a going concern. These procedures included challenging the appropriateness of the directors' key assumptions in their cash flow forecasts (including by assessing management's consideration of the downside scenarios) and assessing historical forecasting accuracy. The FY21 Audit Report stated that these planned audit procedures had been performed.

5.90. As to the latter procedure, the Respondents reviewed SRG's forecast and actual results in FY21 (that period being significantly affected by the exceptional circumstances created by the Covid-19 pandemic) but did not assess the historical accuracy of management's forecasts in respect of periods prior to FY21 (under more normal trading conditions). Given the exceptional conditions in FY21, the Respondents ought to have assessed the historical accuracy of management's forecasts in respect of periods prior to FY21, which would have given a better indication of the past accuracy of their forecasts in previous periods.

<u>The Respondents' failure to properly evaluate and challenge management's sensitivity analysis</u>

5.91. Neither SRG's management nor the Respondents adequately evaluated whether the principal risks they had identified (see paragraphs 5.85 to 5.87 above) were properly addressed in the design and application of the Scenarios. In fact, management's sensitivity analysis (including, but not limited to, Scenario 8 as the purported "worst case" scenario) did not adequately address these principal risks and uncertainties, and their ensuing consequences for SRG's business.

5.92. In particular:

5.92.1. Management did not provide an adequate explanation of: (a) how the impact of the Covid-19 pandemic (including the easing of pandemic-related restrictions), shipping container shortages or economic factors had been modelled or calculated in any of the Scenarios; and (b) why they considered the impact of these factors to be sufficiently reflected in the Scenarios.

5.92.2. Management's sensitivity analysis did not consider the cash flow impact of the principal risks and uncertainties that they had identified, including (but not limited to) the cash flow impact of shipping container shortages that could result in SRG having paid for delayed stock that it was then unable to sell. This is further addressed in relation to Breach 12 below.

5.92.3. More generally, management did not prepare any adequate narrative explanation for its sensitivity analysis, to properly explain the basis upon which management had arrived at the Scenarios. This would have enabled the Respondents to assess that the sensitivity analysis properly engaged with the principal risks and uncertainties faced by SRG.

5.93. The Respondents did not challenge these shortcomings in management's sensitivity analysis. This was even though the Respondents were aware of the principal risks and uncertainties that management had identified in its going concern assessment, and had themselves identified Covid-19 pandemic-related uncertainty and cash flow issues as significant risks in relation to going concern (see paragraph 5.86 above). The Respondents therefore ought to have been aware of the need for management's sensitivity analysis to address those risks, and should have ensured that this was done. This was especially important in circumstances where the FY21 Audit was Mazars' first full-year audit of SRG, and the Respondents had not otherwise carried out adequate audit procedures (e.g. by testing historical forecast accuracy in respect of periods prior to FY21) to assess whether management's downside scenarios were sufficiently severe.

The Respondents' failure to carry out adequate audit procedures to evaluate and challenge the severity of Scenario 8

5.94. Insofar as the Respondents considered and challenged Scenario 8, those audit procedures were also flawed.

5.95. First, the Respondents' asserted justification[4] for accepting management's assessment of the severity of Scenario 8 was wrong. That justification was said to be because an increase in severity would be implausible as the FY22 budget already incorporated a reduction in product revenue of £71.2 million (or 14%) from the FY21 results. However, this was based on an incorrect comparison between the FY22 budget and the FY21 results, the latter including revenue from the Subsidiary which accounted for £71.4 million of product revenue in FY21. As explained above, the Subsidiary was classified as a discontinued operation by SRG in its FY21 Annual Report. Excluding the Subsidiary, the actual product revenue in FY21 of £445.4 million was budgeted to slightly increase in FY22, to £445.5 million. Executive Counsel nevertheless acknowledges that the Respondents recognised the correct comparison between SRG's FY21 results and the FY22 budget elsewhere in the audit file.

5.96. Second, management's response to the Respondents' challenge to Scenario 8 – asking "*could it be possible that some of the downside assumptions would be more severe (i.e. higher % loss of revenue, greater % margin impact, etc.)?*" – consisted only of a bare assertion that increasing the severity of Scenario 8 would be "*implausible*". This response did not properly deal with the Respondents' challenge, in that SRG's

[4] In addition, the Respondents also referred to current trading performance in FY22 (see paragraph 5.98.3 below).

management did not provide any additional evidence to support this assertion – and nor was this requested by the Respondents.

5.97. The Respondents' failure to properly challenge the severity of Scenario 8, and management's assessment thereof, was in spite of comments that had previously been raised by the Second Partner. The Second Partner, who had particular responsibility for the audit of SRG's retail business, had asked whether the sensitivity analysis "*robustly covers potential downside of consumer habits in a post COVID-19 world*". The Second Partner also sought an explanation for why a further increase in severity (beyond a 10% reduction "*across all of the various assumptions*" in the scenarios) was considered implausible "*[p]articularly as there was a decline between FY 2019 and FY 2020 and FY 2021 has been a year of exceptional growth in exceptional circumstances. This one I feel needs some further thought*". The Respondents did not give proper consideration to, and adequately address, those concerns.

