

IN THE MATTER OF

THE EXECUTIVE COUNSEL OF THE FINANCIAL REPORTING COUNCIL

-and-

(1) GRANT THORNTON UK LLP

(2) MR PHILIP WESTERMAN

EXECUTIVE COUNSEL'S FINAL DECISION NOTICE

Pursuant to Rule 18 of the Audit Enforcement Procedure

This Final 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.

Amendments were made to this document for publication in line with the FRC's Publication Policy (Audit Enforcement Procedure).

1. INTRODUCTION

- 1.1 The Financial Reporting Council (the "**FRC**") is the competent authority for *Statutory Audit* in the United Kingdom and operates the Audit Enforcement Procedure (the "**AEP**"), effective 17 June 2016. 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 these defined terms are used, they appear in italics. This *Final Decision Notice* also uses the following additional definitions:
- 1.2.1 "**SDI**" means Sports Direct International plc (now known as Frasers Group plc).
- 1.2.2 "**FY2018**" means the financial year ended 29 April 2018, "**2018 financial statements**" means SDI's consolidated financial statements for FY2018, and "**FY2018 Audit**" means the *Statutory Audit* of the 2018 financial statements.

- 1.2.3 “**GT**” means Grant Thornton UK LLP, the First Respondent and the *Statutory Audit Firm* for the FY2018 Audit.
- 1.2.4 “**Mr Westerman**” means Philip Westerman, the Second Respondent and the *Statutory Auditor* for the FY2018 Audit.
- 1.2.5 “**Respondents**” means Mr Westerman and GT.
- 1.2A Under the AEP, the *Executive Counsel* is concerned only with the conduct of the Respondents. Reference is made to SDI to explain the context of the findings and sanctions against the Respondents. *Executive Counsel* makes no finding about SDI, or anyone else, other than the Respondents
- 1.3 Pursuant to Rule 16(b) of the AEP¹, *Executive Counsel* has decided that the Respondents are liable for Enforcement Action, having made the *Adverse Findings* against each of them that are set out in this *Final Decision Notice*.
- 1.4 This *Final Decision Notice* is issued pursuant to Rule 18 of the AEP in respect of the conduct of the Respondents in relation to the FY2018 Audit.
- 1.5 In accordance with Rule 18 of the AEP this *Final Decision Notice*:
- 1.5.1 outlines the *Adverse Findings* with reasons;
- 1.5.2 outlines *Sanctions* with reasons; and
- 1.5.3 outlines an amount payable in respect of *Executive Counsel’s* costs of the matter.
- 1.6 This *Final Decision Notice* is divided into the following sections:
- 1.6.1 Section 2: Executive Summary of the *Adverse Findings*;
- 1.6.2 Section 3: Background
- 1.6.3 Section 4: Relevant Requirements to which the *Adverse Findings* relate;
- 1.6.4 Section 5: *Adverse Findings*;
- 1.6.5 Section 6: Sanctions; and
- 1.6.6 Section 7: Costs.

¹ This reference to the AEP, and the references to the AEP in the following paragraphs 1.4 and 1.5, is to a previous version of the AEP effective 1 January 2021 (reissued 30 March 2021) that was in force when this *Final Decision Notice* was signed by the FRC.

2. EXECUTIVE SUMMARY OF THE *ADVERSE FINDINGS*

- 2.1 SDI is a well-known retailer consisting largely of sports retail companies. It was founded in 1982 and has been listed on the main market of the London Stock Exchange since 2007.2.2. SDI's 2018 financial statements reported revenue of £3.3bn and an operating profit of £217m.
- 2.2 As set out in this *Final Decision Notice*, there were failures by the Respondents in the manner in which the FY2018 Audit was conducted with regard to inventory provisions and website sales revenue.
- 2.3 As a result, the audit failed in its principal objective: that of providing reasonable assurance that the 2018 financial statements were free from material misstatement.
- 2.4 This *Final Decision Notice* explains the failings in the Respondents' audit work for the FY2018 Audit. It does not make any finding that the 2018 financial statements failed to provide a true and fair view and/or contained material misstatements. In particular whilst the Respondents' audit work in relation to inventory provisions and website sales was inadequate, this *Final Decision Notice* does not make a finding that the inventory provisions were not in fact appropriate or that the figures for website sales or bank receipts were not accurate or complete.
- 2.5 The *Adverse Findings* in this *Final Decision Notice* relate to two important areas of audit work:
- 2.5.1 Inventory Provisions; and
- 2.5.2 Website Sales Revenue.
- 2.6 Section 5 of this *Final Decision Notice* sets out the *Adverse Findings*.
- 2.7 This *Final Decision Notice* imposes the following Sanctions in respect of the Respondents:

