

Business, Energy and Industrial Strategy and Work and Pensions Committees

Oral evidence: Carillion, HC 769

Thursday 22 February 2018

Ordered by the House of Commons to be published on Thursday 22 February 2018.

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Members present: [Frank Field](#) (Chair); [Heidi Allen](#); [Andrew Bowie](#); [Ruth George](#); [Peter Kyle](#); [Rachel Maclean](#); [Rachel Reeves](#); [Antoinette Sandbach](#); [Chris Stephens](#).

Questions 650-997

Witnesses

I: Lesley Titcomb, Chief Executive, The Pensions Regulator; Nicola Parish, Executive Director of Frontline Regulation, The Pensions Regulator; Mike Birch, Director of Case Management, The Pensions Regulator.

II: Michael Jones, Internal Audit Partner, Deloitte; Michelle Hinchliffe, Head of Audit, KPMG; Peter Meehan, Partner, Audit, KPMG.

Examination of witnesses

Witnesses: Lesley Titcomb, Nicola Parish and Mike Birch.

Q650 **Chair:** Welcome. Thank you very much. Lesley, might you introduce yourself and then your team?

Lesley Titcomb: Yes, of course. Good morning. I am Lesley Titcomb; I am the chief executive of the Pensions Regulator, where I have been since March 2015.

Nicola Parish: Good morning. I am Nicola Parish. I am the executive director of frontline regulation. I have been in that role just 18 months. Before that, I was director of case management and before that was leading the legal team at TPR.

Mike Birch: Good morning. I am Mike Birch; I am the director of case management at the regulator. I have been at the regulator for about six years and have been in that position for 18 months.

Lesley Titcomb: Mike and Nicola lead our frontline regulatory work on a day-to-day basis.

Q651 **Heidi Allen:** Good morning, everybody. I want to start by trying to get a bit of a picture as to your involvement with Carillion and specifically the trustees, I suppose. Just to set the scene a little, going back to a couple of old pieces of correspondence, as far back as March 2010, the then Carillion Chair of Trustees wrote to you expressing concern about the inability to reach a satisfactory conclusion, "would welcome assistance you could give" and notes that the recovery plan exceeds a 10-year maximum. It expresses all sorts of concerns. Fast forward to 2013; we have all schemes writing collectively to you. An impasse has been reached; no further progress can be made without the intervention of the regulator. Talk to me about what you did.

Lesley Titcomb: I will just set some context here, and then Mike can talk about the detail of what happened then. What we are dealing with here is a framework set for us by Parliament, which has flexibility built into it. It means that an employer with a deficit in their scheme does not have to pay down that deficit immediately. The trustee, who is the first line of defence for the members, and the employer are required to come to an agreement on the appropriate level of funding for the scheme at that point in time, depending on the scheme's specific circumstances. We as the regulator, usually working behind the scenes so support the trustee, have to balance the objectives of protecting the member benefits and the PPS by ensuring that the scheme is adequately funded but, at the same time, not doing that in a way that imperils the sustainable growth of the employer.

Q652 **Heidi Allen:** That is assuming there is sustainable growth of the



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employer.

Lesley Titcomb: Yes, but that is a fairly widely drawn term in terms of when that objective was given to us, as I understand it. It takes into account a range of circumstances but, most importantly, it is because the best protection for a defined benefit scheme is a strong and sustainable employer. Mike can talk about how that translates into what we did at the time.

Q653 **Heidi Allen:** What did you specifically do here? It sounds to me, to set the scene, that the trustees were asking for your help and saying, "We can do nothing further ourselves".

Mike Birch: Our primary engagement was with respect to the 2011 valuation. We had some engagement from 2008, but it was less intense.

Q654 **Heidi Allen:** Despite them writing to you in 2010.

Mike Birch: We engaged with the trustees on the 2008 situation, including on the Carillion scheme. Our engagement became fuller in 2011. In 2011, we engaged in what is called proactive engagement. By that we mean engagement before the valuation has been agreed. Typically before that tranche of valuations, we were only engaging once the valuation had been agreed.

Q655 **Heidi Allen:** Talk to me about what engaging means.

Mike Birch: Engaging can be a wide range of things. In 2011, we contacted the trustees and we sought to discuss with them the position that the scheme was in. As Lesley has described, they are the first line of defence; they have the first engagement with the company. In this situation, the trustee was initially keen in 2011 and this was at the point when there was a single trustee for a number of the schemes. The trustee was keen to retain that primary locus with the employer and to seek to reach an agreement on an appropriate recovery plan. It became clear that that was not possible; they were not getting agreement from the employer.

Q656 **Heidi Allen:** Why did they write to you in April 2013 saying that, "The trustee has offered arbitration and mediation to the sponsor, but the offer has been refused. The trustee has now reached the position where it believes formal intervention by the Pensions Regulator is necessary"?

Mike Birch: That was the point at which we became more involved. We had sought to be involved earlier. They had said they would like to keep us informed.

Q657 **Heidi Allen:** What evidence can you give us of your attempts to do more then? It sounds like you are saying you wanted to do more with the trustees and they said, "We are fine". What evidence do you have for that?

Lesley Titcomb: It is important to understand the context at that time. This was the first real period that TPR was using this approach of trying



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to intervene proactively. It was a new way of acting at the time. Some trustees were welcoming in some schemes; others were wanting to carry on.

Q658 **Heidi Allen:** Hence the evidence—what did you do?

Lesley Titcomb: That is why we engaged when they came to us.

Mike Birch: We had been engaged with the trustee. They had been keeping us informed of what was happening. It then got to a point when they decided that they could not reach an agreement, and wrote to us with what is called a formal failure to agree. At that point, we engaged directly with the employer. We had meetings with the employer and with the trustees. We got them to present to us the amounts of money that they thought they could pay and why they thought it was constricted. We disagreed with them on that and we sought revised proposals from them. They gave us revised proposals and we then said we thought those were not acceptable. We made clear to them that, if they did not reach something that was better, we would look to use our powers.

The powers that we looked to use were two. The primary one is what is called Section 231. That is a power under which we can set the terms of a valuation and we can also set the recovery plan, so the amount of money that is going to go into the scheme. Prior to doing that, we would appoint what is called a skilled person to look at the business, understand the cash flows that it had and understand the ability to fund the scheme over a reasonable period. On the basis of that, we would then set the amounts in the recovery plan under Section 231.

Q659 **Heidi Allen:** Did you do that?

Mike Birch: No, we made clear to the company that we were considering that. They then gave us and the trustees an improved proposal, which saw the payments stepping up over time and more money going into the scheme. On that basis, we and the trustees agreed that what was offered in response to our threat of use of those powers was acceptable.

Q660 **Chair:** Heidi, can I just interrupt? Mike, can you tell us when the first cry for help was? Was there a timescale for your intervention? There was the pre-period when they said to you, "Don't you worry; we are going to deal with it". When did they say, "Please help us"?

Mike Birch: They made that clear prior to the formal failure to agree, but I would have to check the record to give you a formal date of when they first said to us that they could not reach agreement.

Q661 **Chair:** Was this around 2011?

Lesley Titcomb: This is the 2011 valuation we are talking about, which was due to be submitted to us in 2013 and it was late. It is important to understand that discussions were going on all through this period.

Q662 **Chair:** Heidi's questions are not about this, are they, Lesley? They are



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about when they said help and what you then did. From the answers you gave to Heidi, I thought you were saying 2011. Is that right?

Mike Birch: No, this was the 2011 valuation. This was 2013.

Q663 **Chair:** When did they shout, "Help"?

Lesley Titcomb: It was in 2013.

Mike Birch: In 2013, they wrote to us to say that they could not reach an agreement and there was a failure to agree.

Heidi Allen: The asking for help, I suppose, got stronger and stronger. They first formally document it in 2010, about the previous instances.

Lesley Titcomb: Indeed, when we go back to 2008, you are right, they also had similarly robust negotiations then, but that did not get to the point of the formal failure to agree.

Q664 **Chair:** Was that switching on your red light for you?

Lesley Titcomb: Yes, and that is one of the reasons that they were selected as a proactive case for the 2011 valuations. They were selected again and we continued the negotiations in the work through 2013.

Q665 **Chair:** They came out with their 2011 valuations in 2013. Could you have asked for it earlier? Is it normally like that, two years late?

Mike Birch: It is an end-of-2011 valuation, so the statutory time period for completion of that is 15 months, which would take you to March 2013.

Q666 **Chair:** Who is doing the valuation?

Mike Birch: The trustees were doing the valuation and their advisers.

Q667 **Chair:** Which company did they employ?

Mike Birch: I would need to check that.

Q668 **Heidi Allen:** I suppose what I find slightly curious about that 15-month period is it seems to me that the first time when all three sides of the equation—the trustees, the company and yourselves—got together was in April 2013, when you stated that your role was as a mediator. That is beyond the 15-month window, so the deadline had already passed and, at that stage, you are considering yourselves and describing yourselves as a mediator. At the same meeting, Robin Ellison quoted Richard Adam, who was the financial director at that time, as saying he considered the pension schemes were "a waste of money". Did you agree?

Lesley Titcomb: I do not believe that workplace pension schemes are a waste of money.

Q669 **Chair:** Had you heard these terrible things?

Lesley Titcomb: I cannot say exactly what he said. I was not in the room at the time.



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Mike Birch: I was not in the room at the time either, so I cannot say.

Q670 **Chair:** Was anybody in the room at the time?

Lesley Titcomb: None of the three of us were, no.

Chair: None of your side was there when this was said.

Mike Birch: None of us was directly involved.

Q671 **Heidi Allen:** As an organisation, did you share the trustees' worry that the company was not taking it seriously?

Lesley Titcomb: Absolutely, yes.

Mike Birch: Yes. It is unusual for us to use Section 231 and it is also unusual for us to threaten it. We need to have significant concerns. We do not threaten it when we do not think we would use it, so we were concerned.

Q672 **Heidi Allen:** You threatened to use it in June 2013, July 2013, November 2013, November 2013 again and March 2014, but never actually did. I suppose it is just that wishy-washy area of threatening, threatening, threatening—"Oh gosh, look. The company has gone belly-up". When do you use these powers?

Lesley Titcomb: There are some important issues to unpack here. First of all, Section 231 is a difficult power to use. We are seeking some improvements to it, as part of DWP's work on its White Paper at the moment. Those cases that we launch take a long time when we do go through them. We have got as far as issuing warning notices in certain situations.

Q673 **Chair:** How many times have you used it then, Lesley?

Lesley Titcomb: We have got to the stage of issuing warning notices in three cases so far, I believe, but we have threatened the use of it more times than that. That has had the effect as it did here.

Q674 **Chair:** In how many cases have you threatened it?

Lesley Titcomb: It is quite difficult to say. We have 2,000 funding valuations each year.

Q675 **Chair:** Things might be complicated, but you must know whether you have threatened to use it or not.

Lesley Titcomb: If you think about the type of engagement we are having with the trustee and with the employer, then there is a range of interventions that we as the regulator can have. You have a regulatory toolkit available. Very often the mention of the possibility of using powers has the effect of bringing people to the table, which is, after all, the desired result if you then get more money into the scheme.

Q676 **Chair:** It is not just getting them to the table, is it? It is getting some



money out of them.

Lesley Titcomb: Absolutely, yes, and that is what you are aiming for in terms of the outcome. It is important to say that, as well as the improvements to the powers that we are seeking in that regard, to give us a stronger evidential base and easier ability to use that power, we are also very much of the view that we need to be clearer and quicker. For example, you described us as a mediator in that context.

Heidi Allen: You described yourselves.

Lesley Titcomb: Yes, you quoted that we described ourselves as a mediator. It is absolutely essential that we are able to be clearer about our expectations, and I mean that both in the sense of our published guidance but also in terms of when we are talking to employers and schemes. We need to be clearer about what we expect, what is acceptable and what is not acceptable.

Q677 **Heidi Allen:** Is that not your job? Why is it a revelation that you now know you need to be clearer? Is that not the purpose of the Pensions Regulator?

Lesley Titcomb: I am sure that is how my predecessors felt it was. All I can do is observe from where I am now, with the situation that I have now.

Chair: You have been there years now.

Lesley Titcomb: We need to be clearer and quicker and tougher. We have changed already in that regard, we continue to change and we will change further.

Q678 **Heidi Allen:** If we could turn the clock back on Carillion, what would you as an organisation do differently?

Lesley Titcomb: We would have reached a decision to bring in our powers to bear quicker. We would not have continued so long in that negotiation situation and we would have tried to bring that to a conclusion quicker.

Q679 **Heidi Allen:** Would you have used your powers?

Lesley Titcomb: It is very difficult to say with hindsight, because I do not know the precise circumstances. As I have said, there are some issues with creating a strong case with the certainty of winning.

Q680 **Heidi Allen:** With the greatest of respect though, if you are trying to change the organisation and make it swifter and more responsive, is the way to do that not to learn from what went wrong?

Lesley Titcomb: I completely agree and that is exactly why we are here and why we have been reviewing what happened. These are my observations that I am sharing with you of the lessons we need to learn.



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Q681 **Chair:** If we closed our eyes, we could be talking to you about BHS, so where is the learning going on here, Lesley?

Lesley Titcomb: The learning is going on, Mr Field, and the situation here is that we are talking about a circumstance that is earlier than some of the BHS material. Again, I am looking backwards with the benefit of hindsight to see what happened and what lessons we can learn from it.

Chair: You told us you were doing that on BHS.

Lesley Titcomb: Indeed, and we still are. We will have to do it with this situation as well, but that is why I am saying to you that we clearly have to be clearer, quicker and tougher in this regard.

Q682 **Heidi Allen:** I do understand shareholder jitters, being careful about exercising these powers and that fine balance. I do get that; I really do. Therefore, you probably cannot talk to us about any other cases where you may be learning and being more heavy-handed. The difficulty is that, if no other organisation ever sees you applying those powers, is it not a question of Peter crying wolf? It is not surprising that the financial director did not take you seriously.

Lesley Titcomb: Yes, I agree with you totally. Therefore, I would point out to you that, over the past two years, we have made extensive use of a number of our powers for the first time.

Q683 **Heidi Allen:** Such as?

Lesley Titcomb: For example, there is the power to commission a Section 71 report to assess the affordability in a particular situation and the power to bring criminal prosecutions against people for non-compliance with a Section 72 order.

Q684 **Chair:** Who was that against, Lesley?

Lesley Titcomb: That was against Dominic Chappell, but also against three other people in connection to cases relating to scams. We have been into the High Court and secured £13 million worth of awards using our Section 16 power to get restitution for people who have been scammed. It is very much an ongoing piece of work for us to use more of our powers, and this includes Section 231.

Q685 **Chair:** Mr Chappell and the others are all small fish, are they not?

Lesley Titcomb: They are. That is possibly true, but equally I believe that, if we are to increase our credibility as a regulator in this space, we have to start with the examples that are there for you to deal with at the time. I do not think we can afford to let people who we believe have committed criminal offences off the hook.

Q686 **Chair:** In terms of building credibility, the employers are offering something like £35 million. The pension scheme wanted £65 million. How did you help bridge that gap? What was your effectiveness?



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Mike Birch: £63 million was the number that originally was in the Gazelle report that was prepared for the trustees. They revised that number down significantly and that was the basis on which the trustee was then looking for £35 million.

Q687 **Chair:** Who revised it down?

Mike Birch: It was Gazelle, over the period of engagement with the company.

Q688 **Chair:** What did the company do to their offer?

Mike Birch: The company's offer was £33 million, stepping up.

Q689 **Chair:** Stepping up to what?

Mike Birch: It was stepping up to £42 million over time. In total, the extra payments that were built into the recovery plan that was agreed following the threat of 231 were £85 million more, but they were spread over amounts stepping up over time.

Q690 **Chair:** How many years was that?

Mike Birch: It was 15.

Q691 **Heidi Allen:** I wanted to bring it back to this case, rather than more generic questions about the powers that you choose or do not choose to use. When we think about the argy-bargy between the trustees and the company—"We want more", "No, you can't have it"—do you think it was a fair relationship or that the trustees capitulated more?

Lesley Titcomb: The trustees did a very robust job here in defending the members' interest. As Mr Ellison explained to you, they have the challenge where they have to achieve this balance between what is right for the members, but also ensuring that they do not imperil the growth of the company and take full account of the representations that the company makes to them. It is a challenging job for them and it is a challenging job for us to balance these things. It requires difficult judgments.

Q692 **Heidi Allen:** In looking at the two parties, who did more of the compromising and who was more obstinate?

Lesley Titcomb: That is rather difficult to say with hindsight.

Q693 **Heidi Allen:** Should you not be all over the detail of what happened, Lesley?

Lesley Titcomb: I believe we are in that, working with the trustees, there was £85 million put into the plan.

Chair: That is over 15 years.

Lesley Titcomb: It is over 15 years. That is right, yes, but that is the nature of recovery plans. You do not have to pay down the deficit



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immediately. The employer is permitted to do that over time. If I may set some context to what was happening at the time—

Chair: It was going belly-up, was it not?

Lesley Titcomb: I am talking about the general environment, if I may, which was a strong focus on the growth of employers at the time and a perception, as I understand it from talking to people who were involved, that the regulator was being too hard on companies at the time. That actually resulted in us being given the sustainable growth objective as an additional objective on the face of the legislation. We were in a slightly different environment then. With hindsight, we would have wanted to have secured more into the scheme.

Q694 **Chair:** Will you give us a note on who was claiming you were being too tough, Lesley? Not now but can we have a written note?

Lesley Titcomb: I will look and see whether we have any particular examples of that. I am not sure whether we do.

Chair: I have not read any.

Q695 **Chris Stephens:** The deficit recovery plans were imposed on the trustees and they doubled in length between 2006 and 2013, so did the regulator believe at any stage that these plans had any chance of succeeding?

