

IN THE HIGH COURT OF JUSTICE

BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES

BUSINESS LIST (ChD)

B E T W E E N:

**MANOLETE PARTNERS PLC**

Claimant

- and -

**MSR PARTNERS LLP**

Defendant

---

PARTICULARS OF CLAIM

---

**The parties**

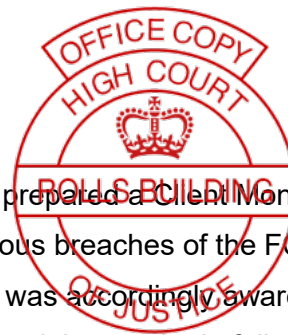
1. The Claimant (company number 07660874) brings this claim as assignee of the claims of Lendy Limited (in administration) (company number 08244913) ("**Lendy**") pursuant to a written assignment made on 6 February 2024 between the Claimant and Lendy acting by its joint administrators Mark John Wilson, Philip Rodney Sykes and Damian Webb. Written notice of the assignment was given by the Claimant to the Defendant by delivery by hand to the Defendant's registered office at 16.00 on 12 February 2024 and also by email to Kelly Sheppard of the Defendant at 11.01 on 13 February 2024.
2. Lendy was incorporated on 9 October 2012. At all material times its directors were Tim Gordon and Liam Brooke, until Mr Gordon resigned on 26 July 2018. On 1 March 2017 all of Lendy's shares were transferred to Lendy Group Limited ("**LGL**"), a company in which Mr Gordon and Mr Brooke held 50% of the shares each until the cancellation of Mr Gordon's shareholding on 26 July 2018.
3. At all material times from 1 April 2014 until its entry into administration on 24 May 2019, and subject to enforcement action and restrictions imposed by the Financial Conduct Authority ("**FCA**") as detailed below, Lendy operated or purported to operate a peer-to-peer ("**P2P**") lending platform to fund the purchase and development of real property. It did so pursuant to interim permission from the FCA dated 1 April 2014, and subsequently

full authorisation from the FCA dated 11 July 2018 under Part 4A of the Financial Services and Markets Act 2000 ("**FSMA**"). Operating a P2P lending platform was and is a regulated activity under Article 36H of the FSMA (Regulated Activities) Order 2001 ("**the RAO**") and Lendy was accordingly an authorised person under FSMA.

4. At all material times the Defendant (company number OC313071) was in business trading as "Moore Stephens" providing auditing and accountancy services, from among other locations 150 Aldersgate Street, London EC1A 4AB. Until 4 February 2019 the Defendant was called Moore Stephens LLP. On 1 February 2019 the Defendant's business was merged with that of BDO LLP. The Defendant held out the auditors and accountants who acted on its behalf as being experienced, skilled and competent among other things in conducting audits, and as having particular knowledge and experience of conducting audits of entities which were regulated by the FCA.

### **The audits**

5. By a letter dated 28 September 2017 from the Defendant to Lendy ("**the Engagement Letter**"), the Defendant offered to audit Lendy's accounts and financial statements. Although not stated explicitly, this was intended to be for Lendy's financial year ending 31 December 2016 (the "**FY2016 accounts**"), but also potentially for future years. That offer was signed and accepted by Mr Gordon on behalf of Lendy on or about 9 October 2017, creating a contract between them for the undertaking of that audit and any future audits by the Defendant unless superseded ("**the Contract**"). The Defendant was accordingly appointed by Lendy as its auditor pursuant to s.485 of the Companies Act 2006 ("**the 2006 Act**") on or about 9 October 2017.
6. This was the first time that the Defendant had been engaged to act as auditor for Lendy. At the point of its engagement, the FY2016 accounts were already overdue for filing at Companies House. The Defendant was selected by Lendy's directors because it was a "top 10" auditor which had experience of auditing entities regulated by the FCA and was on the FCA's Skilled Persons Panel. Lendy changed its auditors because it was considered that its previous auditors, Rothmans Audit LLP, did not have the necessary expertise to audit the FY2016 given Lendy's rapid expansion and its FCA regulation.
7. In addition, as the Defendant's audit team was aware, the FCA had among other things written to Mr Gordon and Mr Brooke on 9 August 2017 setting out key areas of non-compliance by Lendy with rules relating to its application for full authorisation under



FSMA, and on 8 September 2017 the Defendant had prepared a Client Money and Assets (“**CASS**”) Report for Lendy which showed serious breaches of the FCA’s requirements and very weak controls. The Defendant was accordingly aware at all material times that (a) there was a real risk that Lendy might not obtain full authorisation and (b) if Lendy could not satisfactorily address the problems identified by the FCA and/or the CASS Report, there was a material risk that Lendy would not be able to continue facilitating new loans, and might not be able to continue as a going concern.

8. It was an express term of the Engagement Letter, at paragraph 12, and so of the Contract that “*We will conduct our audit in accordance with the International Standards on Auditing (United Kingdom and Ireland)*” (hereafter the “**ISA**”). These included among others and without limitation:

- 8.1. ISA 200, which:

- 8.1.1. Required the auditor to obtain “*reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk... to an acceptably low level...*” (para. 5);

- 8.1.2. Defined materiality as misstatements, including omissions, whether individually or in the aggregate, which could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements (para. 6);

- 8.1.3. Required the auditor to plan and perform the audit with professional scepticism, recognising that circumstances might exist which caused the financial statements to be materially misstated (para. 15).

