



**IN THE SUPREME COURT OF VICTORIA
AT MELBOURNE
COMMERCIAL COURT
GROUP PROCEEDINGS LIST**

Case: S ECI 2023 01835

Filed on: 12/11/2024 04:00 PM

No. S ECI 2023 01835

BETWEEN

JUSTINE LIDGETT

First Plaintiff

CAMERON LIDGETT

Second Plaintiff

AND

DOWNER EDI LIMITED (ACN 003 872 848)

Defendant

AND

KPMG (A FIRM) (ABN 51 194 660 183)

Third Party

REPLY

Date of Document: 12 November 2024

Solicitors Code: 103351

Filed on behalf of: Defendant

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Save as admitted below, Downer joins issue with KPMG on its Defence, and otherwise replies as follows (using terms as defined in Downer's Amended Statement of Claim (DSOC), unless otherwise specified):

J. (ALLEGEDLY) INDIRECT LOSS

J.1 FY20

137. As to paragraph 137:

- (a) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 18(1) of the ACL (Cth) as alleged in paragraphs 56N and 68 of the DSOC is "indirect" within the meaning of the FY20 Retainer, which is denied, KPMG's liability for that loss cannot be excluded or limited by the FY20 Retainer;
- (b) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 1041H(1) of the Corporations Act as alleged in paragraphs 56O and 69 of the DSOC is "indirect" within the meaning of the FY20 Retainer, which is denied, KPMG's liability for that loss cannot be excluded or limited by the FY20 Retainer; and
- (c) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 12DA(1) of the ASIC Act as alleged in paragraphs 56P and 70 of the DSOC is "indirect" within the meaning of the FY20 Retainer, which is denied, KPMG's liability for that loss cannot be excluded or limited by the FY20 Retainer.

J.2 FY21

140. As to paragraph 140:

- (a) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 18(1) of the ACL (Cth) as alleged in paragraphs 70N and 82 of the DSOC is "indirect" within the meaning of the FY21 Retainer, which is denied, KPMG's liability for that loss cannot be excluded or limited by the FY21 Retainer;
- (b) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 1041H(1) of the Corporations Act as alleged in paragraphs 70O and 83 of the DSOC is "indirect" within the meaning of the FY21 Retainer, which is denied, KPMG's liability for that loss cannot be excluded or limited by the FY21 Retainer; and

- (c) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 12DA(1) of the ASIC Act as alleged in paragraphs 70P and 84 of the DSOC is "indirect" within the meaning of the FY21 Retainer, which is denied, KPMG's liability for that loss cannot be excluded or limited by the FY21 Retainer.

J.3 FY22

140. As to paragraph 143:

- (a) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 18(1) of the ACL (Cth) as alleged in paragraphs 84N and 96 of the DSOC is "indirect" within the meaning of the FY22 Retainer, which is denied, KPMG's liability for that loss cannot be excluded or limited by the FY22 Retainer;
- (b) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 1041H(1) of the Corporations Act as alleged in paragraphs 84O and 97 of the DSOC is "indirect" within the meaning of the FY22 Retainer, which is denied, KPMG's liability for that loss cannot be excluded or limited by the FY22 Retainer; and
- (c) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 12DA(1) of the ASIC Act as alleged in paragraphs 84P and 98 of the DSOC is "indirect" within the meaning of the FY22 Retainer, which is denied, KPMG's liability for that loss cannot be excluded or limited by the FY22 Retainer.

L. CONTRACTUAL LIABILITY LIMIT

L.1 FY20

158. As to paragraph 158:

- (a) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 18(1) of the ACL (Cth) as alleged in paragraphs 56N and 68 of the DSOC is suffered "in connection with the FY20 Retainer", which is denied, KPMG's liability for that loss cannot be limited by the FY20 Retainer;
- (b) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 1041H(1) of the Corporations Act as alleged in paragraphs 56O and 69 of the DSOC is suffered "in connection with the FY20 Retainer", which is denied, KPMG's liability for that loss cannot be limited by the FY20 Retainer; and

- (c) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 12DA(1) of the ASIC Act as alleged in paragraphs 56P and 70 of the DSOC is suffered "in connection with the FY20 Retainer", which is denied, KPMG's liability for that loss cannot be limited by the FY20 Retainer.