5.98. Third and more generally, beyond the matters set out in paragraphs 5.95 to 5.97 above, the Respondents failed to challenge the severity of Scenario 8. In particular, the Respondents did not:

5.98.1. identify the fact that total revenue under Scenario 8 was still c. 18% higher than the FY20 results;

5.98.2. adequately recognise, understand or challenge the assumptions underlying SRG's forecast expenditure in each of the downside scenarios, such as by challenging the unusually low forecast bad debt charge (i.e. the annual write-offs) under Scenario 8; or

5.98.3. question, consider or understand matters which were relevant when assessing the significance of SRG's current trading performance, including that SRG continued to benefit from various pandemic-related interventions in the first part of FY22. This was even though the audit team had relied upon SRG's current trading performance as a reason for accepting management's assessment of the severity of Scenario 8.

5.99. The Respondents failed to carry out any audit procedures to test the sensitivity analysis (including Scenario 8) as carried out in management's going concern model. In particular, the model contained hard-coded percentage variations and the Respondents did not carry out any audit procedures to understand the calculations behind these hard-coded percentages.

5.100. Management did not perform any reverse stress testing, and the Respondents did not ask management to calculate what reduction in revenue and/or margin would lead to SRG running out of cash. Nor did the Respondents seek to determine or understand this for themselves. This was even though the continued availability of credit facilities was a key consideration for SRG's business.

Conclusion

5.101. The Respondents were therefore in breach of the following *Relevant Requirements*:

5.101.1. Paragraphs 12-2(b) and (c) of ISA 570, as explained by paragraphs A8-5, A8-6 and/or A8-7 of ISA 570, by failing to adequately test and challenge whether management's sensitivity analysis sufficiently reflected the principal risks and uncertainties identified by management and by the Respondents, and the downside risk for revenue and margin;

5.101.2. Paragraph 12-1(b) of ISA 570, by failing to perform audit procedures to obtain sufficient appropriate audit evidence about whether or not a material uncertainty related to going concern existed; and

5.101.3. Paragraph 12-3 of ISA 570, as explained by paragraph A10-1 of ISA 570, by failing to exercise sufficient professional scepticism when evaluating management's assessment of SRG's ability to continue as a going concern.

Breach 12 – Failure to adequately evaluate or challenge management's cash flow forecast

Base case forecast

5.102. SRG's management prepared a base case cash flow forecast for the Group. The cash flow forecast was based on forecast EBITDA (as derived from the forecast income statements), which was then adjusted for various specified items to arrive at pre-tax cash flow and net cash flow. SRG's forecast cash headroom was calculated by reference to net cash flow.

5.103. Many of the individual adjustments applied to forecast EBITDA to arrive at forecast cash flow were substantial in amount. Moreover, in the 12-month going concern period, the total net adjustments to EBITDA to arrive at net cash flow were £38.6 million.

5.104. The cash flow forecast was important to management's assessment of the use of the going concern assumption, and to the Respondents' conclusion in this regard. The Respondents recognised this in the FY21 Audit Report, which specifically referred to uncertainty regarding the cash flow forecast as a "*significant risk*" relating to going concern (see paragraph 5.86 above). The FY21 Audit Report also stated that the audit procedures included challenging the appropriateness of the directors' key assumptions underpinning their cash flow forecasts.

5.105. It was also important for the Respondents to have an adequate understanding of the adjustments to forecast EBITDA to arrive at forecast cashflow, and specifically the basis and reasons for those adjustments, so as to obtain sufficient audit evidence as to forecast cash headroom. This was especially the case given that the FY21 Audit was the Respondents' first full-year audit of SRG (and as such they would not have gained an understanding of the basis and reasons for any such adjustments in prior years).

5.106. However, the Respondents failed to carry out adequate audit procedures in relation to management's cash flow forecasts, including:

5.106.1. to test or confirm the figures set out therein; and

5.106.2. to enquire into or gain an understanding of the adjustments made by management to forecast EBITDA to arrive at forecast cash flow, or to test or confirm the appropriateness or accuracy of such adjustments.

5.107. In particular, and in order to properly understand and assess management's cash flow forecast, the Respondents should have performed audit procedures such as:

5.107.1. verifying that the opening cash position at the start of the forecast period was consistent with the audited closing cash balance in the financial statements;

5.107.2. evaluating and testing the forecast balance sheets, and then confirming that the adjustments applied to forecast EBITDA to arrive at forecast cash flow were consistent with the balance sheet (including the monthly changes to the balance sheet);

5.107.3. confirming that the adjustments applied to forecast EBITDA to arrive at forecast cash flow were complete, in that the adjustments included all non-income statement cash items and no expected adjustments had been excluded;

5.107.4. reviewing the adjustments applied to forecast EBITDA to arrive at forecast cash flow, including by: (a) verifying the adjustments against any known future events, such as capital expenditure commitments, loan and interest repayment commitments, tax payments, and pension contributions; and (b) considering SRG's cash flow in previous years as compared to income statements; and

5.107.5. confirming that any known seasonal movements, as adjusted for any known changes (such as Covid-19 pandemic-related factors), were factored into the monthly income statement and cash flow forecast.

Scenario 8 forecast

5.108. As a result of the adjustments made by management in preparing their cash flow forecast under Scenario 8, there were considerable variations between the impact of Scenario 8 on EBITDA and cash flow in the 12-month going concern period. For example, the total net change in EBITDA from the FY22 budget to Scenario 8 was -£42.8 million, whereas the total net change in cash flow was -£34.5 million (or a difference of £8.2 million).