GT

2.7.1. A financial penalty of £350,000 adjusted for aggravating and mitigating factors (in particular reflecting an exceptional level of cooperation) by a reduction of 15% and further discounted for admissions and early disposal by 35% so that the financial penalty payable is £193,375;

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

2.7.3. A declaration that the FY2018 Audit report signed on behalf of GT did not satisfy the Relevant Requirements, as set out in this Final Decision Notice; and

2.7.4. A non-financial sanction, in the form of a requirement that GT will undertake thematic reviews into the efficacy of enhancements it has introduced regarding the audit of inventory provisions of retail entities and the use of audit data analytics to audit revenue. GT will report to the FRC's Executive Counsel and Firm Supervisor the findings from the thematic reviews.

Mr Westerman

2.7.5. A financial penalty of £30,000 adjusted for aggravating and mitigating factors (in particular reflecting an exceptional level of cooperation) by a reduction of 15% and further discounted for admissions and early disposal by 35% so that the financial penalty payable is £16,575; and

2.7.6. A published statement in the form of a severe reprimand.

3. BACKGROUND

The Respondents

3.1 In 2020, GT was ranked as the 6th largest audit firm in the UK, with revenues of £496m (of which £131m was income from audit work) and 45 audit principals.

3.2 At the time of the FY2018 Audit:

3.2.1 GT had acted as auditor to SDI continuously since SDI's listing in February 2007; and

3.2.2 Mr Westerman was a partner of GT, with 19 years of auditing experience, and he had been the *Statutory Auditor* for SDI since 2014.

3.3 The Respondents' statutory responsibility was to form an opinion as to whether the 2018 financial statements showed a true and fair view and had been properly prepared in accordance with IFRS and the Companies Act 2006.

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

3.5 Audit evidence is defined in ISA 500 as “information used by the auditor in arriving at the conclusions on which the auditor’s opinion is based”. Audit evidence is primarily obtained from audit procedures performed during the course of the audit.

Audit work in relation to Inventory Provisions

3.6 SDI’s inventory provision for FY2018 was £162.2m. This represented an increase, as compared with the previous year, both in terms of amount (£98.4m) and percentage (15.6% as compared with 13.5%). The amount of this provision was highly material.

3.7 SDI’s management estimated the inventory provision percentage using their own model. The level of SDI’s inventory provision therefore involved considerable judgment.

3.8 The audit team correctly identified inventory provisions as a significant audit risk to be considered in the context of their work on the FY2018 Audit and they planned (among other things):

3.8.1 to consider the appropriateness and consistency of the underlying assumptions within the model used by the Company’s management to estimate the inventory provision percentage;

3.8.2 to challenge management’s assessment of the assumptions applied; and

3.8.3 to review the reports used by management to verify the appropriateness of provision levels.

3.9 However, the audit team’s consideration to the appropriateness and consistency of the underlying assumptions in management’s model, their challenge of management’s assessment of the assumptions applied, and their review of the reports used to verify the appropriateness of inventory provisions, was inadequate.

3.10 As a result, the Respondents failed to obtain sufficient appropriate audit evidence and to adequately document their audit work.

Audit work in relation to Website Sales Revenue

3.11 SDI’s website sales for FY2018 made up £679m out of total revenue of £3,360m. It was the second largest area of revenue for SDI, accounting for 20% of total revenue.

3.12 The audit team also recognised revenue as a significant audit risk in the audit plan for their work on the FY2018 Audit.

- 3.13 The audit team's approach to the confirmation of website sales involved analysing a reconciliation of website sales and bank receipts prepared by SDI and confirming the reasonableness of the inputs by checking them against the bank entries that had been posted to SDI's general ledger. This approach by the Respondents was flawed.
- 3.14 The Respondents' test did not provide audit evidence in relation to the accuracy or completeness of SDI's figures for website sales because the audit team failed to verify the figure for bank receipts taken from SDI's internal records against external sources (such as bank statements). The testing performed by the audit team on website sales was essentially circular (since the reconciliation was between internal records) and provided no audit comfort in relation to the website sales figures.
- 3.15 As a result, the Respondents failed to obtain sufficient appropriate audit evidence.

