

13 March 2018

Rt Hon Frank Field MP
Rachel Reeves MP
Chairs of the Work and Pensions and BEIS Committees
House of Commons
Westminster
London
SW1A 0AA

Dear Mr Field and Ms Reeves

Carillion

Thank you for your letter of 27 February 2018, received on 5 March 2018, where you ask four questions with regard to my answer to Q799 given during the oral evidence session on 22 February and a further question with regard to Deloitte's advice to the Remuneration Committee.

Question 799

In response to Q799, on 22 February I provided some context as to how Carillion controlled its contracts. I referenced management's monthly Project Review Meeting process ("PRM") and their Peer Review process ("Peer Review"). It may be helpful if I provide further context with regard to the policies, processes and controls Carillion's management applied to contracts:

- A key part of Carillion's policies, processes and controls was the PRM. This was a monthly review of each contract undertaken by management; Deloitte did not conduct the PRMs. At the PRM a Commercial Report was discussed which contained a Contract Appraisal that set out the current traded position and end of life ("EOL") forecast. The Contract Appraisal highlighted any management adjustments made to a site team's position. A monthly contract-by-contract summary of the Contract Appraisals was presented to sector and business group management. On a monthly basis, a business group performance review meeting was held with the group executive where each business group presented the performance of selected contracts on a rotational basis.
- Another key aspect of Carillion's policies, processes and controls was management's Peer Review process; Deloitte did not conduct the Peer Reviews. Peer Reviews operated across the group to provide challenge to the financial, operational and commercial performance of contracts and to ascertain compliance with a defined set of control activities recorded in Carillion's Integrated Management System. The reviews were typically undertaken by senior members of Carillion management drawn from the commercial, operational and finance functions. Carillion's management undertook around 100 Peer Reviews each year which typically covered more than half of contract revenue. As part of the Peer Review control process, operated by management, key themes arising from the Peer Review process were reported to the Carillion Executive Leadership team and to the Audit Committee.

Our responses to your questions with regard to Q799 are set out below.

1. Were any of these contracts the ones that formed the basis of the £845m put in place in July 2017? If so, could you provide details of what your 2016 reviews found on these contracts?

Yes. As explained in my answer to Q799 in the oral evidence session, after Carillion's July 2017 announcement we considered the results of the Peer Reviews undertaken by management in the period January 2015 to July 2017 with regard to the contracts for which a provision of £845 million was announced on 10 July 2017. These were not our 2016 reviews. Rather, this was us considering, in July and August 2017, what management's Peer Reviews had concluded at the time they were conducted.

Our work in July and August 2017 found that 42% of the Peer Reviews undertaken in the period January 2015 to July 2017, which related to the contracts for which a provision was allocated, recommended a forecast EOL margin that was less than that in the Contract Appraisal (the Contract Appraisal takes into account any management adjustments to the site teams' positions). For more than half of these, the adverse variance exceeded £5 million. The differences arising with regard to the November 2016 Peer Reviews relating to Royal Liverpool University Hospital and Midlands Metropolitan Hospital were £53.9m and £16.9m, respectively. We understand no Peer Review of Aberdeen was undertaken, reflecting difficulties in agreeing the timing of such a review with the Joint Venture.

2. Does your reference to a more "pessimistic view" mean that you believe that the revenue recognised on these contracts in the financial statements were overstated?

I cannot comment as to whether the revenue recognised on these contracts in the financial statements was overstated because I did not have sight of any judgements or adjustments that may have been made at either a business or group level. My reference to a more pessimistic view reflected that the forecast EOL margin suggested by the Peer Review teams was, in certain instances (as explained in 1 above), lower than the EOL margin set out in the Contract Appraisals. As agreed with the Audit Committee, our role was to complement the work of other assurance providers not to assess the judgements made or conclusions reached by management from an accounting perspective.

3. What was the response of the Board to your more pessimistic views on these contracts?

As set out above these pessimistic views were those expressed by the Peer Review teams.

We had discussions in August and September 2017 where we shared our findings with the CFO and the Chairman of the Audit Committee as well as with the interim CEO. They expressed surprise that management's reporting procedures had not previously brought to their attention the differences highlighted by the Peer Review process and were concerned these differences did not appear to have been followed up by management. We did not meet the full Board to discuss this matter.

4. Did you present any concerns you had to KPMG about the positions being taken on contracts in the financial statements in 2016 or prior years?

In September 2017 I had a telephone conversation with KPMG, in anticipation of the 28 September Audit Committee (which was subsequently cancelled), where I outlined our findings consistent with what I shared with members of the executive and the Chairman of the Audit Committee. In neither 2016 nor previously did we present any concerns to KPMG with regard to the positions being taken on contracts in the financial statements.

Remuneration Committee

5. What advice was given by Deloitte to the Remuneration Committee about the changes to the clawback provisions on bonuses it agreed, particularly in relation to the rationale for the changes and the extent to which they reflected standard practice?

In relation to your question, the Deloitte team who undertook the engagement has confirmed as follows:

- In late 2014 / early 2015, following the publication of the new UK Corporate Governance Code in September 2014 which required companies to adopt malus and clawback provisions on variable pay, Carillion sought advice from Deloitte in relation to:
 - how malus and clawback triggers work in practice;
 - how they could interact with holding periods and deferral periods on the Carillion Share Plan rules (the Long Term incentive Plan known as "LEAP" and the Deferred Bonus Share Plan, the "DBP"); and
 - the types of triggers which the Company might apply based on market practice at that time.
- In February 2015, the Remuneration Committee and Carillion management made a decision to include malus and clawback triggers for gross misconduct and material misstatement of the published accounts in their Share Plan rules and instructed their legal advisors to make the necessary changes. Deloitte were not consulted and did not subsequently provide advice to the Remuneration Committee, nor Carillion management, in relation to their specific decision to include these triggers in their Share Plan rules. We understand that Carillion's legal advisors were instructed in February 2015 to make the necessary changes. Deloitte did not provide advice in relation to these changes to the Share Plans.
- In 2016, Deloitte advised Carillion on the drafting of the 2017 Remuneration Policy. In respect of malus and clawback we advised that the Remuneration Policy should be updated to bring it into line with the wording in the updated Share Plan Rules, on which the Company had received legal advice as referred to above. We noted that the proposed new wording which had been included in the Share Plan rules, and to be reflected in the Remuneration Policy, would not be out of line with majority of market practice for FTSE 250 companies at the time.

I hope this context and the answers to your questions are helpful. Please let me know if you need anything further in this regard.

Yours sincerely



Michael Jones