

Edited for publication

IN THE MATTER OF

EXECUTIVE COUNSEL OF THE FINANCIAL REPORTING COUNCIL

- and -

ERNST & YOUNG LLP

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 Respondent. It does not make findings against any persons other than the Respondent 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**”), published on 29 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. “**FY2020**” means the financial year ended 31 December 2020.
 - 1.3.2. “**FY2021**” means the financial year ended 31 December 2021, “**FY2021 financial statements**” means the financial statements of Evraz plc (“**Evraz**”)

for that period, and “**FY2021 Audit**” means the statutory audit of the FY2021 financial statements.

- 1.3.3. “**Respondent**” means Ernst & Young LLP (“**EY**” or “**EY UK**”) which was the *Statutory Audit Firm* for the FY2021 Audit and all prior year audits since 2011.
- 1.4. In accordance with Rule 102 of the AEP, Executive Counsel entered into settlement discussions with the Respondent. A *Proposed Settlement Decision Notice* was issued by Executive Counsel on 8 April 2024. The Respondent provided written agreement to the *Proposed Settlement Decision Notice* on 30 April 2024.
- 1.5. The *Convenor* subsequently appointed an *Independent Reviewer* to consider the *Proposed Settlement Decision Notice*. On 20 May 2024, the *Independent Reviewer* approved the issuance of a *Final Settlement Decision Notice*.
- 1.6. This *Final Settlement Decision Notice* is divided into the following sections:
- Section 2: Executive summary of the breach of *Relevant Requirements*;
 - Section 3: Background;
 - Section 4: *Relevant Requirements* to which the breach relates;
 - Section 5: Detail of the breach of *Relevant Requirements*;
 - Section 6: *Sanctions*; and
 - Section 7: *Costs*.

2. EXECUTIVE SUMMARY OF THE BREACH OF RELEVANT REQUIREMENTS

- 2.1. Evraz is the parent company of a corporate group engaged in the production and distribution of steel, vanadium and coal products (the “**Evraz Group**” or the “**Group**”). Evraz was listed as a FTSE 100 company until its shares were suspended from trading on the London Stock Exchange (“**LSE**”) in March 2022, following the UK Government placing Evraz’s largest investor on the UK Sanctions List.
- 2.2. By reason of its shares being admitted to trading on the Main Market of the LSE, Evraz was at all material times a *Public Interest Entity* (“**PIE**”) within the meaning of that term in Regulation 2 of The Statutory Auditors and Third Country Auditors Regulations 2016 (“**SATCAR**”).
- 2.3. EY UK has been the *Statutory Audit Firm* of Evraz since it listed in London in 2011.
- 2.4. In early 2021 EY accepted an engagement by Evraz to carry out non-audit work in connection with a proposed disposal of the Evraz Group’s coal-related interests. These were principally held through a Russian company, PJSC Raspadskaya. It was proposed

that this company would demerge from the Evraz Group and that a dividend in kind would be paid as part of the demerger. The proposed disposal was known as Project Gemini.

- 2.5. EY's non-audit work in connection with Project Gemini related to the provision of working capital reporting, assistance with correspondence with the Financial Conduct Authority ("**FCA**"), and a comfort letter in connection with the information in the circular that was prepared to support the demerger.
- 2.6. The FRC's Ethical Standard (revised in December 2019) ("**Ethical Standard**") imposes restrictions on the non-audit services that an audit firm may provide to a PIE, such as Evraz. In particular, paragraph 4.15(b) of the Ethical Standard states:

"the total fees for such services¹ provided by the audit firm shall be limited to no more than 70% of the average of the fees paid to the audit firm in the last three consecutive financial years for the audit(s) of the audited entity and, where applicable, of its parent undertaking, of its controlled undertakings and of the consolidated financial statements of that group of undertakings."