4. RELEVANT REQUIREMENTS TO WHICH THE ADVERSE FINDINGS 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 Regulations 2016*. The Relevant Requirements include, but are not limited to, the International Standards on Auditing (UK and Ireland) ("**ISAs**") issued by the International Auditing and Assurance Standards Board.
- 4.2 The ISAs relevant to *Executive Counsel's Final Decision Notice* are those effective for audits of financial statements for periods ending on or after 17 June 2016.
- 4.3 The Relevant Requirements referred to in this *Final Decision Notice* are:
- 4.3.1 ISA 200 (*Overall objectives of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing (UK and Ireland)*);
- 4.3.2 ISA 230 (*Audit Documentation*); and
- 4.3.3 ISA 500 (*Audit evidence*).
- 4.4 Extracts from the ISAs setting out those parts which are of particular relevance to the *Adverse Findings* are set out in Appendix 1 hereto.

5. ADVERSE FINDINGS

Adverse Finding 1 – Inventory Provisions

- 5.1 With regards to the failures by the Respondents regarding the inventory provision:

- 5.1.1 The audit team did not establish their own expectations in relation to inventory provision percentages before performing their audit procedures.
- 5.1.2 The audit team did not adequately challenge management's assumptions or methodology in relation to the estimation of inventory provisions and also did not adequately record the nature and extent of their challenge to management's assumptions and methodology. The audit team also did not obtain adequate corroborating evidence for management's approach.
- 5.1.3 The audit team benchmarked the inventory provision against other comparable companies and carried out their own market research (conducted by GT's research management solutions team). However, the audit team did not adequately document the results of their audit procedures.
- 5.1.4 The audit team did not carry out adequate testing on management's model for estimating inventory provisions. The testing that the audit team carried out was principally focused on evaluating the mathematical accuracy of the model and the audit team did not reach or document any conclusion on the reasonableness of the model for the estimation inventory provisions.
- 5.1.5 The audit team did not seek to validate the data on which management had relied for the purposes of estimating the inventory provisions beyond reconciling the inventory records between SDI's internal systems.
- 5.1.6 The audit team did not perform any walkthrough testing.
- 5.1.7 The audit team did not ensure that they understood the key controls related to management's inventory provisioning process.
- 5.1.8 The audit team did not seek to confirm the accuracy of the inventory provision for the previous year by reference to actual sales data.
- 5.2 The audit team made enquiries of an employee at SDI (external to SDI's finance team/management). However, the audit team failed to document adequately or at all some of the discussions with members of SDI's management team in relation to inventory provisions.
- 5.3 The Respondents thereby failed:
 - 5.3.1 To design and perform audit procedures that were appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence in

relation to the reasonableness or appropriateness of the assumptions and methodology used by management to estimate inventory provisions in breach of paragraph 6 of ISA 500;

- 5.3.2 To evaluate whether the information provided by SDI in relation to their estimation of inventory provisions was sufficiently reliable for the auditor's purposes by obtaining audit evidence about the accuracy and completeness of that information in breach of paragraph 9 of ISA 500;
 - 5.3.3 To prepare audit documentation that was sufficient to enable an experienced auditor, having no previous connection with the audit, to understand in relation to the audit of the estimate of inventory provisions: (a) the nature, timing and extent of the audit procedures performed, (b) the results of the audit procedures performed and the audit evidence obtained, and (c) significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions, in breach of paragraph 8 of ISA 200; and
 - 5.3.4 To document some discussions of significant matters with management in relation to the estimation of inventory provisions in breach of paragraph 10 of ISA 230.
- 5.4 As a result, the terms in which the auditor's report was expressed, asserting that the Respondents were satisfied based on their audit work that "the judgments made and assumptions used ... were balanced and supported by the evidence", would have given a user of the 2018 financial statements comfort that the Respondents' audit work carried out by the audit team on inventory provisions was more extensive than it in fact was.

Adverse Finding 2 – Website Sales

- 5.5 With regards to website sales, the audit team's approach to the confirmation of website sales involved:
 - 5.5.1 Reviewing a reconciliation of website sales and bank receipts prepared by SDI;
And
 - 5.5.2 Checking the figure for bank receipts against the bank entries that had been posted to SDI's general ledger.
- 5.6 The Respondents' test did not provide audit evidence in relation to the accuracy or completeness of the figures for website sales or bank receipts since the reconciliation was between internal records.

