The accounts of BHS and related companies

The 2005 Dividend of £1.3 billion

In 2005, a massive £1.3 billion dividend was paid by Taveta Investments Limited, Most of it went to Monaco resident Lady Green as shares were registered in her name. No further dividends seem to have been paid right up to the sale of Bhs Limited in 2015.

Bhs Limited is a subsidiary of Bhs Group Limited, which in turn is a subsidiary of Taveta Investments Limited. There are a considerable number of intragroup transactions with other members of the group of companies in the form of management fees, rents, interest payments on intergroup loans, etc. The possibilities of rescue or refinancing of Bhs Limited cannot be understood in isolation from the rest.

How did £1.3bn dividend get paid?

The Players

1) Taveta Investments Limited was incorporated 17 June 2002 as Ibis (780) Limited and on 9 August 2002 changed its name to Taveta Investments Limited. Its ultimate shareholders are the Green family.

2) On 10th September 2002, Taveta Investments Limited made an unconditional offer to purchase Arcadia Group Limited. Arcadia was the owner of Burton Group Plc and included names such as Miss Selfridge, Topshop, Wallis and Dorothy Perkins. Arcadia Group Limited becomes a subsidiary of Taveta Investments Limited, which in turn is owned by Taveta Ltd based in Jersey. This entity’s ultimate controlling party is Lady Christina Green and her immediate family.

3) Taveta Investments Limited offer, through Merrill Lynch, 408 pence in cash for each Arcadia share, valuing the entire issued and to be issued share capital of Arcadia at approximately £850 million. Taveta Investments Limited’s accounts for the period to 30 August 2003 (its very first set of accounts) show that the total consideration (including expenses) was an investment of £866,395,000 (page 26).

Taveta Investments Limited had not paid any dividends in 2003 or 2004.

4) Taveta Investments (No. 2) Limited was incorporated on 25 May 2004 as Alnery No. 2446 Limited and changed its name on 2 September 2004 to Taveta Investments (No. 2) Limited. It is a wholly owned subsidiary of Taveta Investments Limited and acts as an intermediate holding company.
The Transactions

5 23 September 2004: Taveta Investments Limited sold/transferred its entire shareholding in Arcadia Group Limited to Taveta Investments (No. 2) Limited (see filing dated 23 September 2004) in return for shares in that company.

6 23 September 2004: The annual return filed at Companies House shows 2,300,000,000 shares of nominal value of £1 each are issued.

7 The balance sheet of Taveta Investments (No. 2) Limited accounts for the year to 27 August 2005 shows an investment asset (page 5) of £2,300,000,000 (the company’s accounts also state (page 2) that it was inactive prior to 31 December 2004, perhaps meaning that it did not trade).

8 The shares in Arcadia seem to be valued at £2.3bn. The mechanism for arriving at this amount is not clear and PwC are likely to have been involved with this. In August 2003, Arcadia was capitalised in the books of Taveta Investments Limited at £866,395,000 (see above). Perhaps, Arcadia had excellent prospects to justify a valuation of £2.3bn. It is worth bearing in mind that this is an intergroup transaction, which may well have been queried by HMRC. Therefore, documentation relating to this had to be in good order.

9 27 October 2004 - Taveta Investments (No. 2) Limited petitioned the High Court to reduce its authorized and issued share capital by 2,290,000,000 shares of £1 each.

10 No unsecured creditor objected to the 2004 capital reduction arrangements. Perhaps, they were satisfied that the business would remain solvent. The secured creditors may have been content with the charges and mortgages that they held.

11 In 2004-2005, the pension scheme of Bhs Limited was not in deficit. Page 18 of its 2005 accounts noted:

   The aggregate market value of the schemes’ investments at 31 March 2003 was £278,700,000 and the actuarial values were sufficient to cover between 105 percent and 133 percent of the benefits that had accrued to members after allowing for expected future increases in earnings.

12 The trustees of the pension scheme did not object to the 2004 capital reduction scheme even though the related large extraction of cash from the parent company would have disabled Bhs’s capacity to make good any deficits for the foreseeable future. Perhaps, they had seen some internal forecasts which dissuaded them from objecting to the scheme. Their judgment may have been influenced by the continuing solvency of the pension scheme.

13 Perhaps, there was little distance between the trustees of the pension scheme and company directors. A quick search at Companies House shows that at the time of capital reduction (2004) Ian Mark ALLKINS was a trustee of the pension scheme and also simultaneously a director of Bhs Limited, Bhs Group Limited, Arcadia Group Limited and Taveta Investments Limited. There
may also be others holding similar positions which can indicate a conflict of interests. These individuals should have considered the group wide consequences of the capital reduction scheme and subsequent payment of £1.3bn dividend.

14 As a result of the court approved capital reduction plan the balance sheet of the company changed. The 27 August 2005 balance sheet of Taveta Investments (No. 2) Limited shows that its entire share capital is £10,000,000.

