IN THE MATTER OF

THE EXECUTIVE COUNSEL OF THE FINANCIAL REPORTING COUNCIL

-and-

1) ERNST & YOUNG LLP

(2) MS JULIE CARLYLE

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*.

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 31 December 2021, "**FY21 financial statements**" means Made.com Group PLC ("**Made.com**[1]") consolidated financial statements for that period, and "**FY21 Audit**" means the statutory audit of the FY21 financial statements.

1.3.2. **"Respondents"** means:

1.3.2.1. Ernst & Young LLP ("**EY**") which was the *Statutory Audit Firm* for the FY21 Audit.

1.3.2.2. Ms Julie Carlyle ("**Ms Carlyle**"), who was the *Statutory Auditor* of Made.com for the FY21 Audit and signed off the FY21 auditors report on behalf of EY.

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 13 April 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 23 April 2026, the Independent Reviewer approved the issuance of this *Final Settlement Decision Notice* pursuant to Rule 107(a) of the AEP.

1.7. In accordance with Rule 108 of the AEP this *Final Settlement Decision Notice* sets out:

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

[1] Prior to FY21 "Made.com" refers to Made.com Design Ltd, the pre-IPO entity.

1.7.2. The *Sanctions*, with reasons; and

1.7.3. The amount payable by the Respondents in respect of Executive Counsel's Costs.

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*; and

1.8.6. Section 7: *Costs*.

2 EXECUTIVE SUMMARY OF THE BREACHES OF *RELEVANT REQUIREMENTS*

2.1. As is set out in this *Final Settlement Decision Notice*, there were breaches of *Relevant Requirements* by the Respondents in the FY21 Audit relating to two areas - management's use of the going concern assumption and the recoverability of a deferred tax asset ("**DTA**"), including the audit work relating to subsequent events in each area. The breaches are summarised below and described in detail in section 5.

2.2. Whilst this *Final Settlement Decision Notice* makes findings about deficiencies in the Respondents' audit work, it does not question the truth and fairness of the FY21 financial statements. The conclusions of the Executive Counsel are based on an analysis of the available evidence; the purpose of her investigation is not to reperform the Audits. In particular, whilst breaches of *Relevant Requirements* are found in the audit work performed in relation to going concern, it is not suggested that it was not appropriate for management to prepare the FY21 financial statements on a going concern basis or that disclosure of a material uncertainty was required.

Going Concern

<u>Breach 1</u>

2.3. <u>Testing of management's models</u>: In breach of paragraph 12-2(a)(iii) of ISA 570, the Respondents failed to carry out adequate procedures to determine whether the calculations in management's models were applied in accordance with the method and were mathematically accurate.

<u>Breach 2</u>

2.4. <u>Product cost assumptions</u>: In breach of paragraphs 12-2(b) and 12-2(c)(ii) of ISA 570, the Respondents failed to adequately test or challenge the product cost assumptions in management's forecasts.

<u>Breach 3</u>

2.5. <u>Evaluation of key balance sheet items</u>: In breach of paragraphs 12-2(a)(i) and 12-2(c)(ii) of ISA 570, the Respondents did not adequately assess the impact of the method and assumptions adopted by management in relation to certain significant balance sheet items.

<u>Breach 4</u>

2.6. <u>EY's Reverse Stress Test</u>: In breach of paragraphs 12-2(c)(ii) of ISA 570, the

Respondents failed to perform adequate procedures, through EY's Reverse Stress Test (“**RST,**”) to evaluate whether the assumptions on which management’s assessment was based were appropriate.

DTA

Breach 5

2.7. Audit testing: In breach of paragraph 6 of ISA 500, the Respondents did not perform audit procedures that were appropriate in the circumstances to obtain sufficient appropriate audit evidence regarding the recovery of the DTA.

Subsequent events

Breach 6

2.8. In breach of paragraphs 12-2(e) of ISA 570 and paragraph 6 of ISA 560, the Respondents did not give sufficient consideration to the information available up to the date of the auditor’s report in relation to the continuing reliability of management’s forecasts relating to going concern, and the recovery of the DTA.

Sanctions

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

EY

2.9.1. A financial sanction of £1,800,000 adjusted for mitigating factors by a reduction of 5%, and further discounted for admissions and early disposal by 30% so that the amount payable is £1,197,000;

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

2.9.3. A declaration that the FY21 Audit report signed on behalf of EY did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*.

Ms Carlyle

2.9.4. A financial sanction of £70,000 discounted for admissions and early disposal by 30% so that the amount payable is £49,000;

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

2.9.6. A declaration that the FY21 Audit report signed on behalf of EY did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice*.

3 BACKGROUND

Made.com

3.1. Made.com was founded in 2010, operating as an online furniture business selling directly to consumers.[2] By 2021 it was operating in eight countries within Europe and working with over 200 manufacturers globally.[3] Made.com's core business was made-to-order furniture but it had developed and expanded its homeware offering over the years, although in 2021 homewares still represented a smaller proportion of sales.[4]

3.2. From its initial foundation Made.com had achieved significant growth, with gross sales increasing by over 30% per annum from 2015 to 2020 and revenue increasing from £62 million to £247 million in the same period. However, Made.com had also not made any profits during that period, reporting a loss of £8 million in FY20.

3.3. Made.com required customers to pay in full when placing their orders and for 'made to order' items only ordered these from suppliers once customer orders had been received. The pattern of receiving cash up-front combined with the made-to-order business model meant that inventory balances were generally low, and this contributed to Made.com's negative net working capital position.[5]

3.4. This pattern of receiving cash up-front provided Made.com with liquidity advantages but also meant that it could potentially be exposed to fluctuations in costs incurred (principally freight costs) between the date of the order by the customer and delivery to the customer. Also, customers were entitled to cancel orders free of charge at any time prior to delivery and orders could therefore be cancelled in the event of, for example, shipping delays resulting in long periods between order and delivery.

EY

3.5. EY was appointed as auditor to Made.com in 2014 and retained that appointment until Made.com entered administration in November 2022. Ms Carlyle was the engagement partner for the FY21 Audit and had previously been the engagement partner for the Made.com audits in FY14, FY15 and FY20.

[2] Made.com Annual Report and Accounts 2021, page 28 and page 182.
[3] Made.com Annual Report and Accounts 2021, page 2 and page 3.
[4] Made.com Annual Report and Accounts 2021, page 24 and page 71.
[5] Made.com Annual Report and Accounts 2021, pages 23, 40, 42 and 66.

Events 2021 – 2022

3.6. On 21 June 2021, Made.com listed on the premium segment of the main market of the London Stock Exchange ("**LSE**") raising £100m. Made.com intended to use some of the funds raised to implement a strategy of holding increased stocks and reducing lead times, which was expected to drive further increases in sales. The change in strategy with respect to stock would however reduce the liquidity buffer inherent in the Made.com business model, by changing the timing of cash inflows and outflows for a proportion of customer orders.