5.109. These variations were particularly significant in the period between November 2021 and April 2022. In addition, the variations followed a different pattern to: (a) those resulting from the adjustments made by management to the base case forecasts; and (b) the impact of Scenario 8 on monthly and cumulative EBITDA.

5.110. For example, in the 12-month going concern period:

5.110.1. Scenario 8 had a positive cash flow impact in November and December 2021 (of £5.8 million and £18.2 million) as compared to the base case cash flow forecast. This was even though Scenario 8 was intended to be the "worst case" scenario and its overall effect was to reduce SRG's EBITDA both generally and also in every month from July to December 2021. The positive cash flow impact was primarily attributable to the (positive) "*Change in securitisation loan*" and "*Debtors impact*" adjustments applied by management and had a knock-on effect in subsequent months.

5.110.2. The forecast cash headroom in December 2021 under Scenario 8 was £43.3 million, whereas the equivalent figure under the base case forecast was £32.6 million. In other words, the forecast cash headroom in December 2021 was higher under Scenario 8 (i.e. the purported "worst case" scenario) than in the base case.

5.110.3. The difference between the cash flow impact and EBITDA impact of Scenario 8 (as compared with the base case forecast) was also positive in each month from August to December 2021 (with that difference being £9.8 million in November and £22.1 million in December) and in May and June 2022. In other words, the downside impact of Scenario 8 on EBITDA was mitigated to some extent in relation to cash flow by the positive cash flow adjustments (as compared with the base case forecast).

5.111. SRG's business was seasonal in nature with variable net cash outflows in each month of the year. Under Scenario 8, the headroom was forecast to be highly variable for FY22, ranging from £1.6 million in September 2021 to £32.6 million in December 2021. Within this range, the cash headroom was particularly low in some months, such as in September 2021 (£1.6 million), October 2021 (£2.4 million) and February 2022 (£1.8 million). Minor variations in EBITDA or cash flow assumptions in those or previous months could have eliminated the cash headroom that was forecast in (at least) those months. There is no evidence that the Respondents considered the reasons for the low cash headroom in these months.

5.112. More generally, both SRG's management and the Respondents had identified liquidity issues as a principal risk and uncertainty for SRG's business (see paragraphs 5.85 to 5.87 above). It was therefore important for management's sensitivity analysis to address this risk. However, although management modelled the cash flow impact of the Scenarios (including Scenario 8), there is no evidence that either management or the Respondents properly evaluated the results of that modelling in particular in light of the low level of cash headroom in certain months (as described above). Further, there is no evidence that management considered plausible scenarios in which the timing of SRG's receipts or expenses were flexed, and the impact this might have on cash flow and cash headroom.

5.113. Instead, and despite these matters, the Respondents failed to perform any audit procedures in relation to the cash flow forecast under Scenario 8:

5.113.1. to enquire into or gain an understanding of the nature and timing of the adjustments made by management to EBITDA impact, so as to arrive at cash flow impact;

5.113.2. to test or confirm the appropriateness of those adjustments;

5.113.3. to identify and evaluate the reasons for the forecast positive cash flow impact of Scenario 8 in November and December 2021, as compared to the base case cash flow forecast; and

5.113.4. to challenge the severity of the Scenario 8 sensitivity analysis on cash flow, including the implications thereof for SRG's cash headroom in the 12-month going concern period.

5.114. In this regard, as was also the case in relation to the base case forecast (as set out above), the Respondents failed to:

5.114.1. test the underlying source data which supported the adjustments from monthly EBITDA to monthly cash flow under Scenario 8; and

5.114.2. evaluate the assumptions that lay behind management's assessment of the appropriateness of these adjustments under Scenario 8.

Conclusion

5.115. The Respondents were therefore in breach of paragraphs 12-1, 12-2(b), 12-2(c) and 12-3 of ISA 570 in that, in relation to the cash flow forecasts in both the base case and derived from the Scenario 8 sensitivity analysis, they failed to perform audit procedures to obtain sufficient appropriate audit evidence relating to going concern by:

5.115.1. evaluating the relevance and reliability of the underlying data used to arrive at the cash flow forecast under each of the base case forecast and Scenario 8;

5.115.2. evaluating the assumptions on which management based their adjustments to forecast EBITDA to arrive at forecast cash flow under each of the base case forecast and Scenario 8, by determining whether there was adequate support for those assumptions; and

5.115.3. exercising sufficient professional scepticism when reviewing the cash flow forecast under each of the base case forecast and the Scenario 8 sensitivity analysis.

C. FINANCIAL SERVICES INCOME

Background

5.116. SRG earned financial services revenue through the provision of credit to customers upon their purchase of products. As to this:

5.116.1. credit account interest consisted of the interest income from credit account customers; and

5.116.2. other financial services revenue primarily consisted of fees that were applied upon missed payments by credit account customers, which were flat fees of £12 for each missed payment.

5.117. The FY21 SRG Consolidated Financial Statements recorded financial services revenue of £133.2 million, consisting of credit account interest of £116.3 million and other financial services revenue of £16.9 million.

5.118. In SRG's FY21 Annual Report, SRG's management explained that there had been an 8.2% increase in financial services revenue from FY20. This was compared to a 20% increase in the "*closing Eligible Receivables book*" resulting from an increase in the number of credit account customers. Management explained that the lower increase in financial services revenue (as compared to the increase in receivables) was "*due to lower fees being charged to customers who missed payments due to the greater level of forbearance and payment holidays offered to those most affected by the pandemic*".