15 The capital reduction plan resulted in a series of intragroup transactions and generated a distributable profit/reserve in the accounts of Taveta Investments (No. 2) Limited. This enabled Taveta Investments (No 2) Limited to declare a dividend of £1.3bn. Some details are provided on page 9 of the company’s accounts for 2005.

<table>
<thead>
<tr>
<th></th>
<th>Share capital £'000</th>
<th>Profit and loss account £'000</th>
<th>Total 2005 £'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit for the financial period</td>
<td>-</td>
<td>179,603</td>
<td>179,603</td>
</tr>
<tr>
<td>Dividends</td>
<td>-</td>
<td>(1,120,397)</td>
<td>(1,300,000)</td>
</tr>
<tr>
<td>Issue of ordinary share capital (note 9)</td>
<td>2,300,000</td>
<td>-</td>
<td>2,300,000</td>
</tr>
<tr>
<td>Cancellation of ordinary share capital (note 9)</td>
<td>(2,290,000)</td>
<td>2,290,000</td>
<td></td>
</tr>
<tr>
<td>Net change in the period</td>
<td>10,000</td>
<td>1,169,603</td>
<td>1,179,603</td>
</tr>
<tr>
<td>Opening shareholders’ funds</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Closing shareholders’ funds</strong></td>
<td><strong>10,000</strong></td>
<td><strong>1,169,603</strong></td>
<td><strong>1,179,603</strong></td>
</tr>
</tbody>
</table>

16 Taveta Investments (No 2) Limited paid dividend of £1.3bn to its parent company Taveta Investments Limited. Only it can pass this on to the ultimate shareholders and controllers (CS Green and her immediate family). The exact details of its calculations are not known but page 12 of the 2005 accounts of Taveta Investments Limited stated this.

Taveta Investments Limited has not presented its own profit and loss account as permitted by Section 230(1) of the Companies Act 1985. The amount of the consolidated profit for the financial year dealt with in the financial statements of the parent undertaking is £1,267,511,000 (2004: £120,259,000).

17 This profit bolstered Taveta Investment Limited’s distributable reserves and enabled it to pass on a dividend of £1,299,167,000 to its shareholders. Prior to the above transactions, Taveta Investment Limited had distributable reserves of only £291m (page of the 2005 balance sheet) and thus did not have the statutory capacity to pay the £1.3bn dividend. So the surplus from capital reduction is crucial for the distribution of dividend.

18 The 2005 accounts of Taveta Investments Limited show the group’s pre-tax profit to be around £253m and post-tax profit of £185m. So the dividend is about five times the annual pre-tax profit.

19 One consequence of paying the £1.3bn dividend is that it reduced the capacity of Taveta Investments to provide financial support to its subsidiaries and address deficits on pension schemes.
20 Taveta Investment (No. 2) Limited’s 2005 accounts do not show any cash balance. Taveta Investment Limited cash at bank at the end of 2004 accounting was only £114m. The company borrowed money to pay dividend.

21 The 2005 Group accounts for Taveta Investments Limited show (page 6) that the company raised new borrowing/debt of around £985 million.

22 Taveta Investments Limited auditors PricewaterhouseCoopers issued an unqualified audit report and were presumably satisfied and that the despite the large dividend and the related increase in debt the business was still a going concern.

23 At this point, it also appropriate to bear in mind the legal framework for distribution of profits

The legal framework relating to what profits and reserves a company can or cannot distribute as dividends consists of common law and statutory provisions. The calculation of profits is affected by the prevailing accounting standards and practices. Under both the Act and common law, distributions are made by individual companies and not by groups. The statutory provisions for distribution of profits are contained in Part 23 of the Companies Act 2006 (previously the law was part of the Companies Act 1985).

Directors are subject to fiduciary and other duties in the exercise of the powers conferred on them. Examples of fiduciary and other duties include the obligation on directors to safeguard the company’s assets and take reasonable steps to ensure that the company is in a position to settle its debts as they fall due. Directors must therefore specifically consider whether the company will still be solvent following a proposed distribution. Thus, directors should consider both the immediate cash flow implications of a distribution and the continuing ability of the company to pay its debts as they fall due.

24 The payment of large dividend by taking on large debt seems to make little business sense. Bhs Group and its subsidiary had already paid over £423 million in dividends between 2002 and 2004.

<table>
<thead>
<tr>
<th>Dividends Paid</th>
<th>Bhs Group Limited</th>
<th>Bhs Limited</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£000s</td>
<td>£000s</td>
</tr>
<tr>
<td>2002</td>
<td>166,535</td>
<td>124,000</td>
</tr>
<tr>
<td>2003</td>
<td>57,000</td>
<td>70,000</td>
</tr>
<tr>
<td>2004</td>
<td>199,500</td>
<td>220,000</td>
</tr>
<tr>
<td></td>
<td>423,035</td>
<td>414,000</td>
</tr>
</tbody>
</table>

25 Perhaps, there were other reasons for the £1.3bn dividend. At any rate, the dividend helped Philip Green maintain his presence as one of the top five richest people in the Sunday Times Rich List 2005.
Philip Green had made an unsuccessful bid to buy Marks & Spencer. In 2005, Sir Philip Green bought 10 stores from Allders and the UK retail stores of Etam and Tammy and these became part of the Arcadia retail outlets.