3.7. In December 2021, Made.com issued a trading update, citing strong consumer demand set against industry wide supply chain disruptions. The year-end data showed that Made.com had achieved its sales targets but recorded a loss for FY21. The loss was in large part driven by a sharp increase in freight costs, which had increased from an average 3.3% of revenue in FY20 to 18.3% of revenue by December of FY21. Delays in fulfilling customer orders during FY21 had led to an increase in the rate of cancellations, and the inventory balance had significantly increased, as well as the deferred revenue balance, which represented orders taken but not yet delivered.

3.8. The financial statements for FY21 were signed on 8 March 2022 and were prepared on a going concern basis. Financial statements are prepared 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. EY issued an unmodified audit opinion, and no material uncertainty was identified.

3.9. Made.com issued further trading updates in May and July 2022. The May update stated that "*third-party data suggests that the online furniture and home market is down around 30-40% so far this year*".[6] In the July update the company explained that H1 trading had been impacted by worsening consumer sentiment despite what it referred to as "*strong execution of strategic priorities*".[7]

3.10. On 29 September 2022, Made.com released its interim results for the six months to 30 June 2022 reporting an EBITDA loss of £31.5 million.[8] The interim financial statements were prepared on a going concern basis, which was predicated both on Made.com's ability to sell the business, and Made.com having sufficient liquidity until a sale was completed.

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[6] RNS Number: 5365L, 16 May 2022.
[7] RNS Number: 9432S, 19 July 2022.
[8] RNS Number: 2161B, 29 September 2022.

3.11. EY stated that it was unable to obtain sufficient audit evidence to support management's assumptions and issued a "*disclaimer of conclusion*" in relation to its review of the interim financial statements.

3.12. On 25 October 2022, Made.com's shares were suspended from the main market of the LSE and discussions with potential purchasers were terminated.[9] The next day Made.com announced that it was no longer accepting customer orders.[10]

3.13. On 8 November 2022, Made.com went into administration. This was followed by a members' voluntary liquidation that was proposed on 22 December 2022, taking effect on 12 January 2023.

3.14. The failure of Made.com in 2022 took place against the background of a steep rise in inflation, and a significant decline in consumer spending. It is not suggested that the scale and impact of these matters were reasonably foreseeable as at the date of the FY 21 auditor's report.

The FY21 Audit

Going Concern

3.15. In the audit planning report, EY identified going concern as an area of audit focus in FY21, but not as a significant risk. The going concern period adopted covered 15 months from the date of approval of the financial statements, to June 2023. Management had initially considered a going concern period to December 2023; however, this was revised to 15 months following challenge from EY.

3.16. Management's going concern assessment relied primarily on cashflow forecasts contained in three Excel documents: a base case forecast ("**management's base case forecast**"); a severe but plausible scenario ("**management's SC4**"); and a stress test ("**management's SC5**"). Made.com also prepared a narrative paper describing the models and explaining the going concern assessment ("**management's going concern memo**").

3.17. The *Statutory Auditor* and audit team noted in internal EY correspondence that they considered the base case forecast to be "*optimistic*". Separately, EY had commented that management's initial sensitivities ("**SC2**" and "**SC3**"), which considered risks to Made.com's base case, were not severe enough. As a result of EY's challenge, management subsequently produced additional sensitivities in the form of

[9] RNS Number: 0742E, 25 October 2022.
[10] RNS Number: 1545E, 26 October 2022.

management's SC4 and management's SC5.

3.18. EY reported that given the significant headroom shown in management's base case forecast, the audit team had focussed on the revised sensitivity tests prepared by management. The most severe scenario was management's SC5, which modelled a 50% reduction in sales in FY22 and FY23 relative to FY21 and a number of 'stressed' assumptions compared to the base case forecast. This model showed a positive cash balance throughout the assessment period with a minimum cash balance of £6m in June 2023.

3.19. EY also performed an independent RST, which was designed to model a set of assumptions that would cause liquidity to run out in the going concern period, with the audit team then assessing the likelihood of this happening. EY's RST used a different set of assumptions to management's SC5. The assumptions included a lower decline in sales but with higher freight costs and cancellation rates, and also a different set of working capital assumptions.

3.20. The audit team produced two key workpapers that set out the work performed in relation to going concern – the audit team's year-end going concern memo ("**EY's going concern memo**") and EY's RST. EY's going concern memo set out the audit team's consideration of management's going concern assessment, including the audit procedures performed.

3.21. Made.com concluded that the FY21 financial statements should be prepared on a going concern basis, concluding:

> *"Based on the planning work on the Base case scenario, Severe Yet Plausible Downside Case and Stress Test, the Group has demonstrated it would have sufficient cash headroom throughout the assessment period to June 2023 to continue trading and fulfil its obligations."*

3.22. EY concluded in the Independent Auditors Report:

> *"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 Company's ability to continue as a going concern for a period to 30 June 2023."*

3.23. Made.com prepared its base case forecast for the four-year period to December 2025 in an Excel based model. It was used to support both its going concern assessment and its viability assessment. This was supplemented by management's going concern memo, which provided a narrative summary to accompany the numerical work.

3.24. Gross sales and gross margin were important assumptions in management's base case forecast. Gross sales represented the value of sales to the customers at the point of order, excluding VAT. The base case forecast gross sales growth of 32% in 2022 and at a similar level in 2023 and 2024.

3.25. In its going concern memo, EY commented on the forecast sales growth in management's base case forecast, noting that:

3.25.1. The sales growth was derived from an increase in the number of active customers compared to 2021;

3.25.2. Made.com had achieved significant gross sales growth in FY21 of 4% above budget and a 40% increase from FY20; and

3.25.3. External market data predicted growth in the online furniture retail market.

3.26. Gross margin represented revenue less costs of goods sold expressed as a percentage of revenue. Management's base case forecast assumed improvements in the gross margin from FY22 to FY25.

3.27. The two largest components of costs of goods sold were cost of product and freight costs, and the improvements in gross margin were driven by forecast reductions in both.

3.28. Freight costs had increased to 12% of revenue in FY21, up from 3% in FY20. Freight rates were forecast to average 11% of revenue in FY22 and then decrease to 8% in FY23. The expectation was that freight costs had reached their peak, would remain high for a period and then would decline.

3.29. Cost of product was forecast to fall to 35.3% of revenue in FY22 and 34.4% in FY2023. This compared to 40.3% of revenue in FY20 and 36.5% in FY21. The most recent results showed product costs of 38.3% in December 2021 and 41.4% in January 2022.

3.30. In its going concern memo EY commented on Made.com's forecast margin improvement, noting that freight costs were assumed to remain high in the first half of 2022, followed by a gradual reduction, with cost of product reducing year on year from 2021 to 2023.