- 8.2. ISA 315, concerning identifying and assessing the risks of material misstatement through understanding the entity and its environment, which required the auditor:

- 8.2.1. To understand (para. 11):

- 8.2.1.1. The relevant industry and regulatory factors, including the applicable financial reporting framework;

- 8.2.1.2. The nature of the entity, including operations, structure and financing;



- 8.2.1.3. The selection of its accounting policies, including evaluating whether these are appropriate for its business and consistent with the applicable financial reporting framework and policies used in that industry;
- 8.2.2. To understand Lendy's internal control environment (paras. 13-14 and 20-21);
- 8.2.3. To identify and assess the risks of material misstatement (para. 25-26), including:
- 8.2.3.1. Determining whether any of the risks identified are significant and if so, obtaining an understanding of the entity's controls (paras. 27 and 29),
- 8.2.3.2. In deciding which are significant risks, considering at least: whether there are risks of fraud; significant accounting or other developments; complexity of transactions; significant transactions with related parties; subjectivity in the measurement of financial information and/or transactions outside the normal course of business (para.28);
- 8.3. ISA 330, which by paras. 5 and 6 required the auditor to design and implement responses and audit procedures to address the assessed risks of material misstatement at the financial statement and assertion levels.
- 8.4. ISA 500, which by para. 6 required the auditor to design and perform audit procedures which were appropriate in all the circumstances for obtaining sufficient appropriate audit evidence.
- 8.5. ISA 550, which:
- 8.5.1. Required the auditor to perform the audit procedures and related activities to obtain information relevant to identifying the risks of material misstatement associated with related party relationships and transactions (para. 11);
- 8.5.2. Required the auditor to remain alert for arrangements or other information that might indicate the existence of related party relationships or transactions management had not previously identified or disclosed to the auditor (para. 15);
- 8.5.3. Required the auditor to identify and assess the risks of material misstatement associated with related party relationships and transactions and determine whether any of those were significant risks (para. 18);



8.5.4. If the auditor identified related parties or significant related party transactions that management had not previously identified or disclosed to the auditor, required, where the non-disclosure by management appeared intentional and so indicative of a risk of material misstatement due to fraud, evaluation of the implications for the audit (para. 22).

8.6. ISA 720, which:

8.6.1. Required the auditor to consider whether there was a material inconsistency between other information (as defined in ISA 720, but including among other things the Directors' Report and the Strategic Report) and the auditor's knowledge obtained in the audit (para. 14(b));

8.6.2. Where the auditor identified such an inconsistency and/or a misstatement, required it to apply paras. 16 and/or 17, performing additional procedures to confirm their understanding and if satisfied the other information was wrong, request a change to that information or if necessary modify their report.

9. Further, ISA 250 Part B provided, under "*Identifying Matters Requiring a Report Direct to Regulators*":

*"12. Where an apparent breach of statutory or regulatory requirements comes to the auditor's attention, the auditor shall:*

*(a) Obtain such evidence as is available to assess its implications for the auditor's reporting responsibilities;*

*(b) Determine whether, in the auditor's opinion, there is reasonable cause to believe that the breach is of material significance to the regulator;..."*

And under "*The Auditor's Statutory Duty to Report Direct to Regulators*":

*"13. When the auditor concludes, after appropriate discussion and investigations, that a matter which has come to the auditor's attention gives rise to a statutory duty to make a report the auditor shall bring the matter to the attention of the regulator as soon as practicable in a form and manner which will facilitate appropriate action by the regulator. When the initial report is made orally, the auditor shall make a contemporaneous written record of the oral report and shall confirm the matter in writing to the regulator."*

10. Further there were express terms of the Contract that:



- 10.1. The Defendant would report if the financial statements did not comply in any material respect with applicable accounting standards, unless in their opinion the non-compliance was justified in the circumstances;
- 10.2. The Defendant would consider whether other information in documents containing audited financial statements contained apparent misstatements or was inconsistent with the audited financial statements.
11. Further it was an express alternatively implied term of the Contract that:
- 11.1. Any report to Lendy or its members produced by the Defendant would comply with s.495 of the 2006 Act and that the Defendant would carry out any investigations in accordance with s.498 of the 2006 Act;
- 11.2. The Defendant would comply with its obligations under the Financial Services and Markets Act 2000 (Communications by Auditors) Regulations 2001 (**“the CBA Regulations”**);
- 11.3. The Defendant would report to Lendy and its members if it reasonably believed Lendy was not or might in the next 12 months cease to be a going concern;
- 11.4. The Defendant would undertake the audit to the standard of reasonably competent auditors with the expertise which the Defendant held itself and its employees out as possessing.
12. Further or alternatively the Defendant owed a parallel duty of care to Lendy in tort to undertake the audit in the respects set out at paragraphs 8 to 11 above and in any event to the standard of reasonably competent auditors with the aforesaid apparent expertise.
13. The Defendant thereafter undertook or purported to undertake an audit of the FY2016 financial statements, and on 14 February 2018 the Defendant’s Senior Statutory Auditor Kelly Sheppard signed the Independent Auditor’s Report on behalf of the Defendant to the Members of Lendy in unqualified terms, certifying or stating among other things that:



- 13.1. *"The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice)."*
- 13.2. Under *"Opinion on financial statements"* that:  
*"In our opinion, the financial statements:*  
  - give a true and fair view of the state of the company's affairs as at 31 December 2016 and of its profit for the year then ended;*
  - have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and*
  - have been prepared in accordance with the requirements of the Companies Act 2006."*
- 13.3. Under *"Opinions on other matters prescribed by the Companies Act 2006"*:  
*"In our opinion, based on the work undertaken in the course of the audit:*  
  - the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and*
  - the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements."*
- 13.4. Under *"Matters on which we are required to report by exception"*, that:  
*"In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or the Directors' Report. We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:*  
  - adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or*
  - the financial statements are not in agreement with the accounting records and returns; or*
  - certain disclosures of directors' remuneration specified by law are not made; or*
  - we have not received all the information and explanations we require for our audit. "*





14. The financial statements for FY2016 reported revenue of £29,199,126 and profit before tax of £3,255,437. Note 7 referred to corporation tax on profits as being £649,086. On 14 February 2018 the FY2016 financial statements were filed at Companies House.
15. On 13 February 2018 Lendy was verbally notified by the FCA that it was initiating the process of issuing a “Minded to Refuse” letter in respect of Lendy’s application for full permission.
16. On about 26 April 2018 the Defendant commenced audit planning work for the audit of Lendy’s financial statements for the financial year ending 31 December 2017 (“**FY2017**”) and on 1 May 2018 it began on-site testing. To the best of the Claimant’s knowledge and belief, no new engagement letter was sent to or agreed by Lendy in respect of that audit, so the terms which applied were those of the Contract.
17. Paragraphs 5 and 8 to 12 above are repeated *mutatis mutandis* in respect of the audit of the FY2017 financial statements.
18. The Defendant thereafter undertook or purported to undertake an audit of the FY2017 financial statements and on 3 August 2018 Ms Sheppard signed the Independent Auditor’s Report on behalf of the Defendant to the Members of Lendy in unqualified terms, certifying or stating among other things that:
- 18.1.       *“The financial reporting framework that has been applied... is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 ‘The Financial Reporting Standard applicable in the UK and Republic of Ireland’ (United Kingdom Generally Accepted Accounting Practice).”*
- 18.2.       *“In our opinion, the financial statements:*  
- *give a true and fair view of the state of the company’s affairs as at 31 December 2017 and of its profit for the year then ended;*  
- *have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and*  
- *have been prepared in accordance with the requirements of the Companies Act 2006.”*
- 18.3.       Under “*Conclusions relating to going concern*”, that:





*"We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:*

- the director's use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or*
- the director has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue."*

18.4. Under "*Opinions on other matters prescribed by the Companies Act 2006*", a statement in the same terms as set out at sub-paragraph 13.3 above;

18.5. Under "*Matters on which we are required to report by exception*", a statement in the same terms as set out at sub-paragraph 13.4 above;

19. The financial statements for FY2017 reported revenue of £32,168,580 and profit before tax of £764,380. On 29 August 2018 the FY2017 financial statements were filed at Companies House.

20. On 23 July 2018 Lendy paid a dividend of £226,000 and on 25 July 2018 a dividend of £850,000, both to LGL, in reliance on the FY2016 financial statements. On 6 September 2018 Lendy paid a further dividend of £861,930 to LGL, in reliance on the FY2017 financial statements. The total of all dividends paid based on the FY2016 and FY2017 financial statements was accordingly £1,937,930.

#### **FY2016 and FY2017 accounting standards**

21. The accounting standards applicable to FY2016 and FY2017 included FRS 102, and in particular in FRS 102:

21.1. Under "*Going concern*",

21.1.1. Paragraph 3.8, which required that when preparing financial statements, the management of an entity shall make an assessment of the entity's ability to continue as a going concern; and,



21.1.2. Paragraph 3.9, which provided that when management was aware of material uncertainties related to events or conditions that cast significant doubt upon the entity's ability to continue as a going concern, the entity must disclose those uncertainties.

21.2. At paragraph 8.6, that *"An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations... that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements."*

21.3. Under "Revenue",

21.3.1. Paragraph 23.3 which required that *"an entity shall measure revenue at the fair value of the consideration received or receivable..."*

21.3.2. Paragraph 23.4, which provided that: *"An entity shall include in revenue only the gross inflows of economic benefits received and receivable by the entity on its own account. An entity shall exclude from revenue all amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes. In an agency relationship, an entity (the agent) shall include in revenue only the amount of its commission. The amounts collected on behalf of the principal are not revenue of the entity."*

21.3.3. Paragraph 23.14, under "Rendering of services", which provided that: *"When the outcome of a transaction involving the rendering of services can be estimated reliably, an entity shall recognise revenue associated with the transaction by reference to the stage of completion of the transaction at the end of the reporting period (sometimes referred to as the percentage of completion method). The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:*

- (a) the amount of revenue can be measured reliably;*
- (b) it is probable that the economic benefits associated with the transaction will flow to the entity;*
- (c) the stage of completion of the transaction at the end of the reporting period can be measured reliably; and*



*(d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.”*

21.3.4. Paragraph 23.15, also under “Rendering of services”, which provided that:

*“When services are performed by an indeterminate number of acts over a specified period of time, an entity recognises revenue on a straight-line basis over the specified period unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other act, the entity postpones recognition of revenue until the significant act is executed.”*

21.3.5. Under “Percentage of completion method”, which by paragraph 23.21 applied to recognising revenue from rendering services, among others paragraph 23.22, which provided so far as material that “An entity shall determine the stage of completion of a transaction or contract using the method that measures most reliably the work performed...”