L.2 FY21

161. As to paragraph 161:

- (a) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 18(1) of the ACL (Cth) as alleged in paragraphs 70N and 82 of the DSOC is suffered "in connection with the FY21 Retainer", which is denied, KPMG's liability for that loss cannot be limited by the FY21 Retainer;
- (b) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 1041H(1) of the Corporations Act as alleged in paragraphs 70O and 83 of the DSOC is suffered "in connection with the FY21 Retainer", which is denied, KPMG's liability for that loss cannot be limited by the FY21 Retainer; and
- (c) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 12DA(1) of the ASIC Act as alleged in paragraphs 70P and 84 of the DSOC is suffered "in connection with the FY21 Retainer", which is denied, KPMG's liability for that loss cannot be limited by the FY21 Retainer.

L.3 FY22

164. As to paragraph 164:

- (a) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 18(1) of the ACL (Cth) as alleged in paragraphs 84N and 96 of the DSOC is suffered "in connection with the FY22 Retainer", which is denied, KPMG's liability for that loss cannot be limited by the FY22 Retainer;
- (b) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 1041H(1) of the Corporations Act as alleged in paragraphs 84O and 97 of the DSOC is suffered "in connection with the FY22 Retainer", which is denied, KPMG's liability for that loss cannot be limited by the FY22 Retainer; and
- (c) even if the loss suffered by Downer as a result of any of KPMG's contraventions of s 12DA(1) of the ASIC Act as alleged in paragraphs 84P and 98 of the DSOC is suffered "in connection with the FY22 Retainer", which is denied, KPMG's liability for that loss cannot be limited by the FY22 Retainer.

M. DOWNER’S (ALLEGED) FAILURE TO TAKE REASONABLE CARE

165. As to paragraph 165, on the basis that the factual allegations purported to be included as particulars ought properly to have been pleaded as material facts defining KPMG’s case in that respect:

(ii) Downer did not, in any of FY20–22, know any of the matters alleged in particular (ii);

(iii) as to particular (iii):

(A) as described in paragraphs 0–9 of schedule 1 to the DSOC:

(I) Downer had communicated enough to KPMG to enable it, exercising reasonable care and skill in auditing the financial report of Downer Utilities for FY20, to identify the FY20 Subsidiary Overstatement; and

(II) therefore Downer had communicated enough to KPMG to enable it, exercising reasonable care and skill in auditing the Consolidated Financial Report of the Downer Group for FY20, to identify the FY20 Group Overstatement;

(B) as described in paragraphs 1–16 of schedule 2 to the DSOC:

(I) Downer had communicated enough to KPMG to enable it, exercising reasonable care and skill in auditing the financial report of Downer Utilities for FY21, to identify the FY21 Subsidiary Overstatement; and

(II) therefore Downer had communicated enough to KPMG to enable it, exercising reasonable care and skill in auditing the Consolidated Financial Report of the Downer Group for FY21, to identify the FY21 Group Overstatement; and

(A) as described in paragraphs 1–17 of schedule 3 to the DSOC:

(I) Downer had communicated enough to KPMG to enable it, exercising reasonable care and skill in auditing the financial report of Downer Utilities for FY22, to identify the FY22 Subsidiary Overstatement; and

(II) therefore Downer had communicated enough to KPMG to enable it, exercising reasonable care and skill in auditing the Consolidated Financial Report of the Downer Group for FY22, to identify the FY22 Group Overstatement.

(iv) as to particular (iv), Downer:

- (A) admits that, on 8 August 2022, it received an anonymous complaint that the AusNet Contract was “masking a financial loss” because the WIP on the Contract was “materially overstated”, “contrary to Downer’s financial standard”, by “up to \$20–\$25 million” (**Whistle-Blower Complaint**) [DOW.1016.0001.1723]; and
- (B) denies every other allegation made in particular (iv).