3.31. Management's base case forecast also assumed a reduction in cancelled orders due to the expected improvements in lead times. Other costs were assumed to remain broadly stable as a percentage of revenue.

3.32. The forecast by Made.com of increased sales, increased gross margin, reduced cancellations and other costs remaining stable resulted in the base case forecasting that the business would be profitable in FY22, with significant increases in EBITDA year-on-year thereafter.

3.33. Cash headroom in the base case showed a positive balance throughout the going concern period, with a cash low point of £81m in September 2022. The level of headroom was a consequence of the forecast profits but was also driven by movements in working capital resulting from assumptions relating to certain balance sheet items. In particular, management's base case forecast assumed significant reductions in 2022 of both the inventory and deferred revenue balances, which resulted in increased cash holdings, although this was offset in part by the impact of a forecast reduction in trade creditors.

3.34. In the management base case the FY21 to FY25 monthly balances for inventory and trade creditors were calculated by reference to assumptions regarding "*days*".[11] Inventory days were forecast to reduce from 174 days in December 2021 to 95 days throughout FY22, resulting in a reduction in the forecast value of inventories and a matching cash inflow. The base case modelled a reduction in creditor days from 41 days in December 2021 to 20 days in FY22 resulting in a reduction in the trade creditors balance and a corresponding cash outflow.

3.35. EY's going concern memo compared the inventory days and creditor days in the FY22 forecasts to FY21, noting that, in relation to inventory, this reflected the *"planned investment of inventory to reduce customer lead times"* with the forecast 95 days being the *"target level".*

3.36. In relation to management's base case forecast overall, EY's going concern memo recorded *"…given [the] level of headroom in this case our focus remains on the revised stress test (SC5)...".*

SC5

3.37. Management's SC5 stress test modelled a reduction of 50% in gross sales relative to FY21 for FY22 and FY23. Freight costs were modelled at an average of 18.9% of revenue in FY22 and 7.1% of revenue in HY23. Cost of product was modelled at 29.6% of revenue in FY22 and 29.5% in HY23. Cancellation rates were kept at the base case forecast level of 4.5% for FY22 and FY23.

3.38. Management described the assumptions relating to gross margins as "*margin degradation of 10%*". However, the gross margin modelled in management's SC5 for

[11] For example, the number of days that stock was expected to turn over was a key input into the calculation of the forecast monthly inventory balance.

FY22 was 2.3% lower than in Made.com's base case and was higher than had been achieved in FY21. The assumptions in management's SC5 relating to both cost of product and cancellation rates represented a significant improvement compared to FY21.

3.39. The inventory and creditor balances in management's SC5 were calculated in the same way as in the base case forecast i.e. by reference to assumptions about "*days*". The inventory days assumption was the same as in their base case in that inventory days were modelled to drop from 174 days in FY21 to 95 days in FY22. Because management's SC5 also included a 50% decline in gross sales the inventory balance was much lower in management's SC5 than in the base case, decreasing to £17.4m by December 2022 in management's SC5, compared to £51.4m in the base case. Management's SC5 forecast inventory days to fall further in 2023, to 88 days.

3.40. In management's SC5, liquidity would be maintained until August 2023. Management's going concern memo stated that *"[t]his scenario leads to a 'cliff edge' by June/July 2023 with cash holdings reaching £6m."* Made.com considered that SC5 represented a drastic scenario that was highly unlikely to occur, and that mitigating actions would be taken before this point was reached.

3.41. EY's going concern memo included a description of management's SC5 and assessed the reasonableness of certain assumptions. It explained that the improvement in gross margin in management's SC5 compared to FY21 was driven by price increases which had been implemented by management in February 2022 and noted that the forecast reduction in freight costs was consistent with external market analysis. The EY going concern memo did not contain any assessment of the reasonableness of the balance sheet assumptions modelled in management's SC5.

<u>EY's RST</u>

3.42. EY's final report to the audit committee dated 7 March 2022 described EY's RST as follows:

> *"As part of our assessment we have carried out our own reverse stress test and see what combination of assumptions would have to combine to cause the business to run out of cash. To do this, we have taken management's RST and flexed the following assumptions:*
>
> *Working capital days are extended to their high point in 2021 – Inventory - 174 days and Creditors - 41 compared to 95 and 20 respectively in*

management's RST with deferred revenue remaining constant throughout at the 2021 levels.

That freight rates remain at 19% of revenue aligned to the January 2022 levels, which reduces GM to 38% in 2022 and 36% in 2023.

To offset the cash impact of the above we have reduced the gross sales decline (compared to management's reverse stress case of 50%) to a 30% reduction on 2021 in 2022 and then remain flat into 2023.

Using these further stressed assumptions, our assessment shows liquidity running out in April 2023.

Management have identified a number of mitigations including, delayed capex on distribution and price increases to offset inflationary pressures which are not included within the above.

We consider both the Made.com and our further EY stressed case to be remote as both require an immediate and sustained reduction in gross sales which is contrary to the results in recent periods as well the wider market expectations for online furniture retail. Global analysts suggest a broad range of outcomes for the industry, with the consensus being for continued growth throughout the period to 2025, however, at varying rates between 4% and 20%."

3.43. EY's RST model was based on FY21 figures as shown in the base case model. Key assumptions in EY's RST were:

3.43.1. Gross Sales reduced by 30% compared to actual FY21 results. This led to a reduction in revenue of 22%.

3.43.2. Cancellations set at 8.6% of gross sales for FY22, in line with actual FY21 cancellation levels.

3.43.3. Freight costs set at 19% of revenue throughout FY22 and HY23, which was in line with the base case January 2022 forecast and the actual level of cost incurred in that month.

3.43.4. Cost of product reduced from the FY21 amount by the same proportion as revenues (22%). This resulted in cost of product being 38.5% of revenue in FY22, increasing to 41% in HY23.

3.44. EY's RST modelled the majority of costs to move in line with revenue. This meant that for most costs, if revenue decreased, costs would also decrease by approximately the same proportion. EY referred to the variability of costs in articulating their conclusion in EY's going concern memo as follows:

> *"however, you try and stress the assumptions, the level of liquidity together with the high variability of costs means that the model is difficult to break except in the remotest of scenarios, hence, we accept management's assessment that there are no individual or combined events that represent a material uncertainty, based on our procedures performed."*

3.45. As with the base case and management's SC5, inventory and creditor balances in EY's RST were calculated by reference to assumptions about "*days*", although the method of calculation differed. Inventory days were held at 174 days and trade creditor days were held at 41 days for the whole of FY22 and FY23.

3.46. EY described the balance sheet assumptions as resulting in a cash reduction but in fact the working capital movements modelled provided an immediate cash benefit of £13.2 million in January 2022 and an aggregate cash inflow over the going concern assessment period of £17.9 million (as compared to the base case forecast) or £12.6 million (as compared to management's SC5).