The tax arrangements of the Green family are likely to be a key reason for the dividend.

**Key questions for auditors**

The key argument of the remainder of this report is that auditors have been silent about declining state of BHS’s finances. Auditors have unrestricted access to any corporate file, officer, employee, minute, document, invoice, etc., but chose not to draw attention to its declining state of affairs.

The reasons for this silence could be conflict of interests, closeness to Sir Philip Green and his family, fee dependency and perhaps a general unwillingness to highlight problems at a major corporation (can you recall when that happened before?) as the word soon spreads that an auditing firm is uncooperative and may have a knock-on effect on securing audit and consultancy business.

This note suggests that the Committee should probe auditors under four headings

1) **Was Bhs a going concern?**

2) **Were Bhs auditors independent?** They had considerable fee dependency, were party to transactions they audited and were close to Sir Philip.

3) There have been additional material disclosures in the accounts of Bhs Limited even though they are not specifically required by any accounting standard.

4) **After the acquisition of Bhs Limited by Retail Acquisitions Limited who is the company’s auditor?**

1) **WAS BHS A GOING CONCERN?**

This section argues that Bhs Limited auditors PricewaterhouseCoopers (PwC) have a case to answer. KPMG were the auditors of Bhs Limited and Bhs Group Limited until 2008. From 2009, PricewaterhouseCoopers (PwC) became auditors of Bhs Limited and Bhs Group Limited. They reported on the accounts of the companies from 2009 to 2014. PwC have also been the auditors of Taveta Investment Limited since 2003. Most of Bhs’s problems began to deepen from about 2008/09 onwards.

Throughout their existence Bhs Limited and Bhs Group Limited continued to receive unmodified (clean) audit reports. At the very least auditors should have flagged uncertainties about ability of Bhs Limited to survive as a going concern and also meet its pension scheme obligations. An “Emphasis of Matter” audit report could have been issued. It would have drawn attention to red flags and thus alerted regulators, creditors, employees and others (please note that under the Companies
Act 2006 auditors owe a ‘duty of care’ only to the company and not to any individual shareholder, creditors or any other stakeholder. The audit report is addressed to “shareholders”. Nevertheless, the fact is that audit report is a public document and can send signals to a variety of stakeholders).

PwC did not raise any red flags about Bhs Limited even though the company had a history of losses, a deficit on its pension scheme and its parent company’s liabilities exceeded its assets.

Were auditors just looking for quiet life? May be, they did not want to upset directors with an audit qualification and then possibly lose a lucrative client. PwC had a long relationship with Sir Philip Green and acted for his business empire. They derived considerable fees from selling auditing and consultancy fees, including advice on tax, pensions and other matters. PwC may well have played a leading role in creating some financial numbers of the pension scheme. Auditors losing major clients may find the work environment, promotions, partnership, etc, very difficult both internally and externally. After all, who would want to hire an auditor who would make life difficult for company directors?

Altogether, the silence of the auditors did not serve the company, its creditors, employees or regulators well.

1. Bhs Limited had been reporting losses since 2009. This pattern of losses would have raised some questions about the ability of Bhs to remain a going concern. Bhs could have relied on its parent company for possible rescue it, but it too was fighting a rearguard action.

2. In 2010, newspapers were saying that Arcadia could close as many as 200 stores. In 2013-14, Arcadia began shutting stores in a number small-to-medium-sized towns and cities, including South Shields, Barnsley, Scunthorpe, Dartford, Crawley, Erdington, Birmingham and Market Harborough amongst others. Such news could have had a knock-on effect on Bhs and should have been of interest to Bhs auditors.

3. The losses as reported in the annual audited accounts of Bhs Limited are as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Pre-tax Profit/(Loss) £000s</th>
<th>Shareholder Equity £000s</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>21,664</td>
<td>207,291</td>
</tr>
<tr>
<td>2009</td>
<td>( 62,109)</td>
<td>30,501</td>
</tr>
<tr>
<td>2010</td>
<td>( 7,238)</td>
<td>2,519</td>
</tr>
<tr>
<td>2011</td>
<td>( 76,056)</td>
<td>330</td>
</tr>
<tr>
<td>2012</td>
<td>(116,007)</td>
<td>( 80,318)</td>
</tr>
<tr>
<td>2013</td>
<td>( 69,612)</td>
<td>(178,182)</td>
</tr>
<tr>
<td>2014</td>
<td>( 85,117)</td>
<td>(256,288)</td>
</tr>
</tbody>
</table>
4. The profits were declining or disappearing. The trajectory of the reported losses and related events should have encouraged auditors to flag the issues in their audit report to alert creditors, regulators and the general public. The red flags may also have sent meaningful signals to the pension regulator.