5.119. The Respondents did not designate financial services income as a key audit matter or as a significant risk for the FY21 Audit.

5.120. The Respondents carried out substantive analytical procedures for this area of the FY21 Audit, by calculating the expected financial services revenue for FY21 and comparing this with the actual financial services revenue for FY21 (as explained further below).

Breach 13 – Failure to address the difference between expected and actual financial services revenue

5.121. By way of overview, the Respondents applied the following method when carrying out substantive analytical procedures in relation to financial services revenue:

5.121.1. First, the Respondents calculated the average financial services receivables for FY21 and FY20 using the average opening and closing receivables balances in FY21 and FY20, net of ECL (i.e. net receivables).

5.121.2. Second, the Respondents calculated the average yield for FY21 and FY20 – i.e. the total financial services revenue as a percentage of the average financial services receivables in FY21 and FY20.

5.121.3. Third, the Respondents calculated the expected financial services revenue in FY21 by multiplying the average yield in FY20 with the average financial services receivables in FY21. This expectation (of £136.3 million) was compared with the actual financial services revenue in FY21 (of £133.2 million). The difference between these two figures was £3.1 million, or a percentage difference of 1.2%.

5.122. The Respondents recorded in a workpaper the comment "*accept*" in relation to the difference of £3.1 million between expected and actual financial services revenue in FY21. This workpaper also recorded the Respondents' conclusions that, based on the analytical review performed, financial services revenue was not materially misstated and the difference was within the performance materiality threshold.

5.123. In fact, the difference (of £3.1 million) between expected and actual financial services revenue for FY21 was significantly greater than Mazars' threshold for performance materiality (of £1.0 million). The Respondents did not recognise, consider or evaluate the materiality of this difference, including by:

5.123.1. reflecting upon the sufficiency and appropriateness of their audit procedures and the basis on which their expectations had been set; and/or

5.123.2. considering what further audit procedures were necessary to obtain sufficient and appropriate audit evidence.

5.124. The Respondents were in breach of paragraph 26 of ISA 330 and paragraph 5(d) of ISA 520, by failing to recognise, consider and/or evaluate the difference of £3.1 million between the expected and actual financial services revenue for FY21 and therefore to:

5.124.1. properly conclude whether sufficient appropriate audit evidence had been obtained following consideration of all relevant audit evidence; and

5.124.2. properly determine whether the difference was acceptable without further investigation.

Breach 14 – Failure to carry out appropriate and sufficient substantive analytical procedures

5.125. The Respondents failed to carry out an appropriate and sufficient comparison between FY21 and FY20 financial services receivables, or to otherwise determine the suitability of the substantive analytical procedures performed in relation to financial services revenue. In particular, the Respondents failed:

5.125.1. to recognise, consider and evaluate the seasonality of financial services receivables, when calculating average receivables, and instead calculated this figure using a simple average of opening and closing balances (see paragraph 5.121.1 above);

5.125.2. to recognise, consider and evaluate the effect of the Covid-19 pandemic and associated payment holidays upon the incidence of missed payment fees in FY21, when setting expectations as to financial services revenue, even though workpapers on the audit file expressly stated that this would be done;

5.125.3. to use the (correct) financial services receivables figures reported in SRG's financial statements for FY20 or FY21 (i.e. the FY21 SRG Consolidated Financial Statements), when calculating average receivables (see paragraph 5.121.1 above). The opening and closing balances for FY20 and FY21 used by the Respondents in their calculations did not correspond to the reported receivables figures and were incorrect;

5.125.4. to use gross, rather than net, financial services receivables, when calculating average receivables (see paragraph 5.121.1 above), even though financial services income was most closely correlated to SRG's gross financial services receivables;

5.125.5. to record and confirm the interest rates that were applied to outstanding receivables in FY21 and FY20, and whether there were any differences between them, when calculating the expected credit account interest in FY21 (see paragraph 5.121.3 above); and

5.125.6. to segregate credit account interest and missed payment fees, when setting expectations as to financial services revenue, even though these two categories of financial services revenue had different characteristics and different dependent variables. The Respondents instead calculated the average yield for FY21 and FY20 (from which the expected financial services revenue in FY21 was calculated: see paragraphs 5.121.2 to 5.121.3 above) using SRG's <u>total</u> financial services revenue.

5.126. The Respondents were therefore in breach of paragraph 6 of ISA 500, in that, they failed to design and perform audit procedures that were appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.