21.3.6. Under “General disclosures about revenue”, paragraph 23.30, which provided so far as material: “An entity shall disclose:

*(a) the accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services; and*

*(b) the amount of each category of revenue recognised during the period, showing separately, at a minimum, revenue arising from:*

*(i) the sale of goods;*

*(ii) the rendering of services;*

*(iii) interest;... and*

*(viii) any other significant types of revenue.”*

21.4. Under section 33, “Related Party Disclosures”, paragraph 33.9 which stated, so far as material: “If an entity has related party transactions, it shall disclose the nature of the related party relationship as well as information about the transactions, outstanding balances and commitments necessary for an understanding of the potential effect of the relationship on the financial statements. Those disclosure requirements are in addition to the requirements in paragraph 33.7 to disclose key management personnel compensation. At a minimum, disclosures shall include:

*(a) The amount of the transactions.*



(b) *The amount of outstanding balances and:*

- (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement, and*
- (ii) details of any guarantees given or received.*

...

*Such transactions could include purchases, sales, or transfers of goods or services, leases, guarantees and settlements by the entity on behalf of the related party or vice versa."*

### **Subsequent events**

22. As set out above, on 11 July 2018 Lendy was granted full authorisation by the FCA to operate a P2P lending platform, the result among other things of Lendy agreeing to a remediation plan, at an estimated cost of £1,858,646 (which it did not thereafter perform). On 30 July 2018 Lendy received a demand from HMRC for £730,868.15 corporation tax for FY2016. On 28 September 2018 Lendy agreed a payment plan with HMRC in respect of those corporation tax liabilities, following the threat of a winding up petition from HMRC.
23. The last loan advanced through Lendy's lending platform by investors was on 18 September 2018.
24. On about 9 November 2018 Lendy agreed a Voluntary Requirements Notice with the FCA pursuant to section 55L of FSMA, requiring it not to dispose or deal with any of its assets or any client money save for payments under £5,000 in the ordinary course of business without the prior written consent of the FCA. Lendy breached this Notice shortly thereafter, including by making payments on or before 21 December 2018 to various companies in which Lendy and/or its director Mr Brooke had significant control; on 14 January 2019 by paying £90,000 for sponsorship of Cowes Week and on 4 February and 5 March 2019 by paying personal expenses of Mr Brooke exceeding £5,000.
25. On 15 January 2019 Lendy was put on the FCA's supervision watch-list. On 9-10 April 2019 the FCA undertook a short notice audit of Lendy. On 16 April 2019 the FCA imposed an 'Own Initiative Requirements' Notice on Lendy and on 24 April 2019 it imposed comprehensive restrictions on Lendy's activities. On 22 May 2019 the FCA gave Lendy notice that it would be applying to wind it up on just and equitable grounds,

pursuant to its powers under s.367(1) FSMA. On 24 May 2019 Lendy entered into administration on the application of its director, Mr Brooke.



## **Breach**

26. In fact the FY2016 and FY2017 financial statements were defective, as particularised further below, in that:

- 26.1. They did not give a true and fair view of Lendy's affairs and/or its profit as at 31 December 2016 and 31 December 2017 respectively;
- 26.2. They had not been prepared in accordance with applicable UK accounting standards and in particular FRS 102 in material respects as particularised further below and/or UK Generally Accepted Accounting Practice ("**GAAP**");
- 26.3. The information in the Strategic Report and/or the Directors Report was not consistent with the financial statements and/or had not been prepared in accordance with applicable legal standards;
- 26.4. They included material misstatements which could reasonably have been expected to influence the economic decisions of users taken on the basis of them;
- 26.5. They were not in agreement with the relevant accounting records and/or returns and/or full disclosure of directors' remuneration had not been made and/or the Defendant had not in fact received all the information and explanations they required or should have required for their audits in material respects;
- 26.6. They did not disclose material uncertainties related to events or conditions that in fact cast significant doubt upon Lendy's ability to continue as a going concern for a period of at least 12 months from the date of signature of the FY2016 and/or FY2017 financial statements, and which should have been disclosed;
- 26.7. They did not disclose all of the significant accounting policies and/or judgements made by management in applying those policies and which had had a significant effect on the amounts recognised in those financial statements and/or misstated some of those accounting practices in material respects;



26.8. They had not recognised revenue at the fair value of the consideration received;

26.9. They included as business expenses significant sums which were in fact a disguised means of extracting funds from Lendy;

26.10. They had not included in revenue only the gross inflows of economic benefits received and receivable by Lendy on its own account.

27. In particular, as regards the matters in paragraph 26 above:

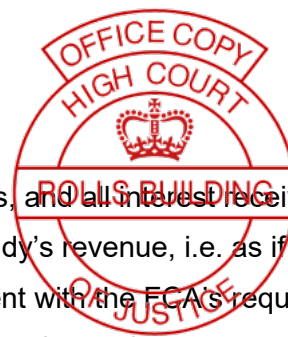
### **Particulars**

27.1. The accounting policies in the financial statements in FY2016 and FY2017 entirely omitted the key judgement over whether Lendy was acting as principal or an agent in the operation of its business, specifically in relation to its “Model 1” and “Model 2” loans.