5. The erosion of equity and the increase in negative equity (i.e. liabilities exceeding should also have been a red flags for auditors.

6. Since about 2009, possibly aided by the banking crash, Bhs Limited had also been reporting a steadily increasing deficit on its pension scheme. By 2014, it was bigger than its net assets shown in the balance sheet and a major factor of its woes. The company was obliged to make this good. The fact that the deficit was escalating and that its repair may be beyond the financial capacity of the company should have encouraged auditors (who were also advising the company on its pension scheme) to examine the matter in detail.

7. The Directors of all UK companies are required to prepare accounts by assuming that the business is a going concern unless there is evidence to the contrary. The Financial Reporting Council (FRC) states\(^1\) that ‘going concern’ is a fundamental accounting concept that underlies the preparation of financial statements of all UK companies.

Under the going concern concept it is assumed that a company will continue in operation and that there is neither the intention nor the need either to liquidate it or to cease trading. If the going concern assumption is not appropriate (which depends on evidence and its evaluation) then accounts may need to be prepared on other basis (e.g. liquidation values).

8. Directors should prepare a budget, trading estimate, cash flow forecast or other equivalent analysis covering such period as they consider appropriate to determine that business will be a going concern.

9. Directors of subsidiary companies of a group need to make their own going concern assessment taking into account the specific facts and circumstances of the subsidiary company and in particular:

- the need for support from the parent company or fellow subsidiaries;
- the ability and willingness of the parent company or fellow subsidiaries to provide such support; and
- the risks to the company’s going concern status arising from support that it has undertaken to provide to other members of the group.

10. In relation to auditor’s duty, the FRC adds that “The auditor is required to make its own assessment of the directors’ conclusion on going concern. If the auditor

concludes that a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity’s ability to continue as a going concern, it is required to modify the auditor’s report. Even if the material uncertainty is explained fully by the directors in the financial statements the auditor is required to include an emphasis of matter paragraph in its report”.

11. As part of their evaluation of the ability of Bhs Limited to remain a going concern, auditors may have considered the financial support that it could secure from its parent company and fellow subsidiaries. But who was Bhs’s parent company? Prior to its sale to Retail acquisitions Limited, Bhs Limited was the subsidiary of Bhs Group Limited. Note 23 on page 23 of the 2004 accounts of Bhs Limited states “Arcadia Group Limited is under the same ultimate control as Bhs Group Limited”.

Note 21 on page 18 of Arcadia Group Limited’s 2004 accounts state that the company’s ultimate parent company is Taveta Investments Limited. So from this it can be deduced that Taveta Investments Limited is also the ultimate parent company of Bhs Limited. Bhs Group Limited was a separate entity until 2009 when it formally became part of Taveta Investments Limited. However, the above indicates that it was being held out as under the de facto control of Taveta Investments Limited.

Of course, the trail does not end there because Taveta Investments Limited is controlled by Taveta Limited in Jersey (as per page 29 of the 2003 accounts of Taveta Investments Limited). The Guardian reported that “Global Textiles Investments Limited is Bhs’s majority shareholder, while Taveta Limited is the controlling shareholder of Taveta Investments, the immediate parent of the old Arcadia operations. Both are Jersey-based and Global Textiles and Taveta have registered offices at 8 Duhamel Place”. Trusts in Jersey and Monaco are thought be behind these entities. All are controlled by the Green family. No financial information is publicly available about these entities.

12. For all practical purposes Taveta Investments Limited is the parent company. Was it in a position to support Bhs Limited?

13. The focus on Taveta Investments Limited is very appropriate because it has accepted the ultimate responsibility to manage the risks. Statement by directors on page 1 of the 2014 accounts of Bhs Limited stated that

The directors of Taveta Investments Limited manage the Company’s risks and those of its fellow subsidiaries at a group level. Furthermore, they monitor the group’s performance on a brand basis rather than at statutory company level.

For these reasons the Company’s directors do not believe that a discussion of the principal risks facing the Company or of the KPIs used to analyse its performance is appropriate for an understanding of its development, performance or financial position.

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2 The Guardian, ‘I can't confirm or deny - and you can't quote me on that', 18 June 2004 (https://www.theguardian.com/business/2004/jun/18/markssspencer1).
The same note had appeared in the accounts since 2009.

The above would suggest that the responsibility for making good pension scheme deficit and safeguarding the future of Bhs lay with Taveta Investments Limited. This may also have comforted auditors, but auditors cannot simply accept management assertions or representations. They must corroborate them with relevant and reliable evidence. What did they do? Did they establish that Taveta Investments Limited was in a position to support Bhs Limited?