3.47. EY's going concern memo considered whether the scenario modelled in the EY RST could be regarded as remote. It noted that:

> *"Made has seen a compound annual growth of 32% in sales (£194m to £441m) over the last 3 years, with any particular year growing by at least 25%;*
>
> *Year on year sales growth in the month of January 2022 is +15%*
>
> *The Pandemic has certainly accelerated the growth trajectory with sales growth of 40% in 2021 but the steep growth had already begun; and*
>
> *Global analysts suggest a broad range of outcomes for the industry. The consensus is for continued growth throughout the period to 2025, however, at varying rates between 4% and 20%."*

And concluded that:

> *"with the backdrop of a growing market in which Made.com is taking market share by growing ahead of market indices we consider it reasonable to assess that a decline of 31% of sales would be considered remote. Therefore, on balance we consider management's conclusion to be reasonable"*

3.48. However, the combination of assumptions in EY's RST meant it was not sensitive to changes in gross sales. The impact on cash of a reduction in sales was offset by reductions in costs and changes in net working capital. As a result, whilst the RST did show cash headroom being eliminated during the going concern assessment period, this occurred in the same month regardless of the level of the reduction in gross sales modelled.

DTA

3.49. A DTA reflects the benefit derived from setting off past losses against future tax payable on profits. A DTA can be recognised to the extent that it is probable that sufficient future taxable profit will be available against which unused tax losses can be utilised.

3.50. IAS 12, the applicable accounting standard, provided that:[12]

> *", the existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that …there is* ***convincing …evidence*** *that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the entity.***"** *[emphasis added]*

3.51. Made.com had recognised a DTA, as set out below:

£'m	**FY18**	**FY19**	**FY20**	**FY21**
Profit / (loss) before tax	(5.7)	(19.3)	(14.6)	(31.4)
Deferred Tax Asset	4.3	5.1	12.2	14.8[13]

3.52. Materiality for the FY21 Audit was £2.4 million and the DTA was therefore material to the financial statements. Made.com had a history of recent losses and therefore should only have recognised a deferred tax asset if there was "*convincing evidence*" that sufficient taxable profit would be available in the future for the carrying value of the asset to be recovered.

3.53. EY planned to test this by carrying out the following procedures:

3.53.1. Obtain details of management's forecast taxable profits and assessment of the utilisation of the accumulated tax losses;

[12] IAS 12, paragraph 35.

[13] The increase in the deferred tax asset in FY21 was due to a change to the UK corporation tax rate being substantively enacted as part of the Finance Bill 2021. No additional losses were recognised.

3.53.2. Validate the schedule against forecasts used elsewhere – impairment and going concern - for consistency;

3.53.3. Assess the reasonableness of key assumptions for growth as part of the going concern process and check this against contra indicators;

3.53.4. Sensitise management's forecast to determine how much forecasted profits would drop to assess the level of sensitivity in the recognition of the deferred tax assets; and

3.53.5. Assess the appropriateness of the tax rate and period over which the losses would be utilised by management.

3.54. Management's assessment of the recovery of the DTA used the base case forecast that had been used for their going concern assessment, which included forecasts for revenue and profit before tax for FY22 – FY25. The forecast was that revenue would increase from £534 million in FY22 to just over £1 billion in FY25 with profit before tax in that period increasing from £1.5 million to over £100 million.

3.55. Management's assessment of the recovery of the DTA was contained in a document titled "*21 MG PLC Viability memo (PBC)*". The memo set out the amount of the asset, the loss relief rules and a table showing the recovery of the DTA under the base case, and recorded:

> "*The deferred tax asset is expected to fully unwind in 2025*".

3.56. Workpaper "*21 MGP - Deferred tax asset recoverability memo*" ("**EY's DTA memo**") set out EY's consideration of the recoverability of the DTA. EY also produced an excel workpaper setting out the recovery of the DTA on the base case, and a scenario where base case forecast profits were reduced by 20%.

3.57. EY's DTA memo recorded that the objective was to "*[c]onsider the probability of the Group generating taxable profits in the future to be able to utilise the assessed losses and recognise a deferred tax asset in the FY21 financial statements.*"

3.58. EY's DTA memo noted:

> *"The forecast used to evaluate the recoverability of DTA is based on the 5 year plan as approved by the board in November 2021. We have assessed the quality of the forecast as part of our going concern and viability assessments […]*
>
> *The base case indicates that management will utilise all tax losses by 2025 as they would make a taxable profit then.*

We challenged management's position that the DTA is recoverable given they are loss making and indicated in 2020 that the losses would be utilised over the three years. The performance last year was behind budget at an earnings level due to:

a. Continued supply chain disruption leading to longer than planned lead times;

b. Continued freight cost pressures which means that GM has lagged behind expectations; and

c. The one off costs of the IPO."

3.59. EY's DTA memo also stated that *"[g]iven that management have made a loss in 2021 it raised the question of whether their forecast is too optimistic. Management's forecasting ability is assessed in the GC paper referenced elsewhere".*

3.60. EY's commentary on management's base case, recorded as being summarised from EY's going concern memo, focused on FY21 results and explanations for why budgeted amounts for revenue and margin were not achieved. There was no assessment in EY's DTA memo of the achievability of the level of profit forecast in the base case for FY22 – FY25.

3.61. EY's DTA memo considered sensitivities performed by management and by EY. It recorded that:

> *"Management have prepared two downside scenarios in their going concern assessment a severe yet plausible [SC4] and a reverse stress test [SC5]. In both of these scenarios no tax would be payable in the period to June 2023."*

3.62. EY also noted that the DTA would not be recovered by 2025 in management's downside scenario:

> *"We note that in the reasonably plausible downside scenario prepared by management the DTA is would not start to be recovered until 2024 which would mean that not all of the asset is recovered by 2025".*

3.63. EY's stated approach was:

> *"In order to understand the level of sensitivity at a PBT level we have applied sensitivity of a 20% drop in Profit over the forecast period. This shows that the DTA would still be utilised by 2025."*

3.64. EY's DTA memo set out EY's conclusion as follows:

> "- *The base case supports the recognition of the asset*

- *The expected utilisation period is reasonable at 3 years*
- *Revenue has continued to grow in January 2022 but the cost pressures have continued with the benefit of the sales price rises in February 2022 not being seen until the product is sold through into March means that the Group has made a greater loss than was forecast in January 22.*
- *The disclosure in the basis of prep clearly identifies this as a judgement and the disclosure in note 11 sets out the basis on which it has been recognised.*
- *On balance it would not be appropriate to derecognise the DTA when there is a Board approved plan which they are tracking at a gross sales level which shows the asset will be recovered.*
- *This is an area that we will continue to monitor going forwards."*

3.65. The conclusion on the DTA relied substantially on the audit work performed on going concern. EY's DTA memo referred to work paper "*21 Made.com plc Going Concern summary*" as containing *"detailed analysis of forecasts for profits & working capital".* This document was management's going concern memo, which did not contain detailed analysis of profitability for 2024 and 2025 when the majority of the DTA would be recovered.