Mike Birch: It is important to put it in context in two ways. One is that the deficits grew significantly in that time. This was the time of the financial crisis. It was a time of reduced expectations for growth in assets and a lower interest rate environment. For all schemes, deficits grew significantly during that time. The length of the recovery plan for Carillion's schemes was longer than the average, and the schemes were marginally worse funded than the average, but the other context of this was that, at the time, the company presented as being a reasonably strong business. We graded it as two—so what we call “tending to strong”—out of four. It was a company that had a growing share price. It was a company that was securing a lot of bank facilities. It was a company that was securing a lot of government contracts. It presented as a very strong company at that time.

What is not clear—and we all know where it has ended unfortunately—is how much the seeds of that ultimate failure were present at the time. That is something that we are looking into with the FRC, the FCA and the Insolvency Service. At the time, we were not alone in thinking that this was a relatively strong and relatively stable business that had the opportunity to address its deficit, which had grown along with that of other schemes. We were giving it time to address it in a context where we expected the business to be surviving. We know now how it ended up, but it was not obvious to most observers, at the time that we were involved in the 2011 valuation, that it would end up where it has ended up.



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Q696 **Chris Stephens:** Can we just get back to that? I am concerned that what I am reading in terms of the meeting notes between the trustees and the regulator is that it was not the case that the regulator had concerns in 2011. Is it not the case that, in the 2008 valuation, the regulator had had a number of concerns at that point and believed that a number of issues would have to be resolved in the 2011 valuation?

Mike Birch: That is true. In 2008, we were concerned by the amount of money going in. We were concerned about the balance between the trustee and the employer, in terms of their payments to the scheme. We agreed to the 2008 valuations on the basis of assurances from the trustees that they felt they could address that through the 2011 valuation, in getting more money. We had concerns in the 2011 valuation. I have presented that we saw this as broadly being a “tending to strong” business. That means that we had some concerns and we saw some strains in the business, but we did not see it as different from a large number of businesses at that time.

Q697 **Chris Stephens:** In a meeting note from a tripartite meeting between the trustees, the company and the regulator, it is the case that the regulator confirmed that their 2008 approach had been flexible and that a number of points would need to be addressed at the next valuation. What points were addressed at the 2011 valuation?

Mike Birch: That is true. At the 2011 valuation, we sought to increase the amount of money going into the scheme, and the amount of money going into the scheme was increased. Again, 2011 was a compromise in the context of seeing that as a business that had time to address the deficit.

Q698 **Chris Stephens:** The regulator then concluded in March 2014, “We continue to have concerns that the level of investment risk remains substantial”. That does not seem like a company that is strong.

Lesley Titcomb: The investment risk point relates to the investments of the pension scheme though.

Mike Birch: We got comfortable with or accepted the valuation and the recovery plan as presented, but we sought—and this was relatively unusual at the time—to continue to engage with both the company and the trustee to de-risk the investments that the scheme took.

Q699 **Chris Stephens:** You signed off the 2008 valuation on the understanding that the 2011 valuation would add to further de-risking of the schemes, only then to approve the 2011 valuation, which shows little evidence of de-risking. Why was that the case?

Mike Birch: At that point we still saw that as a live issue and continued to engage with it.

Q700 **Chris Stephens:** Robin Ellison’s letter to this inquiry makes clear that Carillion’s refusal to pay a higher contribution is limited to the extent to



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which the trustees were able to de-risk. There is a letter from the regulator to both the trustees and Carillion that says, "The debt recovery plan payments that the company was proposing is a range that we would not consider acceptable, based on the evidence we have seen". Is that the case?

Mike Birch: Is that from the regulator saying that?

Chris Stephens: Yes.

Mike Birch: Is that prior to agreeing to it?

Chris Stephens: Yes.

Mike Birch: That would have been prior to them increasing their offer.

Q701 **Chris Stephens:** That was in March 2014, so why was the agreement not challenged then?

Mike Birch: I would need to look at our records in the context of that, but I would expect that was not in the context of the final offer that we accepted.

Q702 **Chris Stephens:** The last recovery plans were 16 years for the largest scheme. What proportion of the schemes you regulate have such plans?

Mike Birch: This is an outlier in terms of the length of the recovery plan. Are you talking about 2011?

Chris Stephens: I am talking about the fact that there is a 16-year recovery plan. What I am trying to assess, in terms of the regulator and its work, is what proportion of pension schemes you look at that have a deficit recovery plan of 16 years.

Mike Birch: The reason I am querying the 16 years is because our records show that the 2013 valuation, and this is for the five schemes that make up the single trustee scheme, had a 12-year period of paying into the scheme.

Chris Stephens: The largest scheme had a 16-year recovery plan. That is my understanding.

Mike Birch: That is unusual. The average at that time was around eight to nine years.

Rachel Reeves: The question is about how many have recovery plans of 16 years, not what the average was.

Mike Birch: My point is I do not know how many. I cannot give you an exact number.

Q703 **Rachel Reeves:** This is quite an important point and you knew you were coming to give evidence to our Select Committees today. You know that one of our concerns and one of the concerns that Frank Field's Committee has expressed previously is that recovery plans of more than 10 years



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just do not seem to us to be acceptable. We are asking you how many schemes that you are supposed to be regulating have recovery plans of more than 10 years and more perhaps than 16 years. What is the answer to that question?

Lesley Titcomb: The number changes constantly.

Q704 **Rachel Reeves:** What is the number at the moment, Lesley?

Lesley Titcomb: I cannot answer that question.

Q705 **Rachel Reeves:** Why not? Are you not on top of the detail of the schemes that you are regulating? You knew you were coming to give evidence to our Committees today. It seems that so far, in the half an hour that you have been answering questions, you have been asking us to clarify the questions and saying you have to go away and look for more details. You are giving evidence to a Select Committee. We are all busy people who have a lot to do with our time, and we feel today—or I feel certainly—that you are going to have to come back and answer these questions again, because you do not have the detail. Do you know how many schemes have recovery plans for longer than 10 years, a previous recommendation of Frank Field's Select Committee?

Lesley Titcomb: I do not know precisely at this point in time.

Q706 **Rachel Reeves:** Do you know roughly?

Lesley Titcomb: We deal with just under 6,000 schemes. 2,000 have their triennial valuation each year. I cannot answer, off the top of my head now, how many precisely have a recovery plan of 16 years.

Q707 **Rachel Reeves:** Do you not think that that is a piece of information you should have had when you were giving evidence to our Select Committee today, Lesley?

Lesley Titcomb: There are many pieces of information I wish I could hold in my head.

Heidi Allen: With the greatest of respects, Lesley, something like that is a major KPI in your organisation. How many schemes are struggling and pushing their deficits down the river.

Q708 **Chair:** This is actually the red light, is it not?

Lesley Titcomb: If I may say so, the length of the recovery plan is one of the flexible elements of the framework that I described to you earlier.

Q709 **Heidi Allen:** You call it a red warning light; you call it flexible. That just sums it up really, does it not?

Lesley Titcomb: The increase in a recovery plan is not in itself a signal of a scheme in difficulty. It is one of the elements that the trustees and the employer can flex in coming to the right funding solution for a scheme, at a particular point.



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Q710 **Rachel Reeves:** Did Carillion have the right flexibilities? Did it have the right recovery plan to close that deficit?

Lesley Titcomb: As we explained to you, we felt it was a reasonable judgment for the trustees to have come to at the time. It is noticeable, for example, at the time of the 2013 valuation that the deficit had substantially reduced on the six schemes. The deficit was therefore expected to be paid off in 12 years.

Q711 **Chair:** We have had you before us twice recently. One was BHS; one is Carillion. Both of them had this extraordinary length of time for repayment, and you still cannot answer Chris's and Rachel's questions. How many schemes are in a similar position? Both of them promised you big recovery payments but paid nothing upfront. You talked earlier on about how you negotiated £81 million extra. In the first two years, you got nothing extra, did you? It was £30 million-odd and they continued to pay that, and then they went belly-up.

Lesley Titcomb: It was £85 million, but you are absolutely right about the profile of the extra recovery money.

Chair: They just agreed that with you and kicked the can down the road.

Lesley Titcomb: It is very easy to say that with hindsight, but the fact is that, as I said, negotiating a recovery plan that balances the interests of the members with also the ability of the organisation to address its other obligations and to deal with its commercial priorities is a key part of this. It results in these difficult decisions and, sometimes, a longer recovery plan is appropriate.

Q712 **Chair:** You cannot even answer Rachel's questions. How many other schemes are in this position? How many other schemes were coming before you pleading poverty—"We need all these extra years"—but were paying dividends? How many were in that position, Lesley? Could you tell us that?

Lesley Titcomb: I cannot answer that question either. These are complicated numbers that change constantly over a period of time. I would be happy to send the Committee a note on how many schemes are in that situation at present.

Q713 **Chair:** That should be your daily diet, should it not? Every week you should meet your staff and say, "Here are those that are most vulnerable, still paying huge dividends. What action are we taking?"

Lesley Titcomb: I can assure you that we take forward the sorts of issues you have identified there with our very committed staff down in Brighton.

Q714 **Chair:** We do not doubt the staff's commitment. We doubt your action.



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Lesley Titcomb: We have to take these things forward, as I have said, according first of all to the number of schemes that we can engage with according to the level of resources we have, and clearly—

Q715 **Chair:** How are you engaging with them, Lesley?

Lesley Titcomb: Nicola can talk about how many we are engaging with at any particular time.

Chair: You do not know the answer, Lesley.

Lesley Titcomb: I do not, off the top of my head. I am going to ask Nicola to answer this, because of the fact that my remit covers not only defined benefit schemes but also defined contribution schemes, public sector schemes and so on.

Rachel Reeves: It is not like we have just bumped into you.

Q716 **Andrew Bowie:** Is there a list of pension schemes?

Lesley Titcomb: No, there is no public register of pension schemes.

Q717 **Chair:** You have a register, do you not?

Lesley Titcomb: We have a list, absolutely. We have our list.

Andrew Bowie: It would not have been beyond the realms of possibility to have that with you today, in terms of the ones you are worried about.

Lesley Titcomb: It is not indeed. There are 6,000 schemes. We have a range of tools that we use to monitor them and our principal way of doing that, as Nicola will explain, is through the case work that we do on funding, but there are a number of other engagements. We are also changing our approach to this, so that, for some of these higher-risk schemes, we expect to be engaging and dealing with them not just around the three-year valuation point, but on an ongoing basis, so that we can monitor further developments in support of the trustees on those bigger schemes and so on, but that is a new approach that we are moving to.

Q718 **Chair:** Lesley, if Rachel and I bumped into you at a bus stop, we would expect you to be better informed than you are now.

Lesley Titcomb: I can only apologise if you feel that I do not have the information available, but there is a great deal of it. It is complex and I cannot hold it all in my head.

Q719 **Chair:** Are you saying that there are so many ones in near-crisis that you cannot have a list of them?

Lesley Titcomb: No, I am saying that there are 6,000 DB schemes that we look after, plus all the DC and public sector ones, and I cannot hold every single number in my head.

Q720 **Rachel Reeves:** Lesley, nobody is asking you to keep every single



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number in your head. You know the previous recommendations of this Select Committee about the timeframe to close deficits. You know the concerns that we have around Carillion, around the 16-year timetable for closing that deficit. We are not asking you how many schemes in the DC area you have concerns about or some obscure company that no one has ever heard of. We are asking you about things that are pertinent to the issues we are discussing today.

There are lots of people who are saving for pensions today, but not enough people saving for pensions today. One of the reasons why people do not save for the future is that they are worried, if they pay in money in their 20s or 30s, whether it will be there when they are in their 60s. They look in the end to people like the three of you, but particularly you, Lesley Titcomb, to ensure that their schemes are properly funded, so they can rely on that money on their retirement. I expect there are a lot of people who will feel they are right to doubt the ability of the money that they save today to deliver for the future, if the custodians of that and the regulators of that, which is what you are and what you are paid to do, are not on top of the detail. Frank Field is absolutely right. There should just be, I assume, a few schemes that have 16-year payment plans, in which case I would expect you not just to be able to tell us the number but to name them. The fact that you cannot do that sends huge shock waves of red alert, as Heidi Allen and Chris Stephens have said, that you are not on top of the detail at all.

Lesley Titcomb: I wish to make clear, please, that we are very much on top of the detail.

Rachel Reeves: You are not.

Lesley Titcomb: At the regulator, we work very hard to take into account a number of indicators about a scheme's situation.

Chair: I do not doubt any of that.

Lesley Titcomb: The recovery plan is one; it is an important one, but it is not the only one.

Rachel Reeves: It is not one that you can tell us about.

Q721 **Antoinette Sandbach:** Do you have a red/amber/green system? How many are in the red zone?

Lesley Titcomb: There are various ways that we classify schemes. Mr Birch has indicated one, which is the covenant strength of the employer, which is where we grade the employer out of four.

Q722 **Antoinette Sandbach:** My question is really, out of the 6,000, how many are in the red.

Mike Birch: We engage with about 200 out of the 2,000 schemes each year that have valuations. That is for a variety of reasons but, principally and fundamentally, it boils down to us being uncomfortable with the



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length of the recovery plan, the amount of money that is going in, the covenant grade and the long-term viability. Not all of those will have recovery plans of the length you are talking about.

Q723 **Chair:** Antoinette's point was different. She did not want to know how many you engage with because they are having a revaluation. I chair a very small mutual, and we have these red lights at every meeting on every aspect of our business. Antoinette has asked you how many are in the red, amber and green categories of the thousands you are looking after.

Lesley Titcomb: As is widely known, the majority of those 6,000 DB schemes, so we are talking over 5,500, are in deficit or were at the last point that there was a valuation performed.

Q724 **Chair:** We are not asking that question. Antoinette asked a different question. She asked, so you are focused on them, how many have a red mark against them. How many of the schemes that you are a policeman for have that now?

Mike Birch: There are roughly 200 a year we engage with. That will be for a number of reasons. It may be because their valuation comes up. It may be because we see that there is a takeover happening. It may be because we see profit warnings. Broadly those would be in the red zone.

Q725 **Chair:** This is not the question that Antoinette asked you. You may engage with that number. Antoinette asked a very simple question: how many of the schemes for which you have stewardship or duty of care do you have a red mark against? Never mind how many you engage with. How many have flashing lights, as Antoinette asked?

Mike Birch: We do not formally classify schemes into red, amber and green in the way that you have described. We assess all valuations that we get each year and decide whether they meet our risk criteria. That is based on the strength of the covenant, the level of the funding and whether we think it is appropriate to seek to change the valuation. We engage with some of those before, because we have assessed them on the same metrics. Those will be the larger schemes we engage with to try to address the valuation before it is agreed, and then we have others that we engage with because we have concerns, because they are subject to a takeover or they have profit warnings. We find those through a variety of means. There are a number of different ways that we scan the horizon to find those schemes, and we are looking to increase that in what Lesley describes as TPR Future, so our new approach to addressing schemes. We will increase the focus on proactively scanning the horizon for situations which are showing corporate distress.

Chair: Antoinette, I do not understand the answer, but do you? Are you happy with that?

Nicola Parish: Would it help to say, in terms of how many are in the red, it will not be more than 200, because of the way Mike has described



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how it works? Within those 200, there will be some red and some other colour as well. It is just that we do not classify them in the way in which you have classified them. They are the ones that we are focusing on every year. We will be focusing on that sort of number.

Antoinette Sandbach: I understand that that is what you are focusing on, but Lesley's evidence was that 5,500 out of the 6,000 were in deficit.

Nicola Parish: Yes, that is absolutely right. Of course, the way the regulatory framework is set up enables employers to pay that deficit off over a period of time. There are 5,500 in deficit at any one time, and our role is to ensure that an appropriate plan is put in place for the payment of that deficit.

Q726 **Antoinette Sandbach:** Where, like Carillion, you have very high dividends being paid out and high pension deficits, do you flag up those schemes and go in to protect the interests of not only the pensioners but the taxpayer who has to pick up the tab when you have failed to do your job properly?

Nicola Parish: The issue of the amount of dividends is certainly something that is taken into account when considering whether it is an appropriate recovery plan. That is absolutely right.

Q727 **Chair:** They were paying these mega-dividends. You negotiated a new scheme. In the first two years, they paid hardly a penny extra, did they?

Nicola Parish: It is all about getting that balance right.

Chair: It is, precisely.

Nicola Parish: Exactly, so we worked on the basis of the audited published accounts, which told us the strength of the employer. The strength of the employer is a relevant factor in relation to when it is paying out dividends.

Chair: They were pretending they were very strong.

Nicola Parish: We now know that with hindsight.

Q728 **Chair:** The problem is, because they were presenting themselves as very strong, it gave you a strong basis to ask for more money now, not that you were looking into the future, thinking, "God, this company is going to collapse. We had better be careful with them".

Nicola Parish: One way in which the regulatory framework operates, which is interesting, is that the stronger an employer is the more they can withstand risk in their investment strategy.

Chair: They could pay you more and you did not get more money from them.



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Nicola Parish: They are more able to support the risk in a pension scheme. Therefore, it does not always follow that, although they may be able to pay more money, they have to pay more money under the regulatory framework. That is where this balance comes into play.

Chair: There was no balance at all.

Q729 **Chris Stephens:** We will come back to the evidence later. I am quoting the regulator's own code of practice: "A longer recovery plan period may be appropriate where technical provisions reflect a particularly low risk approach". The trustees were telling the regulator that Carillion was asking the trustee to ensure no de-risking of its assets, so how is that approach consistent with your own guidance on long deficit recovery plans, compared to the low level of contributions that Carillion was setting out?

Mike Birch: Their approach to setting their valuation terms was not particularly low-risk. It was marginally worse than normal in terms of the discount rate that they used to set that and, therefore, that was the reason that we sought to improve things. The level at which we agreed, with hindsight, is something that, if we had known then what we know now, we would have sought more.

Q730 **Chris Stephens:** It seems to be against your own code of practice. The code of practice of the regulator is giving advice to companies. If companies are ignoring that code of practice, why are you not using your powers?