- 2.7. The average of the fees paid to EY UK for its audits of Evraz in the three consecutive financial years prior to it carrying out work on Project Gemini was \$400,462. 70% of this figure is \$280,323. The total fees for EY UK's non-audit services on Project Gemini that were subject to the 70% cap amounted to \$535,000 and therefore exceeded \$280,000 by a significant margin.
- 2.8. EY UK discovered this breach in or about August 2021 in the context of Evraz requesting that they carry out further non-audit services on a different project, Project Delta. The audit team at that time carried out an analysis of the non-audit services fee cap and identified the breach in relation to Project Gemini. EY UK requested a waiver on 1 September 2021 from the FRC to allow it to carry out this further project, and as part of that request, notified the FRC of the breach which forms the subject of this Final Settlement Decision Notice. The FRC declined that request. EY UK formally reported this breach to the FRC on 4 October 2021 as part of its biannual reporting on breaches of ethics requirements, as required by the Ethical Standard.
- 2.9. As regards the reasons for the breach, it appears from EY's evidence to the FRC that:
- 2.9.1. In February 2021 EY carried out certain engagement acceptance checks before undertaking work on Project Gemini but failed to carry out a check of how the 70% fee cap test applied at a UK level. It appears that EY only tested

¹ Referring to non-audit services other than those referred to in Regulation 80 of SATCAR (Amendment)(EU Exit) Regulations 2019 (SI 2019/177). That Regulation does not apply to the services provided by EY in this case.

compliance with the cap at a network level, i.e. including the fees paid to EY's Russian member firm ("**EY Russia**") for their work on the audit of Evraz.

2.9.2. In April 2021 a new team commenced work on the audit of Evraz, including a new Senior Statutory Auditor². This team did not perform its own tests to ensure compliance with paragraph 4.15 of the Ethical Standard. Instead, they relied on the results of the tests conducted in February 2021.

2.9.3. In July 2021 EY's audit team carried out an interim review. As part of this review two members of the review team prepared and then reviewed a memo called "EVRAZ non audit fees summary (NAS) 6m2021". In that document they carried out the test required by paragraph 4.15(b) of the Ethical Standard, i.e. considering the application of the 70% cap by reference to audit fees received only by EY UK in the UK. However, when assessing the level of non-audit fees, they wrongly omitted fees relating to Project Gemini. This document was thus incomplete and did not show a breach of paragraph 4.15(b) of the Ethical Standard.

2.9.4. The breach of the 70% cap was not identified until August 2021.

2.10. Whilst this *Final Settlement Decision Notice* explains the failings in the Respondent's compliance with requirements regarding non audit services it does not question the truth or fairness of the FY2021 financial statements.

2.11. Section 5 of this *Final Settlement Decision Notice* sets out the detailed breach of *Relevant Requirements*.

2.12. This *Final Settlement Decision Notice* sets out the following *Sanctions* on the Respondent:

2.12.1. A **financial sanction** comprising: i) £121,305 in respect of disgorgement of profits earned on non-audit fees in excess of the fee-cap; and ii) £200,000 which is the additional component of the financial sanction, separate to disgorgement, and subject to a discount of 35% for admissions and early settlement, such that the total financial sanction will be £251,305, to be paid within 28 days of service of the *Final Decision Notice* ;

2.12.2. a published statement in the form of a **reprimand**; and

2.12.3. a **non-financial sanction** in the terms set down at Section 6 below.