27.1.1. Model 1 loans involved funds being lent by investors to Lendy who then lent them on to borrowers. Model 2 loans were structured as ones where the investors provided funds to Lendy which Lendy then provided to borrowers, with Lendy acting as an agent to facilitate the lending, handle payment collection and recoveries.

27.1.2. At the material time Lendy had ceased offering Model 1 loans and was only offering Model 2 loans. Lendy had been required to do this by the FCA because under the rules applying to P2P platforms, a lender must not accept, take or receive the transfer of full ownership of moneys relating to P2P agreements.

27.1.3. However in the financial statements there was no reference to the two types of loans which were or had been advanced by or via Lendy and the different accounting treatments applicable to each. An explicit accounting policy in relation to Model 2 loans in particular was essential, because the Model 2 contractual documents between Lendy and investors, and Lendy and borrowers were all premised on Lendy acting as an agent, with the borrower and the investor as principals. Nevertheless, Lendy’s financial statements had been prepared on the basis that all sums received from investors for the purpose of



making loans were treated as Lendy's assets, and all interest receivable from loans made to borrowers was treated as Lendy's revenue, i.e. as if it was acting as principal, even though this was inconsistent with the FCA's requirements and with the terms of the Model 2 loan agreements themselves.

27.1.4. Furthermore, Lendy did not consistently act as if its business was that of an agent, in accounting terms, since it paid the initial set up costs for each loan; its servicing costs depended upon payments being received from borrowers; and it controlled payments to investors and how recoveries from borrowers were allocated (including choosing to pay its own costs prior to making payments to investors). Further in some cases it made payments to investors from its own funds in respect of interest said to be due from the borrowers.

27.1.5. The true position was therefore fundamentally inconsistent and confused, in that Lendy was required by the FCA to act solely as an agent, but its actual conduct of its business was in some ways more characteristic of a principal. This should have been expressly resolved and reflected by the accounting policies directly addressing whether it acted as a principal or agent. Since they failed to do so, the financial statements were highly misleading and could not be approved by the Defendant consistently with its obligations under ISA 315 para 11, 25 and/or 26; ISA 330 paras. 5 and 6 and/or ISA 500 para. 6.

27.2. If the assessment was that Lendy was acting as a principal, this should have been consistently applied throughout the financial statements. However, in Lendy's balance sheets in FY2016 and FY2017 (but not in its income statements), amounts owed by borrowers and amounts invested by investors were netted off, which was characteristic of a relationship of agency, not principal. Such hybrid treatment was wrong. Further, no explanation of the judgements made in this treatment in the balance sheets was made in the accounting policy, as it should have been.

27.3. The only reference in the significant judgements and estimates section in the accounting policies to loans was *“Determine the provisions for loan losses and/or bad debts. The carrying amount of loans receivable is reduced by an allowance for loan losses which is maintained at a level which, in management's judgement, is adequate to absorb credit losses inherent in the loan portfolio and in particular, those loans that are in default.”* This was wholly insufficient given the nature of





Lendy's business. It failed to provide any details as to how the judgement was made, and so missed the whole point of making the disclosure.

- 27.4. Instead the FY2016 financial statements included an inappropriate emphasis on impairment of fixed assets, despite the fact that Lendy's fixed assets totalled less than £1M and so could not give rise to significant judgement or estimation uncertainty.
- 27.5. At note 2, page 13 of the financial statements for FY2016, it was stated that *"loan arrangement fees are recognised on the formation and formal acceptance of each loan agreement"*. This would only have been an acceptable accounting policy if Lendy had been acting as an agent and had no responsibilities or risks in relation to those loans going forward. However, as stated above, sums received from investors for making loans were treated in Lendy's financial statements as Lendy's revenue. In those circumstances, arrangement fees should not have been recognised on the formation and acceptance of each loan agreement but instead, along with exit fees, should have been recognised on a combined basis, together with interest, over the period of the loan term. This error had the effect of incorrectly bringing forward revenue recognition and inflating apparent profits to a material extent. The overall effect was to overstate profits before tax in FY2016 by an amount provisionally estimated as being between £1M to £1.25M (subject to sight of the audit files), which would clearly be material.
- 27.6. The revenue recognition policy at page 13 in FY2016 was a "boilerplate" statement: *"Turnover is recognised at the fair value of the consideration received or receivable for services provided in the normal course of business. The fair value of consideration takes into account any trade or settlement discount"*. This was not a policy appropriate to a P2P lending platform operator like Lendy; rather it would have been more suitable for a trading company.
- 27.7. Note 14 in FY2016 simply referred to *"Provisions for liabilities"* of £2,855,556 as *"a provision is made against the potential future default of borrowers."* This was inappropriate because the balance was material and it was not clear why any provision was recorded as a separate liability, as opposed to recording reductions in the carrying value of amounts receivable from borrowers to reflect potential impairment. Further it was inappropriate for this balance to be reflected as a liability because no relevant past event had taken place; rather the carrying value of the



receivables should have been reduced. Further the provision fund was in fact held by Lendy Provision Reserve Limited (also owned by LGL) and not by Lendy.

27.8. Reference was made that “*Basic financial liabilities ... are initially recognised at transaction price and are subsequently carried at amortised cost less any impairment.*” However there cannot be an impairment of a liability, because impairment only applies to assets.