3.66. The focus of EY's going concern memo was on the period to June 2023 and on EBITDA rather than profit before tax. It contained only limited references to the period after June 2023 and did not contain any assessment of the reasonableness of Made.com's profit before tax forecasts for FY24 or FY25.

3.67. EY's going concern memo also included an assessment of management's historical forecasting accuracy, which identified variances between actual and forecast amounts for a number of metrics in FY21. It identified that EBITDA had been forecast as breakeven or profitable in each year from FY18 to FY21, whereas the actual results in each year were lossmaking. It noted that the variances "*indicate a number of challenges in forecasting the results of the business"* and that *"Primarily the variances in forecasting have been driven by* "*1) the ongoing supply chain disruption extending lead times; and 2) the freight cost rises that meant GM has deteriorated*". These factors had impacted significantly on EBITDA in FY21; there was no assessment of why management's forecasts had been inaccurate in FY18, 19 and 20.

3.68. EY's final audit results report was dated 7 March 2022. It stated that EY accepted the amount of DTA recognised by management was reasonable but flagged the risk that it might not be recoverable, stating:

> *"The current forecasts suggest that all recognised losses will be used by the end of 2024. …Management should continue to monitor the recoverability of the DTA and if forecast taxable profits are not achieved further consideration will need to be undertaken by management as to whether they remain recoverable."*

Subsequent events

3.69. EY's auditor's report stated that the evaluation of going concern included *"comparing management's forecasts to actual results through the subsequent events period and performing inquiries to the date of this report"*.

3.70. The audit team obtained Made.com's January 2022 management accounts and discussed the contents with management on 5 March 2022. EY's record of this discussion was contained in workpaper "*21 MG PLC - final minutes and challenges*". EY stated:

> *"The January management accounts were finalised ahead of finalising the audit so a detailed understanding of the performance of the Group was undertaken ahead of this with the [senior member of Made.com's Finance Planning & Analysis team] …as well as the CFO …on 5 March 2022. The context of this discussion was really to understand whether this provided any evidence that the scenarios performed were sufficient to reflect the performance in January."*

3.71. The management accounts recorded actual amounts for Made.com's financial performance in January 2022 and compared these to prior year results for January 2021, and to figures described as "Budget" amounts. The "Headline" amounts showed that:

3.71.1. Gross sales had increased by 12.2% on the prior year but was 12.6% lower than the budget amount;

3.71.2. Net revenue had increased by 41.8% on the prior year but was 16.2% lower than the budget amount;

3.71.3. Gross margin in January 2022 was 36.0%, compared to 52.4% in the prior year and the budget figure of 41.7%; and

3.71.4. EBITDA in January 2022 was a loss of £6.5 million, which was higher than both the prior year amount (a profit of £0.5 million) and the budget amount (a loss of £2.4 million).

3.72. In the workpaper "*21 MG PLC - final minutes and challenges*" the audit team considered these differences and commented on each.

3.73. In relation to gross sales the work paper recorded:

> *"Sales are down 12.6% on budget but 12.2% up on prior year. The sales decline are a combination of two primary factors; softening decline in the market offset by the impact of the marketing initiatives planned.*
>
> *The wider market is seeing a softening of demand due to the macro factors of inflation and geopolitical uncertainty.*
>
> *Importantly though the decline on budget is much lower than the reverse stress test performed."*

3.74. In relation to revenue the workpaper recorded:

> *"Revenue is down 16.2% on budget reflecting the sales performance and the continued high level of deferred revenue which has not unwound as quickly as expected being £1.5m behind budget.*
>
> *Importantly though the unwind of deferred revenue continues in the right direction being £2.0m ahead of prior year."*

3.75. In relation to gross margin the workpaper recorded:

> *"Gross margin in January was 36.0% down from the budget of 41.7%. The main change is the inflation cost of the product making it 41% of revenue compared to the budget of 36%.*
>
> *Management have already responded to this change through implementing price increases in February of 10%. The impact of that won't yet be seen until the March or April performance as the sales at those prices unwind through revenue.*
>
> *Therefore, the 36% is expected to be the short term impact of the cost inflation which will be remedied through pricing.*
>
> *As it relates to going concern, the EY stress test model has reduced GM to 36% through the period so have already considered the impact."*

3.76. In relation to EBITDA the workpaper recorded:

> *"Given the revenue performance and reduced GM, EBITDA is £4.2m behind budget at January.*
>
> *January was already forecasting a loss given the increased promotional activity that typically takes place in December that is unwound through revenue in January"*

3.77. The cash balance for the end of January 2022 was £99.1 million, a reduction of £8 million from FY21 year end and £1.5 million less than the budget amount. In relation to cash the workpaper recorded:

> *"The cash decline of £8.0m to £99.1m is consistent with the management accounts expectation of £7.6m due to the offset of the EBITDA movement and working capital"*

3.78. The 'budget' figures used for the comparison in the January 2022 management accounts were, however, different from the base case figures, which had formed the basis for the going concern assessment. EY did not compare the base case forecasts with actual balances in the January 2022 management accounts. For most of the profit and loss items the differences between the budget and base case amounts were small but the differences in the balance sheet items were more significant; in particular the January 2022 actual cash balance of £99.1 million was £15 million lower than in the base case forecast.

3.79. Supply chain disruption had led to inventory and deferred revenue being elevated at the end of FY21. A senior member of the audit team had noted in an email on 13 December 2021:

> *"All of their product is landing over a two to three week period in December and they don't have the logistics capacity to get it out […] Means that they just can't get it out of the door in December. They do expect it to unwind through Jan and into Feb (we'll know by the audit)"*

3.80. In fact, both the inventory and deferred revenue balances had increased in January 2022 rather than decreased. EY did not comment on this in workpaper "*21 MG PLC - final minutes and challenges*".