14. Auditors cannot seek refuge in the fact that management had made promises (see above). The UK auditing standard 570 titled (Going Concern), issued by the Financial Reporting Council (FRC) stated that

“If adequate disclosure is made in the financial statements, the auditor shall express an unmodified opinion and include an Emphasis of Matter paragraph in the auditor’s report to:

(a) Highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity’s ability to continue as a going concern; and to

(b) Draw attention to the note in the financial statements that discloses the matters set out …”

15. Following the payment of a £1.3 billion dividend in 2005 (see a separate note on that), Taveta Investments Limited did not appear to be in a strong position to provide continuing financial support to Bhs Limited.

16. After paying the £1.3 billion dividend Taveta Investment Limited (which also included Arcadia) began reporting negative equity i.e. its liabilities were in excess of the assets. This by itself does not make a company insolvent as depending upon its ability to raise cash and the structure of liabilities, it may still be able to meet its obligations as and when they fall due. Nevertheless, the negative equity is a factor which should have put auditors upon inquiry and consider whether the matter casts doubts on the ability of the company to remain a going concern and should be highlighted.
### Shareholder Equity (Negative) £000s

<table>
<thead>
<tr>
<th>Year</th>
<th>Shareholder Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>303,546</td>
</tr>
<tr>
<td>2005</td>
<td>(826,204)</td>
</tr>
<tr>
<td>2006</td>
<td>(670,350)</td>
</tr>
<tr>
<td>2007</td>
<td>(526,936)</td>
</tr>
<tr>
<td>2008</td>
<td>(403,827)</td>
</tr>
<tr>
<td>2009</td>
<td>(362,384)</td>
</tr>
<tr>
<td>2010</td>
<td>(287,837)</td>
</tr>
<tr>
<td>2011</td>
<td>(347,397)</td>
</tr>
<tr>
<td>2012</td>
<td>(357,439)</td>
</tr>
<tr>
<td>2013</td>
<td>42,306</td>
</tr>
<tr>
<td>2014</td>
<td>140,221</td>
</tr>
</tbody>
</table>

17. It should be noted that by 2009, Bhs Limited was also signalling deficits on its pension schemes. The correction of such deficits was dependent on the profits, cash flow and solvency of Bhs. As stated above, the company had been reporting losses. This again should have raised red flags from auditors but did not.

18. For each of the years 2009-2014, PricewaterhouseCoopers (PwC) issued an unqualified audit report i.e. they expressed no reservations and did not flag any problems even though the company had a history of reporting losses. There was no Emphasis of Matter paragraph in the auditor’s report.

19. PwC may have discussed the matter with Bhs directors, examined their profit forecasts, cash flow statements, agreements with lenders, etc, and then concluded that in the light of that evidence it is reasonable to assume that the business is a going concern. However, the audit report did not flag anything and did not say what steps the auditors had taken to satisfy themselves that the assumption of going concern was reasonable.

Overall, auditors should be questioned about their silence.

### 2) WERE BHS AUDITORS INDEPENDENT?

1. Sir Philip’s relationship with PricewaterhouseCoopers (PwC) predates his purchase of Bhs.

2. KPMG were the auditors of Bhs (previously British Home Stores) and were retained after the company’s acquisition by Sir Philip. They were replaced in 2009 by PwC. KPMG had provided a range of services including auditing, tax and consultancy. PwC also provided auditing, tax and consultancy. They also appear to be closely involved in the management of the pension schemes.

3. The fees paid to the auditing firms are as follows:
Fees Paid to Auditors (Bhs Limited and Bhs Group Limited)

<table>
<thead>
<tr>
<th>Year</th>
<th>Audit £000s</th>
<th>Non-Audit £000s</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>KPMG 77</td>
<td>48</td>
</tr>
<tr>
<td>2003</td>
<td>KPMG 93</td>
<td>62</td>
</tr>
<tr>
<td>2004</td>
<td>KPMG 102</td>
<td>92</td>
</tr>
<tr>
<td>2005</td>
<td>KPMG 101</td>
<td>111</td>
</tr>
<tr>
<td>2006</td>
<td>KPMG 97</td>
<td>85</td>
</tr>
<tr>
<td>2007</td>
<td>KPMG 100</td>
<td>33</td>
</tr>
<tr>
<td>2008</td>
<td>KPMG 101</td>
<td>58</td>
</tr>
<tr>
<td>2009</td>
<td>PricewaterhouseCoopers 27</td>
<td>-</td>
</tr>
</tbody>
</table>

In July 2009 Taveta Investments (No. 2) Limited, a subsidiary of Taveta Investments Limited, acquired Bhs Group Limited (and Bhs Limited). Bhs Group Limited handled the financial functions. After this date fees paid to auditors have been added to the accounts of Taveta Investments Limited.