27.9. As to loan provision, there was reference only that, “*The directors assess whether there is objective evidence that account receivables have been impaired at each balance sheet date and are required to make best estimates of probable losses with the loan book*”. However the requirement is to derive expected future cash receipts and then discount them to derive a present value of those future cash flows, and then reduce (if this is lower than the existing carrying value) the carrying value to this lower balance, with the difference recorded as an impairment expense. Likelihood of loss did not need to be probable: an impairment provision should have been recorded whenever the present value was less than carrying value.

27.10. For FY2017 the loan “provision” at note 13 was £3,715,083, but the basis upon which it was supposedly calculated (4% of the “overterm” loan balance of £43,066,146 plus the balance on the provision bank account) was not logically related to the actual amount of the liabilities for potential future default of borrowers.

27.11. Turnover in note 2 of FY2016 was split into three separate classes of business: exit fees, loan (arrangement) fees and interest. Since Lendy did not provide any discrete service or perform any discrete function specific to any of these three categories of revenue, GAAP required that they be assessed on a combined basis, if assessed on the basis that Lendy was acting as a principal.

27.12. At note 17, page 21 in FY2016 under “*RELATED PARTIES DISCLOSURES*”, the matters referred to were (only) a Deed of Adherence of 7 November 2016 relating to the Wealth Protection International Remuneration Trust; that the directors were 100% shareholders of Teal Limited (“**Teal**”), a company trading in property development; and that during the year a total of key management personnel compensation of £83,417 was paid, those personnel being deemed the directors. These disclosures did not comply with section 33 of FRS 102, and in particular paragraph 33.9 because they did not disclose amounts owing from the Trust, or the

transactions with Teal and there was no description of the potential effect of the relationship for either the Trust or Teal, such as why £600,000 needed to be paid to the Trust or what Teal was said to be doing for Lendy.



27.13. No reference was made under “*RELATED PARTIES DISCLOSURES*” in either FY2016 or FY2017 to payments totalling £6.849M (“**the Marshall Islands Payments**”) which had been paid by Lendy to three companies registered in the Marshall Islands offshore jurisdiction: Laurus Holdings Ltd (“**Laurus**”), Delplane Limited (“**Delplane**”) and Emporis Limited (“**Emporis**”). This included at least £2,671,000 paid in 2016 and £1,218,000 in 2017, as well as at least £1,770,000 in 2015. Further there was clear evidence received by the Defendant which indicated that this was not genuine business expenditure in any event. In particular:

27.13.1. The documents and information which had been provided to the Defendant about these payments, in response to the questions from the Defendant's employees, plainly suggested that these entities were in fact connected with Lendy and/or its directors, that transactions with them were not at arm's length and that it was questionable whether any genuine services had been provided at all, in that they:

27.13.1.1. Gave radically inconsistent explanations of the services supposedly provided by these companies for these payments (sometimes described as fees for introduction of borrowers, sometimes as fees for introduction of investors; elsewhere said to be for provision of web-based services);

27.13.1.2. Were on their face of doubtful authenticity: supposed service level agreements were undated, unsigned, had numerous typos, omitted obviously relevant clauses as to e.g. applicable law or dispute resolution, and had inconsistent payment provisions;

27.13.1.3. Supposed invoices from Laurus, Delplane and Emporis were each numbered consecutively, indicating they had no clients other than Lendy;

27.13.1.4. All documents relating to all 3 companies were signed by the same person, Mr Anthony Smith “*on behalf of Conduit Asset Management Ltd*”;



27.13.1.5. Supposed confirmation statements, sent on 15 February 2018 from Mr Smith, were in the cases of Emporis and Laurus, not addressed to anyone;

27.13.1.6. Where they were described as brokerage fees, this was inconsistent with the brokerage fees also being paid to others.

27.13.2. The payments were clearly highly material. There was no or no proper explanation of the oddities and inconsistencies in the documentation and responses, and no explanation of why services were being provided by companies located in the Marshall Islands. Further the assertions from Lendy's directors that these entities were not related parties and the relationships were purely commercial were unconvincing and, had appropriate professional scepticism been applied, should have raised questions as to the integrity of the directors. If more searching enquiries had then been raised, either it would have been established that these were not genuine business transactions, or Mr Brooke would have provided unconvincing justifications for them that in turn would have led to further inquiries and heightened questions as to his integrity.

27.13.3. Accordingly recording these payments as genuine business expenses gave rise to material misstatements, meant that the financial statements had not been prepared in accordance with FRS 102 and/or that full disclosure of directors' remuneration had not been made and/or that the Defendant had not received all the information and explanations it required for its audits in material respects.

27.14. The net inflows from investors and the net outflows to borrowers were presented in a misleading way. The figures in FY2016 suggested that ignoring impairment, the cash from investors (net £97.8M) was over £10M higher than the cash lent to borrowers (net £87.3M), so that Lendy held over £10M of cash, even though this was in effect "client money", as at 31 December 2016. This falsely presented cash that was held on behalf of investors as if it were Lendy's own cash (this approach was corrected in FY2017, indicating that the Defendant accepted it had been wrong). The FY2016 statement of cash flows provided no indication of this mismatch or its consequences. In fact all or a significant part of the apparent rise in cash recorded by Lendy in FY2016 (from £4.5M to £15.3M, or £10.8M) stemmed from this mismatch in client money. Consequently this apparent rise in cash was actually an unsustainable mismatch which would ultimately reverse, especially if



business contracted. This should also have been reflected in the going concern assessment, which needed to reflect that at some future point this cash mismatch would reverse.