² Not a respondent in this matter

3. BACKGROUND

- 3.1. In 2022, EY was ranked as the fourth largest audit firm in the UK, with audit fee income of £626m and 122 audit principals. Its total fee income for 2022 was £3.3bn.³
- 3.2. Evraz is the parent of a corporate group whose principal activities are the production and distribution of steel, vanadium and coal products. The Group includes the largest steel producer in Russia and also operates through subsidiaries in North America and Kazakhstan.
- 3.3. Evraz described itself in the Governance Report in its FY2021 financial statements as *“a public company limited by shares incorporated in the United Kingdom. It is a premium-listed company on the Main Market of the London Stock Exchange and is a member of the FTSE 100 Index”*.⁴ By reason of having its shares admitted to trading on the Main Market of the LSE, Evraz was a *“Public Interest Entity”* for the purposes of audit regulation.
- 3.4. The Group first listed on the LSE in 2011. From that time EY UK has been its *Statutory Audit Firm*. The audit engagement is with EY UK and the *Senior Statutory Auditor* on the engagement is a partner of EY in the UK. EY has described to the FRC that the UK audit team *“led the audits of both EVRAZ plc and also its UK registered subsidiary EVRAZ North America plc”*. However because the Group’s operations are outside the UK and its finance function is based in Russia, the audit is carried out by a team made up of personnel from EY Russia and EY UK.
- 3.5. In February 2021 Evraz sought to engage EY to provide non audit services in connection with a proposed demerger of the Group’s coal business. Evraz described this in its FY2021 financial statements as a *“potential demerger of its metallurgical coal assets”*.⁵
- 3.6. EY has described to the FRC the nature of the non-audit services that it performed in connection with this proposed demerger (Project Gemini). They included reporting on the working capital of the Group, on the basis the demerger had taken place, in order for the Group to comply with Listing Rule 13. They also included a review of cash flow projections, assistance with correspondence containing questions from the FCA on a draft circular, and provision of a comfort letter in relation to historical financial information in that circular.

³ FRC Key Facts and Trends in the Accountancy Profession 2023
[https://media.frc.org.uk/documents/FRC_Key_Facts_and_Trends_in_the_Accountancy_Profession_for_2023.pdf]

⁴ FY2021 financial statements, p.114.

⁵ FY2021 financial statements, p.117.

- 3.7. Before accepting the engagement for these non-audit services, in February 2021 EY performed certain tests to ensure compliance with paragraph 4.15 of the Ethical Standard. Although EY performed a test using audit fees across the EY network (see para 5.2.1 below) it did not perform a separate test comparing the fees for non-audit services with audit fees paid to EY UK only.
- 3.8. EY therefore did not carry out the test required by paragraph 4.15(b) of the Ethical Standard at all. The test using audit fees across the EY network is relevant to paragraph 4.15(a) of the Ethical Standard, which requires a comparison of (i) fees for non-audit services provided by the whole EY network to Evraz and its controlled undertakings, with (ii) 70 % of a three-year average of fees paid to the EY Group for the audit of Evraz. However fees across the EY network are not relevant to paragraph 4.15(b), which is a separate test looking at the UK position only. EY did not appreciate at that time the need to consider not only audit fees across the EY network, but also audit fees received only by EY UK. In a document from February 2021 entitled “Project Gemini – EA work around”, EY reported that:

“Independence procedures

We have checked that our services are within the limit of NAF ratio.”

- 3.9. The document did not recognise that the “NAF [non-audit fees] ratio” had to be applied not only to fees across EY’s network but also fees paid to EY UK alone.
- 3.10. In April 2021 a new audit team took over the audit of Evraz. It did not perform tests in accordance with paragraph 4.15(b) of the Ethical Standard but relied on the work carried out in February 2021.
- 3.11. In July 2021 members of the EY audit team prepared and then reviewed a memorandum called “EVRAZ Non audit fees summary (NAS) 6m2021”. This was prepared for the purposes of interim reporting at the time of the 2021 interim review.
- 3.12. The document showed non-audit services fees received by EY in relation to Evraz, but it was incomplete as it did not include consideration of the fees paid on Project Gemini. Accordingly the document did not identify a breach of paragraph 4.15(b) of the Ethical Standard in relation to the Project Gemini engagement.
- 3.13. The breach was not identified by EY UK until August 2021.

