

Stephen Haddrill  
Chief Executive Officer

Chris Shaw  
Clerk, BEIS Select Committee  
House of Commons  
London  
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*Dear Chris,*

During my evidence to the Joint Committee inquiry into Carillion on 30th January, I undertook to provide the Committee with additional information on a number of points. This information is attached.

I hope that this information is helpful to the Committees. Please let me know if you have any follow-up questions.

*Best wishes,*

*Stephen Haddrill*

**Stephen Haddrill**  
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### Supplementary information

#### **The size of the FRC enforcement team**

The speed and effectiveness of our Enforcement team is extremely important and we continue to prioritise investment in this area. In January 2016 there were 20 members of our Enforcement team, including lawyers, forensic accountants and legal assistants. This number now stands at 29, with further recruitment in hand. As I advised the Joint Committee, this investigation is a priority and we are dedicating sufficient resources to ensure the investigation into KPMG's audit of Carillion is conducted with thoroughness, quality and speed.

#### **What is the cooling off period for auditors before they're allowed to join a firm they previously audited?**

The FRC's Audit and Assurance Ethical Standard requirements that applied to Carillion's December 2016 financial statements states that:

- where an audit partner leaves the firm and is appointed as a director (or NED) or to a key management position with an audited entity, there should be no less than a two year gap between 1) a partner leaving an audit firm and being appointed as a director of an audited entity; and 2) an audit firm accepting appointment (or-reappointment) as auditor of that entity.

The rules if the person leaving the firm is not a partner are slightly different:

- where a former member of the engagement team (other than an audit engagement partner, a key partner involved in the audit or a partner in the chain of command) leaves the audit firm and, within two years of ceasing to hold that position, joins the audited entity as a director or in a key management position, the audit firm must consider whether the composition of the audit team is appropriate.

In June 2016, the Ethical Standard was revised and the latest requirements are stricter. If an audit partner leaves and were to join a Public Interest Entity (PIE) client of the firm as a director (or NED) or fills a key management position within a two year period, then the firm should resign as auditor. A one year provision applies to persons other than the partner.

If a partner leaves and joins an entity that is not a client of the firm as a director or NED the firm cannot bid for that audit for a period of two years. A one year prohibition applies where the firm is a non-PIE.

#### **What is the section of the Companies Act that requires disclosure of dividends?**

Disclosure of dividend payments is required by International Financial Reporting Standards (IFRS). International Accounting Standard (IAS) 1 (paragraph 107) requires disclosure of the amount of dividends recognised during the financial period and the amount per share. In addition, paragraph 137(a) requires disclosure of the amount of dividends proposed or declared after the balance sheet date (but before the accounts were authorised for issue) and the amount per share.

In addition, section 416(3) of the Companies Act requires the directors' report to state the amount that the directors recommend should be paid by way of dividend.



**Did the FRC look at dividend disclosure in Carillion's accounts?**

During the Corporate Reporting Review of Carillion's 2015 accounts the FRC looked at all disclosures made. I can confirm that Carillion made the disclosures required by International Accounting Standard 1 on page 96 of its 2015 report and accounts.

**Do the FRC and FCA have the same understanding about what is reasonable in terms of the treatment of goodwill for accounting purposes?**

Yes. Accounting for goodwill is based on the application of specific International Financial Reporting Standards (IFRSs) that apply to all UK listed groups of companies.

Goodwill is an asset that represents the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised. It is calculated as the excess of the fair value of consideration paid over the fair value of identifiable net assets acquired on the purchase of a business. IFRS 3, 'Business Combinations' sets out how goodwill is to be measured at the time of the business acquisition.

IAS 36, 'Impairment of Assets', set out the circumstances under which goodwill is to be tested and considered for impairment. The FRC's Corporate Reporting Review (CRR) puts questions to companies where there is, or may be, a question whether their report and accounts fail to comply with relevant accounting requirements. CRR's review of a set of report and accounts focuses on the adequacy of disclosures provided in support of their accounting approach. CRR also questions the company where there is apparent evidence that trading has deteriorated in a business unit to which material amounts of goodwill have been allocated.

**What were the twelve points raised in relation to the FRC's 2015 Corporate Reporting Review of Carillion's accounts and how were they resolved?**

The accounts of large public companies are selected for review through a combination of cyclical coverage, priority sectors and risk profiling. We looked at Carillion's published 2015 accounts as part of that process. We wrote to the company with 12 issues. These were:

The Strategic report

1. Lack of explanation of a significant decline in the book to bill ratio.
2. Lack of explanation regarding the temporary benefits from rescaling UK construction activities, those benefits having apparently expired in 2015.

Deferred and contingent consideration

3. Lack of a year on year reconciliation.

Goodwill

4. Not clear whether any reasonably possible change in assumptions would have led to an impairment in goodwill.

Joint ventures

5. Not clear how the various disclosures on disposal of joint ventures (which were all PPP investments) could be reconciled.

Derivative financial instruments

6. Not clear where amounts released from hedging reserve were reflected in the income statement.

Retirement benefits

7. Not clear what period was covered by the deficit recovery plan agreed with the trustees in 2014 and what cash contributions the plan specified.
8. Whether the company should have disclosed details of individually significant pension plans.

Accounting for contracts

9. Not clear how the company determined the stage of completion on service contracts.
10. No disclosure of contract mobilisation costs.
11. The accounting for a specific construction and maintenance contract.

Sources of estimation uncertainty

12. Further disclosure of information regarding outcomes of construction contracts in progress.

Our enquiries and correspondence with Carillion resulted in enhanced disclosures in the 2016 accounts, which we were satisfied met the required standards. The company referred to our regulatory intervention in their December 2016 report and accounts and the fact that it had led to enhanced disclosures in their 2016 report.

The additional disclosures that were made did not impact any of the reported numbers in the report and accounts under review.

**What memoranda of understanding the FRC and Insolvency Service have previously held? When does the FRC expect to publish the full Memorandum of Understanding referenced in the Committee meeting and their letter of 18 January to the Insolvency Service?**

We have undertaken regular enforcement case-specific cooperation with the Insolvency Service, including on our investigation into PwC's audit of BHS. This consisted of regular meetings between investigation teams and the disclosure of investigation material through information gateways.

We have now supplemented these exchanges with a temporary arrangement for the exchange of information between the FRC and Insolvency Service, which was published on the FRC's website on 25<sup>th</sup> January. This agreement enables us to cooperate fully in respect of the investigation into Carillion. We expect to sign a full permanent Memorandum of Understanding after the implementation of GDPR.