Mike Birch: That was why we threatened to use our powers.

Q731 **Chris Stephens:** You threatened to use them but you did not use them.

Mike Birch: We did not use them.

Lesley Titcomb: The outcome we are trying to achieve here is a good one for the scheme. We will use whatever tools are available to us in our armoury. When we threatened to use our powers that had an effect on what the company was doing.

Q732 **Chair:** It did not at all. They hardly paid a penny more. It had no effect.

Lesley Titcomb: I maintain that they did.

Chair: They promised you candy floss in the future.

Lesley Titcomb: On the basis of what the situation was at the time, the trustee was content to accept that offer.

Chair: Ah, so it is the trustee now.

Lesley Titcomb: No, we supported that. I absolutely agree we supported that. With hindsight, as Mike has said, we would take a different view now.



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Q733 Chris Stephens: Given the purported health of the company, they are saying to the public that everything is fine, but for pension trustees it is not. Why was that not worthy of intervention?

Mike Birch: We did intervene in terms of being engaged with the company. We did intervene in terms of threatening to use our powers. As you say, we agreed to something that, in the end, has not resulted in significantly more cash going into the scheme, given when the company failed. It is something that we are learning from. It is something that the business presented as being strong. It was in what we call our grade two, so not without risk but a good company. One of the areas on which we are putting much more focus and where we are trying to seek improved powers is in addressing what I would call unnecessary risk. In the context of this situation, this presented as a good company. If we had pushed for more money in a way that was effective that would have been a good thing. We are looking now for improved powers to use our Section 231 power more effectively.

Q734 Chair: You did not use the powers you had though, did you?

Lesley Titcomb: No, and one of the reasons, as I understand it, as to why that was is the challenge with these words in Section 231. It is particularly the fact that we have to demonstrate that what is being offered is not prudent or is inappropriate.

Q735 Heidi Allen: You can see the dividends that have been paid out. It is very clear. Anybody can go on to Companies House and see the dividends. That should have been an absolute warning light.

Lesley Titcomb: Indeed, but the fact is that we then have to demonstrate that it is actively not prudent, not inappropriate and it is also reasonable for us to take action.

Q736 Chair: You did not have to do any of this, Lesley. When they came before us they came like peacocks into the room. They staggered in looking around, thinking they were going to be admired. They were in Noddy land, clearly. They could not understand why these mega-dividends had all stopped and all the rest of it. When you were negotiating with them, they were boasting of these mega-dividends. Why the hell did you not use your powers? They were shovelling money out to themselves; they were shovelling it out to shareholders. Why did you not get them to shovel it the pensioners' way? None of you was at the meeting, though you were the senior people, when one of the senior people on the other side said he thought pensions were rubbish.

Lesley Titcomb: It is very important to say that regulating in these circumstances is not just about using the enforcement powers.

Chair: It is about being effective.

Lesley Titcomb: Very often the threat of using those powers brings people to the table. Difficult judgments were made at the time, in terms



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of that revised offer that you have described, which was made by the employer, and the decision was taken to accept it. Given all that we know now and as Mr Ellison said himself, whether we would have accepted that at the time knowing what we know now is of course debateable, but the fact is that it had to take into account a variety of things. That was done and the revised offer was achieved.

Q737 Chris Stephens: That is our concern. What this inquiry needs to try to establish is how many other Carillions there are out there with schemes like that. How many schemes are you threatening to use your Section 231 powers on at the moment?

Mike Birch: We have had two situations in the past, one where we have issued a warning notice and one where we were close to issuing a warning notice, where there was settlement at the level that we wanted. We currently have three cases that are live—one where we have issued a warning issue and two others where we have skilled persons who are helping us build our case.

Q738 Chair: This is out of your list of 200.

Mike Birch: Yes, we have others in there that we are close to starting that formal process on as well.

Q739 Chair: We do not want the names of the companies—I can see that—but would you give us a list of the 200 and actions that you are taking? You think these are the companies that are vulnerable, and we would love to see how your threats of use of action are bringing them all to the table.

Lesley Titcomb: We are constrained to a degree on what information we can give you.

Q740 Chair: No, I am asking you for that information. I do not want the names of them; I want from one to 200 and then the details about the scheme and the action you are taking.

Lesley Titcomb: That would be our particular case load at any point in time.

Chair: It is just the now one.

Lesley Titcomb: We can certainly give you some descriptions of what is in there in relation to funding the cases—

Chair: We want 200.

Q741 Andrew Bowie: Good morning. We know that Carillion was heavily dependent on purchasing other companies for its growth and that some of these companies already had significant DB pension scheme deficits. McAlpine, as we know, was purchased in February 2008 and had a deficit of £110 million in its pension scheme, which was eight times more than Carillion's at the time. By the end of 2008, Carillion's pension deficit had risen by 348%. The Chairman of the McAlpine scheme is a Robin Ellison,



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and he has told us of his concerns. He said, "The challenge we were facing was: was Carillion a worse covenant than McAlpine? It was difficult to balance. First of all, we did not have a veto anyway, but on calculation of the covenant the margins that Carillion was making were so small compared to McAlpine's that it was a real worry for us". Did the Pensions Regulator share the concerns of Mr Ellison?

Lesley Titcomb: It is fair to say that, in these circumstances where there is a takeover, the thing we are always looking at is whether or not the covenant for the schemes that are affected by that takeover—so that will be both the acquiring and the acquired companies in this case—is going to add to or detract from the strength of the covenant.

Chair: Lesley, that is not Andrew's question. Andrew asked you what you were doing in this case. What were you doing?

Andrew Bowie: It is quite obvious there was a problem.

Mike Birch: This case was one where they did not, I believe, come for clearance. We do not have a power to stop takeovers. We do not have that power. We do have a power retrospectively to act where the effect of a transaction is materially detrimental to the covenant of the scheme.

Chair: This is not Andrew's question. Andrew's question asked you about a specific point in the history of this firm, which further destabilised it, so what is your answer to Andrew's question?

Q742 **Andrew Bowie:** It destabilised it over nearly a decade. It was quite clear that, every year, the situation got worse because of the acquisitions that they had made, so you must have shared the concerns that others were publicly saying they had at the time.

Lesley Titcomb: That is absolutely right and that reflected the fact that we were engaging.

Q743 **Andrew Bowie:** Did anything happen as a result of that engagement?

Lesley Titcomb: We were regulating the individual schemes before they then became part of Carillion. You then have to start looking at the position of those schemes together. Obviously they then also appointed a single trustee, so you start looking at them much more in the round then.

Q744 **Chair:** That is not Andrew's question. What did you do?

Nicola Parish: How it feeds into the system is, when a business acquires another business, the acquirer will have a review of their covenant when it comes through to the triennial valuation. If in acquiring that business it has weakened the overall covenant that will then be reflected in how we view the proposals for repairing the deficit, going forward.

Lesley Titcomb: That would have meant, in this particular case, that would have been taken into account in the discussions that the trustees



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and we were having with the employers on the 2008 valuations, in terms of the acquisitions that happened then, and then in the period after 2008.

Q745 **Andrew Bowie:** You did not actually do anything. Despite everything that you were seeing on the ground and the concerns that were being raised by various different people, the Pensions Regulator decided not to do anything.

Mike Birch: We did not seek to use our contribution notice powers on the basis of it being materially detrimental to the scheme. We do not have the power to stop the transaction. We then sought to regulate the scheme as a normal scheme within that business that had acquired it. We did not take action to stop the transaction or to seek specific extra payments into the scheme at that time.

Chair: In answer to Antoinette's question, was it already part of the top 200 you were looking at? Does Andrew's question suggest you then put a red light, as we like to think of it, on this company or not?

Q746 **Andrew Bowie:** Was a red light put on that when this takeover happened in 2008?

Mike Birch: We do not flag them in that way. We engage with them. We have engaged.

Q747 **Chair:** Were they part of your 200?

Mike Birch: They were part of the 200 or so that we engage with each year in the 2011 valuation, as part of the five schemes. They were one of the five schemes.

Q748 **Andrew Bowie:** If you had the power to block acquisitions, would you have done so in this case, and not just in the McAlpine case, which was the biggest one, but the Mowlem case as well?

Lesley Titcomb: I find it difficult to answer that question with hindsight, because we do not know.

Q749 **Andrew Bowie:** It is a recommendation in the Work and Pensions report on DB pension schemes. If you did end up getting that power, would you use it if a company the size of Carillion acquired a company the size of McAlpine with a pension deficit the size it was at the time?

Lesley Titcomb: We would not in itself, no. As the law stands at the minute, if that were to be translated into a company coming to us for clearance, we would have to satisfy ourselves as to whether or not there was material detriment and then, if there is material detriment, whether or not there is any mitigation being provided, for example in the form of additional payments into the scheme or the ability to take security.

Chair: There were not. There was a bigger deficit locally and no additional payments. You did not act.



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Lesley Titcomb: I think we have explained what we were doing at the time. We did not act in the particular circumstances of the acquisitions. We were taking account of the deficits within the funding discussions that were happening around the subsequent valuations.

Andrew Bowie: You said that you would not have acted even if you had the power to act.

Lesley Titcomb: No, I am not saying that. I am saying I cannot answer the question definitely, because I do not know the precise circumstances at the time. We would have had to consider, for example, if we felt there was material detriment and whether or not there was mitigation available for that. That is the type of situation you are faced with there.

Chair: Given the example that Andrew has given you, where the schemes are clearly weakened by this acquisition, I do not see why you find it so difficult to answer. Either with the wonderful business of hindsight we were wrong or we did not use our powers.

Lesley Titcomb: If we see evidence now of takeover situations where there is detriment to the scheme, then we indicate that we will open an investigation and see if we should use our powers, absolutely.

Q750 **Andrew Bowie:** If you had the power to stop those, would you use them?

Lesley Titcomb: That would be the sanction that we would have to consider.

Q751 **Andrew Bowie:** All the evidence that we have heard so far is that you do not even use the powers that you have.

Lesley Titcomb: We have to consider whether, for example, in that situation, if we said, "We are launching an investigation here", there may be material detriment. This happens frequently in mergers and takeovers.

Q752 **Chair:** How many times have you used that emergency power?

Lesley Titcomb: We have used the anti-avoidance powers about 27 times over the life of the regulator, for various reasons.

Q753 **Chair:** How many years is that, Lesley?

Lesley Titcomb: That is since 2005, Chairman. What we would do there is say, "We think this is a situation where there is detriment to the scheme. What mitigation are you going to give for that?" Sometimes they come up with; sometimes they do not and we continue with the action. There are a number of those that we are pursuing. One is in the Upper Tribunal at the moment, for example.

Q754 **Andrew Bowie:** Moving on, two weeks ago Keith Cochrane, the interim chief executive of Carillion at the time, confirmed that Carillion began to



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explore the option of a regulated apportionment arrangement in October 2017. It took until December 2017 for Slaughter and May to advise Carillion that one of the key recommendations of the regulated apportionment arrangement was that a company be inevitably insolvent within 12 months. Why do you think it was that an RAA was not sought before this?

Mike Birch: We put very stringent guidance around the situations where an RAA can happen, and the reason for that is that an RAA is a mechanism to separate the scheme from the employer. It therefore improves the position of the employer and it worsens the position for the members of the scheme, who generally end up in the PPF, so we are very resistant to those happening unless they absolutely need to happen.

Andrew Bowie: By this stage it was quite clear that an RAA was—

Mike Birch: We had had discussions, not directly with Keith Cochrane but with other members of management.

Q755 **Chair:** How low down were they?

Mike Birch: They were with Emma and also with Lee Watson, who is from EY, who was their senior restructuring officer.

Q756 **Chair:** It was not the chairman.

Mike Birch: I do not believe it was with the chairman, no.

Q757 **Chair:** Even though it was crucial.

Mike Birch: Our discussions were focused on identifying whether they thought that a regulated apportionment arrangement would be likely and to make sure that, if they did think that, they knew what the terms were. For most of that time, they maintained that it was very unlikely and the reason for that is that we insist that all other creditors get treated equitably in the context of what would happen to them in an insolvency. Actually, the pension schemes were closer to the assets. They were in the companies where the assets sat, whereas the banks were at the top of the business in the holding company. Therefore, for an RAA to happen the banks would need to be fully equitised and the company maintained that that was unlikely to be something that they would be bringing forward.

As the situation deteriorated further and as it became clear that they were likely to need to equitise most of the banks anyway, they engaged with us very late on, in January. They put to us what was a high-level letter setting out a principled approach to what they would look to do. It clearly did not meet all of our criteria, principally because it was from a situation that was not funded. For us to do an RAA, it has to be clear that it creates a better position. They did not have the funding to do that.

Q758 **Andrew Bowie:** Just to be clear, you wait for them to engage with you.



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Mike Birch: Yes, we do not encourage people to do RAAs, because they are generally bad for members.

Andrew Bowie: That is even in a situation like Carillion.

Mike Birch: We were aware that this was something that might be considered and we opened the door to the company by saying, "Are you considering it? Because, if you are, you need to do it in the right way and we will engage with you if you are". For a lot of that period, they did not consider that it was likely to happen.

Q759 **Andrew Bowie:** Do you think this process might have been sped up if the Government requirement for insolvency to be inevitable within 12 months was removed? This was one of the recommendations of the Work and Pensions Committee.

Mike Birch: If that were removed, it would make it easier for people to do RAAs. Generally that would not be a good thing for members and that would not have changed the position here, because it was clear that there was a high risk of insolvency anyway, so it would not have changed the outcome here.

Q760 **Ruth George:** We have got to January and the company became insolvent on 15 January but, on 18 January, you opened an anti-avoidance investigation into Carillion. Can you explain the timing of that, please?

Nicola Parish: We opened an anti-avoidance investigation, as you say. In between 15 and 18 January, we were obviously in close contact with the trustees of the scheme. There were a number of things that needed to be done immediately following the announcement of the compulsory liquidation, but the formality for opening our investigation happened on 18 January. That investigation was to look at whether there was any evidence that would enable us to use our powers to seek to get some recoveries for the pension scheme.

Q761 **Ruth George:** What could you possibly hope to retrieve? There was £29 million left in the entire company.

Nicola Parish: Our contribution notice powers can go wider than just looking at corporates. They can look at individuals who are connected to and associated with corporates as well.

Q762 **Chair:** Is that happening? Are you looking at individuals? They all made a lot of money out of this company, that top gang.

Nicola Parish: We are looking at all avenues for the use of our powers, yes.

Q763 **Chair:** You are fingering their collars.

Nicola Parish: We are working closely with other agencies, as you know. There is the Insolvency Service, the FCA, the FRC and us.



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Q764 **Chair:** Are you doing anything, Nicola? Never mind about all these other people who never seem to report. What are you doing?

Nicola Parish: We have an investigation on foot, but the important point is that there are four different agencies here, all with an interest in pretty much the same set of facts and circumstances.

Q765 **Chair:** Are you after the boss group who made so much money? That is Ruth's question. Are you fingering their collars now?

Nicola Parish: If fingering their collars means are we pursuing an investigation and looking into the activities of all of the parties concerned to see what all of the possibilities are for the use of our powers, yes, we are, but—

Q766 **Chair:** Have you served any notice on them?

Nicola Parish: If I can just come on to my "but", because there are four different agencies, we are really keen that we do not trip over each other, do not duplicate this and get through this as efficiently as we possibly can.

Q767 **Chair:** You have a job for pensioners. Never mind about these other organisations. You should be in there.

Nicola Parish: That is agreed and that is at the front of our minds.

Q768 **Chair:** Ruth's question is different. We do not want you to play football with the sector. Are you in there?

Nicola Parish: We are gathering information. If "Are you in there?" means are we out there getting information in now, yes, we are.

Chair: After 10 years, you are gathering information.

Q769 **Ruth George:** Bearing in mind where we are now, surely the anti-avoidance investigation is likely to produce, particularly as you are in competition with three other bodies as to where the tiny amount of money that might be extracted can go. Would it not have been better to have avoided this happening in the first place and to have been able to put some avoidance measures in place earlier? This Committee recommended, two years ago, punitive fines on companies that avoid their duties to pensions. Do you think that that would encourage them to take TPR more seriously?

Lesley Titcomb: You have picked up an important point there and that is something we are pursuing with the Department for Work and Pensions, as part of our work with them on the White Paper. We do see that some improvements could be made to, for example, the contribution notice regime, whereby it could provide an incentive on the people concerned to have the scheme at the forefront of their minds in these situations. That may be more helpful than an ability to fine, because then you would get extra money into the pension scheme, rather than a fine that would go to the Treasury.



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Q770 **Ruth George:** We realise that you are juggling four different statutory objectives at TPR, and we have seen the play-off between those objectives where Carillion was concerned. Do you think that TPR would benefit from a simplified objective, simply aimed at protecting member benefits, as has been recommended?

Lesley Titcomb: That is an interesting question and I saw what Chris Martin said about that when he appeared before this Committee. I am a great pragmatist. We actually have six objectives at the minute; four are relevant in this particular case. Obviously we have to work with what we have now. Any change to our objectives would require legislation and is likely to take a long time, when there is clearly a squeeze on the legislative timetable.

Q771 **Chair:** That is what the Government say. What about Ruth's question? Would you want a single objective?

Lesley Titcomb: It is not top of my list of priorities.

Q772 **Chair:** What is top of them?

Lesley Titcomb: There are three things: the improvements to the funding regime that I have spoken about; making sure that we are adequately resourced, in terms of quantity of resource and our capabilities to do our job; and also that we implement our proposed changes to our approach to regulation, which is how we do regulation on the ground and use our existing powers. It is for the politicians and the department that sets the rules to consider whether we would benefit from a single objective. That may be the case, but the fact is, in the way that defined benefit regulation works, we would still have to take into account the ability of the employer to support the scheme in the longer term. That will always be a factor. To have a pensions regulator that does not take that into consideration is going to mean that we are setting recovery plans and deficit repair contributions that could seriously impact on the survival of the company, which in itself is not good for the scheme, even if we had a simpler set of objectives.