Fees Paid by Taveta Investments Limited

<table>
<thead>
<tr>
<th>Year</th>
<th>Audit £000s</th>
<th>Non-Audit £000s</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>PricewaterhouseCoopers 240</td>
<td>50</td>
</tr>
<tr>
<td>2004</td>
<td>PricewaterhouseCoopers 285</td>
<td>442</td>
</tr>
<tr>
<td>2005</td>
<td>PricewaterhouseCoopers 294</td>
<td>220</td>
</tr>
<tr>
<td>2006</td>
<td>PricewaterhouseCoopers 298</td>
<td>296</td>
</tr>
<tr>
<td>2007</td>
<td>PricewaterhouseCoopers 300</td>
<td>313</td>
</tr>
<tr>
<td>2008</td>
<td>PricewaterhouseCoopers 362</td>
<td>700</td>
</tr>
<tr>
<td>2009</td>
<td>PricewaterhouseCoopers 280</td>
<td>492</td>
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<tr>
<td>2010</td>
<td>PricewaterhouseCoopers 295</td>
<td>1067</td>
</tr>
<tr>
<td>2011</td>
<td>PricewaterhouseCoopers 305</td>
<td>929</td>
</tr>
<tr>
<td>2012</td>
<td>PricewaterhouseCoopers 330</td>
<td>1191</td>
</tr>
<tr>
<td>2013</td>
<td>PricewaterhouseCoopers 355</td>
<td>2860</td>
</tr>
</tbody>
</table>

4. There is additional complication that Bhs Limited does not remunerate its own auditors. They are paid by Arcadia Group and included in the above data. Note 7, Bhs Limited accounts – year to 28 August 2010 stated

Prior to its acquisition by Taveta Investments Limited in 2009, the Company incurred distribution costs and administrative expenses (including auditors’ remuneration) in its own right. Subsequently, the cost of these services, together with certain other functions which were previously included in cost of sales, have been borne by Arcadia Group Limited on the Company’s behalf. Arcadia Group Limited levies a management charge in respect of the services it provides, which is included within administrative expenses.

The above practice has continued and is repeated in Note 4 of Bhs Limited accounts – year to 30 August 2014.
So PwC were paid by Arcadia for conducting the audit of Bhs Limited. Arcadia then charged Bhs Limited for the fees. Was there a profit loading in that? If so, that means that some Bhs profits/revenues were being shifted to Arcadia.

Why was this arrangement introduced? This is an unusual practice though someone may argue that this is the norm in one or more industries. Did Bhs subcontract its audit out to Arcadia? As a result of the above did auditors (PwC) of Bhs Limited now owe a ‘duty of care’ to Arcadia, who after all was paying them? Were auditors PwC charged to protect the interests of Arcadia or Taveta Investments or Bhs Limited? Were the interests of Bhs pension fund creditors now subordinated to Arcadia group audit? The Committee should ask for a sight of the audit contract (known as the letter of engagement) to see how the above arrangement was being operationalised though predictably PwC would not cooperate and hide behind duty of confidentiality, etc.

5. The net effect of providing non-auditing services is that auditors become instigators of the very transactions that they then audit. It is impossible for them to objectively question the transactions resulting from their own advice. Even if another team from the same accountancy firm is used to offer non-auditing services, the audit team is extremely unlikely to question the transactions created by colleagues from the same firm.

6. The provision of non-auditing services increases fee dependency on clients and again generates pressures to be silent. With huge fees at stake, auditors would not qualify the accounts of a company even though in the case of Bhs there is strong evidence indicating that they should have.

7. What instructions did the audit partners of KPMG and PwC give to audit staff about being robust with the management of Bhs Limited? Can they share the contents of their audit files with the Committee?

8. We all remember that the senior partner of Coopers & Lybrand (now part of PwC) had instructed the audit team auditing the business empire of late Robert Maxwell that “The first requirement is to continue to be at the beck and call of Maxwell, his sons and his staff, appear when wanted and provide whatever is requested”. Of course, PwC and KPMG collected large amounts in audit and non-audit fees from Bhs and related companies. In view of that what evidence is there that the auditors were robust?
9. No doubt it would be argued that the fees from Bhs empire form only a tiny fraction of the total fees of the accountancy firm and thus cannot sway auditor judgement. Such an argument is false because the performance monitoring regimes within accountancy firms apply to each office which has to meet its revenue generating targets. The firms also claim to have Chinese Walls and other mechanisms.

Some glimpses of accounting firms practices are occasionally provided. For example, in December 2008, PwC was criticized yesterday by the UK accounting regulator for using loopholes to sell lucrative consulting services to its audit clients - a practice discouraged since the Enron scandal. The Financial Reporting Council (FRC) singled out the firm in the UK for its practice of allowing senior partners involved in making key audit judgments - but outside the audit department itself - to sell advisory services to audit clients.

In December 2008, the FRC also raised concerns about a KPMG partner appraisal that focused on generating advisory fees from clients - including from one of that partner's audit clients.