5.7 The Respondents thereby failed:

5.7.1 To design and perform audit procedures that were appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence in relation to website sales in breach of paragraph 6 of ISA 500;

5.7.2 To evaluate whether the information provided by SDI in relation to website sales was sufficiently reliable for the auditor's purposes by obtaining audit evidence about the accuracy and completeness of the information in breach of paragraph 9 of ISA 500; and

5.8 To obtain sufficient appropriate audit evidence in breach of paragraph 17 of ISA 200.

6. SANCTIONS

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

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

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

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

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

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

6.3. Executive Counsel has considered the Policy in relation to each of the Respondents individually and imposes the following Sanctions:

In respect of Grant Thornton UK LLP

- 6.3.1. A financial penalty of £350,000 adjusted for aggravating and mitigating factors (in particular reflecting an exceptional level of cooperation) by a reduction of 15% and further discounted for admissions and early disposal by 35% so that the financial penalty payable is £193,375. The financial penalty shall be paid no later than 28 days after the date of this Final Decision Notice;
- 6.3.2. A published statement in the form of a severe reprimand;
- 6.3.3. A declaration that the FY2018 Audit report signed on behalf of GT did not satisfy the Relevant Requirements, as set out in this Final Decision Notice; and
- 6.3.4. A non-financial sanction, in the form of a requirement that GT will undertake thematic reviews into the efficacy of enhancements it has introduced regarding the audit of inventory provisions of retail entities and the use of audit data analytics to audit revenue. GT will report to the FRC's Executive Counsel and Firm Supervisor the findings from the thematic reviews.

In respect of Mr Westerman

- 6.3.5. A financial penalty of £30,000 adjusted for aggravating and mitigating factors (in particular reflecting an exceptional level of cooperation) by a reduction of 15% and further discounted for admissions and early disposal by 35% so that the financial penalty payable is £16,575. The financial penalty shall be paid no later than 28 days after the date of this Final Decision Notice; and
 - 6.3.6. A published statement in the form of a severe reprimand.
- 6.4. In reaching this decision, Executive Counsel has, in summary, considered the following matters in accordance with the Policy. Where a consideration is specific to one Respondent alone this has been specified. Otherwise, the considerations apply to each Respondent equally.

Nature, seriousness, gravity and duration of the breaches

- 6.5. The breaches in this case are breaches of basic and important Relevant Requirements which are designed to ensure the quality and effectiveness of an audit and fundamental to the work of an auditor. The FY2018 Audit, due to failings in the auditing of inventory provisions and website sales revenue, failed in its principal objective, namely to obtain reasonable assurance about whether the 2018 financial statements as a whole were free from material misstatement. While Executive Counsel has not made a finding that the 2018

financial statements were misstated or that there has been actual loss suffered by third parties as a consequence of the failings, the breaches of the Relevant Requirements set out in this Final Decision Notice indicate that the auditing in these areas was inadequate.

- 6.6. Obtaining appropriate audit evidence is fundamental to a good audit. When performed properly, it provides support for an auditor's opinion in relation to a company and its financial statements. It also provides corroboration for management's assertions and any information that might contradict such assertions. Users of financial statements trust that, when an opinion is provided by auditors about a company, it is given based on the evidence the auditor has seen. Users of financial statements may rely on the auditor's opinion to assess the viability of a company.
- 6.7. For the FY2018 Audit, both the carrying value of inventory and revenue were identified as significant risks by GT. Notwithstanding the heightened risk, GT failed to obtain sufficient and appropriate audit evidence to reduce the audit risk to an acceptably low level and to draw reasonable conclusions on which to base their opinions.
- 6.8. The breaches of Relevant Requirements are confined to one set of financial statements and confined to two discrete areas.
- 6.9. It is noted that Mr Westerman did not cause or encourage other individuals to breach the Relevant Requirements.
- 6.10. Executive Counsel considers it unlikely that the same type of breaches will be repeated and notes that GT has undertaken some remedial action to address the concerns.