Q773 **Chair:** This was never so with this company, Lesley, because until the last minute, let us say, the investors did not take fright, until quite late in the game. They thought this was a viable company, just that you did not get any extra money.

Lesley Titcomb: You are absolutely right; we were relying, as many others were, on the information that was made available to us through the published audited accounts.

Q774 **Chair:** You did not get any extra money hardly. In the first two years, you hardly increased it by a penny, did you?

Lesley Titcomb: You have explained that situation. We have explained it is £85 million over the 15-year recovery plan.

Q775 **Chair:** In the first two years it was almost nothing, so they got away, did



they not?

Lesley Titcomb: I do not believe they did. I think that some difficult decisions had to be made at the time. They were difficult judgments that were made.

Q776 **Chris Stephens:** Why was there no agreement in relation to having the pension contributions at the same rate as dividend payments, given that that was a key concern for the regulator?

Lesley Titcomb: There is no single simple ratio of dividend payments to deficit repair contributions.

Q777 **Chair:** There was no ratio at all here, was there?

Lesley Titcomb: There was, and the ratio was actually rather better than in certain other companies at the time, which goes to the wider context I spoke about earlier. One of the things we wanted to be able to say in setting out clearer expectations to people is what good looks like in such circumstances and what poor looks like, what is not acceptable. We are already doing this through things like our annual funding statement, being clearer about what we are looking for in respect of dividends to DRCs, but it is not a simple ratio. It will depend on the particular circumstances at the time. We cannot prevent and should not prevent companies paying dividends, if that is the right thing to do. There is a balance to be struck here, because shareholders have to have some return.

Q778 **Chris Stephens:** You could have insisted that it was the same level.

Lesley Titcomb: We could have insisted it was at the same level. Whether we would have been able to sustain a case supported by our powers on that basis is another question entirely.

Chair: On that note, can I thank you all three for coming? We are very grateful to you.

Examination of witnesses

Witnesses: Michael Jones, Michelle Hinchliffe and Peter Meehan.

Rachel Reeves: Thank you very much for coming to give evidence to our session this morning. You have heard evidence from the Pensions Regulator and we are now looking, in this session, at the relationship between Carillion and its audit function, both internal and external. We will crack on with the questions and start with Antoinette Sandbach.

Q779 **Antoinette Sandbach:** Thank you very much. I just wondered, to the KPMG partners here, whether you saw the evidence session with the



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directors. Did you watch that evidence session with the directors and former directors?

Peter Meehan: Yes.

Michelle Hinchliffe: Yes, we have.

Q780 **Antoinette Sandbach:** You are aware that, in their evidence, they claimed that part of the cause of the collapse was the failure to recoup payments for the contracts in Qatar. As Carillion's auditors, is the statement of the former directors and the chairman that one of the major problems was the Qatari contract correct?

Peter Meehan: I am the audit partner at KPMG who signed the audit opinion on the accounts at December 2016, so I will answer that question based on the knowledge I am aware of at the time that we did the audit. The simple answer is no. I cannot see how that was the cause in itself at all. The complex nature of the contracts and the judgments and estimates that you heard from the director panel is such that there was a wide range of judgments and estimates involved, and there is a wide range of acceptable answers. There is no right answer in terms of those judgments and estimates on contracts.

On the Qatar one in particular, Mr Howson was talking about numbers at March and September, which is when he left, from memory. What I do know is that the balance that was recoverable or in the balance sheet at 31 December 2016 was considerably less than the number he has quoted. I would quote from the company schedules that we have on our file, because that is what we audit and that number was considerably lower.

Q781 **Antoinette Sandbach:** I am quite interested because, in 2014, EOT claims 1 and 2 were lodged in relation to that contract, and that was over £40 million of variations. In March, £100 million of debt was owed. Had Mr Howson disclosed to you that he was going out? I think he said to us he was going out 10 times a year to chase the money and he felt like a bailiff. Had he disclosed that to KPMG?

Peter Meehan: He had not used the language of the latter part about "bailiff", but I was aware that Mr Howson went out there on a regular basis. I cannot say 10 times a year at all, but I do not know that he would report back to the board on a regular basis. Whether it was 10 times a year I do not know, but I was aware of that.

Q782 **Antoinette Sandbach:** KPMG went out to Qatar to look at that contract, did they not?

Peter Meehan: Yes, we went out there. I went out there in 2014 myself and my senior manager went out there in 2015.

Q783 **Antoinette Sandbach:** Were there visits in 2016?



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Peter Meehan: No, site visits are just part of the audit evidence that one compiles in terms of each contract and then we look at the accounts in terms of the contracts overall. We did not plan to go in 2016 because, as has been explained before, that contract had overrun considerably. It was originally a three-year contract, more or less, and it ended up extending to six years. When we entered into 2016 and we planned our approach to various contracts and the site visits in particular, that contract was due to finish in the year and, therefore, there is not a lot to see. There is not a lot of benefit. You get the benefit from the site visits on the ones that are still in progress.

Q784 **Antoinette Sandbach:** Mr Meehan, the evidence to us was that there had been 38,000 changes, new drawings required by Carillion. You were out there in 2014 when the first lot of changes were made and again in 2015. Now your company says that it compares financial performance of selected contracts against budget and historical trends. Did you do that in relation to that contract that you went out to look at in Qatar?

Peter Meehan: Yes, we did. The company presents to us a position paper at the year-end. They cannot compile them all as at 31 December, just through time. They will do it for all the major contracts on the portfolio, and the Qatari one was done in October, but then I would update what I am told on that position paper, which is prepared by the local team, with the MD for the MENA region, the CFO and also Richard Howson. We were aware of the cost to complete, because we have seen that paper, and we were aware of the claims and receivables. I will just explain some of the dynamic in the numbers here.

Q785 **Antoinette Sandbach:** Can I just ask—because the role of an auditor is to treat issues with scepticism and challenge—where was the scepticism and challenge on the Qatari contracts?

Peter Meehan: The scepticism and challenge is that we do challenge the numbers as presented in those papers. The claims in the balance sheet, at 31 December 2016, were around £74 million, £73.9 million. In terms of challenging those numbers, they comprised three key elements. There were retention monies where, because the contract had built up to quite near the end, 5% is kept until 12 months after the completion of the contract. That was quite a large element.

Q786 **Antoinette Sandbach:** Mr Meehan, I am just going to stop you there, because we know or we have information that, by 31 July—I have 2016, but I am going to give him the benefit of the doubt. It says here by 31 July 2016 roughly £278 million was owed. Where is that allowed for in your audit?

Peter Meehan: The balance sheet element is what is incurred to date. There is then the cost-to-complete element in the complications here, so it will be variations from the client or anticipated cost to the end of life of the contract, but they are not in the balance sheet and owing, as of the date of the accounts that we signed.



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Q787 Antoinette Sandbach: There is clear information that this was on the balance sheet and owing. I have a date here. This is a piece of paper from Mr Howson that has been provided to the Committee that says, as at 31 July 2016, there are claims in relation to the extensions of time 3A and 3B, plus effectively the £100 million or, you say, £74 million on the balance sheet as at 31 December. What has happened to the 31 July 2017 figures? If you add the three of them up, and I will remove a little bit, they show £278 million owing. That was not a write-down in the accounts.

Peter Meehan: There are many moving parts. I apologise; it is frustrating, I can tell. There is the cost to complete, which will not be in the balance sheet. That is not owing. There are variations. For instance, part of that development was a large hotel. If the client has up-specified the bathrooms in the hotel and we are only at level 5 at the moment and there are 14 floors, there are nine more floors of extra spend on bathrooms to agree. That is not owing at the moment. We have not spent the money.

Q788 Antoinette Sandbach: Mr Meehan, what I am trying to say is that there was a write-down in this contract. The accounts were signed off on 31 March and, two months later, those types of figures were issued in the profit warning. Why is it that you did not pick that up in your December audit?

Peter Meehan: There are a number of contributory factors to the write-down on 9 July. At December we did our audit and, as you rightly say, we signed that on 1 March based on the facts that we were aware of at the time, as were management. By the 10 July announcement, there were events that took place and those events were both things that affected what was there on the balance sheet date but that were new information. That could be things like the Qatari situation with the blockade, et cetera.

Q789 Antoinette Sandbach: Was the reality not that you had done the deep dive that you should have done on the audit, in effect, looking at the challenges and challenging the risks, and you then discovered about the rosy picture that had been painted for you? You had not actually done the independent checking yourself to see, as you put it in your own document, that you "perform a detailed reconciliation of all position papers and contract reports to the general level held at site level, both with risks and opportunities".

Peter Meehan: Yes, we did that. From a personal perspective, a key part of that challenge, which is also in the work that we do which is in the audit opinion, is site visits. The team went on 24 sites visits in the UK in 2016. You get a lot of powerful evidence from going around the sites and understanding the business. Over the three years up to 2016, I went on 30 site visits, which would include those in the Middle East, Canada and the UK. You go the site visits to understand and also to challenge, and that is what we did.



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Q790 **Chair:** You did not spot much though, did you? Antoinette is putting it very politely to you. You had all these site visits, which are supposed to be all great learning experiences, but you did not really spot anything. It did not make any difference to your judgment, did it?

Peter Meehan: Yes, it did, because we did challenge and that was evidenced in the papers that we presented to the audit committee in respect of 31 December 2016. The audit committee papers were presented on 23 February.

Q791 **Rachel Reeves:** How many references did you make to Qatar in the report on the 2016 accounts?

Peter Meehan: They are not my accounts; they are the company's accounts. I will again apologise if that is not the best answer. It is frustrating.

Chair: You put your name on them though.

Peter Meehan: In terms of the accounts, I do not know how many times Qatar has mentioned. On our audit committee paper to the board, it is definitely mentioned and it is a prominent feature of our discussion on contracts.

Q792 **Antoinette Sandbach:** Can I just clarify the date? You said that was on the 2016 presentation.

Peter Meehan: December 2016, yes, which was presented to them on 23 February 2017, from memory.

Q793 **Antoinette Sandbach:** You did a presentation highlighting the risks in Qatar. Did you also identify the risks of the projects in Scotland and in Canada, because you said you went out to Canada?

Peter Meehan: Yes.

Q794 **Antoinette Sandbach:** Were those mentioned in that report?

Peter Meehan: Yes.

Q795 **Antoinette Sandbach:** Do you have a copy of that report available for us today?

Michelle Hinchliffe: We do have copies of the report. They are probably annotated but, if you would like us to send that through to the Committee, we are happy to do so.

Antoinette Sandbach: That would be really helpful, because I have your June 2017 report but I do not have the 2016.

Peter Meehan: 23 February 2017 is the report. To explain the process, for a bit of context, we conclude our audit procedures in the period. There is obviously a bit of controls testing up to the year-end, but it is largely done post year-end on the closed-out numbers. 23 February was the presentation to the audit committee. The audit committee takes



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evidence from ourselves, from internal audit and of course from management, and then recommends to the board to sign the accounts, which were signed subsequently on 1 March.

Q796 Antoinette Sandbach: Mr Jones, you were doing the internal audit. Is that right?

Michael Jones: That is correct, yes. I am the Deloitte partner responsible for our internal audit services to Carillion.

Q797 Antoinette Sandbach: Did you detect the risks from the Qatar contract in the persistent late payments?

Michael Jones: I was aware from attending the audit committee, when I attended to present our reports, that it was discussed and I was aware that Richard Howson had been out to collect monies. I was aware of that.

Q798 Antoinette Sandbach: When it was discussed, was discussion made of a provision in the accounts to reflect the late payments and the fact that Mr Howson was having to be, in his words, a bailiff?

Michael Jones: I cannot recall that. I can very clearly recall him talking about going out there to collect money, but that is as far as I can recall.

Q799 Antoinette Sandbach: Did you spot any warning signs in your role on the audit committee, in relation to the contracts that later led to the profit warning that was issued on 9 July or 10 July?

Michael Jones: With regard to the broader contracts, it is probably helpful just to talk a little bit about how Carillion controls its contracts from my perspective, from an internal audit perspective. There are three things they do. They have regular project review meetings every month, when an independent member of management goes through the accounts for the contract. Secondly—and this is very important for the audit committee—they have an independent peer review process, which is where a senior member of the commercial team or finance team will look at the contracts and they will consider things such as the traded position, the end-of-life forecast, positions taken on claims, et cetera. That is a separate piece of activity. They look at about 100 contracts a year covering more than half the value of the contracts and any recommendations made. That gets rolled up, ultimately, and the results of that are reported to the audit committee and indeed to the executive leadership.

Antoinette Sandbach: All of that failed to spot the issues that then led to £1.5 billion over a six-month period in the company effectively being written off.

Michael Jones: When there was the profits write-down, we wanted to look and understand exactly that question. We had these issues in terms of the peer project review meetings and the peer review process. We looked at the 50-odd contracts that had given rise to the provision and



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we went back to look at the peer reviews that had taken place with regard to those. In a number of cases, those peer reviews had taken a more pessimistic view of the performance than was presented in the numbers in terms of the—

Chair: Michael, did you make a recommendation?

Q800 **Antoinette Sandbach:** Sorry, Chair; I just wanted to hear. That was actually really important. The peer reviews, you say, had taken a more pessimistic view than was presented in the numbers. I want you to finish your sentence.

Michael Jones: We looked at the peer reviews and there was a good proportion where the peer review team had reached a different conclusion, a more pessimistic view, than the position that was taken in what is called the contract appraisal, which is the P&L account that supports the project review. Of course, what I do not then see is how that is rolled up, because of course there are many judgments that people will take over how these then ultimately end up, but we saw that.

Q801 **Chair:** Michael, did you actually make the decision? Who made the decision about the size of the write-down? You are the internal auditor.

Michael Jones: I am the internal auditor. Our role as internal audit is to assess and make recommendations with regard to the key controls and the control environment that the company operates. We do that on a sample basis. We agree a plan with the audit committee, but we do not look at the financial numbers.

Q802 **Chair:** Who came up with the figure for the write-down?

Michael Jones: It was not me and I was not present in the July audit committee when that was discussed.

Q803 **Chair:** Why were you not present?

Michael Jones: I do not attend all audit committees and that was an exceptional audit committee. I was not there, but I believe it took place over a weekend in July.

Rachel Reeves: Internal audit does not attend the audit meetings.

Michael Jones: In the normal course of business, Carillion would have four audit committees a year. They would have one in February, one in June, one in August and one in December. We typically did not attend the June audit committee. We would attend in September, August and December.

Q804 **Rachel Reeves:** Who does attend an audit meeting, if not the auditors?

Michael Jones: We are the internal auditors.

Rachel Reeves: So KPMG attended.



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Michael Jones: In fairness to the audit committee, there are many matters that an audit committee considers that would be beyond internal audit and, indeed, separate from external audit.

Q805 **Chair:** You must have seen the papers, must you not, and what they were proposing? Your company did not turn up.

Michael Jones: I saw the minutes of that, but that is not unusual. Our obligation is not with regard to the financial statements, so I do not think it is unusual that we would not have been called to be present.

Q806 **Chair:** You did not turn up but you took your money.

Michael Jones: We were not invited to turn up and I really do not think that, in that discussion, we would have added any value.

Q807 **Rachel Reeves:** Before we move on to Rachel Maclean's question, are you aware that the Qatari company disputes the claim that they owed Carillion nearly £200 million?

Michael Jones: I am only because of the information that has been made public by them as a result of this Committee.

Q808 **Rachel Reeves:** When you were working for Carillion, KPMG and Deloitte, you were not aware that the Qataris disputed this. You just took the word of Carillion that they were owed this money.

Michael Jones: From my perspective and internal audit's perspective, the debt was out there. It was then management's responsibility to collect that debt.

Q809 **Rachel Reeves:** The dispute is about whether it was a debt, Mr Jones. That is what I am asking you. The Qatari company disputes that they owed nearly £200 million to Carillion. You were not aware that that £200 million was disputed.

Michael Jones: No, I was not and nor would I necessarily have expected to be aware of that.

Q810 **Rachel Reeves:** Peter Meehan and Michelle Hinchliffe, were you aware of that?

Peter Meehan: No, I was not aware, but I am also not aware of when the Qatari company says that that claim against Carillion arose and whether it was before 31 December or not. I do not believe it was, but I was never aware of it.

Michelle Hinchliffe: No, and perhaps I could just clarify that my role at KPMG is as the head of audit. In terms of the detail, Peter is probably best placed to answer that.

Q811 **Rachel Reeves:** Can I ask Michael Jones if you assess that part of your role in risk management is to look at whether debts are likely to be honoured or whether they exist?



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Michael Jones: We would look at the control environments perhaps as to whether we raise debts as quickly as we should, in accordance with a contract. Do we have a proper debt collection process, in terms of when we send out a letter to people, when we then chase them and when we instruct a third party to sue? We would look to see that those sorts of controls were set out and that those sorts of controls were applied?

Q812 **Chair:** And were they working?

Michael Jones: If we did a review in that area, we might consider that.

Chair: You might.

Michael Jones: If we did a review in that area, we would consider it. I do not think anybody is suggesting that Carillion's processes in terms of raising bills or its debt collection procedures were an issue.

Q813 **Rachel Reeves:** You said earlier, Michael Jones, that you knew that Richard Howson was going out to Qatar to collect the money. Do you know how much he collected? You knew he was going out there to do that.

Michael Jones: No.

Q814 **Chair:** Did you not ask him?

Michael Jones: No, and I would not see that as being something—

Q815 **Rachel Reeves:** What is your job, Mr Jones? You have told us a lot of things that are not your job or are not your responsibility. What is your job?

Michael Jones: Very helpful. Our role is to assess and make recommendations with regard to the company's control environment. The way we do that is we put together a plan, and we typically do that on a three-year basis and then we have a plan for each year. We do that in discussion with the company and ultimately we take that to the audit committee and we set out to the audit committee what we are doing and what we are not doing.

