

Funding the Future

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I only talk about auditing on this blog every now and again, even though the role of the auditor is absolutely fundamental to the operation of market capitalism of the sort on which the UK, Western Europe, the USA and vast numbers of other countries around the world rely.

The role of the auditor is to act as an agent, entirely independent of the company on whose financial statements they will report, tasked with forming an opinion on whether the accounts in question present a true view of the income of the entity for a period, and of its financial affairs on its period end date.

Let me be clear, the auditor does not say that the accounts are correct. Despite the commonplace belief that accounting is just a matter of adding up, the reality is that it is a complex exercise during which large numbers of exercises of judgement are required. This means that for any organisation, except perhaps the simplest of cash-based businesses, their accounts will be profoundly subjective.

The auditor is, in that case, not just checking whether the transactions of the entity have actually been recorded, or even whether accounting rules have been properly applied, but has, when undertaking their duties, to decide whether the management of the organisation whose affairs they are considering has exercised sound judgement in the course of fulfilling their obligations to:

- * prepare accounts,
- * properly report to their shareholders,
- * meet their duties to the creditors of the company, whose best interests they are not allowed to compromise because of their trading, and
- * meet other legal, ethical and social obligations.

Undertaking this exercise properly is no easy task. I might have criticised auditors over the years, but I have never underestimated the challenges that they face, although I think that many of them have done so.

I say all this to put this [letter filed by KPMG on public record](#) in context:



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KPMG are the fourth largest firm of auditors in the world, and coincidentally, is both the one that has received the most criticism for its professional conduct in the UK in recent years, and with which I trained to be a chartered accountant between 1979 and 1982.

This letter refers to KPMG's resignation as auditors of P&O Ferries Division Holdings Limited (P&O). They must file such a letter as they have resigned during the course of their period in office, which extends from one annual general meeting to the next. That is because they are technically appointed by the shareholders, and not by the company itself. Such a resignation creates a legal obligation within the UK to state whether there are any circumstances surrounding their resignation which should be drawn to the attention of the members and creditors of the company from which they are resigning.

This letter from KPMG is decidedly unusual, in my opinion, and I have been the author of a number of such letters in my time, because the firm of chartered accountants of which I was once the senior partner was a registered auditor.

Decoding what KPMG are saying, their message is in three parts.

Firstly, it is clear that they are saying that the management of P&O did, in their opinion, bring pressure to bear upon them to complete an audit of the 2023 accounts of that company over a time period that KPMG thought to be inadequate for the amount of work that they believed would be necessary for the work in question.

What this, in my opinion, suggests is that there has been a fundamental breakdown in the relationship between the company and KPMG as its auditor. The likelihood that the odd harsh word has been spoken is, in my opinion, very high indeed.

Most importantly, the construction of KPMG's letter makes it very clear, in my opinion, that they are questioning the judgement of the management of this company. In the process, they are implying that the management in question is neither giving necessary attention to the need for a proper audit, nor understanding their obligation to all the users of the accounts of the company, to whom both they and the auditors of the company are responsible. When, as I have noted above, an audit is, above all else, an expression of judgement on the integrity of the management of an entity and their ability to make appropriate decisions with regard to the financial management process, the implication of this statement is, in my opinion, that KPMG doubted that the required necessary sound judgement exists in this case.

KPMG then, secondly, refer to the fact that all the conditions that led to the delay in the filing of the company's 2022 accounts do, to a very large extent, still exist. Those [accounts for 31 December 2022](#) should have been filed on public record by 30 September 2023. They were actually filed on 15 November 2024. This meant that there was a delay in filing those accounts of more than thirteen months.

When the accounts were filed, the following explanation was supplied for the reasons

for their delay, all of which reasons related to the application of the 'going concern principle' to the accounts, which is an assumption that it can continue in trade without prejudicing its creditors

P&O FERRIES DIVISION HOLDINGS LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2022

GOING CONCERN

The financial statements have been prepared on a going concern basis which the directors consider to be appropriate for the following reasons.