5.127. In addition, the Respondents were in breach of:

5.127.1. Paragraph 5(b) of ISA 520, in that by reason of the facts and matters set out in paragraphs 5.125.3 to 5.125.4 above, they failed when performing substantive analytical procedures to evaluate the suitability, relevance and reliability of the data from which they calculated SRG's expected financial services revenue in FY21; and

5.127.2. Paragraph 5(c) of ISA 520, in that by reason of the facts and matters set out in paragraphs 5.125.1, 5.125.2 and 5.125.6 above, they failed when performing substantive analytical procedures to evaluate whether SRG's expected financial services revenue as calculated was sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

6. *SANCTIONS* – MAZARS AND MR ALLEN

6.1. Paragraph 10 of the FRC's Sanctions Policy (Audit Enforcement Procedure) (the "**Policy**") provides that *Sanctions* are intended to be effective, proportionate and dissuasive. The reasons for imposing *Sanctions* are identified in paragraph 11 of the Policy as the following:

6.1.1. to declare and uphold proper standards of conduct amongst *Statutory Auditors* and *Statutory Audit Firms* and to maintain and enhance the quality and reliability of future audits;

6.1.2. to maintain and promote public and market confidence in *Statutory Auditors* and *Statutory Audit Firms* and the quality of their audits and in the regulation or the accountancy profession;

6.1.3. to protect the public from *Statutory Auditors* and *Statutory Audit Firms* whose conduct has fallen short of the *Relevant Requirements*; and

6.1.4. to deter *Statutory Auditors* and *Statutory Audit Firms* from breaching the Relevant Requirements relating to *Statutory Audit*.

6.2. Paragraph 12 of the Policy provides that the primary purpose of imposing *Sanctions* for breaches of the *Relevant Requirements* is not to punish, but to protect the public and the wider public interest.

6.3. In considering *Sanctions* to be imposed on Mazars and Mr Allen, Executive Counsel has, in summary, considered the following matters in accordance with the Policy.

Nature, seriousness, gravity and duration of the breaches

6.4. As a result of the breaches of *Relevant Requirements*, the FY21 Audit failed in its principal objective, namely to obtain reasonable assurance about whether the FY21 SRG Consolidated Financial Statements as a whole were free from material misstatement.

6.5. Going concern in particular is fundamental to statutory audits and it is of the utmost importance that this area is audited in accordance with *Relevant Requirements*. Further, two out of the three areas in which there were breaches (going concern and ECL) were key audit matters and were assessed to be significant risks for the FY21 Audit.

6.6. The breaches of *Relevant Requirements* were serious, numerous and pervasive.

6.7. In particular, there were a number of breaches of *Relevant Requirements* which were fundamental to the role of the independent auditor and the conduct of a proper audit. For example, the breaches include failures:

6.7.1. to maintain professional scepticism;

6.7.2. to obtain sufficient appropriate audit evidence;

6.7.3. to use professional judgement; and

6.7.4. to ensure adequate quality control by the Engagement Partner.

6.8. Whilst it is not alleged that the FY21 SRG Consolidated Financial Statements were in fact misstated, in aggregate the breaches:

6.8.1. potentially adversely affected a significant number of people in the United Kingdom (such as the public, investors or other market users), and could have harmed investor, market and public confidence in the truth and fairness of the financial statements published by *Statutory Auditors* or *Statutory Audit Firms*. SRG's shares were listed on the main market of the London Stock Exchange; and

6.8.2. undermine confidence in the standards of conduct in general of *Statutory Auditors* and *Statutory Audit Firms*, and/or in S*tatutory Audit*.

6.9. As regards Mazars, the FRC's 2019-2020 Audit Quality Inspection Report on Mazars published in July 2020 highlighted the need for Mazars to improve the consideration of judgements in key areas including the valuation of expected credit loss for financial instruments.

6.10. Against this:

6.10.1. Mazars is not one of the UK's largest audit firms. Its UK fee income as of 2024 was approximately £362.40 million[5] and its audit fee income was approximately £150.20 million. It has 76 principals.

6.10.2. The breaches relate only to one audit year.

6.10.3. The breaches were neither intentional, dishonest, deliberate nor reckless.

6.10.4. Mazars did not stand to gain any profit or benefit, beyond the fee chargeable for the FY21 Audit, from the breach of the *Relevant Requirements*.

6.11. As regards Mr Allen, he has no previous adverse disciplinary record.

Identification of *Sanction*

6.12. In accordance with paragraph 47(c) of the Policy, Executive Counsel has taken into account the size / financial resources and financial strength of the Respondents and the effect of a financial sanction on Mazars' business and Mr Allen personally, when assessing the amount of financial sanctions to be imposed.

6.13. Having assessed the nature, seriousness, gravity and duration of the breaches, Executive Counsel has identified the following combination of *Sanctions* against the Respondents:

Mazars

6.13.1. a financial sanction of £950,000;

6.13.2. a published statement in the form of a severe reprimand;

6.13.3. a declaration that the FY21 Audit Report signed by Mr Allen on behalf of Mazars did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*; and

6.13.4. an order that Mazars:

i) Within 6 months of the date of this *Final Settlement Decision Notice:*

a. produce to its FRC Supervisor a report which sets out the remedial steps that have been taken to reduce the risk of recurrence of the breaches in the ECL and FSI areas;

b. produce to its FRC Supervisor a report on what steps (if any) have been taken to reduce the risk of recurrence of the deficiencies in

[5] These figures are derived from the FRC Key Facts and Trends in the Accountancy Profession Excel document dated October 2025.

the going concern work as set out in this *Final Settlement Decision Notice* in future audits on non-financial services entities;

ii) Within 12 months of the date of this *Final Settlement Decision Notice:*

a. produce to its FRC Supervisor a report on the details of any further remedial steps that will be implemented to address any deficiencies in audit work on going concern that have not been addressed in paragraph 6.13.4(i)(b) above;

b. implement training for Mr Allen on going concern and ECL (such training to be approved by the FRC in advance); and

c. perform effectiveness testing and produce a report to its FRC Supervisor on the same in relation to paragraph 6.13.4(i) above.