Q816 **Chair:** That is if you turn up to the meeting, you set it out.

Michael Jones: It is not unusual for internal audit not to be present.

Q817 **Rachel Reeves:** It might not be unusual but I find it quite surprising. Maybe that is the way that you go about your business, but it seems quite surprising to me that internal audit does not turn up to the quarterly audit meetings.

Michael Jones: Many companies set out a schedule of the matters to be considered at an audit committee. They might have management come in. There might be particularly busy periods dealing with external audit planning or external audit final reporting. They have a schedule of activities, and we attended three times a year to present our plan and to



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present our findings from the work that we had done in connection with our plan. That is not unusual.

Q818 **Rachel Reeves:** You had found, until the end of 2016, nothing wrong at the company. You were happy with how it was going compared to your three-year plans.

Michael Jones: We reported in the three years ended December 2017. We issued something like 80 audit reports. We made 350 recommendations. We grade the reports very simply: red, amber or green. More than half of them were in the amber category. It was very unusual for Carillion to have red-rated reports.

Q819 **Rachel Maclean:** Antoinette Sandbach has talked about the Qatar contract. I want to focus on the three other major contracts that have been flagged. They are in Liverpool, Sandwell and also in Scotland—Aberdeen. We have just been talking about the audit report. We have a copy of the 2017 report and, just six weeks after this report was published, obviously Carillion issued a profit warning. I see in this report here that the risks of potential impact on financial statements and the likelihood of material mismanagement were already very high in two of the key risk areas. There is already a risk of significant financial misreporting in these areas.

Michelle Hinchliffe: Excuse me, would you mind just clarifying the date of the report, because we have a few reports? It would be helpful.

Q820 **Rachel Maclean:** It is this report here, the 8 June report. What I am trying to get at is what our Chair has just been talking about. There are a number of things in this report that are already causing concern to yourselves, KPMG, and to yourself, Peter Meehan, I presume, going back a number of years. Your company has been auditor for Carillion for 19 years, I believe. Is that correct?

Peter Meehan: Yes.

Q821 **Rachel Maclean:** There are already high risks here on this dashboard, in these reports. You have talked about a number of reports. We have three other major contracts that are in trouble as well. What I am trying to get at is what is happening with your processes. How can we be sure that you were effective in flagging this up and causing anything to change in Carillion?

Peter Meehan: At December 2016, the accounts showed that the company had challenges and that those challenges were clear for people to see. I am coming to your question. In terms of the margins that the company makes, they are very clearly plain for people to see on the profit and loss account, the key income statement, where it shows its £5 billion turnover and, over the last few years, it makes £150 million to £200 million a year. It is low-margin. It has debt issues that are discussed by management upfront in the accounts, and then the pensions deficit is clear for people to see. That had grown year on year. Matters



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like goodwill are very apparent in the accounts, so people knew it had challenges, but the company also had the reserves to deal with those challenges.

Q822 Rachel Maclean: Risk number one is recognition of contract revenue. That is a risk where it is a judgment call; the contracts are not going to deliver, not only Qatar but these three other big contracts, about £345 million, so just under half of the £845 million that was in the profit warning. It is known to you already that these might not deliver. The risk is getting worse on that particular risk.

Peter Meehan: There is a timeline factor here. If I can just explain, that meeting in June is our audit plan communicating the plan for the year ended December 2017. That was a prearranged audit committee in a normal cycle, but it was rather overtaken by events of the 9 July write-down. That paper was written mindful of the write-down that was coming on 9 July.

Q823 Rachel Maclean: You knew the write-down was coming when you published this on 8 June.

Peter Meehan: Is that 8 June?

Rachel Maclean: Yes, this is 8 June.

Peter Meehan: We knew a write-down. We had no idea of numbers. I was first alerted to numbers with regards to the write-down at the end of May.

Q824 Chair: Who came up with this write-down figure, Peter? Michael did not; he told us it was nothing to do with him. Who came up with the figure of the write-down?

Peter Meehan: The write-down of £845 million was presented to us in the paper of 9 July. I am not sure if you have that, but there was a number in there prepared by the company. I think Keith Cochrane alluded to this in the previous hearing, but that number was £695 million. That was announced on 10 July. I was at Carillion's offices on the Saturday and the Sunday prior to close off that review, which had been undertaken by my team. As I say, the company first alerted me to a write-down but no numbers towards the end of May. They provided us with their first position paper on one of those 11 contracts on 15 June, and then my team worked through those and then we got to the weekend before 10 July. £695 million was the number that was being presented by the company at that stage. Our paper had £695 million at that stage, which is the 9 July paper if you have it, but we had red lights against a couple of contracts—four in fact.

Q825 Rachel Maclean: Was that the three I have just mentioned: the Sandwell hospital, Liverpool and Aberdeen?

Peter Meehan: Aberdeen certainly was. Msheireb certainly was. I cannot remember the other two. I think Liverpool hospital was. On that



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Sunday, I discussed with Mr Cochrane and with Emma Mercer the adequacy of the £695 million that was being proposed. There was an agreement between us that that should be higher. That was higher to reflect a few factors. It is key to note that the £845 million is not all about the small number of contracts with the adverse change. It is also about management's decision to exit territories, which will obviously have a negative effect on sentiment in those territories. The supply base knows that you are not going to give them any work anymore. They will get tough. The customer knows you are not going to be there in 12 months to fix retentions and so forth. There are various reasons why that will have an impact.

Secondly—and this is important—management decided to move where they were in the acceptable range. We have all heard at the previous hearings that there is no right answer on these contracts. There is a very broad acceptable range. On the Qatari situation, bizarrely, the letter only came out to my attention today, but it just shows that one party thinks it is £200 million this way and one party thinks it is £200 million that way. These are difficult judgments.

Q826 Rachel Maclean: Mr Meehan, your job is to be objective and flag up risks, and be sceptical, as has been said before. The other risk identified in here, risk number three, is the significant audit risk. In your report, it says, "Management override of controls". What I think this means, as it says in your document, is, "Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls". These are not my words but in your document. This was already a very high risk in this document and it got higher, so you are saying that this write-down and this judgment only became apparent after this document was being published, yet you have been auditing them for 18 years.

Peter Meehan: No, the management override of controls is a requirement for us. Going back to the scepticism point, it is a requirement for us from auditing standards to have that as a risk. It will be a risk in the year-end accounts as well. It would always be a risk.

Chair: You did not even come up with the figures. What I have learned today is that the company came up and said, "We are doing these write-downs". I always thought it was Michael and Peter, your companies. You are being paid money. All of a sudden, the company comes down Mount Sinai with another figure and you accept it. I find this extraordinary.

Q827 Rachel Maclean: I would agree with Frank Field. Why did you not prepare? Why did you not flag up that there would be some kind of profit write-down, either internally or externally? You are the big four auditors.

Michelle Hinchliffe: Perhaps I could just explain, because it is a very important point you raise in terms of the role of the auditors. It is our role to assess the judgments that management makes. We are actually



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prohibited from forming management views. We are not allowed to come up with the estimates but, as we have quite rightly said before, it is our role to challenge those estimates.

Q828 Rachel Maclean: Were you challenging enough, given that you had already flagged that the management capacity to make these judgments was already very high, by your own judgment in this report here? Presumably it had been high before. Did you do enough challenging of their judgments, in your view? There was £300 million in the contracts in the Royal Liverpool Hospital, for example, where the beams were cracking and the hospital was cracking at the seams.

Peter Meehan: Can I give some clarity to that point, because I happened to visit the Liverpool hospital as part of our December 2017 planned audit procedures?

Q829 Rachel Maclean: When did you visit the hospital?

Peter Meehan: I went there on 11 January this year.

Q830 Rachel Maclean: Was that the first time you went?

Peter Meehan: No, I had been there in 2014 and 2015, because it was one of the significant contracts.

Q831 Rachel Maclean: That was 2014. When were these cracked beams?

Peter Meehan: The client prepares a position paper for us, because of the complexity of the big contracts. For all large contracts there will be a position paper. That position paper recorded that there was a cracked beam in, I think, November 2016. As at December 2016, there was still an assessment going on with regards to the impact of that on the outturns.

Q832 Chair: The company told us there was a queue.

Peter Meehan: If I may continue, I will come to that.

Q833 Chair: The tax advisers in Liverpool say the building has to be pulled down. Who is right?

Peter Meehan: I am an auditor; I am not a technical expert but I will come to that point, because there is a valid point there. That cracked beam, which I think Mr Howson explained, resulted in the company doing the right thing and reviewing all the structural beams in that hospital. I think he quoted eight; I am not sure if six were identified as needing remedial action. I do not know if that means repairs; I think he said that they volunteered to make sure they were okay by carrying out some remedial works. When I saw that hospital on 11 January, three of those beams were still undergoing those remedial works. That was a real disruption in the whole timeline of that hospital.

Q834 Rachel Maclean: It sounds like it was a surprise that something like this could go wrong. Carillion is a major constructor. They have built



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hospitals before. They surely know what to look out for when putting in beams and seeing if beams are cracked and, all of a sudden, there is a surprise that these beams have been put in. They are already in the hospital. It is not like they are in the beam factory being made or checked. Who is checking them to see that they are not cracked before they go into the hospital?

Peter Meehan: As a non-builder, I would be as shocked as you that that happens, but it did happen.

Q835 **Rachel Maclean:** You are there to challenge those judgments made by the management, are you not?

Peter Meehan: These are eight-foot-by-four-foot concrete beams. They are massive. I am not qualified.

Q836 **Rachel Maclean:** How big is the crack, then? The whole thing looks like this situation has allowed to happen where these enormous cracked beams have gone into this huge hospital, costing millions of pounds, where taxpayers and residents in Liverpool are waiting for this hospital to treat them. They are waiting for their operations and someone is not even looking, doing the basics, to check that the construction is continuing properly. You have a part to play in that.

Peter Meehan: I have a part to check what is recorded in the accounts, in respect of the construction project. I appreciate that and I try my best to understand what is happening at the grass roots to help in that understanding. What I saw myself was that, at the year-end last year, there was one cracked beam as we approached the year-end. The company made an adequate provision based on what they knew at the time. That was being investigated. I got comfortable with the position they took on that beam, but then they went through this phase of looking at other beams around the hospital. They found six or eight; I do not know. What I do know is, from them finding those in the April or May time, but still working on those now, it has been a long journey to repair those.

Q837 **Rachel Reeves:** Mr Meehan, we have a letter here from The Hospital Company (Liverpool) Ltd. It says that cracks were first discovered in two beams on 24 November 2016. That was before the 2016 year-end when you signed off the accounts and well before the March when those accounts were presented. In fact, the exclusion zone above the beams was in place until 24 March 2017, so about the time that the 2016 accounts were presented, the work had been done on the six beams that required remedial work. Should all this not have been identified in the 2016 accounts and report?

Peter Meehan: The work on the remedial beams is still ongoing now, when I was there in January.

Rachel Reeves: They were identified on 24 November 2016.



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Peter Meehan: That is when the one or two cracked beams were found, but the remedial work came afterwards.

Q838 **Rachel Reeves:** I know you are not a builder—you are an accountant—but there were two beams and then there were six. Those are the numbers. There were two beams discovered on 24 November 2016. What I am wondering is that you said there were four sites that were flagged a red. I guess this is one of them, is it?

Peter Meehan: Yes.

Q839 **Rachel Reeves:** You went there in 2014 and 2015. You did not manage to get the train up in 2016 or 2017 to one of your red sites.

Peter Meehan: I did go to that site. Well, it was 2018, in fact. I am sorry.

Q840 **Rachel Reeves:** So you did not go there in 2015, 2016 or 2017.

Peter Meehan: Sorry, I got the dates wrong earlier. I went in 2014 and 2015 to the hospital.

Q841 **Rachel Reeves:** You did not go in 2015 or 2016, or you did not go in 2016 or 2017.

Peter Meehan: I went in 2015 and 2016, and 2018 in respect of 2017. I am sorry.

Rachel Reeves: It is difficult to keep on top of it, because the years have changed several times in the short time you have been with us today.

Peter Meehan: I know; I am sorry.

Q842 **Rachel Reeves:** The cracks were first discovered in two beams on 24 November 2016. When did you next visit Liverpool after 24 November 2016?

Peter Meehan: It was on 11 January 2018.

Q843 **Rachel Reeves:** This is a red site. You were in charge of external audit for Carillion and, for 14 months, you did not go to challenge and see them.

Peter Meehan: That is one of a number of sites.

Q844 **Rachel Reeves:** You have four that are red.

Peter Meehan: The red assessment is at 9 July 2017.

Rachel Reeves: You did not go to Qatar either during that period.

Peter Meehan: The red assessment is at 9 July 2017, and obviously I went for the 2017 year-end, albeit on 11 January 2018.

Q845 **Chair:** What is the answer to Rachel's question? When are we going to



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get our hospital in Liverpool?

Peter Meehan: I am afraid, going back to the comment that one of you rightly made, I not a builder; I am an accountant.

Q846 **Rachel Maclean:** Can I just finish really quickly by asking whether it is normal? You are the auditor. You are earning a lot of fees from these projects, the Liverpool hospital and the Sandwell hospital—not the Aberdeen one, I do not think, but certainly those two, because you are earning fees from auditing Carillion. Do you see any conflict of interest in that?

Michelle Hinchliffe: If I answer that question, we have very strong procedures in place to assess conflicts. It is not unusual for us to be auditors of, in this case, a construction company and one of their clients. We are looking at the financial information.

Q847 **Rachel Maclean:** You actually have the same individual. It is Peter Meehan as an individual person, who is auditing Carillion. He is the person responsible for Carillion and also these projects. Is that right?

Peter Meehan: It is for the hospital company, which is the SPV that is set up. Carillion has a 50% interest in that. That is not unusual at all.

Q848 **Rachel Maclean:** Am I right in saying that you are the person in KPMG responsible for auditing Carillion's accounts and also auditing the SPV, the hospital, which they are delivering?

Peter Meehan: Yes.

Rachel Maclean: You are auditing both of those yourself.

Chair: You were auditing the pension scheme as well, were you not?

Rachel Maclean: Your strong procedure and your control is okay with having the same person.

Peter Meehan: Carillion owns 50% of the SPV and it is not unusual at all that I would audit a company in that situation. With regard to the pension funds, we are auditors to some of those, I believe, not all of them. There is an absolute Chinese wall between me and the people who do the pension fund audit. I do not know anything about them.

Q849 **Andrew Bowie:** Good morning. Mr Jones, Deloitte has been acting as internal auditors for Carillion from 1999 until the collapse of the company. Is that correct?

Michael Jones: It was from 2009, I think.

Q850 **Andrew Bowie:** 2009. Do you think then that Deloitte should take some responsibility for what happened to Carillion?

Michael Jones: As I have said, our role is to put together our plan, which we do with regard to the key risks that the company faces and the controls. We present that plan and agree it with management, then we



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execute on that plan and present our findings to those charged with governance in the audit committee. Over the years, we have found many issues. We are not management; we do not take strategic decisions. In fact, the Chartered Institute of Internal Auditors prohibits us from doing that and being part of management. While we do look at the controls and we call out control issues, we do not take those management decisions.

Q851 Andrew Bowie: Do you therefore agree that the role of an internal audit is to provide independent assurance that an organisation's risk management, governance and internal control processes are operating effectively?

Michael Jones: Efficiently and effectively, yes.

Andrew Bowie: In Carillion's case that was exactly what was happening.

Michael Jones: That is the work that we did, exactly.

Q852 Andrew Bowie: Did you agree with the board's position on risk?

Michael Jones: We looked at risk in a number of ways. We looked at the way they pulled together risks, at a contract level, at a divisional level and also at a group level. We participated in group risk forums, the discussions that they have and we obviously considered this as part of individual work.

Q853 Andrew Bowie: You must have had concerns personally with how the company was performing and the decisions that were being taken between 2009 and 2018?

Michael Jones: As I say, our job is to assess those controls. We present reports and we raise findings. It is for management then to address those findings. Carillion was actually very good at addressing findings. They were, in my experience, one of the best, actually.

Q854 Andrew Bowie: I was going to ask how they compared to other companies.

Michael Jones: One of the key things we look at is if an issue we have raised or a recommendation we have raised is not addressed, and we then call that overdue by the deadline that we set them to fix the problem, or we agree with management when they are going to fix the issue. We report to the audit committee all overdue issues or outstanding issues. Carillion had virtually no outstanding overdue points, sometimes none, and that is really quite unusual, to my mind.

Q855 Chair: You must have been asking the wrong questions then, must you not?

Michael Jones: I can understand that comment, but that was not what we found.

Q856 Andrew Bowie: Would you say that the company's internal audit



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committee was effective?

Michael Jones: I had very good engagement with the chairman of the audit committee, Andrew Dougal. He was very engaged. He would meet us in advance of each audit committee, but outwith that he would also meet us regularly during the year to go through reports. He would read those reports in detail and we would discuss them together, so we could give him feedback.

Q857 **Andrew Bowie:** That is lovely, but were they effective?

Michael Jones: I thought that they asked good questions and I thought Mr Dougal led it well, yes.

Q858 **Andrew Bowie:** How closely did you work with KPMG?

Michael Jones: Just as we would with any external auditors, we worked well with KPMG. We would engage with them as part of audit committee, but we would also engage with them separately. We would meet them to discuss our plan, so they knew what we were looking at and we knew that they were looking at. We would again discuss reports that we had and, every six months, we also had meetings with divisional leadership of Carillion, and KPMG would join those meetings. We would discuss the performance issues and the results of our work. We would share with them where we had got to in terms of reports, reports that were upcoming and any outstanding points that they might have that the divisions needed to close.

Q859 **Andrew Bowie:** A lot of people who are watching this who are not conversant with how audit works will be baffled at how two major auditors, KPMG and Deloitte, could let the situation arise in Carillion as it did, with the company collapsing in December and January. Have you got any comment to make on that?