Particulars

See schedule 1.

168. As to paragraph 168, Downer repeats paragraph 165(iv), above.

O. SET-OFF

O.2 (Alleged) Misleading or Deceptive Conduct

173. Each of the declarations stated in paragraph 173(a) was made, in accordance with s 295(4)(d) of the Corporations Act:

- (i) “in the directors’ opinion”;
- (ii) to the shareholders in Downer.

175. Each of the declarations stated in paragraphs 175(a)–(c) was made, in accordance with s 295A(2)(a)–(c) of the Corporations Act:

- (i) “in the ... opinion” of each of the Chief Executive Officer (**CEO**) and of the CFO of Downer;
- (ii) to the directors of Downer.

177. Each of the representations stated in paragraphs 177(a) and (b) was made, by the CEO and CFO of Downer, “to the best of [their] knowledge and belief, having made such inquiries as [they] considered necessary for the purpose of appropriately informing [them]selves”.

178. As to paragraph 178, KPMG “identified nothing from [its own] testing [of the Whistle-Blower Complaint] which would cause [it] to reassess [its] ability to rely upon management representations” [KPM.501.001.9173, [62]].

N Owens

A J Weinstock

P Meagher

N Wootton

Dated: 12 November 2024

A handwritten signature in black ink, appearing to read 'Chymel', is written over a horizontal line.

Gilbert + Tobin

Solicitors for Downer EDI Limited

Schedule 1

Particulars to paragraph 165(iv)(B) — investigation of Whistle-Blower Complaint

1. From May 2020 to July 2022, Downer had been investigating the accrual of WIP on the AusNet Contract, and discussing it with AusNet and KPMG.
2. In the course of that process, on 17 June 2022, KPMG reported to the Audit & Risk Committee of the Downer Group that “[r]ecognition” of WIP on the AusNet Contract was “acceptable”, and “[t]he current level of accounting recognition appear[ed] appropriate” [DOW.3000.0071.9605_0080 at _0106] (bold in original).
3. Nevertheless, on 8 August 2022, Downer received the Whistle-Blower Complaint [DOW.1016.0001.1723].
4. On 9 August 2022, at 1:29 pm, Suzanna Dabski, Deputy Company Secretary of Downer, emailed the Whistle-Blower Complaint to Paul Taylor (**Taylor**), Group Executive General Manager of the Project Management Office of the Downer Group (**PMO**), and asked him to “revert to us with the suggested investigation approach and plan” [DOW.1016.0001.1722].
5. On 9 August 2022, at 4:47 pm, Taylor emailed his plan to Peter Lyons, Company Secretary of Downer (**Lyons**) [DOW.1037.0004.3736]:

In order to undertake a project financial review, I would need the following data/information as a starter

- June 2022 Month End, YTD (Year to Date) and LTD (Life to Date) JDEGS P&L results down the BU/WBS coding level (I need to validate the project's monthly excel report attached, specifically tab 'OMSA EBIT June 22' which I accessed off the Downer DGM Solution, plus to determine how WIP is calculated on the project)
- June 22 project accruals
- April to June Revenue data for each month, YTD and LTD, including monthly progress claims, invoices and client payment certificates
- June 22 Debtor analysis
- The project's profit recognition approach/accounting methodology
- The contract Payment Methodology for the Schedule of Rates (work orders) and Lump Sum items etc

- The status of Work Order completion and associated payment positions
- An explanation of the upward WIP trend over the past 12 months, the forecast WIP curve to completion and the full term forecast to complete if one exists

...

The PMO has undertaken similar reviews on other projects in the past to determine the underlying reasons for large positive WIPs.

As per those project reviews and to protect the identity of the whistleblower, I propose initially to contact the GM of the business and discuss

- That the PMO undertakes oversight and governance across the whole of Downer
- ...
- Given the increased focus and growth in the services, operations and maintenance work in Downer, the PMO is now working through these projects that don't have system project valuations, starting with those with large WIP values and checking the underlying reasons for the WIP positions. We've already started in RTS on a number of their projects.
- I would note the docs/artefacts that I would require for the review and whether the Project/Contract Mgr was the best person to talk to, plus answer any queries might have.
- I'd also note that I'd like to get on to it straight away as I have a number of TCC Project Hold Point reviews planned for mid/late August (which is true), so I only have a small window to get this one done.