In May 2015 the FRC again criticised PwC because it “did not adequately assess the significance of a self-interest threat which arose by virtue of the substantial amount of fees earned from non-audit services commissioned by a connected party of the audited entity”. The firm’s report to the audit committee of the unnamed company “did not identify the threats to the firm’s independence arising from its relationship with the connected party or include details of the non-audit services arising from this relationship, notwithstanding that processes to gather information regarding these non-audit services had been established”.

Concerns about auditor independence, fee dependency and silence were raised by the Treasury Committee in its report on the demise of Northern Rock, but the auditing industry with support from the FRC has always resisted a total ban on the sale of consultancy services by auditors to their audit clients.

It has become fashionable for big accounting firms to claim that “there s no evidence to show that the sale of consultancy services impairs audit independence”. This is simply not true and Appendix 1 includes some authoritative evidence to rebut this position

3) Should there have been additional material disclosures in the accounts of Bhs Limited?

This section argues that Bhs Limited accounts are economical with information. In view of the significant transactions between Bhs Limited and its directors, majority shareholders and other group members, there should have
been higher quality of disclosures. Not only company directors, but auditors also failed to ensure that.

Auditors should be asked to explain why they did not press Bhs Limited directors for greater disclosures. If directors were resistant do additional disclosures then there is nothing to prevent auditors from flagging that in their audit report. They did not do that.

1 The accounts of Bhs Limited contain numerous related party transactions. Examples are:
   - Transaction with Carmen Properties Limited (registered in Jersey) for the sale and leaseback of property. The Green family is understood to be the party controlling Carmen.
   - A lease labelled “Mildenhall” relates to rental arrangements reached in 2005 whereby BHS was renting its head office building from Sir Philip Green.
   - There are also intragroup loans.

The accounts of Bhs Limited provide little information. For example, the reasons for such transactions and their implications. Are directors or majority shareholders of Bhs Limited the ultimate beneficiaries of the sale and leaseback, rental and interest payments on intragroup loan arrangements?

2 What is a related party? International Accounting Standard (IAS) 24 offers the following examples

(a) A person or a close member of that person's family is related to a reporting entity if that person:
   - (i) has control or joint control over the reporting entity;
   - (ii) has significant influence over the reporting entity; or
   - (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

(b) An entity is related to a reporting entity if any of the following conditions applies:
   - (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
   - (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
   - (iii) Both entities are joint ventures of the same third party.
   - (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
   - (v) The entity is a post-employment defined benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
• (vi) The entity is controlled or jointly controlled by a person identified in (a).
• (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).
• (viii) The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

3 A related party may be in a position to exercise undue influence or secure favourable arrangements. The general requirement of IAS 24 is that if there have been material transactions between related parties, the accounts should disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. The standard also grants some exemptions which obscures relationships between parent company and subsidiaries. Hence the sparse disclosures in Bhs accounts.

4 The doctrine of “true and fair view” would require that matters even if not required by the prevailing laws and accounting standards should be disclosed, if the information would enable the reader of the accounts to fully appreciate the material aspects of financial statements.

Arguably, the sparse information about related party transaction does not enable the reader to fully appreciate the financial affairs of Bhs Limited.

5 The primary responsibility for preparation of “true and fair” accountants rests with company directors. Section 393 of the Companies Act 2006 requires that the directors of a company must not approve accounts unless they are satisfied they give a true and fair view.

UK companies (with some minor exceptions) are required to publish audited financial statements. Auditors must be independent (this is governed by legislation, auditing standards issued by the Financial Reporting Council, and some commonsensical practices) of the company and its officers.

6 There are also obligations for auditors. The obligations of an auditor when giving an opinion on a company's financial statements are set out in sections 393 (2) and 495 to 497, Companies Act 2006. Those obligations include stating whether, in their opinion, the accounts give a true and fair view (section 495 (3)(a)). In relation to the audit report Section 495(3) states that

(3) The report must state clearly whether, in the auditor’s opinion, the annual accounts—
(a) give a true and fair view—
(i) in the case of an individual balance sheet, of the state of affairs of the company as at the end of the financial year,
(ii) in the case of an individual profit and loss account, of the profit or loss of the company for the financial year,
(iii) in the case of group accounts, of the state of affairs as at the end of the financial year and of the profit or loss for the financial year of the undertakings included in the consolidation as a whole, so far as concerns members of the company;
(b) have been properly prepared in accordance with the relevant financial reporting framework; and
(c) have been prepared in accordance with the requirements of this Act (and, where applicable, Article 4 of the IAS Regulation).
Expressions used in this subsection that are defined for the purposes of Part 15 (see section 474) have the same meaning as in that Part.

(4) The auditor's report—
(a) must be either unqualified or qualified, and
(b) must include a reference to any matters to which the auditor wishes to draw attention by way of emphasis without qualifying the report.