The Group experienced a challenging year in 2022, due to the continuing, albeit reducing impact of COVID, uncertainty associated with Brexit and the disruption caused by the change to the crewing model in March 2022. As a result, the Group has reported a loss for the year of £249 million, and at 31 December 2022 showed net current liabilities of £180 million and an equity deficit of £163 million. In addition, as of 31 December 2022 the Group was in breach of covenants with respect to its external debt.

In those circumstances the Group continued to manage very carefully the funding and liquidity position. At the 31 December 2022, the Group's cash balance was £58 million, an increase from £10 million as of 31 December 2021. At the balance sheet date the main sources of debt funding were external bank loans and shareholder loan.

Since 31 December 2022 and up to the date of approval of these accounts the Group has taken numerous actions to improve and strengthen its financial position. Most notably:

- The Group has extended the terms of its shareholder loan by a further £70 million, from £295 million to £365 million, of which £35 million is available under that facility at the date of approval of these accounts. The loan is not repayable until 31 October 2028 at the earliest and interest payable is rolled up to that point.

- The Group has transferred the obligations associated with vessels under construction at 31 December 2022 to DP World France SAS, a wholly owned DP World legal entity outside the P&O Ferries group, which has arranged financing for those vessels. The vessels have subsequently been chartered back to the Group on an arm's length basis.

- In April 2024 the Group put in place an additional, temporary loan of up to £76.9 million from its shareholder, which it drew down to settle all of the remaining external loan finance that was outstanding at that time, certain external loan finance having been previously discharged. Due to the terms of this arrangement, the additional temporary loan will be settled by the proceeds from the sale of the Spirit of Britain which was sold in May 2024 to the related party, DP World France SAS, for £76.9 million and then onwards by DP World France SAS to a third party.

- The Group has rescheduled its contributions to the MNRPF, in connection with the finalisation of the MNRPF's actuarial valuation as of 31 March 2023, and provided the MNRPF with additional security in connection with the arrangement.

- The Group has agreed in principle a new set of contributions to the P&O Ferries Division 2008 pension in connection with the finalisation of the P&O Ferries Division 2008 scheme's actuarial valuation as of 31 March 2023 and is also providing the scheme with additional security in connection with the arrangement.

In deciding that the accounts should be prepared on going concern basis, the Board has considered various factors including the recovery from COVID 19, ongoing impacts of the UK's exit from the European Union and consequential effects on movements of goods between the UK and the EU, the general economic environment in the UK and various geopolitical issues in Europe and beyond and competition on key routes.

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P&O FERRIES DIVISION HOLDINGS LIMITED

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2022

The directors have prepared cash flow forecasts and performed a going concern assessment, using a base case and severe but plausible downside case. The assessment covers the period from the date of approval of these accounts through to 31 December 2025. The assessment is taken through to the end of 2025, which is a period longer than 12 months, due the final months of the year being a historically low period of cash generation and due to a significant pension contribution falling due in that period.

The base case assessment uses latest forecasts for 2024 and provisional budget for 2025. It sees the Group generate a positive EBITDA for 2024 and this continuing going forward, this driven by a continuing recovery in the passenger market, and a stable performance in a challenging freight market. In the base case assessment, the group will require total funding of up to £57 million from its ultimate parent company DP World Limited during the period which would be funded from £25 million that was drawn on 15th October 2024 and the drawdown of the remaining available shareholder facility. The key assumptions in producing a severe but plausible downside scenario are the market share, the revenue volumes, the contribution and an element of cost recoverability for variable costs.

The severe but plausible downside scenario assumes the freight and passenger markets will be impacted by challenging economic conditions and has also made an allowance for the possible negative impact of the European Entry System ("EES") and the European Travel Information and Authorisation System ("ETIAS") checks, even if the exact impact, timing and methodology of implementation remains uncertain at the date of the approval of these accounts. The impact of challenging economic conditions results in a total plausible downside on the base case of 5% of passenger, freight and Ferrymasters volumes but with a further downside factored in for the EES and ETIAS of 5% on tourist volumes. A 5% rate decrease was also applied to the severe but plausible downside but with a cost recovery on direct costs of 25% on contribution.

No impact has been included in the forecast, in either the base case or the severe but plausible downside scenario as no material financial outflow is expected from the ongoing civil investigation of the Insolvency Service.