3.81. EY also obtained and reviewed minutes of Made.com's board meeting in February 2022. These were received on 4 March 2022 and summarised in a work paper called "*21 MG PLC - Board Minutes".*

3.82. The minutes recorded discussion of the "Trading Environment", with the CEO stating that:

> *"the external operating environment remains difficult, with the UK market in particular proving very challenging. Trading has been challenging over the last couple of months and there is a risk to the full year sales target unless the macroeconomic environment improves, and there are therefore key decisions to be taken regarding the mitigating actions to be taken."*

3.83. As regards pricing, the CEO stated that:

> *The results of pricing changes are being tracked and early indications suggest the lower price point products have been impacted more negatively than higher price products. Management will be keeping this under close review and will take corrective action as necessary.*

3.84. The minutes recorded discussion of “Sales scenario planning”, with the CFO noting that:

> “*the budgeted 2022 sales growth of +32% assumed a +10% YoY market growth alongside growth driven by proposition improvement, whereas the YTD market is currently in decline*”.
>
> And that
>
> *“Management are currently exploring a number of tactical actions to drive incremental sales growth, focussed on on-hand stock position and realistic execution potential, which could provide a route back to achieving the budget.”*

The minutes recorded discussion of “Financial Planning”, with the CFO noting that:

> *“a number of the risks identified when setting the budget had started to materialise, which are being partly offset by price increases.*
>
> *…*
>
> *the lower demand scenarios would put further pressure on the financial position. …”*

3.85. The work paper did not record any comment on the content of the board minutes other than “*This is consistent with our understanding*” and a conclusion that “*The board minutes above are consistent with information obtained during our audit procedures*.”

3.86. The subsequent events work papers did not refer to recovery of the DTA as an issue discussed with management or considered by the audit team. However, as noted in paragraph 3.63 above, EY’s DTA memo referred to the January 2022 results in the management accounts, recording that whilst revenue had continued to grow in January 2022, Made.com had made a greater loss than was forecast.

3.87. The conclusion was:

> *“On balance it would not be appropriate to derecognise the DTA when there is a Board approved plan which they are tracking at a gross sales level which shows the asset will be recovered.”*

3.88. The audit report was not signed until 8 March 2022. EY did not obtain trading data for Made.com’s financial performance in February 2022 as part of their going concern assessment. They did however receive management information relating to February 2022 as part of the audit testing on inventory. This included gross sales data for FY21, January 2022 and February 2022 which showed that February 2022 gross sales were considerably lower than both the level of sales in the base case forecast and the equivalent month in the prior year.

4 *RELEVANT REQUIREMENTS* TO WHICH THE BREACHES RELATE

4.1. Rule 1 of the AEP states that *Relevant Requirements* has the meaning set out in regulation 5(11) of the Statutory Auditors and Third Country Auditors Regulations 2016 ("**SATCAR**"). The *Relevant Requirements* include, but are not limited to, the International Standards on Auditing (UK) ("**ISAs**"), issued by the Financial Reporting Council and based on the standards issued by the International Auditing and Assurance Standards Board.

4.2. The ISAs relevant to Executive Counsel's *Final Settlement Decision Notice* are those applicable to the FY21 Audit.

4.3. The *Relevant Requirements* referred to in this *Final Settlement Decision Notice* are the following:

4.3.1. ISA 500 (Audit Evidence);

4.3.2. ISA 560 (Subsequent Events); and

4.3.3. ISA 570 (Going Concern).

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

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

5 BREACHES OF *RELEVANT REQUIREMENTS*

Going Concern

Breach 1 – Accuracy and integrity testing of management's model

5.1. Paragraph 12-2 of ISA 570 provides:

> *"The auditor shall perform audit procedures that include:*
>
> *(a) Evaluating management's method to assess the entity's ability to continue as a going concern, including determining:*
>
> *…*
>
> *(iii) Whether the calculations are applied in accordance with the method and are mathematically accurate.*

5.2. Management's base case forecast was presented in an Excel spreadsheet containing 144 complex and interlinked worksheets, with numerous inputs and formulae which interacted to produce outputs. This complexity made it challenging to test whether calculations were applied in accordance with the method. In particular, understanding how a single figure was calculated might involve tracking through multiple tabs of the spreadsheet and numerous calculations, and some formulae contained a mixture of calculations and hardcoded numbers, representing manual adjustments to the output of the formula. As a result, cells a user might expect to be calculated consistently with each other were not in fact treated consistently.

5.3. Also, certain FY21 figures in management's base case were not 'actual' amounts reflecting FY21 reported results but were calculated by formulae. For example, monthly inventory balances were calculated by reference to an assumed number of 'days' for the balance to turn over and were thus outputs of the model rather than inputs.

5.4. The auditor's report stated that the audit team had performed the following procedures:

> *"testing the inputs to the model and agreeing them to the latest Board approved forecasts"*

and

> *"checking the arithmetical accuracy of the cash flow forecast models".*

5.5. EY's going concern memo also stated that the audit team had:

> "*obtained management's forecasts and checked the mathematical accuracy of the models, including the application of sensitivities. We completed the relevant*

> *IPE [Information Produced by Entity] documentation.* ***21 Made.com plc Going Concern summary***."

However, "*21 Made.com plc Going Concern summary*" is a reference to EY's interim going concern workpaper, where testing was performed at half-year on a different set of forecasts presented in a different model.

5.6. The information in EY's going concern memo that referred to management's forecasting approach did not describe the model itself or provide evidence that audit procedures had been performed in relation to the various elements listed. There is no record of the performance of any procedure agreeing inputs to management's forecasts, or of checking the mathematical accuracy of the model. In each case significant work would have been required to perform these checks properly and there is insufficient evidence to show that the audit team fully understood the nature and complexity of the calculations in the model, or the source of the data and inputs to which the calculations were applied.

5.7. The Respondents thus did not perform adequate procedures to determine whether the calculations applied in management's model were in accordance with the method adopted and were mathematically accurate and consequently there was a breach of paragraph 12-2 of ISA 570.

<u>Breach 2 – Product cost assumptions</u>

5.8. Paragraph 12-2 of ISA 570 provides:

> *"The auditor shall perform audit procedures that include:*
>
> *…*
>
> *(b) Evaluating the relevance and reliability of the underlying data used to make the assessment;*
>
> *…*
>
> *(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:*
>
> *…*
>
> *(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."*

5.9. As noted above in paragraph 3.29, actual product costs were 40.3% of revenue in 2020 and 36.5% of revenue in 2021, and were forecast to fall to 35.3% of revenue in 2022 and 34.4% in 2023. The forecast EBITDA for 2022 was 3.3% of revenue. Achieving this level of EBITDA was largely dependent on the forecast reduction in product costs being achieved. The forecast EBITDA for 2023 was 5.4% of revenue, and a significant contributor to the improvement in EBITDA was the forecast reduction in product costs. Made.com's assumptions regarding product cost during the going concern period were thus significant.

5.10. In management's SC5 product cost was set at 30% of revenue, significantly lower than both the prior year and base case forecast figures. EY's RST modelled that product costs would represent the same percentages as in FY21 and HY21 respectively being 38.5% of revenue in FY22, and 41% in HY23.

5.11. Thus, all management's modelled outcomes forecast a reduction in product costs during the going concern period, and EY's RST forecast a level of product costs comparable to the prior year. None of the models considered any scenario where product costs were *higher* than recent experience, whether as a short-term phenomenon or for a sustained period.

