



## MG Rover Group – Companies Act Inspectors’ Report

### Progress Report from Financial Reporting Council

November 2009

#### Introduction

This is a report on the progress made by the Financial Reporting Council (FRC) in its consideration of the matters arising from the Report of the Inspectors appointed under the Companies Act 1985 to investigate the affairs of Phoenix Venture Holdings Limited, MG Rover Group Limited and 33 other companies. In the press release issued by the Department for Business, Innovation and Skills on 11 September announcing the publication of the Inspectors’ Report the Secretary of State, Lord Mandelson, announced that he had asked the Financial Reporting Council (FRC) and certain of its operating bodies to consider various aspects of the Report.

The report explains the work which the FRC and its operating bodies have undertaken on the Inspectors’ Report, our conclusions to date and the work which continues.

We also draw attention to a specific issue which would be for the Government to act upon if it judged it to be appropriate.

#### Accountancy and Actuarial Discipline Board (AADB) investigation into Deloitte & Touche LLP (Deloitte)

On 17 August 2005 the Accountancy Investigation and Discipline Board (as the AADB was then known) announced that it had initiated an investigation into the conduct of Deloitte as auditors and advisers to the MG Rover Group. The initial focus of the investigation was on the audits of the 2003 accounts of MG Rover Group Limited and its ultimate parent company, Phoenix Venture Holdings Limited and certain non-audit services provided by Deloitte to the Group. The Inspectors’ Report contains information which was not previously available to the AADB and is proving to be of assistance to the AADB in its work. The AADB’s investigation is not yet concluded and may take several more months to complete. After the completion of the investigation the AADB’s Executive Counsel will make an assessment as to whether to lay charges against Deloitte which would be heard in public before a Tribunal convened under the AADB’s Accountancy Scheme. It would be inappropriate for us to comment on the investigation at this time. The Executive Counsel’s decision will be announced in due course.



## Accounting Standards

### *Accounting standards – going concern disclosures*

In a section of their Report relating to going concern the Inspectors raised the question of:

*“whether improvements could be made to the ... financial statements as a whole [to make them] more informative and useful to a reader...”*

The Financial Reporting Council (FRC) has been very active over the last 18 months in ensuring that the guidance for directors on going concern is appropriate given the difficult economic conditions that we are facing. In November 2008 the FRC issued An Update for Directors and in October this year the FRC issued final Guidance on Going Concern and Liquidity Risk for directors of all companies (including now, for the first time, unlisted companies such as MG Rover). This revised guidance is based on three key principles and emphasises the importance of directors making a thorough assessment and in making full and frank disclosure about the material uncertainties and key assumptions that are present.

UK Listed companies are required in their consolidated accounts to comply with Accounting Standards issued by the International Accounting Standards Board (IASB) as adopted by the European Union and individual UK companies are permitted by the Companies Act to adopt IFRS in place of UK standards on a voluntary basis. The FRC has recently written to the IASB to encourage them to adopt the three principles in our new guidance and to enhance their disclosure requirements.

The UK Accounting Standards Board (ASB), one of the operating bodies of the FRC, is responsible for setting accounting standards that are applied by UK companies that have not adopted IFRS. The ASB has recently published a consultation paper ‘Policy Proposal: The Future of UK GAAP’ that asks for views on whether the ASB should adopt the IFRS for SMEs (‘Small and Medium-sized Entities’) for a range of companies in place of the existing UK accounting standards. The FRC’s letter to the IASB emphasises the need for them to also consider the going concern guidance in this standards.

The ASB is considering whether its existing disclosure requirements in Financial Reporting Standard 18 ‘Accounting Policies’ need enhancement given the publication of the FRC’s guidance for directors on going concern, the FRC’s approach to the IASB, and the ASB’s own proposals for the future of UK GAAP.



### *Accounting standards – transactions with group companies*

The Inspectors' report raises questions about whether disclosures of transactions between group companies and between group and parent companies and/or beneficial owners should be enhanced. In their Report the Inspectors noted that:

*“...whenever assets are transferred between parties at values below their true or potential value, it seems to us that a reader of that company's financial statements would be better informed if the true or potential value of these assets is explained. Accounting standards do not require such disclosures to be made; however we are of the view that making such disclosures mandatory would improve transparency and help readers of all financial statements to gain a better understanding of a company's financial performance.”*

The issues relating to the adequacy of accounting standards in relation to the measurement and disclosure of assets and tax losses transferred between companies in a group is already covered by Financial Reporting Standard 8 (FRS 8) 'Related Party Transactions'. The ASB revised FRS 8 in 2008 to reflect changes to company law in line with the provisions of EU Directive 2006/46/EC, but has agreed to consider whether further changes are needed to the standard.