Identification of Sanction

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

In respect of Grant Thornton UK LLP

- 6.11.1. A financial penalty of £350,000;
- 6.11.2. A published statement in the form of a severe reprimand;
- 6.11.3. A declaration that the FY2018 Audit report signed on behalf of GT did not satisfy the Relevant Requirements, as set out in this Final Decision Notice; and

6.11.4. A non-financial sanction, in the form of a requirement that GT will undertake thematic reviews into the efficacy of enhancements it has introduced regarding the audit of inventory provisions of retail entities and the use of audit data analytics to audit revenue. GT will report to the FRC's Executive Counsel and Firm Supervisor the findings from the thematic reviews.

In respect of Mr Westerman

6.11.5. A financial penalty of £30,000; and

6.11.6. A published statement in the form of a severe reprimand.

Aggravating and Mitigating factors

6.12. 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).

In respect of Grant Thornton UK LLP

Aggravating factors

6.13. Executive Counsel has considered GT's disciplinary history. GT was recently sanctioned, in 2019, for similar breaches of Relevant Requirements relating to Audit Evidence and Audit Documentation.

Mitigating factors

6.14. Since the breaches in this case, GT has updated its audit templates in respect of inventory provisions and revenue, which are designed to better evidence the audit work undertaken.

6.15. Further, GT initiated a three-year audit quality plan in Spring 2019 to improve audit quality. The plan covers a range of initiatives and is well established and understood throughout the firm. Regular progress reports are provided to the Audit Quality Board and the FRC has seen evidence of oversight and challenge accordingly.

6.16. GT provided an exceptional level of cooperation during the investigation of the breaches by Executive Counsel in that it dealt timeously, properly and fully with all requests. In particular, it took exceptional proactive action to ensure that Executive Counsel was provided with documents relevant to the investigation.

6.17. In light of the mitigating factors, Executive Counsel considers that a discount to the financial penalty of 15% is appropriate.

In respect of Mr Westerman

Aggravating factors

6.18. There are no aggravating factors in respect of Mr Westerman that have not already been considered in the context of the seriousness of the breaches of Relevant Requirements.

Mitigating factors

6.19. Mr Westerman (through GT) provided an exceptional level of cooperation during the investigation of the breaches by Executive Counsel in that he dealt timeously, properly and fully with all requests. He also took exceptional proactive action to ensure that Executive Counsel was provided with documents relevant to the investigation.

6.20. In light of the mitigating factors, Executive Counsel considers that a discount to the financial penalty of 15% is appropriate.

Deterrence

6.21. 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

6.22. Having taken into account the full admissions by the Respondents 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 Policy), Executive Counsel determined that a reduction of 35% to the financial penalties is appropriate, such that a financial penalty of £193,375 is payable by GT and a financial penalty of £16,575 is payable by Mr Westerman.

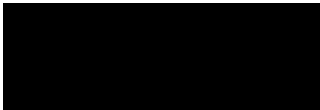
Other considerations

6.23. In accordance with paragraphs 47(c) and (d) of the Policy, Executive Counsel has taken into account the size of GT, and the financial resources and strength of the Respondents, the effect of a financial penalty and whether the financial penalty is likely to be covered by any insurance.

7. COSTS

7.1. Executive Counsel requires the Respondents to pay her costs in full in this matter being £94,811.69. Such costs shall be paid no later than 28 days after the date of this Final Decision Notice.

Signed:

A solid black rectangular box redacting the signature of Jamie Symington.

**JAMIE SYMINGTON
DEPUTY EXECUTIVE COUNSEL**

Date: 5 November 2021

APPENDIX 1 – EXTRACTS OF RELEVANT REQUIREMENTS

International Standards on Auditing (UK and Ireland) (“ISA”)

1. **ISA 200: Overall objectives of the independent auditor and the conduct of an audit in accordance with ISAs**

1.1 Paragraph 8 states as follows:

“The form of opinion expressed by the auditor will depend upon the applicable financial reporting framework and any applicable law or regulation.”

1.2 Paragraph 17 states as follows:

“To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor’s opinion.”

2. **ISA 230: Audit documentation**

2.1 Paragraph 10 states as follows:

“The auditor shall document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.”

3. **ISA 500: Audit evidence**

3.1 Paragraph 6 states as follows:

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

3.2 Paragraph 9 states as follows:

“When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor’s purposes, including as necessary in the circumstances:

(a) Obtaining audit evidence about the accuracy and completeness of the information;

[...]