5.12. EY's going concern memo stated:

> *"Product cost improvements in raw material sourcing is expected through Made's deeper integration into tier two sourcing, thereby sourcing direct and enabling economies of scale and to maintain quality."*

There was no further explanation, or any evidence identified, to support the level of reduced costs forecast in management's models.

5.13. EY considered management's forecasts of gross margin, in which cost of product was a significant factor, but the work was focused on freight costs, and the "*Evaluation of Key Assumptions"* in the going concern memo did not include any comments on cost of product.

5.14. EY did not test or challenge management's explanation nor did they obtain further data or perform any analysis to enable them to conclude that management's assumptions in relation to product costs assumptions were reasonable. The Respondents thus did not perform adequate procedures to evaluate either the data or assumptions relating to product cost on which management's assessment was based and consequently there was a breach of paragraph 12-2 of ISA 570.

Breach 3 – Evaluation of key balance sheet items

5.15. Paragraph 12-2 of ISA 570 provides:

> *"The auditor shall perform audit procedures that include:*
>
> *(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;*
>
> ,,,
>
> *(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:*
>
> …
>
> *(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."*

5.16. Management's base case and management's SC5 both modelled inventory balances assuming a fixed level of inventory days in FY22 and a different, fixed level in FY23. EY's RST assumed a single, fixed number of inventory days throughout the period of the going concern assessment. A similar approach was also taken in both management's base case and management's SC5, and EY's RST, to the modelling of creditor days.

5.17. However, EY was aware that Made.com's historical experience was of seasonal variations in working capital that impacted monthly inventory balances and deferred income. EY's going concern memo recorded:

> *"There is a degree of seasonality in Net Working Capital, generally following trading patterns, with lower balances arising around January and July, following higher promotional sales resulting in lower stock levels and higher deferred income.* ***This is expected to continue in the forecast period"*** (emphasis added).

5.18. EY was also aware that Made.com's strategy for FY22 was to reduce lead times by managing and refining its stock-holding strategy, which was also likely to be inconsistent with the fixed level of inventory days used in the models.

5.19. The approach to modelling inventory and other balance sheet items using a fixed number of days either for an entire year or (in the case of EY's RST) for the entire going concern assessment period was unlikely to reflect Made.com's actual experience on a monthly basis. This was important as the seasonal fluctuations combined with the implementation of a new stock holding strategy would be expected to have a potentially significant impact on working capital and consequently on the level of cash from one month to the next.

5.20. The use of fixed but different levels of both inventory days and creditor days for each of FY21, FY22 and FY23 in management's models also led to unrealistic outcomes in January 2022 and January 2023 when there was an abrupt change in the underlying assumption. For example, in management's SC5 the inventory balance decreased by £33.4m from December 2021 to January 2022 but the cost of product in January 2022 was only £5.7m. Therefore, the reduction in inventory exceeded the value of goods sold by more than £27.7m.

5.21. Both management's models and EY's RST used flawed approaches to calculating inventory balances. EY was aware of the likely monthly fluctuations in key balance sheet items during the going concern assessment period but did not go on to consider whether, in light of that, using a method that fixed both inventory and creditor days was appropriate for forecasting cashflows. EY did not perform sufficient sensitivities to assess the impact of the balance sheet assumptions adopted or likely changes during the assessment period. The Respondents thus did not perform adequate procedures to evaluate whether the method for modelling inventory and other balance sheet items on which management's assessment was based was appropriate, and consequently there was a breach of paragraph 12-2 of ISA 570.

Breach 4 – EY's RST

5.22. Paragraph 12-2 of ISA 570 provides:

> *"The auditor shall perform audit procedures that include:*
>
> *[…]*
>
> *(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:*
>
> *[…]*

(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"

5.23. As noted in paragraph 3.42 above, in its final report to the Audit Committee dated 7 March 2022, EY described the approach to the EY RST as 'flexing' the assumptions used in management's SC5 and concluded that:

"Using these further stressed assumptions, our assessment shows liquidity running out in April 2023"

EY then considered whether the scenario modelled was remote and concluded that it was. The conclusion was based on EY's consideration of the likelihood of Made.com suffering a 30% decline in sales.

5.24. However, EY's RST was not sensitive to reducing the level of sales, with cash being eliminated in the same month with reductions in sales of 30% (as in EY's RST) or 50% (as in management's SC5). In fact, in EY's RST cash would be eliminated in the same month if sales were held at FY21 levels, or increased by 32%, as in the base case forecast.

5.25. EY's RST modelled a set of assumptions that would cause the business to run out of cash during the going concern assessment period. The audit team then concluded that the sales decline reflected in EY's RST was remote and therefore management's going concern conclusion was reasonable. However, the point at which cash was exhausted, as modelled in EY's RST, was not sensitive to changes in the level of sales and therefore the audit team could not reasonably rely on the conclusions drawn from EY's RST. The Respondents thus did not, through the EY RST, perform adequate procedures to evaluate whether the assumptions on which management's assessment was based were appropriate, and consequently there was a breach of paragraph 12-2 of ISA 570.

DTA

Breach 5 – Audit Testing

5.26. Paragraph 6 of ISA 500 provides:

"The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence."

5.27. EY relied on the audit work performed on management's going concern assessment to support management's conclusion that it was appropriate to continue to recognise the

DTA. However, that work was to determine whether the going concern basis was appropriate and any material uncertainty existed and was focused on forecast cashflows rather than profit. It did not directly address whether the forecast profits in the GC period were reasonable and whether they could be relied on for the purposes of recoverability of the DTA. No assessment was recorded, either as part of the going concern work or DTA work, that addressed the reasonableness of the level of profits forecast for FY24 and FY25, during which the majority of the DTA was forecast to be recovered.

5.28. EY noted that the failure to achieve forecast profits indicated a degree of optimism but did not challenge management on its forecast of increasing profit levels from FY22 onwards. EY's going concern work on management's historical forecasting did not provide support for the accuracy of profit forecasts for the recovery period.

5.29. The sensitivity testing performed, involving a reduction of 20% from the base case for forecast PBT, indicated that the DTA would be recovered, but there was no explanation recorded as to why this sensitivity was considered appropriate. In management's 'reasonably plausible' downside scenario (management's SC4) the full DTA would not be recovered, which was noted by EY but not addressed in the conclusion reached.

5.30. The procedures performed did not provide assurance that Made.com had presented the 'convincing evidence' required under IAS 12 to conclude that sufficient profit would be available to support recovery of the DTA.

5.31. Accordingly, the Respondents did not perform adequate audit procedures that were appropriate in the circumstances to obtain sufficient appropriate audit evidence and there was a breach of paragraph 6 of ISA 500.

Subsequent Events

<u>Breach 6 – Subsequent events</u>

5.32. Paragraph 12-2 of ISA 570 provides:

"The auditor shall perform audit procedures that include:

...