In the severe but plausible downside case, total funding of up to £97 million would be required, £40 million beyond the base case scenario. The additional £40 million would be funded through a further extension of the facility or via the repayment of amounts receivable from other group undertakings.

It is noted that there are various other measures that the Group may take to mitigate the severe but plausible downside scenario, including extending existing facilities or securing additional finance on the vessel the Spirit of France, which became unencumbered following the settlement of external debt. However, as these measures are not fully in control of the Group, they have not been reflected in both base case and severe but plausible downside case.

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Via a letter of support DP World Limited, indicated that it will make available the necessary support to meet the base case scenario through an extension of the existing shareholder loan facility by a further £30 million, which was executed on 24th October 2024. It has further indicated sufficient funding will be made available to meet the funding requirements of the severe but plausible downside scenario.

As is apparent from this documentation, it is clear that the auditors did, in signing off the 2022 accounts, rely on assurances given as late as October 2024 that helped them form the view that the company might be able to settle its liabilities as they fell due, about which ability an auditor is specifically required to form an opinion.

It is also clear that when forming that view, KPMG delayed until budgets could be prepared for 2025.

Implicit in the second point in KPMG's letter is a suggestion that they now, again, have doubt as to the ability of the company to make payments to its creditors on time, and that matters have not improved, as they might have hoped, since they expressed their opinion on the 2022 accounts. This can, I suspect, only imply that they have doubts as to whether the financial forecasts that they were presented with at that time have stood up in the face of actual trading experience. That is speculation, but what is clear from the statement that KPMG have made is that they continue to have serious concerns about the future funding of this company, and they have drawn this concern to the attention of the creditors, as they are legally required to do.

Finally, turning to the third point, KPMG's claim that little work has been undertaken to date on the performance of the statutory audit for the year to 31 December 2023 is surprising. That firm must have sufficient resources to dedicate to this task, but they have not done so. That must either be because the company has refused to make payment for the necessary work, or impediments have been put in the way of that work being completed. It is hard to interpret this in any other way. It would seem clear that KPMG are saying that P&O has not got the necessary commitment to the preparation of financial statements to which a proper audit report can be prepared.

What to conclude from all this? I suggest there are three things.

Firstly, it is appropriate to congratulate KPMG on its approach to this matter. They might have been subject to a great deal of professional criticism in recent years, and quite appropriately so in many cases, but on this occasion it looks as if they have acted ethically and appropriately, and once their resignation letter is properly decoded, they are rightly sending out distress signals which all creditors of this company should take note of.

Secondly, it is quite extraordinary that this company is still trading despite the fact that it filed its last account 13 months late, and it is now more than seven months late in filing accounts to 31 December 2023, with there being no indication provided as to when these might be published. This company is in gross breach of its obligations in UK company law, and it is the clearest sign that this law is not being enforced in this country that it is still being allowed to trade despite that fact, and despite its auditors having drawn attention to the doubts that they have on the ability of the company to settle its liabilities as they fall due. Given that this last issue is the supposed priority of UK company law, it would appear that government intervention should now take place

to ensure that the affairs of this company are either regularised, or that its trade now be closed down, with priority being given to the settlement of all obligations.

Failing to file accounts is not a crime equivalent to, for example, failing to file a tax return on time. Third parties formed of real people can get hurt if they do not know the financial status of an entity with which they are trading. Failing to file a tax return might just hurt HMRC, and they have the power to bite back. Creditors of a company left at risk because of its failure to file accounts have no such chance. Failing to file accounts is, then, both a crime and a moral abuse of the business community and society at large.

Thirdly, if this is not indication of the need for a major overhaul of company law in the UK that is supposedly required to ensure that creditors are protected from the risk of abuse that limited liability entities expose them to, then the political signalling that KPMG has effectively included within their resignation letter are not being picked up by politicians who should be attuned to such issues.

If UK company law is not to be seen as something little more than a joke, which anybody can both abuse and ignore, then urgent action on this matter is required now, and both ministers and Parliament should give this matter their full attention to ensure that such abuse cannot happen again.