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 Ethical Standard, published by the FRC in December 2019, which provided at paragraph 4.15 as follows:

“When the audit firm, or a member of its network, provides to a public interest entity that it audits, its parent undertaking or its controlled undertakings, non-audit services other than those referred to in Regulation 80 of The Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 (SI 2019/177):

(a) the total fees for such services provided to the audited entity and its controlled undertakings shall be limited to no more than 70% of the average of the fees paid in the last three consecutive financial years³⁶ for the audit(s) of the audited entity and of its controlled undertakings and of the consolidated financial statements of that group of undertakings; and

(b) the total fees for such services provided by the audit firm shall be limited to no more than 70% of the average of the fees paid to the audit firm in the last three consecutive financial years for the audit(s) of the audited entity and, where applicable, of its parent undertaking, of its controlled undertakings and of the consolidated financial statements of that group of undertakings” [emphasis added].

5. BREACH OF RELEVANT REQUIREMENTS:

PARAGRAPH 4.15(b) OF THE ETHICAL STANDARD

EY UK breached paragraph 4.15(b) of the Ethical Standard by providing non-audit services to Evraz in FY2021, in circumstances where the total fees for such services were not limited to no more than 70% of the average of the fees paid to EY UK in the last three consecutive financial years for the audit of Evraz, its controlled undertakings and the consolidated financial statements of its group.

- 5.1. EY UK was required to comply with the Ethical Standard when carrying out *audit engagements* and other *public interest assurance engagements*.
- 5.2. Paragraph 4.15 of the Ethical Standard sets out a test applicable to the provision of non-audit services by an audit firm to a public interest entity that it audits. The test is comprised of two limbs:
- 5.2.1. The first limb involves a comparison of the total fees for such non-audit services with 70% of the average of the fees paid in the last three consecutive financial years for the audit of the audited entity. This comparison includes fees paid to

any members of the audit firm's network for their work on the audit of the audited entity (the "**Network Test**").

5.2.2. The second limb involves a comparison of the total fees for such non-audit services with 70% of the average of the fees paid in the last three consecutive financial years to the audit firm for the audit of the audited entity (the "**Firm Test**").

5.3. EY has provided the FRC with the following figures for the fees for its non-audit services on Project Gemini, and the fees received by EY UK for the audit of Evraz in the years FY2018, FY2019 and FY2020. These show, as regards the Firm Test:

5.3.1. [redacted]

5.3.2. The average of these fees is \$400,462.

5.3.3. 70% of this average, which is the "cap" for the purposes of Rule 4.15(b) of the Ethical Standard, is \$280,323.

5.3.4. The total fees for non-audit services provided by EY UK to Evraz in connection with Project Gemini in FY2021 were \$635,000. Of this, \$101,000 fell outside the cap because it concerned public reporting services and paragraph 4.16 of the Ethical Standard excludes from the test in paragraph 4.15 any non-audit services that are required by national legislation.

5.3.5. Accordingly the fees for non-audit services falling within paragraph 4.15(b) of the Ethical Standard were \$535,000 and exceeded the "cap" of \$280,324 by \$254,676. This equated to £192,548 on the date when the relevant invoice was delivered.

5.4. In these circumstances EY breached the Firm Test in paragraph 4.15(b) of the Ethical Standard.

6. SANCTIONS

- 6.1. Paragraph 10 of the FRC's Sanctions Policy (Audit Enforcement Procedure) (the "**Sanctions Policy**") provides that *Sanctions* are intended to be effective, proportionate and dissuasive. The reasons for imposing *Sanctions* are identified in paragraph 11 of the Sanctions 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. Paragraph 12 of the Sanctions 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 reaching this decision, Executive Counsel has, in summary, considered the following matters in accordance with the Sanctions Policy.

Nature and gravity of the breach

- 6.4. The non-audit fee-cap requirement is important as it is designed to protect the independence of the auditor. This is set against the fact that there was no loss of objectivity and it appears to have been an oversight.
- 6.5. This is a case where financial gain was derived from the breach (beyond the audit fee itself) because EY earned non-audit fees in excess of the fee cap. The Sanctions Policy provides for *Sanctions* to be imposed to disgorge respondents of financial benefit resulting from the breach, and, at paragraph 81, directs that no discount should be applied to this amount:
- However, no discount should be applied to the amount of any financial penalty that equates to the disgorgement of any benefit gained or loss avoided, or to an order for the waiver/repayment of client fees*
- 6.6. The parties have agreed for the purposes of this decision that the applicable profit earned by EY in excess of the fee cap was £121,305. This was earned by EY in breach of the

restriction contained within the Ethical Standard and it is appropriate to make this amount subject to disgorgement.