(d) Evaluating management's plans for future actions in relation to its going concern assessment, including determining whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.

…

(e) Considering whether any additional facts or information have become available since the date on which management made its assessment."

5.33. Paragraph 6 of ISA 560 provides:

"The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified."

5.34. The audit team obtained management accounts for January 2022 and discussed the results with management. They also obtained and reviewed the board minutes of 17 February 2022 (the "**February board minutes**"). Taken together, the management accounts and February board minutes raised issues that should have resulted in further enquiries being made of management, and consideration by EY as to whether the forecasts that had been the basis of the going concern assessment could still be relied on.

5.35. The CFO had reported to the board that the forecast sales growth assumed a growing market, whereas the market was "*in decline*". Management was considering "actions" that *"could provide a route back to achieving the budget"*. This suggested that there was some doubt as to whether management still believed that the base case forecast was achievable.

5.36. Gross margin in January 2022 was significantly lower than forecast, with EY commenting that this "*is expected to be the short term impact of the cost inflation which will be remedied through pricing".* It was recorded in the February board minutes that price increases were being tracked and early indications suggested the lower price point products had been impacted more negatively than higher price products, and that management would be keeping this under review and would take "*corrective action"* as necessary. Further, the lower margin was reported to be due mainly to an increase in cost of product, which had been forecast to reduce in all management's models.

5.37. The inconsistency between the expected 'unwind' in inventory and deferred revenue in January 2022 and the actual increase in these balances, as well as the substantial difference between the forecast and actual amounts, suggested management's assumptions regarding supply chain disruption and freight costs may have been optimistic.

5.38. The February board meeting minutes also recorded that there were "*key decisions to be* *taken regarding the mitigating actions to be taken”*. Made.com had identified a number of potential ‘actions’ in its going concern memo and in the Viability report in the FY21 annual report but EY had not performed any specific audit procedures to consider the likely impact or feasibility of these. EY’s going concern memo referred to:

> *“…considerable levers with management in terms of the variable cost in the business which can be pulled at any time in the event the business is not following the expected trajectory mainly being a reduction in marketing spend, overheads…”*

5.39. Whilst EY’s going concern memo referred to reducing marketing spend as one of the levers that management could pull, the February board minutes indicated that management intended to maintain the level of marketing expenditure relative to sales. The CEO explained that:

> “*… management recommended maintaining marketing investment as a percentage of gross sales in the lower demand scenario.”*

5.40. In all the circumstances EY should have revisited and re-evaluated their assessment of the feasibility of management’s plans.

5.41. Further, EY had relied on the audit work performed over going concern and the base case forecast to conclude on the recovery of the DTA. EY’s DTA memo identified that January trading did not meet management’s forecasts but referred to a “*Board approved plan which they are tracking at a gross sales level which shows the asset will be recovered”*. However, the audit team was aware from the audit work performed that Made.com had consistently forecast, and achieved, significant growth in sales, but had also forecast, and failed to achieve, profitable results. In light of the contents of the January 2022 management accounts and board meeting minutes EY should have sought confirmation from management that they still considered that the DTA would be recovered, and considered whether there was “convincing evidence”, as required by IAS12.

5.42. The Respondents thus failed to give proper consideration to the information contained in the January 2022 management accounts and the February board meeting minutes and the impact (including in respect of the feasibility of mitigating actions) on the evidence obtained relating to the going concern assessment and the recovery of the DTA.

5.43. Consequently, there were breaches of paragraph 12-2 of ISA 570 and paragraph 6 of ISA 560.

6. *SANCTIONS*

6.1. Paragraph 10 of the FRC's Sanctions Policy (AEP) (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 of 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. In considering *Sanctions* to be imposed on the Respondents, Executive Counsel has, in summary, considered the following matters in accordance with the Policy.

Nature, seriousness, gravity and duration of the breaches

6.3. The ISAs engaged in this case are all important *Relevant Requirements*, designed to ensure the quality and effectiveness of an audit.

6.4. The breaches of *Relevant Requirements*:

6.4.1. Were serious as they include a number of failures in relation to the audit of Made.com's conclusion as to its going concern status and separately the amount of recoverable DTA which was material;

6.4.2. Related to a single audit year; and

6.4.3. Were not intentional or deliberate, reckless or dishonest and did not involve financial gain.

6.5. The Respondents did not derive or intend to derive any profit or benefit from the breaches of the *Relevant Requirements* (beyond the audit fee chargeable for the FY21 Audit).

6.6. 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 its business. EY is a large audit firm. Its UK fee income as of 2024 was £3,701 million and its audit fee income was £837 million. EY received an audit fee of £400,000 for the FY21 Audit.

6.7. EY has had Sanctions imposed on it under the AEP on four previous occasions in the last three years. Ms Carlyle has not been the subject of any previous enforcement investigations and has no previous adverse compliance or disciplinary record.

6.8. Both Respondents have accepted their responsibility for the breaches and expressed contrition.

Identification of Sanction

6.9. Having assessed the nature, seriousness, gravity and duration of the breaches, Executive Counsel has identified the following combination of *Sanctions* as appropriate:

6.9.1. A financial sanction of £1,800,000 in the case of EY and £70,000 in the case of Ms Carlyle;

6.9.2. A published statement in the form of a severe reprimand in the case of each Respondent; and

6.9.3. A declaration that the FY21 Audit report signed on behalf of EY did not satisfy the *Relevant Requirements*, as set out in this *Final Settlement Decision Notice* in the case of each Respondent.

Aggravating and mitigating factors

6.10. Executive Counsel has then 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).

<u>Aggravating factors</u>

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

<u>Mitigating factors</u>

6.12. In response to the FRC's Audit Quality Review team's inspection of the Audit, EY conducted a Root Cause Analysis ("**RCA**")**.** This included setting out remedial actions for both the firm and the Partner, intended to prevent the recurrence of the failings identified. The RCA was shared with Executive Counsel at the outset of the investigation. Additionally, EY updated Executive Counsel on further relevant remedial measures that have been implemented more recently, to drive audit improvements in respect of going concern and DTA.

6.13. Having regard to the remedial steps taken, Executive Counsel considers that a discount of 5% to EY's financial sanction is appropriate. The financial sanction for EY is therefore reduced to £1,710,000.

Deterrence

6.14. 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.

Discount for Admissions and Settlement

6.15. Having taken into account the admissions made by the Respondents and the stage at which those admissions were made (at a point within Stage 1 of the case in accordance with paragraph 84 of the Policy), Executive Counsel determined that a reduction of 30% as to the financial sanction is appropriate, such that a financial sanction of £1,197,000 is payable by EY and a financial sanction of £49,000 is payable by Ms Carlyle.

7. COSTS

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

Signed:

[Redacted.]

Jamie Symington

DEPUTY EXECUTIVE COUNSEL

Date:07 May 2026