6. On 9 August 2022, at 5:03 pm, Lyons replied, "Please proceed as outlined" [DOW.1037.0004.3736].
7. Accordingly, on 9 August 2022, the PMO commenced its investigation of the Whistle-Blower Complaint, as proposed by Taylor.
8. On 10 August 2022, Michael Ferguson, Chief Financial Officer (**CFO**) of the Downer Group, reported the Whistle-Blower complaint to Stephen Isaac, partner of KPMG (**Isaac**); Nigel Virgo, partner of KPMG (**Virgo**); and Rhys Hopkins, Director, Audit, Assurance & Risk Consulting, of KPMG (**Hopkins**) [KPM.501.001.9173, [1]].
9. A copy of the Whistle-Blower Complaint was shown to KPMG [KPM.501.001.9173, [3]].

10. KPMG “consider[ed] the complaint made to require a specific audit response prior to opining on the 30 June 2022 Downer EDI Limited financial statements” [KPM.501.001.9173, [7]].
11. Between 9 and 11 August 2022, James Kafanelis, Head of Utilities of the Downer Group, and Hein Scholtz, General Manager, Finance, Utilities of the Downer Group (**Scholtz**), met with representatives of KPMG to discuss the Whistle-Blower Complaint further.
12. On 12 August 2022, at a meeting of Downer’s Audit & Risk Committee, attended by Isaac and Virgo [DOW.3000.0071.9606 at _0001]:
 - (a) “[t]he [Whistle-Blower Complaint] was discussed”;
 - (b) it was “noted” that “[t]he external auditor” had been “notified of the disclosure”; and
 - (c) “[i]t was noted that the external auditor [would] conduct additional transaction sample testing and process review in relation to the [WIP] balance”.
13. For the purpose of that testing and review, KPMG “identified ... risks specific to the [AusNet] contract” such that “testing to address [those] risks would detect whether the Whistle blower complaint ha[d] substance” [KPM.501.001.9173, [30]–[31]].
14. Then KPMG “designed the following procedures to mitigate the risks identified”:
 - (a) “[t]est 100% of [contract] invoice revenue to [recipient-created tax invoices] and cash received”;
 - (b) “recalculate the WIP balance at 30 June and corresponding revenue recognition” [KPM.501.001.9173, [36]].
15. KPMG performed those procedures [KPM.501.001.9173, [37]–[38]].
16. In the course of performing those procedures, on 12 and 13 August 2022, KPMG emailed Scholtz numerous queries about the calculation of the WIP on the AusNet Contract [DOW.1001.0001.2549, DOW.1001.0001.2561].
17. Those queries were addressed:
 - (a) in a series of emails sent on 12 and 13 August 2022 [DOW.1001.0001.4983, DOW.1001.0001.4986, DOW.1016.0001.1162, DOW.1001.0001.2588, DOW.1001.0004.6021]; and
 - (b) in a meeting held on 15 August 2022 among Hopkins; Scholtz; Priya Maganty, Finance Manager, Transport and Infrastructure, of the Downer Group;

Mark Duckett, General Manager, Power and Gas Distribution, of the Downer Group; Brendan Fleming, Manager, Electricity Distribution, of the Downer Group; and Elly Strangwick, Senior Management Accountant, AusNet Electrical, of the Downer Group.