6.7. The breach:

6.7.1. Was not committed deliberately or recklessly. No dishonest behaviour was involved. It appears to have been unintentional.

6.7.2. Did not cause or risk the loss of significant sums of money.

6.7.3. Did not adversely affect, or potentially adversely affect, a significant number of people in the United Kingdom.

6.7.4. Is not ongoing.

6.8. The FRC was promptly informed of the breach in the context of the Project Delta waiver application. The breach was then formally reported to the FRC as part of EY's biannual reporting cycle, which is mandatory under the Ethical Standard.

6.9. EY do not have any previous disciplinary findings relevant to this matter.

6.10. In response to concerns raised by the FRC, EY introduced a template in December 2021 which audit teams will use to assess non-audit fees in a more methodical way. Executive Counsel considers that this, combined with the proposed non-financial sanctions, significantly reduces the likelihood that the same type of breach will recur.

Identification of Sanction

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

6.11.1. A **financial sanction** comprising: i) £121,305 in respect of disgorgement of profits earned on non-audit fees in excess of the fee-cap; and ii) £200,000 which is the additional component of the financial sanction, separate to disgorgement, and subject to a discount of 35% for admissions and early settlement, such that the total financial sanction will be £251,305, to be paid within 28 days of service of the *Final Decision Notice*;

6.11.2. a published statement in the form of a **reprimand**; and

6.11.3. a **non-financial sanction** in the following terms:

6.11.3.1. Within 3 months of the date of the *Final Settlement Decision Notice*, EY to provide Executive Counsel and the FRC Executive Director of Supervision with a report which:

- identifies why it considers that the breach occurred, why the firm's processes and controls did not prevent the breach and whether the firm's current processes would lead to a different outcome;
- sets out any actions taken in response to the wider issue around EY's handling of the approval and assessment of non-audit services, identified in the FRC's 2023 Audit Quality Inspection and Supervision Report;
- provides an assessment, with reference to evidence, as to how any actions taken have worked; and
- considers whether any further actions are needed.

6.11.4. EY to present their report to Executive Counsel and the Executive Director of Supervision and answer any questions posed.

6.11.5. Thereafter, the firm shall implement such remedial action as is proposed by Executive Counsel and the Executive Director of Supervision in light of the report, by a date to be agreed between EY and the FRC.

Aggravating or Mitigating factors

6.12. There are no aggravating or mitigating factors that have not already been considered in the context of the seriousness of the breach.

Deterrence

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

Discount for Admissions and Settlement

6.14. Having taken into account the admissions by EY and the stage at which those admissions were made (at an early point within Stage 1 of the case in accordance with paragraph 84 of the Sanctions Policy), Executive Counsel determined that a reduction of 35% as to the financial sanction is appropriate.

6.15. As per paragraph 81 of the Sanctions Policy, this discount will not apply to the amount of the financial sanction which equates to the disgorgement of benefit gained. The discount will therefore apply to the additional component of £200,000, reducing it to £130,000. When the disgorged profits on the non-audit fees are included, the total financial sanction payable amounts to £251,305.

Other considerations

6.16. In accordance with paragraph 47(c) of the Sanctions Policy, Executive Counsel has taken into account the size and financial resources and financial strength of EY, the

effect of a financial sanction on its business and whether any financial sanction would be covered by insurance.

7. COSTS

Executive Counsel requires that the Respondent pays her costs in full in this matter, being £45,000. Such costs shall be paid no later than 28 days after service of this *Final Settlement Decision Notice*.

Signed:

[Redacted.]

**Claudia Mortimore
DEPUTY EXECUTIVE COUNSEL**

Date: 23 May 2024