Michael Jones: We are not the financial accountants. That is not my role as internal auditor. We are not financial accountants. We do not pull the numbers together. As I say, we look at the control environment that the company has over a very wide area, whether it is Carillion construction services, Canada, the Middle East, HR, the supply chain, whistleblowing and fraud, or IT. Reports we would look at would be as broad as whether a driver who is driving their snow ploughs in Alberta has the right insurance versus the state of their labour camps in Qatar where they house their people. We would look at a very broad range of issues that Carillion faced. I appreciate the conversations around the contracts and of course they are very important. I have tried to explain the control environment Carillion had over those, but that is just one aspect.

Q860 **Chair:** You would not look at the numbers then.

Michael Jones: We do not do substantive work around the numbers, no.



Michelle Hinchliffe: From an external audit perspective, as Peter said before, the role of the audit is to give an opinion on the financial statements, that they are true and fair and that the disclosures are appropriate in accordance with accounting standards. I know the reference to a “clean bill of health” has been used before and that is simply not what an audit is. You can give a true and fair opinion on a set of accounts if the company is not profitable, it is increasing its level of debt and perhaps if contracts they are entering into are below market prices.

Q861 **Chair:** You do not check the figures, Michelle.

Michelle Hinchliffe: Absolutely we check the figures. We do and we make sure they are in accordance with accounting standards, but it is not a guarantee that the company will continue or that management is making effective decisions.

Q862 **Andrew Bowie:** That is not the job of KPMG or Deloitte, is it?

Michelle Hinchliffe: It is not what an audit is. There are regulations and they do not require us to make qualitative assessments around management or the decisions that a management is making. We are responsible for making sure that the accounts reflect the financial performance and that they have been prepared in accordance with accounting standards.

Q863 **Rachel Reeves:** We are going to come on to some of these issues in a minute. Can I just ask about Deloitte’s role on the remuneration committee decision? I believe that Deloitte was also acting as adviser to the remuneration committee. Is that correct, Michael Jones.

Michael Jones: Yes, it is. I would just say in answering these questions on the remuneration committee that I am an internal audit partner with Deloitte. I am aware of the work we have done and will do my best to answer around the remco, but just recognise that that is not my expertise.

Q864 **Rachel Reeves:** In 2016, the rules around clawing back of bonuses were changed. What was Deloitte’s view, as an adviser to the committee, on those changes that made it harder to claw back bonuses?

Michael Jones: I understand that we did not advise on the changes to the share-based scheme with regard to clawback.

Q865 **Rachel Reeves:** What advice were you providing to them in the remuneration committee?

Michael Jones: As I understand it, our work was for the committee, for the chairman of the committee, who indeed you met, and the head of HR at Carillion. We would provide benchmarking advice and market-analysis advice. We would help them pull together the report and accounts, in terms of the disclosures and technical aspects of that. Also to take 2017, they had a new interim chief executive and a new finance director—



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anticipation of the finance director who was due to join in 2018. Any issues around that they would have advised on.

Q866 **Rachel Reeves:** The changes that Carillion made to the clawing back of bonuses were unusual. Would Deloitte not have flagged up as an adviser to the remuneration committee, about standards and processes in other businesses, anything about those changes?

Michael Jones: I am afraid I cannot comment. I do not know.

Q867 **Rachel Reeves:** Could you get back to us on any role that Deloitte did have in that area?

Michael Jones: Certainly, yes.

Q868 **Heidi Allen:** We have touched already a little, with KPMG, on the profit warning and the provision increasing from £695 million up to £845 million. It seems to me that a lot of the vulnerability of the company was around how revenues were being forecast and calculated. Can you talk to me about the amount and quality of auditing that you were doing as an organisation to check whether, in fact, there was a problem there?

Peter Meehan: Contracts and revenue on contracts are a key risk, and that is in the audit opinion as the key risk. Our work is outlined in the accounts and also in our letter in response to your inquiry before. As has been mentioned, the work would involve site visits, which we talked about.

Q869 **Heidi Allen:** Could you outline a bit more for us here today, because certainly the deep dive that was done highlighted further issues that were not routinely pulled up in the regular auditing? The fact is that the FRC has been looking at the quality of audits of Carillion over the last few years. Just to give some numbers, in 2016-17 insufficient revenue testing was performed on three audits they found; in 2015-16, out of 15 audits they looked at, four had poor auditing in that regard; in the 2014-15 accounts were eight out of 13. Repeatedly they were already questioning the quality of the audits, and I am interested in whether you think you were routinely carrying them out sufficiently well.

Peter Meehan: They were not Carillion audits. They were looking at audits across the spectrum.

Heidi Allen: These were different pieces of work.

Peter Meehan: They were nothing to do with Carillion. It is not Carillion at all, sorry.

Michelle Hinchliffe: The numbers that you have referred to are the results of the AQR. These are the FRC's reviews, for which they take a sample of files across all of our portfolio. In the years that you have referred to, as a point of clarification, Carillion was not one of the accounts that were selected.



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Q870 **Heidi Allen:** But it says something about the way that you are carrying this work out and whether it is good enough.

Michelle Hinchliffe: If I can address the last year, the comments that you raised, or the areas that you raised, absolutely are the points that the FRC raised in their review of our files. Revenue recognition was a point they raised for all the firms. They felt that across the board we needed to enhance the procedures we do around revenue recognition, and we have been addressing those as part of the work we are doing to improve audit quality. That was a general point, but maybe you would like Peter to answer the specific on Carillion.

Q871 **Heidi Allen:** It is whether it was a core factor in Carillion's demise that just was not picked up by KPMG.

Peter Meehan: We challenge the contract positions at the year-end. As I was saying earlier, when we went to the audit committee, having gone through the key contracts, based on what we knew on 1 March, we summarised the key risks on those larger contracts to management. I am sorry to labour this point, but there is this acceptable range on contracts, because there are so many judgments and estimates involved. We pointed out to management in the paper that you will see—it is page 20 on there—a summary of the riskier contracts and our appraisal of the exposure on those riskier contracts. That was not highlighting to management anything they did not know; it was just saying to them, in simple words, that in that spectrum of cautious to optimistic, you are towards the optimistic end in the assessment that you are making. There were numbers quoted there that would bring them back down to cautious. Management said they were happy at that time with being where they were in that spectrum, and that is their choice. I do not draw up their accounts; I sign an opinion as to whether I think their accounts are true and fair.

Q872 **Heidi Allen:** It is the quality of auditing. Is it not a fact that the deep dive that was done looking at these contracts revealed a different opinion from that which you had given in your previous audit?

Peter Meehan: The deep dive was effectively the same level of work as an audit.

Q873 **Heidi Allen:** The results were different.

Peter Meehan: It found differences because of the events that happened subsequently. I alluded to events that changed positions with regard to December and new events, like Aberdeen, the road bridges and the weather impact of the extended contract, which were new events that extended the costs going out on the contracts. It made those contracts onerous in the future, and you booked that loss straightaway. The £845 million is a number of factors and, importantly, it is also management taking a view at July that they then want to move back towards the more cautious end. It is a management view.



Once they had posted that announcement on 10 July, they knew two things. First, sentiment was going to be against them, obviously from the crash in the share price but also, operationally, customers and suppliers, understandably, were going to be nervous about dealing with them. There would be fewer new contract awards. Subcontractors would perhaps not want to go to site until they are paid in advance and that sort of thing. Also, the company knew that they were going to be in a position where they were going to need cash and would potentially sacrifice cash for a higher-profit settlement on some of these claims that they had. It was because they needed cash; customers will take advantage of that, but the company would not be keen on entering into longer mitigation. That all changed after the December position.

Q874 Heidi Allen: That is what I want to absolutely understand. You are saying there is nothing different in the way that you audited that second time round. It is purely that time had passed and circumstances had changed.

Peter Meehan: The only thing I did, as I alluded to earlier, because we had a start date of effectively 15 June and we had to be done by the beginning of July—we had two weeks to get through this—is I therefore engaged some help from some specialists within our organisation in construction contracts. That was to help get through the volume of information and in view of the size of the write-downs that were then being indicated.

Q875 Heidi Allen: In hindsight, would you not have had more expertise, if that is what it was, the first time around, routinely in your auditing on these sorts of companies?

Peter Meehan: No, I am not saying I introduced it for that expertise. I introduced because of the timeline.

Heidi Allen: It was just volume.

Peter Meehan: It was the volume to get through in the timeline, yes.

Q876 Heidi Allen: I just have a final question. If you could turn the clock back, knowing what we know now, would you have done anything different as an organisation in terms of the way that you audited, specifically looking at the way the company was declaring revenue or expecting revenue?

Peter Meehan: I cannot turn the clock back to what I did on 1 March. I only knew what I knew on 1 March.

Heidi Allen: You would do nothing differently.

Peter Meehan: At 1 March, no, I would not, no.

Q877 Chair: Is there anything you did, that you can recall, to help save the company? You think, "Gosh, that decision I made was really important. That helped save the company".



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Peter Meehan: Is there anything I could have done?

Q878 **Chair:** No, was there anything you did do? Everybody is before us. Nobody understands why this company went phut, as though you are staggering out on to the street thinking, "God, that was a surprise". You were all paid to look after that. What single act did you do that you think might have helped save the company?

Michelle Hinchliffe: Perhaps I can come back to this again.

Q879 **Chair:** No, I am asking Peter. What single action did you take?

Peter Meehan: Did I take?

Q880 **Chair:** Yes, did you think, "I am proud of that. If more of that had been followed, we would have saved the company". Is there one thing that you are proud of that you did to save this company?

Peter Meehan: I am not proud of where the company has ended up, if I can make that clear. I am very sorry for what has happened to the families of those employees who have lost their jobs, the subcontractors and any other stakeholders. Of course I am. As you can probably tell from my accent, I live in the area, I see it live on the news every day and obviously I know some of those employees. It does hurt, but my role is to be the auditor. I am not in the shoes of management. Independence does not allow me to make decisions on behalf of the company.

Q881 **Chair:** Michael, is there any decision you are proud of?

Michael Jones: Common themes that came up as part of the work that we did around contracts would be with regard to capturing variations and making sure that they were followed up quickly.

Q882 **Chair:** Is there one thing for which you think, "God, that was a good move on my part. It just was not big enough to save the company"?

Michael Jones: No, I can say that there is a range of things. A focus on mobilisations has been regarded as an issue. We did reports on that. Common themes were around how they deal with variations and how they deal with making sure you had the right contracts. On design of these contracts there were points that came up on more than one contract, so there was a number of recommendations that we raised over the period that might resonate. When you are dealing with 400-odd contracts, it is not surprising that you will find issues such as that. Indeed, some of those were common themes in terms of how they deal with subcontractors, training, et cetera.

Q883 **Rachel Reeves:** I will come to Antoinette in one moment. I just want to ask Peter Meehan something about the year-end audit, the 23 February document. On page 20, as you highlighted earlier, you have the exposure to different contracts, and it has 10 contracts there where you have put an exposure. You said earlier that four were red, so not all of those 10, even though there is an exposure.



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Peter Meehan: No, the four red were on 9 July. I am sorry.

Q884 **Rachel Reeves:** Were any of them red at the end of the year?

Peter Meehan: I would not say red, but they were amber.

Q885 **Rachel Reeves:** Were all 10 of them?

Peter Meehan: No, not all 10; they were the higher-risk ones.

Q886 **Rachel Reeves:** Which ones would you say, at the end of 2016, were amber?

Peter Meehan: Qatar certainly was, through its size, and Aberdeen.

Q887 **Rachel Reeves:** Just two of them. Six months later, four of them are red. On Qatar, you have put the exposure at £70 million. When Richard Howson gave evidence to us, he said that, at the end of 2016, they were owed £180 million to £190 million on that Qatari contract. Where does the £70 million exposure come from?

Peter Meehan: The £70 million goes back to what was in the balance sheet at the year-end on that job, as opposed to Mr Howson's number, which I think was a different date. He was talking about March, so things had moved on.

Rachel Reeves: No, he said 2016. The letter that he followed up with, which he sent to the Committee yesterday, has a number.

Antoinette Sandbach: It shows £278 million outstanding.

Rachel Reeves: Only 80% of it is attributable to Carillion.

Antoinette Sandbach: £177 million of it related to extension of time provisions, which had been lodged in 2016.

Q888 **Rachel Reeves:** That was 31 July 2016 that he said that was owed to Carillion. Did you not have those numbers, Mr Meehan?

Peter Meehan: No, I do not have those numbers.

Q889 **Rachel Reeves:** Did Richard Howson give you those numbers in 2016?

Peter Meehan: No, I have the numbers that were on the company schedule at 2016.

Q890 **Rachel Reeves:** How many times did you meet Mr Howson during 2016?

Peter Meehan: I met Mr Howson probably 10 times a year.

Q891 **Rachel Reeves:** He was saying that they were owed £180 million by the Qataris in the middle of July 2016 and yet, at the end of the year, you signed off reports that said that the exposure was £70 million. There is quite a big difference there.



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Peter Meehan: The other potential difference could be that, clearly, if you are pursuing claims against a customer, it would not be unusual in construction to claim for a higher amount.

Q892 **Rachel Reeves:** We will come on to this, but that is quite aggressive accounting. You are basically saying you are going to get £120 million of it in.

Peter Meehan: You book in your accounts a lower number than you claim against the customer. That would not be unusual.

Q893 **Rachel Reeves:** That is a £120 million difference.

Peter Meehan: That would be prudent accounting if that is the difference, but I do not recognise the Mr Howson number.

Q894 **Rachel Reeves:** You are saying that this is prudent accounting.

Peter Meehan: If you are booking £70 million against a claim of £170 million, if that was the claim number, then that would be prudent accounting, but it depends on the individual circumstances of the case.

Rachel Reeves: You are booking £120 million, are you not, not £70 million, because you are only putting down the exposure of £70 million? You are booking £120 million off the £180 million.

Peter Meehan: I do not recognise the £120 million.

Rachel Reeves: £120 million is the difference between £190 million and £70 million. 190 take away 70.

Peter Meehan: Yes, but you are starting with Mr Howson's number, which I am saying I unfortunately do not recognise.

Q895 **Antoinette Sandbach:** Can I ask you to turn to page 16, please, of the February audit committee? We have very clear figures here for extension of time 3A and 3B, which are different from what you have. You clearly saw those figures, because you mention that on page 16, under the Qatar contract. You talk about EOT 3B was presented to the client on 26 August 2016. We actually have the date of 31 July and, together with EOT, Carillion submitted claims of £82.2 million for £44.4 million, but in fact our figures show that it was £177 million, so how have you got that? You are claiming that you did not see these figures, but clearly you did.

Peter Meehan: I do not recognise the figures. The position paper you have there I did see. What we have in our books there is the £44 million, but the claim submitted is £82 million. The £82 million is not in our books; the £44 million is. The next bit is the £61 million in variations, but only £11 million are incurred to date. Only £11 million of that is in the balance sheet; the rest is future costs not incurred yet, so it will not be in the balance sheet.

Q896 **Antoinette Sandbach:** It was written off six months later. There was a



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massive write-down of £200 million six months after. Less than six months after this report, there was a write-down of over £200 million. What changed on this contract between then and the write-down?

Peter Meehan: What changed was in April the relationship went very sour, to my understanding, from what I was told by the company. In May the Qatar customer brought in a new contractor.

Q897 **Rachel Reeves:** Do you think, Mr Meehan, that the company was being honest with you?

Peter Meehan: Yes, I have no reason to believe otherwise. In May there was a new contractor and, in June, the blockade meant that it was very difficult to get people and materials to site. It was much more costly to complete.

Q898 **Rachel Reeves:** When Richard Howson is giving us information that shows that, at the middle of 2016, they were owed £180 million or £190 million and yet, in your year-end accounts, you put an exposure of £70 million, £120 million has gone missing somewhere. Did he not give you those numbers that he is now providing?

Peter Meehan: I am saying what was in the balance sheet at year-end as owed. Mr Howson could be referring to the different things of the variations and the elevated amount of claim.

Q899 **Chair:** Did you ever realise you were dealing with fantasists?

Peter Meehan: I do not think I was dealing with fantasists.

Chair: That was the image they gave us.

Q900 **Rachel Reeves:** Did you ever talk to the Qatari counterparts, because they are saying that the Richard Howson numbers are a fiction?

Peter Meehan: No, but I would not normally go and speak to Carillion's customers. I would not do that on any job.

Q901 **Rachel Reeves:** What did you do when you went to Qatar? It was a long time ago, but what did you do when you went to these projects?

Peter Meehan: When you go to a project, there are essentially three things on a site visit. Number one is a presentation and it is quite a formal presentation. The project director and the commercial lead will present to you. The commercial lead is the guy who looks after all the finances; the project director owns the site, effectively. That would be about an hour and a half. In a couple of hours or so, you would tour the site and then, after that, stay with the commercial lead to go through all of the paperwork backing up the documentation as to where they are in the project, in terms of cost to their customers.

Q902 **Rachel Reeves:** You said earlier, Mr Meehan, that there is a big range. Your job is not an exact science.

Peter Meehan: There is no right answer.



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Q903 **Rachel Reeves:** There is no right answer, so Carillion could owe £200 million to Qatar or Qatar could owe £200 million to Carillion. It is somewhere in that range, £400 million.

Peter Meehan: I am not saying that is the right range, but I am just saying that displays the differences of opinion that there can be on these contract.

Q904 **Rachel Reeves:** It is not a matter of opinion, is it? Surely in the end there is a contract. Someone owes someone or someone owes someone else. It cannot be both things at the same time. Someone is wrong, and surely the role of an accountant is to get an accurate picture of what is going on in the business financials.

Peter Meehan: The company manages the company and they try to determine, as best they can, with duty to shareholders and other stakeholders, the settlement of disputes in their favour. If you look at the cracked beams at Liverpool, they were designed by somebody else. They were fitted by somebody else.

Rachel Reeves: I would stick with the Qatar issue.