If the ASB concludes that any changes to FRS 18 and/or FRS 8 are warranted, it will consult publicly on any proposals for change.

### **Auditing Standards**

The Auditing Practices Board (APB), one of the operating bodies of the FRC, will review the Inspectors' observations that impact upon the adequacy of auditing standards including those relating to the nature and extent of information to be included in the auditor's report.

The Inspectors thought that it should be clear to readers:

*“what work the auditors have (and have not) undertaken including the extent to which they have independently verified management representations”*

They also questioned:

*“ whether improvements could be made to the audit report to make it ... more informative and useful to a reader, and also to narrow the 'expectations gap' between auditors' actual duties and the public's perception of those duties.”*



The existing auditing standards require comprehensive disclosures in reports to audit committees and encourage (but do not mandate) a 'short form' style report to shareholders. In recent years some investor groups have challenged this paradigm and APB is actively exploring what changes can practically be made to the auditor's report to provide more useful information to investors. This project addresses the extent to which more detailed information should be provided on the detail of the work performed and basis for their conclusions (the concern highlighted by the BIS Inspectors).

In undertaking the project the APB will follow the principles of better regulation, including the preparation of an impact assessment and consulting publicly on any proposals for change. The APB has not yet concluded whether any changes to auditing standards are warranted but expects to come to a preliminary conclusion in 2010. The APB will make public the results of its deliberations.

### **Ethical Standards for auditors - non-audit services**

The Inspectors' Report states that the total fees paid to Deloitte in the six years from 2000 to 2005 were £30.7m, consisting of audit fees of £1.9m and non-audit fees of £28.8m. The APB already has under review the appropriateness of auditors undertaking non-audit services for audit clients. In May 2009 the Treasury Select Committee published a report entitled 'Banking Crisis: reforming corporate governance and pay in the City'.

In its report the Committee called for the appropriateness of the provision of non-audit services by auditors to the entities that they audit to be revisited, saying:

*"We strongly believe that investor confidence, and trust in audit would be enhanced by a prohibition on audit firms conducting non-audit work for the same company".*

In response, on 6 October 2009 the APB issued a Consultation Paper providing relevant background information and inviting views on this important issue. The APB will carefully consider responses to this consultation in determining whether changes need to be made to the Ethical Standards.

This deliberation will also reflect the BIS Inspectors' Report into MGRG. A particular issue which the Inspectors' Report has highlighted is the need for clarity about whom the auditor is acting for in circumstances in which there may be conflicts between the interests of the company being audited and the personal interests of the directors of the company.



### Disclosures of fees paid to auditors

We have identified a further matter arising out of the Inspectors' Report which was not the subject of specific comment by the Inspectors but which we believe warrants further consideration. This matter related to the disclosure in a company's financial statements of fees paid to its auditors. The requirement to disclose of audit and non-audit fees is set out in 'The Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008'. The content of these Regulations is a matter for the Government, subject to the approval of Parliament and is not the direct responsibility of the FRC or its operating bodies.

Audited financial statements for the top holding companies controlled by the "Phoenix Four" (Techtronic in 2000 and Phoenix Venture Holdings for 2001 - 2005) are available for the years 2000 to 2005. A comparison of the fees paid to Deloitte as disclosed in the 2000 - 2005 financial statements of the holding companies and as reported in the Inspectors' Report is set out below:

	<b>Financial statements</b>	<b>Inspectors' Report</b>
	<b>£m</b>	<b>£m</b>
Audit fees	2.0	1.9
Non-audit fees	<u>21.3</u>	<u>28.8</u>
Total	<u>23.3</u>	<u>30.7</u>

Although a reader of the PVH financial statements would have gained the impression that Deloitte were earning non-audit fees which were substantial and several multiples of the value of the audit fees, the actual level of fees as revealed in the Inspectors' Report was higher still. We have not undertaken a complete investigation of the differences but the main reason for these appears to be the level of fees paid to Deloitte by companies or partnerships which were not part of the PVH group but in which members of the Phoenix Four had a significant interest. An example of such a fee is the £7.5m paid in respect of Project Platinum (the purchase of BMW's Rover loan book).

The Regulations do not include a requirement for disclosure by a company of fees paid to its auditors by the directors of the company or entities controlled by them or in which they have a material interest. Given the developments in transparency in recent years it is at least arguable that readers of financial statements would now have an interest in those amounts in addition to the amounts paid directly by the company and its subsidiaries. As mentioned above, this is a matter for the Government. The FRC recommends that the content of the Regulations be reviewed. It would seem sensible to do so after the results of the APB consultation on Non-Audit services are known. That way it can be considered alongside any other issues in the Regulations that may emerge from that consultation.