18. After its queries had been addressed, “[KPMG’s] overall conclusion with respect to the testing performed [was] that”, while “there [were] overstatements of revenue and WIP”, “[t]he net adjustment of these matters was \$6.0” [KPM.501.001.9173, [39]].
19. Accordingly, KPMG “raised an audit misstatement” of \$6.0m, but “assess[ed] that the misstatement [was] not material to the Group” [KPM.501.001.9173, [43], [56]].
20. KPMG “considered [its] testing results and conclusions with respect to non-compliance with laws or regulations”, and “identified no indicators that there ha[d] been non-compliance with laws or regulations” [KPM.501.001.9173, [57]].
21. These findings were reported by Virgo to Nicole Hollows, Chairman of the Audit & Risk Committee of Downer, on 15 August 2022 [KPM.501.001.9173, [61]].
22. Further, on 15 August 2022, Isaac emailed Vivian Tam, Deputy CFO of the Downer Group, “an updated audit difference schedule”, recording a “[j]udgmental audit difference in relation to OMSA” of \$6.0m (**Updated Audit Difference Schedule**) [DOW.1016.0001.1197, DOW.1016.0001.1198].
23. Meanwhile, by 15 August 2022, the PMO’s investigation of the Whistle-Blower Complaint had not found any evidence to substantiate it.
24. KPMG reviewed the PMO’s investigation and found that the PMO, which “ha[d] the required expertise to perform such an investigation,” had “performed a series of tests which [were] similar in nature to those outlined within [KPMG’s] testing”, “[i]ncluding stratification of WIP between the schedule of rates and variation components, consideration of ageing and internal assessment of the recoverability of the WIP balance” [KPM.501.001.9173, [9], [10]].
25. Although “there was no evidence found [by the PMO] to substantiate the complaint made,” “[t]here were no aspects of management’s work performed, or findings, which [KPMG] consider[ed] require[d] a specific response” [KPM.501.001.9173, [11], [12]].
26. Nevertheless, “[KPMG] ha[d] not placed any reliance on management’s testing and ha[d] performed [its] own independent testing and assessment of the complaint made” [KPM.501.001.9173, [12]].

27. In the course of that testing, KPMG “identified nothing from [its] testing performed which would cause [it] to reassess [its] ability to rely upon management representations” [KPM.501.001.9173, [62]].
28. The investigations carried out by management and KPMG were summarised in a draft paper, prepared for the board of Downer, entitled “Our Voice Disclosure” (**Our Voice Disclosure Paper**) [DOW.1013.0002.2336]. In that draft of the Our Voice Disclosure Paper, it was reported that:
- [s]ince becoming aware of the [Whistle-Blower Complaint], Management and the external auditor (KPMG) have spent considerable efforts on validating the existence and valuation of the WIP balance.
- ...
- Based on the work performed, no evidence has been found by management or KPMG to substantiate the allegations.
29. That draft of the Our Voice Disclosure Paper was forwarded by Lyons to Virgo on 15 August 2022 at 6:56 pm [DOW.1013.0002.2335].
30. The same day, at 7:09 pm, Virgo replied that he would “take a look” [DOW.1013.0002.2361].
31. Virgo did not express any disagreement with the contents of the draft Our Voice Disclosure Paper.
32. A final version of the Our Voice Disclosure Paper, which contained the same conclusions as the draft but attached the Updated Audit Difference Schedule, was put before the board of Downer on 16 August 2022, at 7:30 am. At that meeting, attended by Virgo [DOW.3000.0071.9637 at _0003]:

The paper titled ‘Our Voice Disclosure’ was noted.

The Chief Financial Officer gave an update on the matter, advising that:

- A significant volume of work had been completed by management and KPMG to validate the OMSA WIP balance as at 3 June 2022;

...

- There is no evidence to substantiate the allegation that the [Schedule of Rates] Component is overstated, which represents \$31.3 million of the \$31.8 million WIP balance ...

...

Nigel Virgo gave a summary of the work performed to validate the OMSA WIP balance at 30 June 2022 ...

33. Virgo did not, at that meeting, express any disagreement with the update given by the CFO.
34. After the meeting, at 8:25 am on 16 August 2022, Isaac asked Lyons by email to send him the final version of the Our Voice Disclosure Paper [DOW.1016.0001.1271].
35. Lyons did so by email at 8:47 am on 16 August 2022 [DOW.1016.0001.1271].
36. Isaac did not express any disagreement with the contents of the Our Voice Disclosure Paper.
37. Further particulars may be provided after discovery.