Peter Meehan: I am just saying that there are many ingredients. There is no right answer and the disputes are very complicated.

Q905 **Antoinette Sandbach:** I find it unbelievable that, on 1 March, you say you have an assessment and then, six weeks later, you have done a 180-degree turn.

Peter Meehan: That was based on events that happened after 1 March.

Q906 **Antoinette Sandbach:** Nobody makes 38,000 design changes on a project without there being a difficult client/customer relationship.

Peter Meehan: Mr Howson referred to him collecting cash in July 2016.

Q907 **Antoinette Sandbach:** His evidence to us was that he had been going out there 10 times a year for six years to try to twist people's arms to collect cash, and you did not see that as a risk.

Peter Meehan: I did see it as a risk. It is on the risks on page 20.

Antoinette Sandbach: It is not the right amount.

Peter Meehan: You also have to look at the track record, and they did have a track record of recovering claims on contracts.

Q908 **Rachel Reeves:** They did not on this contract, Mr Meehan. They did not get the money in.

Peter Meehan: On this one they did, actually, on that July receipt. There is forex and everything else in here, but around £40 million was received in July 2016. That was for claims that were lodged—all these changes of drawings and so forth—from inception of that contract in late 2011 and early 2012.



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Q909 **Rachel Reeves:** Overall, how much was the Qatari contract worth, Mr Meehan?

Peter Meehan: I cannot remember the absolute value at the end. It doubled in timespan, but I cannot remember the values where it ended up.

Rachel Reeves: They got in £40 million.

Q910 **Antoinette Sandbach:** Ms Hinchliffe, in 2014-15, the FRC said it had reviewed the audit of goodwill and other intangible assets on 11 audits in relation to audits done by KPMG, and it indicated that there was insufficient testing of the reliability of cash flows within the impairment assessment of goodwill or the capitalisation. There were similar criticisms in 2015-16 by the FRC: "We identified a number of concerns in relation to the audit valuation, impairment reviews of goodwill and other intangibles". It was the same again in 2016-17: "weaknesses in the audit approach adopted for goodwill impairment". What steps has KPMG taken to deal with the same criticisms that have been levelled at you over a three-year period, not just once, not just twice, but three times?

Michelle Hinchliffe: We have absolutely taken on board the comments that the FRC has raised.

Antoinette Sandbach: Sorry, I asked the steps that you had taken.

Michelle Hinchliffe: If I can explain, we have implemented a revised approach to testing, for example of goodwill, where we have mandated all teams.

Q911 **Antoinette Sandbach:** When did you implement this revised approach?

Michelle Hinchliffe: I came into my role as the head of audit on 1 October last year, and I have implemented mandatory processes for every audit. A number of these procedures were already applied to many audits, but now they are mandatory across the board.

Q912 **Antoinette Sandbach:** Given the importance of goodwill and Carillion being considered a going concern, and in fact a true and fair account, have you gone back, looked and assessed whether the audit signed off on 1 March 2017 in relation to Carillion complies with those standards that you have now implemented?

Michelle Hinchliffe: That review is ongoing. It has not been completed, so I could not give you an answer today, I am afraid.

Q913 **Antoinette Sandbach:** A company has gone down owing huge amounts of money. It had a goodwill value of £1.5 billion that disappeared overnight and you have not considered that assessment. We have had several weeks now and that process is not complete.

Michelle Hinchliffe: We are doing a complete review of the files. That is thousands of work papers.



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Q914 **Antoinette Sandbach:** I am specifically asking you around goodwill, because three years running the FRC identified problems with the way that KPMG calculates goodwill and impairment values. What I am asking is whether you have done that assessment in relation to the Carillion accounts, particularly bearing in mind that you were the auditor for all three years when issues were found generally—I am not at this moment saying specifically about Carillion—in relation to goodwill.

Michelle Hinchliffe: If I could just clarify a point, it is not the role of the auditor to calculate the goodwill. The management will go through a process where they will calculate goodwill or substantiate the amount of goodwill. The role of the auditor is then to go through, look at the judgments and look at the underlying documentation to confirm we are happy with the judgments that management has made. That is the process that we undertake. That is the process, as I said before, which is now mandatory for all firms. We are reviewing the work that was done on the Carillion audit. That is ongoing.

Q915 **Antoinette Sandbach:** When do you expect that to be completed?

Michelle Hinchliffe: I could not give you a date now, because we are going back and, quite rightly, we want to do a thorough review. As the FRC also announced, they are undertaking an investigation and looking at our files.

Q916 **Antoinette Sandbach:** Mr Meehan, you signed off the goodwill. Again, can I take you to page 23 of the February document? Carillion's goodwill had not had any impairment over a substantial number of years. In fact, did you ever make an impairment or did the management ever make an impairment write-down of Carillion's goodwill?

Peter Meehan: It certainly did not in the three years I was involved.

Q917 **Antoinette Sandbach:** In this document on page 23, your comments in relation to the goodwill say, "This implies management base is very optimistic. Particularly we observe that the pension deficit contributions are excluded and construction working capital benefits are taken into perpetuity". Then it said, "Having said that, the group's enterprise value of £2.3 billion is still £0.1 billion in excess of the group's book value. Year on year the gap has reduced and the committee should be mindful that an enterprise value below the group's book value is a strong indicator of impairment". At the time that you made this assessment, were you aware of how much Carillion's stock was being shorted on the stock exchange?

Peter Meehan: Yes, because that is something that the board monitored in their board minutes and it is something that I would consider in my overall thinking around the audit generally, not just attached to goodwill, but obviously the going concern and many other factors. I would also balance that against all investor commentators, if you like. At the time of signing the accounts, 73% of broker reports were positive or hold.



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Q918 **Antoinette Sandbach:** You had insight perhaps that others did not. You knew that all of this was based on so-called judgments, judgments that now appear to us to be substantially impaired.

Peter Meehan: I agree. The short sellers and broker reports is something I am mindful of. What I rely on most are the company records that are presented to me and I challenge those records. Here on this page is where we are challenging the company's forecast that supports the carrying value of the goodwill. The £1.57 billion that you mention is the total goodwill but, as I think you are aware, the bulk of that is £1.2 billion related to the UK services business. That UK services business was not part of the £845 million write-down. That was a good business making rather positive margins relative to the rest of the sector.

Q919 **Antoinette Sandbach:** You were aware of the increasing debt profile of the company.

Peter Meehan: I was aware of the increasing debt profile, yes.

Q920 **Antoinette Sandbach:** You just described to us that one of the key risks that you identified was the reducing margins, which you said were clearly visible from the accounts.

Peter Meehan: That is a risk that is clearly visible from the accounts, yes. Those margins are reflected in the forecasts that are prepared by management to support the carrying value of goodwill. We challenged those forecasts and we said their base case was, as you say, optimistic. Even when we scaled that back they still had headroom.

Antoinette Sandbach: Not much.

Peter Meehan: They had plenty of headroom. On that page, it says £840 million on the KPMG sensitised case, so there was plenty of headroom after the sensitising of the base case.

Rachel Reeves: There was not after an £845 million write-down though.

Q921 **Antoinette Sandbach:** In relation to the large amounts of goodwill that were left on the balance sheet, the approach to it considered and assessed by you over the three years when KPMG was being criticised for their approach to goodwill and impairment, do you regret supporting in the way that you did the goodwill as signed off on the accounts on 31 March? That is something that has disappeared completely. We are talking about the taxpayer picking up £800 million of pension liabilities.

Peter Meehan: The feedback from the FRC and others, as you mentioned, would be fed down through the audit function by the head of audit at the time and we would act upon that. I am happy that our challenge around goodwill reflected the criticisms of the past.

Q922 **Chair:** Who in the company thought up this figure?

Peter Meehan: The figure is not thought up. I know there is a lot said about this and it is complex but, in a nutshell, if you buy a company for



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£10 million and it has assets of £2 million, the goodwill is the £8 million. Why did you pay £10 million for it? It is because you often buy a company based on a multiple of its income.

Chair: They were buying companies with pension debts galore.

Q923 **Antoinette Sandbach:** Carillion in its reports identified that its biggest asset was its people, and yet the chief financial officer told us that they just used to run off a personnel account to see what the headcount was in the company. That does not identify skills. That does not identify values. It does not identify deliverables, does it?

Peter Meehan: When you assess goodwill for impairment, you look at the carrying value of that £1.2 billion in the services, for example, against the forecast for that business. It is called a CGU, in technical speak.

Q924 **Rachel Reeves:** Most assets depreciate over time, do they not? Why would goodwill be different?

Peter Meehan: That is an extremely valid point. Just as the accounting standards require you to record goodwill, because you have paid £10 million for something and there is a difference of £8 million, so that has to be goodwill, you assess it for impairment afterwards. In old technical standards you used to impair that goodwill. In new technical standards you do it on an amortisation basis.

Rachel Reeves: That did not happen.

Peter Meehan: The accounting standards changed and now you have to carry that goodwill at its carrying value, but assess it every year for impairment.

Q925 **Rachel Reeves:** Even without the change to accounting standards, you could have done that, could you not? Did you ever challenge them about the value of goodwill that they put in their accounts?

Peter Meehan: The paper outlines that we did and they still had headroom. We concurred with the fact that they had headroom, based on the forecasts for the business.

Q926 **Antoinette Sandbach:** Can I move on to the aggressive accounting that Carillion has been criticised for, Ms Hinchliffe? Is that a term that you recognise in relation to the way Carillion approached their accounts?

Michelle Hinchliffe: I certainly do not recognise it. As I said before, in my role I was not directly involved in the audit. That is Mr Meehan, so it may be better for him to answer that question.

Q927 **Antoinette Sandbach:** Is that a practice that you look out for in the companies that you audit? Is that a concern to you as an audit question?

Michelle Hinchliffe: We look at the accounting practices adopted by management. First and foremost, they need to be in accordance with the



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auditing standards. Within those auditing standards, there are always many judgments that need to be made. In the making of those judgments, all audit teams are mindful of where companies stand and whether they are at the more optimistic or aggressive end, in terms of the application. It is a key issue that is focused on in every audit.

Q928 **Antoinette Sandbach:** As head of audit, given that KPMG concluded that generally there is a lack of consistency and guidance around the group in when to recognise value on claims, we consider that claims are booked earlier in the group than would be done by certain others in the industry. Is that a concern to you?

Michelle Hinchliffe: Would you mind just confirming that?

Peter Meehan: That is the 9 July review of the write-downs and the period after December 2016.

Q929 **Antoinette Sandbach:** It does not change the conclusion does it, Mr Meehan? That shows that all of this was there. It had not been identified by KPMG before 9 July, but these concerns, a lack of consistency and guidance around the group in when to recognise value on claims, was not something that just arose between 1 March and 9 July, was it?

Peter Meehan: It was something that arose in the period after 1 March.

Q930 **Antoinette Sandbach:** I understand that that is what you are seeking to blame, because there were or may have been some changes, but this is a more fundamental assessment about when to recognise value on claims and that the claims were booked earlier in the group than would normally be done by others in the industry. In other words, Carillion was doing different things internally than other companies in that sector.

Peter Meehan: That is the 9 July paper. I say again: at the year-end that was not something that we recognised.

Q931 **Rachel Reeves:** That was only because you had not done the work.

Peter Meehan: Yes, we did do the work.

Q932 **Rachel Reeves:** You came in and did a deep dive, and looked at it in a bit more detail.

Peter Meehan: I said earlier the deep dive language was just compared to a normal interim review, which is a half-year review, which is just observation and inquiry. You would not normally do any audit work at all, so it is relative to that.

Q933 **Rachel Reeves:** You honestly expect people to believe that, between March and July, all of this happened and, up until then, things were going very well.

Peter Meehan: The company had challenges on 31 December 2016 and those are outlined.



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Rachel Reeves: Nothing could have been foreseen.

Peter Meehan: This was a series of significant adverse events on a small number of contracts.

Q934 **Antoinette Sandbach:** Four out of over 300 brought the company down—four.

Peter Meehan: That was with the combined impact of decisions to withdraw from certain territories and to move the dial down to a more prudent point of view by management.

Q935 **Antoinette Sandbach:** In relation to drawing the line between aggressive accountancy and fraud, where is that drawn, Ms Hinchliffe? What signs would you look for in relation to fraud?

Michelle Hinchliffe: Depending on the industry, there are many signs. One would be management override of controls. One would be referring to judgments, if management was moving from more cautious to more optimistic. All that changes over a period of time.

Q936 **Antoinette Sandbach:** Moving from a cautious to an optimistic approach would be an indication of fraud.

Michelle Hinchliffe: I would not say it is an indicator; it is one of the factors you take into account in assessing why a company decided to do that. It is an area that we would always challenge management on if they decided to move. There may be very legitimate reasons why a company may do that in response to an external environment, if they can see that an external environment is becoming more challenging. Sometimes the passage of time identifies new issues.

Q937 **Antoinette Sandbach:** When a company has the most shorted stock on the stock exchange and that is widely known—it was at the time one of the most shorted stocks—if it had this aggressive accounting method, would you be concerned? Clearly the market is saying something very different from what is potentially being presented to the public.

Michelle Hinchliffe: As Peter said earlier, the shorting of stocks is where investors see that a company is potentially overvalued. They are looking to make a profit. That is not a view on the long-term future of the company.

Q938 **Antoinette Sandbach:** Is that even though the stock in this company had been shorted for years and this was a company that ultimately failed on four contracts?

Michelle Hinchliffe: There are many companies where stocks are shorted and they continue to trade profitably. It is a factor, but it certainly does not by itself suggest that a company is going to fail. It is one of the factors.

Q939 **Chair:** Would you expect anyone concerned with the company, making money out of the company or advising the company to be shorting?



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Would you expect any of the companies who were shorting also to be playing a role in the company, whether it is advice to pension schemes or advice to the board? What would you think of those companies that were doing that?

Michelle Hinchliffe: I can speak from an audit perspective. We are not permitted to hold shares in any of our clients.

Q940 **Chair:** What is the view of the industry? Is that actionable? Is it a civil action or a criminal action? Is it fraudulent?

Michelle Hinchliffe: It would depend on the regulations and who was involved in that. I am not sure I can give you a specific answer to that question.

Q941 **Rachel Reeves:** Just following on from the evidence session that we had with the directors of the company, Emma Mercer told us that, on her return from Canada, Carillion's accounting had become more aggressive. She returned in April 2017. Do you think that is a fair description, Mr Meehan?

Peter Meehan: I personally would not use the words "more aggressive", but I would say, as our paper suggests in a summary we did, we showed that the company had moved towards the more optimistic end of the range. That was outlined to the company at the time.

Michael Jones: I do not look at the commercial accounting judgments, so it is difficult to comment.

Q942 **Rachel Reeves:** At the same evidence session, Keith Cochrane said to us that he thought it was strange that advanced revenue could be recognised. Is it prudent accounting to do the accounting in that way? Was he right? He became the chief executive and that was his feeling.

Peter Meehan: The accounting was in accordance with the accounting standards. That is the normal way to account for long-term contracts. You take the margin as you go through the contract, rather than take all the margin at the end, so you naturally have a mismatch between cash and the receivable in your balance sheet, so you will have a build-up on the balance sheet.

Q943 **Rachel Reeves:** That money was being used to pay dividends, was it not, even though it was not yet paid?

Peter Meehan: The company paid dividends, but the company paid its dividends from distributable reserves. Our role is to ensure that the company has distributable reserves to pay the dividends from.

Q944 **Peter Kyle:** Michelle Hinchliffe, KPMG has audited Carillion for the entire length of the company's life. Is 19 years just too long to be impartial?

Michelle Hinchliffe: 19 years was not unusual in the industry.

Peter Kyle: That was not the question.



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Michelle Hinchliffe: I do not believe it is too long to be impartial. There are requirements that the audit partner needs to rotate every five years and that is what has happened. The rules have changed going forward, so there are now requirements for mandatory rotation after 20 years. The 19 years are still within the period that the regulator believes to be appropriate.

Q945 **Peter Kyle:** What do you believe?

Michelle Hinchliffe: Independence for me is a mind set. For myself and all my fellow partners, independence and integrity are absolutely critical to our profession. For me, that is the most important thing, as opposed to the length of time.

Q946 **Peter Kyle:** At a strategy meeting of Carillion, at which neither of your companies were present, they concluded that there was “a possibility that the longevity of some staff in the business had led to wilful blindness”. Is the same not appropriate to you, Peter Meehan?

Peter Meehan: No, I do not recognise that comment. The longevity point is in relation to the client. I have been on the client for three years and, as Michelle says, there is a requirement to rotate the audit partner—

Peter Kyle: It is a client that went bust.

Peter Meehan: Subsequently, yes.

Q947 **Peter Kyle:** You are saying that there is nothing more; no other company could have looked under any other rocks and could have exposed any other things that could have indicated what was happening and helped the company turn around.

Peter Meehan: No.

Q948 **Peter Kyle:** Michael Jones, do you have a view on the longevity issue?

Michael Jones: Is that with regard to external auditors?

Peter Kyle: No, just in terms of auditing in general.

Michael Jones: You have the EU rules that have come out now that we are transitioning to, which are causing a great deal of transition. We have to pitch for external audits every 10 years and we have to mandatorily rotate after 20. We are moving to that now and that process is ongoing.

Q949 **Peter Kyle:** Michael Jones, your fees spiked to £815,000 in 2016 and then dropped again. Why did your fees drop? Did you lower the price or did they get less?

Michael Jones: No, we would have done some extra work in 2016. I cannot recall what that related to.

Q950 **Peter Kyle:** This is to Michael Jones. We have received evidence from



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several whistleblowers that Carillion would routinely ask creditors to delay invoices until after reporting deadlines. Were you aware of this practice?

Michael Jones: I can only comment insofar as the payment terms that we were on with Carillion. I certainly did not receive any evidence from those whistleblowers.

Q951 **Peter Kyle:** You did not notice this happening.

Michael Jones: Not to ourselves, no.