6.13.5. The scope and requirements for the reporting and effectiveness testing required by this order shall be agreed with Executive Counsel and the Firm's FRC Supervisor.

Mr Allen

6.13.6. A financial sanction of £55,000;

6.13.7. a published statement in the form of a severe reprimand;

6.13.8. a declaration that the FY21 Audit Report signed by Mr Allen on behalf of Mazars did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice;* and

6.13.9. an order that Mr Allen shall, within 12 months of the date of this *Final Settlement Decision* Notice, undertake training on going concern and ECL relevant to the breaches of *Relevant Requirements* set out in this *Final Settlement Decision Notice* (such training to be approved by the FRC in advance).

6.14. Executive Counsel has taken into account any aggravating and mitigating factors that exist (to the extent that they have not already been taken into account in relation to the nature, seriousness, gravity and duration of the breaches).

Aggravating factors

6.15. There are no aggravating factors that have not already been considered in the context of the seriousness of the breaches.

<u>Mitigating factors</u>

6.16. All relevant mitigating factors have already been considered, except the level of co-operation provided by the Respondents. Paragraph 69 of the Policy explains:

"*In order for cooperation to be considered as a mitigating factor at the point of determining sanction it will therefore be necessary for Statutory Auditors and Statutory Audit Firms to have provided an exceptional level of cooperation. Non-exhaustive examples of conduct which may constitute such cooperation include: a) self-reporting to the FRC and/or bringing to the attention of the FRC any facts and/or matters which may constitute an allegation of a breach of the Relevant Requirements…*"

6.17. Mazars and Mr Allen (through Mazars) provided an exceptional level of co-operation during the investigation of the breaches by Executive Counsel in that they:

6.17.1. Voluntarily conducted a Critical Self-Review assessing the audit work in relation to going concern, ECL, and FSI, which self-reported breaches of *Relevant Requirements*.

6.17.2. Provided a Remediation Report and Root Cause Analysis in relation to the identified breaches of *Relevant Requirements*.

6.17.3. Voluntarily performed an investigation into the facts relevant to the Macro-Economic Factors Report.

6.17.4. Dealt fully and timeously with matters relating to going concern that were raised after the initial Investigation Report had been issued.

6.18. In light of the mitigating factors, Executive Counsel considers that a discount to the financial sanction of 10% is appropriate.

<u>Deterrence</u>

6.19. Having considered the matters set out at paragraphs 72 and 73 of the Policy, Executive Counsel considers that no adjustment for deterrence is required in this case.

<u>Discount for Admissions and Settlement</u>

6.20. Having taken into account the full admissions by the Respondents and the stage at which those admissions were made (well within Stage 1 of the case in accordance with paragraph 84 of the Policy), the level of detail contained within those admissions and their impact on the investigation, Executive Counsel determined that a reduction of 32.5% as to the financial sanction is appropriate, such that (when the 10% discount to reflect exceptional cooperation is also taken into account) a financial sanction of £577,125 is payable by Mazars and £33,412 is payable by Mr Allen.

7. COSTS

7.1. Executive Counsel requires that the Respondents pay her costs in full in this matter, being £973,356. Such costs shall be paid no later than 28 days after the date of this *Final Settlement Decision Notice*.

Signed:

[Redacted]

JUSTINE MARIE DAVIDGE
ACTING DEPUTY EXECUTIVE COUNSEL

Date: 31 March 2026

APPENDIX 1 – EXTRACTS OF RELEVANT REQUIREMENTS

ISA 200 – Revised June 2016 (Effective for audits of financial statements for periods commencing on or after 15 December 2019)	
16	The auditor shall exercise professional judgment in planning and performing an audit of financial statements. (Ref: Para. A25–A29)
ISA 220 – Revised November 2019 (Effective for audits of financial statements for periods commencing on or after 15 December 2019)	
17	On or before the date of the auditor's report, the engagement partner shall, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. (Ref: Para. A19–A21)
ISA 230 – Revised June 2016 (Effective for audits of financial statements for periods commencing on or after 15 December 2019)	
8	The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand: (Re: Para. A2–A5, A16–A17) (a) The nature, timing and extent of the audit procedures performed to comply with the ISAs (UK) and applicable legal and regulatory requirements; (Ref: Para. A6–A7) (b) The results of the audit procedures performed, and the audit evidence obtained; and (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. (Ref: Para. A8–A11)
9	In documenting the nature, timing and extent of audit procedures performed, the auditor shall record: (a) The identifying characteristics of the specific items or matters tested; (Ref: Para. A12) (b) Who performed the audit work and the date such work was completed; and

	(c) Who reviewed the audit work performed and the date and extent of such review. (Ref: Para. A13)
ISA 330 – Revised July 2017 (Effective for audits of financial statements for periods commencing on or after 15 December 2017)	
26	The auditor shall conclude whether sufficient appropriate audit evidence has been obtained. In forming an opinion, the auditor shall consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements. (Ref: Para. A62)
ISA 500 – Updated January 2020 (Effective for audits of financial statements for periods ending on or after 15 December 2019)	
6	The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. (Ref: Para. A5–A29)
ISA 520 – June 2016 (Effective for audits of financial statements for periods ending on or after 15 December 2010)	
5	When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with ISA (UK) 330 (Revised July 2017), the auditor shall: (Ref: Para. A4–A5) (a) Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions; (Ref: Para. A6–A11) (b) Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation; (Ref: Para. A12–A14) (c) Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and (Ref: Para. A15) (d) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation as required by paragraph 7. (Ref: Para. A16)