27.15. The presentation of cash inflows and outflows in the cash flow statement also masked the significant outgoings which Lendy was suffering in setting up each loan.

27.16. The financial statements failed properly to identify defaulting loans, so there was insufficient doubtful debt provision and material overstatement of revenue.

27.17. Submission of the FY2016 financial statements was already significantly late, but no allowance had been made for interest and/or penalties on the consequent delayed corporation tax payment, which was a misstatement and probably a material one.

27.18. In the management and governance report for FY2017, it was noted that *“the 2016 corporation tax return had yet to be submitted to HMRC and therefore no tax has been paid in 2017”*. Given the delay to the completion of FY2016, and the fact Lendy had not submitted either a revised tax return for FY2015 or a tax return for FY2016, there must have been substantial interest and penalties balances then outstanding, potentially difficulties with completing those tax returns and certainly pressure from HMRC for payment, and so a heightened risk of misstatement of corporation tax liabilities arising from FY2015 and FY2016. Note 7 to FY2017 showed no tax had been paid for FY2016. However no allowance had been made for interest and/or penalties on the unpaid FY2016 corporation tax, which was a misstatement and probably a material one.

27.19. The *“Loan provision policy”* at note 14 of FY2016, which stated: *“the principle [sic] evidence of impairment is arrears on contractual payments. Loans are deemed to be impaired when one [or] more contractual monthly payment is in arrears at the month end.”* This was defective since it did not specify how the amount of the impairment was calculated, merely referring to when an impairment (of an undefined amount) was required to be recognised.

28. The Defendant, acting through its employee and agent Ms Sheppard or otherwise, acted in breach of the aforesaid express and/or implied terms of the Contract and/or negligently in providing an Independent Auditor’s Report to the Members of Lendy which

was unqualified and/or was in the terms set out above, in respect of Lendy's financial statements for FY2016 and/or for FY2017.



### **Particulars**

- 28.1. Signing and/or providing an unqualified independent auditor's report in respect of financial statements, for FY2016 and FY2017, when in fact the position was as set out at paragraph 26 above, for reasons including but not limited to those set out at paragraph 27 above and/or when approval of those financial statements as drafted must have entailed failures by the Defendant to comply with ISA 200, ISA 315, ISA 330, ISA 500, ISA 550 and ISA 700, amongst others;
- 28.2. Signing and/or providing the aforesaid reports when, because there was no accounting policy concerning whether Lendy was acting as a principal or an agent, and/or how Lendy's actual conduct of its business squared with FCA requirements as to operation of a P2P lending platform, there was confusion and inconsistency and so material misstatement in the financial statements including as to the principles which applied to revenue recognition and expense recognition;
- 28.3. Further, given Lendy's non-compliance with its permissions to operate from the FCA, signing and/or providing the aforesaid report without having undertaken appropriate audit procedures as required by ISA 315, including para. 11, and/or obtaining any or any sufficient understanding of those permissions, and/or designing and/or performing sufficient audit procedures in response to the risks arising from Lendy's non-compliance and/or evaluating the results of such procedures;
- 28.4. Signing and/or providing the aforesaid reports when on a proper analysis there was at the very least real doubt as to whether Lendy would be able to continue to operate as a going concern for at least the next 12 months;
- 28.5. In view of the Marshall Islands Payments, signing and/or providing the aforesaid report without having undertaken further audit procedures in accordance with ISA 550 and in particular sub-paragraph 22(e), applying heightened professional scepticism and seeking truly independent corroborative evidence, rather than relying upon uncorroborated assertions from the directors;



- 28.6. Signing and/or providing the aforesaid reports when the impairment provision to the carrying balance of the debtor balance failed properly to reflect the risk from borrowers defaulting and/or without having obtained sufficient audit evidence as to the extent of that risk, including, where security was relied upon, obtaining sufficient audit evidence that that security existed, had been fairly valued and would be legally enforceable;
- 28.7. In relation to corporation tax liabilities, signing and/or providing the aforesaid report without having first obtained and/or paid sufficient heed to all correspondence with HMRC concerning corporation tax liabilities and/or questioning Lendy and its accountants Jelliff Lamprey as to why it had not submitted the outstanding tax returns, given there was a heightened risk of misstatement of corporation tax liabilities as a result among other things of the matters stated at sub-paragraphs 27.17 and 27.18 above, plus the risk of potentially sizeable disallowables in both FY2016 and FY2017, and/or without considering properly or at all whether this was a deliberate attempt to avoid payment (and so whether they should continue to act as auditors) or whether this was due to cashflow issues (and so whether this affected the Defendant's going concern assessment);
- 28.8. Causing or permitting Lendy to pay unlawful dividends;
- 28.9. To date the Defendant's solicitors have refused to disclose the Defendant's audit files for FY2016 and FY2017 to the administrators. The Claimant accordingly reserves the right to provide additional particulars of breach upon disclosure of the audit files by the Defendant and their consideration by expert forensic accountants instructed by the Claimant.
29. As regards the Marshall Islands Payments, instead of signing and/or providing an unqualified independent auditor's report in respect of the financial statements for FY2016 (and thereafter for FY2017), the Defendant should have made a report to the FCA under paragraph 12 of ISA 250B, further to its statutory duty to the FCA. This would have immediately resulted in the FCA suspending Lendy's business and prevented Lendy from offering any further loans (as in fact happened as a consequence of the FCA Notices in November 2018 and April 2019). Further or alternatively the Defendant should have resigned as auditor and/or agreed only to a qualified or adverse report which reflected the issues at paragraph 27 above.