Q952 **Peter Kyle:** If this was regular, you would have seen bunching-up of invoices coming in on certain dates. Our whistleblowers have been quite clear that this has been happening and you did not notice it.

Michael Jones: As I say, we put together a plan and we look at the audits that are on the plan. That kind of cash collection profiling was not something that we looked at.

Q953 **Peter Kyle:** When they gave evidence, the directors said that they had no idea that this was happening. Is it credible that, if it was happening, the directors would not know?

Michael Jones: I cannot comment on what the directors would or would not have seen. I know what our payment terms were.

Q954 **Peter Kyle:** As the internal auditor, you would not be able to comment on what is appropriate for directors to see.

Michael Jones: I do not think the directors would necessarily be that close to the day-to-day cash receipts that the company was or was not experiencing.

Q955 **Heidi Allen:** These are the same directors where the chief executive is personally going out there to bring the cash in.

Michael Jones: That was for a very large amount. They obviously had cash reports. They had weekly cash meetings, when they would have looked at the cash position as a whole.

Q956 **Peter Kyle:** A good, active, proactive director would not have known that this was happening.

Michael Jones: I cannot comment as to whether there was bunching at the end of the year. It was not something that we experienced. They paid us consistently, in accordance with the terms that we agreed with them.

Q957 **Peter Kyle:** Michelle Hinchliffe, in your experience, is it good practice to encourage suppliers to act in this way, to invoice and delay invoicing to get through reporting deadlines?

Michelle Hinchliffe: That is a very general statement. Every business will be different and every business will have different terms that they



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negotiate with their suppliers, so you would have to look at it on a case-by-case basis.

Q958 **Peter Kyle:** In this case, do you think it was good practice? If this was happening, do you think it should have been known about, discouraged or reported differently?

Michelle Hinchliffe: I could not comment on the internal reporting. I am sorry.

Q959 **Peter Kyle:** Finally, I want to come back to this £200 million figure with suppliers in the Middle East. We heard, when directors gave evidence here, Mr Howson very clearly said that he was owed between £180 million and £200 million. You would have seen the letter this morning from Msheireb Properties. They say in this letter that "Msheireb Properties entirely disputes Mr Howson's statement that Msheireb Properties owed Carillion somewhere between £180 million and £200 million in March 2017". Furthermore, they say, "In fact, Msheireb Properties consider that Carillion owes Msheireb Properties a similar amount of money". Can I ask specifically not to give a narrative around this dispute but to give us an opinion, a fact: who owed who £200 million?

Peter Meehan: At March 2017 I do not know, because I signed the December 2016 accounts.

Q960 **Peter Kyle:** You do not know whether your client was owed £200 million or it owed £200 million.

Peter Meehan: I know that my client was owed £73.9 million in the balance sheet at 31 December 2016. They are the accounts that I signed and that is the client's paperwork at that time.

Q961 **Peter Kyle:** Your client has given evidence here, before a parliamentary committee, that he was owed £200 million. We have heard from the client to a parliamentary committee that they believed they were owed £200 million. You were the auditor. You have audited the company for 19 years. Who owed £200 million?

Peter Meehan: I appreciate the frustration because this is complex, but I can only speculate on what Mr Howson told you.

Peter Kyle: It is not actually complex. It is not complex.

Peter Meehan: I am talking about the amount that is in the balance sheet. What you claim from a customer can be different from what you book in the accounts. They could have claimed much higher than what is booked in the accounts.

Q962 **Peter Kyle:** We are not talking petty cash. If your client is saying that it is owed £200 million, even if you have put £70 million on the balance sheet, is it not just worth making a couple of calls to check that that £70 million is actually owed?



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Peter Meehan: We did check the £70 million.

Rachel Reeves: You said that you did not talk to the customer, Mr Meehan.

Q963 **Chair:** Who did you check it with?

Peter Meehan: We checked the £70 million by reference to the position paper, the procedures that we undertook to ensure it is valid and to check, as I said earlier, that there was a track record of collecting cash on a similar amount.

Q964 **Peter Kyle:** You took it at face value when you were told that they were owed this money. There was no independent verification of it whatsoever.

Peter Meehan: Do you mean the £200 million?

Peter Kyle: Even the £70 million.

Peter Meehan: You do not write to Carillion's clients to confirm the balance on a construction contract. You look to the books.

Q965 **Peter Kyle:** They are disputing even the £70 million. They are saying they were owed £200 million. It does not matter whether it was £70 million or £200 million; they are saying that they were owed it, not that they owed the company, Carillion.

Peter Meehan: I never saw any books or letters from the customers.

Q966 **Peter Kyle:** You did not proactively verify whether the debt was a credible one.

Peter Meehan: Yes, I did.

Q967 **Peter Kyle:** You did it by not contacting the people who owed the money.

Peter Meehan: We checked it to backing documentation, which will show the amount of spend on variations and claims. It will be checked by specialists as appropriate.

Peter Kyle: Clearly it was wrong.

Peter Meehan: There might be legal letters. I cannot remember the detail but, for those contracts that were in our sample, we will check the backing documentation that supports the claim that is in the balance sheet.

Q968 **Peter Kyle:** Did you not check it well enough? Is the way you check it not right? Do we need to modernise the rules that you apply in these situations?

Peter Meehan: No, I am happy that we checked the £73.9 million. That is the number in the balance sheet on December 2016.



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Peter Kyle: Carillion is right and the supplier is wrong then.

Peter Meehan: You are talking about the number in March, which is different.

Q969 **Peter Kyle:** What I am saying is that I do not know whether I can look at a balance sheet that you have audited, which says that the company has a creditor of £200 million, and know whether that is correct or not, or whether it is completely the opposite. I do not know anymore.

Michelle Hinchliffe: If I could maybe help, the numbers in the balance sheet are management's numbers. I appreciate there are lots of different numbers here, but management prepared the balance sheet.

Q970 **Chair:** We have external and internal audit. How do you earn your money?

Michelle Hinchliffe: Absolutely.

Q971 **Chair:** Absolutely what?

Michelle Hinchliffe: It is unusual that we have one set of numbers prepared by management and you have other evidence from management saying different numbers. I am sorry; we just cannot reconcile those, because we do not have details.

Q972 **Peter Kyle:** It is not £10 in a petty cash tin. This is £200 million. The entire company rests on it. Surely there should be a different standard for this kind of debt, to figure out whether it is actually a credible debt or not.

Michelle Hinchliffe: Coming back to the debt that was in the balance sheet, which was management's records, we carried out those procedures to get the evidence we needed to say that that amount was recoverable, as at 31 December 2016. I am sorry we cannot help with the other numbers, but we did not have these other numbers.

Q973 **Peter Kyle:** You say it is complex; I think it is quite simple. For me it comes down to this: I would not hire you to do an audit of the contents of my fridge because, when I read it, I would not know what is actually in my fridge or not. That is the point of auditing, is it not—to tell us what exists, what is there and what is robust or not?

Peter Meehan: We are telling you what was there per the company's records, which is the £73.9 million in the balance sheet.

Q974 **Rachel Reeves:** That is like saying I want you to do an audit of my fridge and I am going to tell you what is in it. I am going to show you the receipts from the supermarket and that is enough. You have to open the fridge and have a look at what is in there, do you not, Mr Meehan?

Peter Meehan: We did in 2014 and 2015, but in 2016 we did not visit that site. You would not go to every site every year. We did not go, to



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repeat, because that job had extended a long time and was due to complete in that year. That is why it was not a planned exercise.

Q975 Rachel Reeves: You have already said, Mr Meehan, that just a few contracts brought down this company. What we find surprising is that you did not dig a little bit deeper into that small number of contracts. We are not saying you had to look at the £300 million. You clearly had an idea and a grip on where the problems were, but I think it quite surprising—I would probably say shocking—that you did not then dig a bit deeper into what was going on.

I just come back to this letter from Richard Howson. I am not quoting him because I believe everything he is saying. I have some scepticism about some of his evidence, but it is the difference from what you are saying that gives me cause for concern. He talks about the end of 2016 in this letter, and he talks about these changes, with the extension of time contracts. He says, "Following which the employer immediately certified the £50 million on account in anticipation of further validation of costs associated with the EOT claim, and we have made good progress with agreeing the variations with the employer during 2016". The point is they had made good progress with agreeing the variations. At the end of 2016, it was not clear that the conversations between Carillion and the Qataris had decided on exactly how much was owed by whom to whom. In the accounts that you have signed off, I do not think, from my reading of them, that that was properly highlighted.

Peter Meehan: It was. I go back to the acceptable range. As I say, there is a portfolio of contracts. Some of those, in arriving at, you have moved to the more optimistic; some will be towards the higher end of optimistic and some will be back at balance. That is the balance. By the number in my document, Qatar was clearly one that had focus from us.

Q976 Rachel Reeves: It had focus up to a point. You mentioned it, but you did not do the digging that was needed to ascertain whether, on the one hand, it was £200 million owed to Carillion or, on the other hand, £200 million owed to the Qataris. Still, at the moment, we do not know which way round that was, and part of the reason we do not know is that the external audit function did not ask those questions and ascertain the true facts of the matter. As a result, it is part of the reason that we are here today.

Can I come on to the issue of investors and what they knew? This is the final area we want to explore today. As Antoinette Sandbach has already mentioned, some investors, including Standard Life Aberdeen and Kiltearn, began divesting in their shares in 2015 because of risks that they saw. Did you see those risks? Do you understand why those investors did what they did?

Peter Meehan: As I said earlier, we audit based on the evidence that we see in front of us. We are mindful of what other commentators will say. In respect of the analysts that you talk about, some of them say they



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divested based upon the accounts. That is a sign that they do read the accounts. It goes back to what I said: the accounts do outline the challenges that the company faced at December 2016. With regards others, some say they still saw it as a going concern in November 2017. There is a mixed bag there. I cannot rely on that for my audit. I will be mindful of it, but I will audit the evidence that is presented to me by the client.

Q977 Rachel Reeves: There was an interview in the *Guardian* today with a former executive at Carillion, and he told the *Guardian* that “the supply chain wasn’t being paid, money was getting transferred [between different parts of the group] to pay salaries, loans were coming in from the UK to the whole of the Middle East. By mid-2016 we were already seeing these problems”. He then goes on to say, “For them [directors] to say it all happened in April and May 2017 when the world changed ... it’s absolute nonsense. [The write-downs] were all lurking and developing, they had even crystallised, but nobody was accepting it. There was no cash”.

The investors seemed to know what was happening. People who worked for the company seemed to know what was happening. The only people who did not seem to know what was happening are those who were paid to detect it, and those are the directors and the auditors of the company. Do you recognise the concerns that that whistleblower had in 2016, or do you stand by what you said earlier: that all of these problems really crystallised between March and July 2017?

Peter Meehan: I stand by the accounts signed as at 31 December 2016. I did see the whistleblower remarks. In terms of Carillion’s control environment, which I thought was good as well, one of the better features of it was the whistleblowing feature itself. To find an individual who is now saying, some 18 months on, that there were all these negative attributes going on, which never came through the whistleblowing line, I find rather surprising. I have no evidence at all to back up what that anonymous person is saying.

Q978 Rachel Reeves: EY noted, when they were called in to try to turn around the company in July 2017, in their report to the audit committee, “a culture of non-compliance in relation to ignoring central procurement requirements and also a bias towards delivery, a lack of accountability and a culture of making the numbers up”. Do you think that EY was correct in that analysis of what was going on in the business?

Peter Meehan: I do not recognise those comments at all. I cannot remember EY going to an audit committee. I go to the audit committees, but I cannot remember them being there.

Q979 Rachel Reeves: That was a report they gave in July 2017 to the audit committee.

Peter Meehan: I do not remember that at all. They were looking at cash forecasting.



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Q980 **Rachel Reeves:** Michael, do you remember that?

Michael Jones: I cannot remember EY ever being at an audit committee and those comments do not resonate. Carillion was pretty strict on procurement.

Q981 **Chair:** It could have been one you were not at though, could it not?

Michael Jones: I have explained why I was not at it and it is quite normal for me not to be at it.

Q982 **Rachel Reeves:** Michael Jones and Peter Meehan, if you were auditing another company, internally or externally, and you saw some of the warning signals that existed at Carillion, would you do anything differently next time?

Peter Meehan: Clearly, with what has happened, things are very sad and it of course makes one think, "Could I have done things differently?" I have pondered this long and hard. You would be amazed if I had not. The answer is, for everything I reflect on, me and my team all did the best we could and the best job. I stand by the opinion that we gave on the 31 December 2016 accounts.

Q983 **Rachel Reeves:** Mr Meehan, that was not my question. My question was: if you were in a company in the future and you saw some of the warning signs that you saw at Carillion, would you do anything differently? You said that there were risks and warning signs at the end of 2016, but they did not properly crystallise until the spring or summer. If you were in a company in six months' or a year's time that had some of the warning signs that Carillion exhibited, would you do anything differently next time?

Peter Meehan: I cannot think I would, to be honest. One is always learning in life and one must learn from experiences. There is an investigation going on into the audit, for example, as we know, and there will be lessons to learn from that, perhaps. If there are, I will take them on board.

Q984 **Rachel Reeves:** I have learned lots of lessons in the three evidence sessions that we have held already. What have you learned since the middle of January when Carillion collapsed? Is there anything you have learned so far, in the last six weeks?

Peter Meehan: I suppose I have learned what a tough job it is.

Michael Jones: To your earlier point, I would encourage people to be proactive when faced with the signs. The trouble is, if you look back at Carillion, they discuss cash. They discuss the problem contracts, certainly around the audit committee table; I do not go to the board. As you say, those issues were well known.

Q985 **Rachel Reeves:** If, in your internal audit function at a different firm in the future, you saw some of the warning signals that Carillion exhibited,



would you do anything differently, Mr Jones?

Michael Jones: I would encourage people to be proactive, much as Carillion was, making sure that you are open in terms of the capital structure, which they were in their accounts. It is very difficult. Ultimately, these were issues around difficult contracts that were taken on over a long period of time.

Q986 **Chair:** In Peter's language, would you open the fridge door?

Michael Jones: As part of our plan, absolutely.

Q987 **Chair:** Peter, would you open the fridge door now?

Peter Meehan: I believe I did.

Q988 **Heidi Allen:** This is just a slightly indulgent question, I suppose, but I want to ask it to you all. In a country and a world where the average person is becoming increasingly distrustful of big organisations that do not appear to have their interests at heart, or they are the last people who they worry about—not every large organisation is like that, of course—they will look at Carillion, and they will look at a huge blue-chip auditor like KPMG or Deloitte, and think, "These people just do a job, but they do not care about what happens to me". What needs to change in the system? I am hearing from all of you, "We did our job within the rules. Within the parameters, we did our job". What needs to change in the system, so that something like this does not happen again?

Michelle Hinchliffe: From my perspective, what you have highlighted is an expectation gap from an external audit perspective of what an audit is and what the public expects from an audit. As we have said, the audit is an opinion on whether the financial statements give a true and fair view. It is clear the public expects that there is more around that. An audit is not a guarantee that a company will not fail. Companies will fail and it does not mean that management made the wrong decision.

Q989 **Heidi Allen:** What needs to change?

Michelle Hinchliffe: From an external audit perspective, perhaps an audit needs to do more. Perhaps an audit needs to provide a more ongoing assessment of the risks within the business, not at a 12-month snapshot. Perhaps an audit needs to provide more qualitative analysis on decisions made by management. Within the current framework that simply is not what an audit is or what we are required to do. To change that requires a change in regulation; it requires investors to agree that this is worthwhile, because there is a cost involved in that. To me, there is clearly this expectation gap. As an auditor and having been an auditor for many years, it is tough when this trust does not exist. I understand that. We have to do something to deal with that, because we have many very good auditors who are doing a great job, and it is tough when people do not have that trust in what we are doing.

Q990 **Chair:** Should we break you up as these big combines?



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Michelle Hinchliffe: For large complex companies the intensity of audit increases. There is more regulation and we need more specialist resource to deliver the audit quality that is absolutely needed.

Q991 **Chair:** It all came to naught. Heidi's point is that there is a real question about your integrity. There is a little gang of you that competes for these contracts. Should we recommend in our report that Government should seriously think about breaking you all up?

Michelle Hinchliffe: To deliver the quality audit that we have to, we need scale. We need to have specialist resources and you can only have that scale if you are of size and can invest.

Q992 **Chair:** What about the other work you do with companies as well, all four of you? Michael, should we break you up?

Michael Jones: Could I just say that I have worked for Deloitte or its predecessor firms for over 30 years and have been a partner for over 20 years? I can tell you it does not feel like a cosy club when we are pitching against each other for work. I understand the point about these very large audits, these FTSE 100 audits that are predominantly just audited by the big four, but in other parts of our work we compete with many people, whether it is PA Consulting or McKinsey, or in my line of work, where I compete with much smaller firms as well.

Q993 **Chair:** Peter, do you think we should leave you alone?

Peter Meehan: To me as an audit partner, as Mr Jones has just said, the marketplace seems very competitive.

Q994 **Rachel Reeves:** Michelle, could you just tell us how many of the FTSE 100 companies KPMG provides external audit to?

Michelle Hinchliffe: That changes over time, but we are around 23%.

Q995 **Rachel Reeves:** What about internal audit?

Michelle Hinchliffe: I am sorry; I would not have those figures to hand.

Q996 **Rachel Reeves:** Michael Jones, do you know the answer to those questions?

Michael Jones: I think we are of the order of 26% for external audit, but I am slightly guessing.

Q997 **Rachel Reeves:** That is about a quarter each. In the last 19 years, how much in fees have you taken from Carillion for audit and non-audit work?

Peter Meehan: It is £29 million.

Michael Jones: I think our fees from Carillion, in terms of the letter we presented you with, were £11 million.

Rachel Reeves: That is £40 million between you. Thank you very much, the three of you, for coming to give evidence to our Committee today and



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for the detail in your answers.