ISA 540 – Revised December 2018 (Effective for audits of financial statements for periods beginning on or after 15 December 2019)	
14	The auditor shall review the outcome of previous accounting estimates, or, where applicable, their subsequent re-estimation to assist in identifying and assessing the risks of material misstatement in the current period. The auditor shall take into account the characteristics of the accounting estimates in determining the nature and extent of that review. The review is not intended to call into question judgments about previous period accounting estimates that were appropriate based on the information available at the time they were made. (Ref: Para. A55–A60)
22	When testing how management made the accounting estimate, the auditor's further audit procedures shall include procedures, designed and performed in accordance with paragraphs 23–26, to obtain sufficient appropriate audit evidence regarding the risks of material misstatement relating to: (Ref: Para. A94) (a) The selection and application of the methods, significant assumptions and the data used by management in making the accounting estimate; and (b) How management selected the point estimate and developed related disclosures about estimation uncertainty.
23	In applying the requirements of paragraph 22, with respect to methods, the auditor's further audit procedures shall address: (a) Whether the method selected is appropriate in the context of the applicable financial reporting framework, and, if applicable, changes from the method used in prior periods are appropriate; (Ref: Para. A95, A97) (b) Whether judgments made in selecting the method give rise to indicators of possible management bias; (Ref: Para. A96) (c) Whether the calculations are applied in accordance with the method and are mathematically accurate; (d) When management's application of the method involves complex modelling, whether judgments have been applied consistently and whether, when applicable: (Ref: Para. A98–A100) (i) The design of the model meets the measurement objective of the applicable financial reporting framework, is appropriate in the

	circumstances, and, if applicable, changes from the prior period's model are appropriate in the circumstances; and (ii) Adjustments to the output of the model are consistent with the measurement objective of the applicable financial reporting framework and are appropriate in the circumstances; and (e) Whether the integrity of the significant assumptions and the data has been maintained in applying the method. (Ref: Para. A101)
24	In applying the requirements of paragraph 22, with respect to significant assumptions, the auditor's further audit procedures shall address: (a) Whether the significant assumptions are appropriate in the context of the applicable financial reporting framework, and, if applicable, changes from prior periods are appropriate; (Ref: Para. A95, A102–A103) (b) Whether judgments made in selecting the significant assumptions give rise to indicators of possible management bias; (Ref: Para. A96) (c) Whether the significant assumptions are consistent with each other and with those used in other accounting estimates, or with related assumptions used in other areas of the entity's business activities, based on the auditor's knowledge obtained in the audit; and (Ref: Para. A104) (d) When applicable, whether management has the intent to carry out specific courses of action and has the ability to do so. (Ref: Para. A105)
A103	Management may evaluate alternative assumptions or outcomes of accounting estimates, which may be accomplished through a number of approaches depending on the circumstances. One possible approach is a sensitivity analysis. This might involve determining how the monetary amount of an accounting estimate varies with different assumptions. Even for accounting estimates measured at fair value, there may be variation because different market participants will use different assumptions. A sensitivity analysis may lead to the development of a number of outcome scenarios, sometimes characterized as a range of outcomes by management, and including 'pessimistic' and 'optimistic' scenarios.
25	In applying the requirements of paragraph 22, with respect to data, the auditor's further audit procedures shall address:

	(a) Whether the data is appropriate in the context of the applicable financial reporting framework, and, if applicable, changes from prior periods are appropriate (Ref: Para. A95, A106); (b) Whether judgments made in selecting the data give rise to indicators of possible management bias; (Ref: Para. A96) (c) Whether the data is relevant and reliable in the circumstances; and (Ref: Para. A107) (d) Whether the data has been appropriately understood or interpreted by management, including with respect to contractual terms. (Ref: Para. A108)
ISA 570 – Revised September 2019 (Effective for audits of financial statements for periods commencing on or after 15 December 2019)	
10-2	In performing risk assessment procedures, the auditor shall obtain an understanding of the following matters: […] (h) The entity's information system, and related business processes, as it relates to going concern, including: […] (ii) How management identifies the relevant method, assumptions and data that are appropriate in assessing the entity's ability to continue as a going concern; (Ref: Para. A3-13–A3-15)…
A3-15	A review of the outcome of previous forecasts (retrospective review) may also assist the auditor in obtaining information regarding the effectiveness of management's process for assessing going concern.
12-1	The auditor shall perform audit procedures, that include procedures designed and performed in accordance with paragraphs 12-2–12-3, to obtain sufficient appropriate audit evidence about: (a) Whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern; (b) Whether or not a material uncertainty related to going concern exists; and