30. Lendy and/or its management relied on those unqualified financial statements for FY2016 and/or FY2017 in continuing to offer a P2P lending platform, accept sums from investors and make loans to borrowers, and/or in pursuing their application for full permission including making representations as to the financial position of Lendy to the FCA, and in paying the aforesaid dividends. Further the FCA as a matter of fact relied on the FY2016 financial statements in granting full permission to Lendy to operate a P2P lending platform, and would not have granted that permission and/or would have required Lendy to cease accepting further investments at a far earlier date if the FY2016 financial statements had been prepared non-negligently.

### **Causation**

31. All or some of the defects in the financial statements for FY2016 and/or FY2017 set out at paragraph 27 above, and in particular those relating to Lendy's breaches of FCA permissions, the Marshall Islands Payments and/or the going concern assessment, were not ones which could have been rectified in a way which would have permitted the Defendant to provide an unqualified independent auditor's report for FY2016 or FY2017. If the Defendant had not acted negligently and in breach of contract as set out above, then Lendy would have been unable to file financial statements for FY2016 or FY2017 at Companies House which bore an unqualified auditor's report and also it could not have paid the dividends that it did. The FCA, which, as set out at paragraph 15 above, notified Lendy on 13 February 2018 that it was initiating the process for serving a "Minded to Refuse" letter, and in fact restricted Lendy's operations by its notices in November 2018 and April 2019, would rapidly have taken enforcement action against Lendy, forcing it to stop accepting any further funds from investors or facilitating any new loans within a very short period of time. Lendy would not therefore have incurred additional liabilities in particular to investors from the date on which such enforcement action was taken by the FCA and would have been wound up as being insolvent or on just and equitable grounds, or put into administration shortly thereafter.

32. The Claimant claims the losses of Lendy, suffered as a result of the negligence and/or breach of contract of the Defendant, its agents or employees as set out above, as particularised below, being the sums invested by investors from shortly after 14 February 2018, which would not have been invested if Lendy had stopped receiving funds or facilitating loans by such date, plus the amount of the dividends paid by Lendy in 2018. Insofar as those losses depend on the actions of a third party, and in particular the FCA, the Claimant claims those losses on a loss of a chance basis. The Claimant's case is



that there is such a high degree of certainty that the FCA would have taken rapid enforcement action against Lendy to prevent further investment and lending if the Defendant had acted non-negligently that no discount from the full measure of loss is appropriate.

### **Particulars of loss**

- 32.1. From 1 March 2018 until Lendy's administration on 24 May 2019 the additional amounts invested by investors totalled £27,552,398. The loss on these additional sums invested is estimated at £15,599,571. Further, there is a reasonable chance that additional sums could have been recovered from borrowers if administrators had been appointed sooner. Further particulars will be provided upon disclosure of the Defendant's audit files and the Claimant obtaining expert evidence thereon.
- 32.2. Total value of the dividends of £1,937,930 paid on the basis of the FY2016 and FY2017 financial statements approved by the Defendant, which were unlawfully paid alternatively would not in fact have otherwise been paid.
- 32.3. Increased costs of the administrators; and interest and penalties charged by HMRC due to delayed payment of the corporation tax liabilities.

### **Scope of duty**

33. The aforesaid losses fell within the scope of the Defendant's duty of care to Lendy. Without limitation:

- 33.1. The purpose of the Defendant's duty was to take care against the risk of Lendy's financial statements for FY2016 and FY2017 including a material misstatement and/or failing to give a true and fair view and/or of misstatement of Lendy's profits and/or of material uncertainties related to events or conditions which cast significant doubt upon the Lendy's ability to continue as a going concern, by reason of all or any of the matters set out at paragraph 27 above;
- 33.2. There was a sufficient nexus between the aforesaid losses and the subject matter of the Defendant's duty of care, among other things because the losses resulted from payments continuing to be accepted from investors into Lendy's P2P lending platform and lent to borrowers, on the basis its lending model was financially



sustainable, that it had sufficient cash flow, that impairments were appropriately recognised and were being incurred at a sustainable level and/or apparent expenses had been properly incurred; or were dividends paid directly reflecting the Defendant's approval of the stated amount of profits.

### **Interest**

34. Further the Claimant claims and is entitled to interest pursuant to Section 35A of the Senior Courts Act 1981 at such rate and for such period as the Court thinks fit.

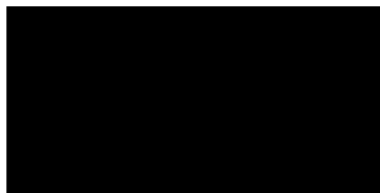
### **AND THE CLAIMANT CLAIMS:**

1. Damages;
2. Interest pursuant Section 35A of the Senior Courts Act 1981 as set out above.

NICOLA RUSHTON KC

### Statement of truth

The Claimant believes that the facts stated in these Particulars of Claim are true. I understand that proceedings for contempt of court may be brought against anyone who makes, or causes to be made, a false statement in a document verified by a statement of truth without an honest belief in its truth.



.....  
Steven Mark Wilson, Solicitor, for and on behalf of the Claimant

Dated: 12 June 2024

Served by Gateley Plc t/a Gateley Legal, One Eleven, Edmund Street, Birmingham B3 2HJ,  
Solicitors for the Claimant