	(c) The appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.
12-2	The auditor shall perform audit procedures that include: (Ref: Para. A8–A10-1, A11-1–A12) (a) Evaluating management's method to assess the entity's ability to continue as a going concern, including determining if: (i) The method selected is appropriate in the context of the applicable financial reporting framework and the auditor's understanding of the entity; (Ref: Para. A8-4) (ii) Changes from the method used in prior periods are appropriate; and (iii) Whether the calculations are applied in accordance with the method and are mathematically accurate. (b) Evaluating the relevance and reliability of the underlying data used to make this assessment; (Ref: Para. A8-5–A8-6) (c) Evaluating the assumptions on which management's assessment is based by determining whether there is adequate support for the assumptions underlying management's assessment. This shall include determining: (i) Whether the assumptions are appropriate in the context of the applicable financial reporting framework, and if applicable, changes from prior periods are appropriate; and (ii) Whether the assumptions are consistent with each other and with related assumptions used in other areas of the entity's business activities, based on the auditor's knowledge obtained in the audit.
A8-5, A8-6	Relevance and Reliability of Data (Ref: Para. 12(b)) A8-5. Matters the auditor may consider when evaluating the relevance and reliability of the underlying data used to make the assessment, may include, for example: the appropriateness of management's rationale for the selection of the data, the source of the data, or the consistency of the data used with data used in previous periods. A8-6. ISA (UK) 500 requires the auditor to evaluate whether the information is sufficiently reliable for the auditor's purposes, including as necessary in the circumstances, to obtain audit evidence about the accuracy and completeness

	of the information and evaluate whether the information is sufficiently precise and detailed for the auditor's purposes.
A8-7	Assumptions (Ref: Para. 12(c)) A8.7. Matters the auditor may consider when determining if there is adequate support for the assumptions used by management include, for example: • Management's rationale for the selection of the assumptions. • Whether a change from prior periods in selecting an assumption is based on new circumstances or new information. When it is not, the change may not be reasonable or may be an indicator of possible management bias. • Whether and, if so, how management considered alternative assumptions by, for example, performing a sensitivity analysis, including 'pessimistic' and 'optimistic' scenarios, to determine the effect of changes in the assumptions on the data used in making the assessment.
12-3 A10-1	In accordance with ISA (UK) 200 (Revised June 2016), the auditor shall maintain professional scepticism throughout the audit and in particular when reviewing future cash flow relevant to the entity's ability to continue as a going concern. (Ref: Para. A10-1) Professional Scepticism (Ref: Para. 12-3) A10-1. The auditor is required by ISA (UK) 200 (Revised June 2016) to plan and perform the audit with professional scepticism. Maintaining professional scepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material uncertainty related to going concern exists.
13-1(b)	When performing audit procedures in accordance with paragraph 12-1–12-2, the auditor shall: […] (b) Consider whether management’s assessment includes all relevant information, including all available information about the future, of which the auditor is aware as a result of the audit. (Ref: Para. A11-1–A11-3)

ISA 620 – Revised November 2019 (Effective for audits of financial statements for periods commencing on or after 15 December 2019)	
12	The auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including: (Ref: Para. A32) (a) The relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence; (Ref: Para. A33–A34) (b) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and (Ref: Para. A35–A37) (c) If that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness and accuracy of that source data. (Ref: Para. A38–A39)
ISA 701 – Revised November 2019 (Effective for audits of financial statements for periods commencing on or after 15 December 2019)	
13	The description of each key audit matter in the Key Audit Matters section of the auditor's report shall include a reference to the related disclosure(s), if any, in the financial statements and shall address: (Ref: Para. A33-1–A41) (a) Why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter; and (Ref: Para. A42–A45) (b) How the matter was addressed in the audit, including significant judgments made by the engagement team with respect to the matter. (Ref: Para. A46–A51)

IAS 1 – Revised December 2003, as amended (Applicable to annual periods beginning on or after 1 January 2009)	
25	When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going

	concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.
26	In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, the entity may reach a conclusion that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate

IFRS 9 – August 2020 (Applicable to annual periods beginning on or after 1 January 2018)	
5.5.5	Subject to paragraphs 5.5.13–5.5.16, if, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, an entity shall measure the loss allowance for that financial instrument at an amount equal to 12-month expected credit losses.
5.5.6	For loan commitments and financial guarantee contracts, the date that the entity becomes a party to the irrevocable commitment shall be considered to be the date of initial recognition for the purposes of applying the impairment requirements.
5.5.7	If an entity has measured the loss allowance for a financial instrument at an amount equal to lifetime expected credit losses in the previous reporting period, but determines at the current reporting date that paragraph 5.5.3 is no longer met, the entity shall measure the loss allowance at an amount equal to 12-month expected credit losses at the current reporting date.
5.5.9	At each reporting date, an entity shall assess whether the credit risk on a financial instrument has increased significantly since initial recognition. When making the assessment, an entity shall use the change in the risk of a default occurring over the expected life of the financial instrument instead of the change in the amount of expected credit losses. To make that assessment, an entity shall compare the risk of a default occurring on the financial instrument as at the

	reporting date with the risk of a default occurring on the financial instrument as at the date of initial recognition and consider reasonable and supportable information, that is available without undue cost or effort, that is indicative of significant increases in credit risk since initial recognition.
5.5.17	An entity shall measure expected credit losses of a financial instrument in a way that reflects: (a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes; (b) the time value of money; and (c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.
5.5.18	When measuring expected credit losses, an entity need not necessarily identify every possible scenario. However, it shall consider the risk or probability that a credit loss occurs by reflecting the possibility that a credit loss occurs and the possibility that no credit loss occurs, even if the possibility of a credit loss occurring is very low.