The term “true and fair view” is of particular significance here and there are numerous controversies about it may signify. The key point is that “true and fair view” is associated with making sense of the financial affairs of a company. The financial statements should be useful, credible and informative, and should enable the reader/user to appreciate material aspects of a company's financial affairs. They may be constructed in accordance with the prevailing legislation rules, accounting standards (issued by the Financial Reporting Council) and industry specific practices, but that mechanical compliance alone will not necessarily lead to accounts being described as “true and fair”.

7 The law permits what is called a “true and fair override”. For example, where compliance with an accounting standard would result in accounts being so misleading that they would conflict with the objectives of financial statements, the standard should be overridden.

8 From the above it follows that if auditors are to discharge properly their legal responsibilities, they should stand back as they approach finalisation of those accounts and consider whether, viewed as a whole and in view of the issues that they have addressed in the course of the audit, the accounts do indeed give a true and fair view. This means that auditors:

3 Ever since the 2007-08 banking crash there has been a big dispute between the Financial Reporting Council (UK’s accounting regulator) and institutional investors. Investors argue that most of the accounts published by major UK corporations are unlawful and that the FRC has facilitated this state of affairs through its closeness to big corporations and accounting firms and degrading the significance of “true and fair view”. For example, see the legal opinion on ‘true and fair view’ obtained (October 2013) by the FRC from Martin Moore QC (https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Martin-Moore-QC-Opinion-3-October-2013.pdf) which is a counter to the legal opinion obtained by institutional investors (http://www.lapfforum.org/Archive/LAPFF-obeats-further-Legal-Opinion-from-George-Bompas-QC); also see the FRC’s June 2014 statement here https://www.frc.org.uk/FRC-Documents/Accounting-and-Reporting/True-and-Fair-June-2014.pdf
Should always stand back and ensure that the accounts as a whole do give a true and fair view;
Seek additional disclosures when compliance with an accounting standard is insufficient to present a true and fair view;
Apply the true and fair override where compliance with the standards does not result in the presentation of a true and fair view;

9 If directors are unwilling make the additional disclosures then there is nothing to prevent auditors from flagging that in their audit report.

10 Bhs Limited auditors seem to have simply accepted director’s position, possibly because fee dependency and closeness to the Green family may have compromised their independence.

4) Who is the Auditor of Bhs Limited After the Sale to Retail Acquisitions Limited?

Does Bhs Limited currently have an auditor? Who?

1. On 12th March 2015 Sir Philip Green sold Bhs Limited to Retail Acquisitions Limited for £1. The name Retail Acquisitions Limited was registered at Companies House on 3rd March 2015.

2. On 12 March 2015 PricewaterhouseCoopers (PwC) were the auditors of Bhs Limited and Bhs Group Limited. The filings at Companies House do not show that PwC resigned or were replaced. If that is a true record then PwC would have been able to candidly discuss the state of financial affairs of Bhs with its new owners, including the deficit on its pension scheme.

3. Did PwC continue as auditors of Bhs Limited? Did they resign? Section 516 of the Companies Act 2006 states that an auditor of a company may resign his office by depositing a notice in writing to that effect at the company as registered office. This notice (Section 519) must be accompanied by a statement stating that there are circumstances in connection with the resignation that need to be brought to the attention of members or creditors of the company (note the reference to creditors, which could also include members of the pension scheme which was in deficit); or a statement that there are no circumstances in connection with his ceasing to hold office that need to be brought to the attention of members or creditors of the company. The company must within 14 days of the deposit of a notice of resignation send a copy of the notice to the registrar of companies.

No such notice of statement can be found at Companies House. If PwC are still auditors when what did they tell the new owners about the pension scheme liabilities and other matters. The firm had been closely involved with the management of the pension scheme and should have been in a position to make informed comments.

4. Perhaps, the auditors of Bhs Limited did change? Retail Acquisitions Limited has been advised by Grant Thornton on its purchase of Bhs Limited. It is quite likely that this firm would have replaced PwC to become auditors of Bhs Limited. But there is
no record of this at Companies House. Section 485(3) of the Companies Act 2006 states that the directors may appoint an auditor or auditors of the company—(a) at any time before the company's first period for appointing auditors, (b) following a period during which the company (being exempt from audit) did not have any auditor, at any time before the company's next period for appointing auditors, or (c) to fill a casual vacancy in the office of auditor.

If auditors were changed or appointed by the new owners of Bhs Limited there is no record at Companies House.

5. On 25 January 2016 Bhs Limited informed Companies House that it had extended its accounting period from 31 August 2015 to 28 February 2016. This may be have been an attempt to align the year-end of Bhs Limited with other operations carried out by Retail Acquisitions Limited or may be an attempt to fully gauge the affairs of Bhs Limited (was this not done before the purchase of Bhs?) before the publication of its accounts. One assumes that the change accounting was made after some consultation with auditors. Who was consulted and what do they know about the difficulties experienced by Bhs?

6. Section 487(2), Companies Act 2006 states that

<table>
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<th>Where no auditor has been appointed by the end of the next period for appointing auditors, any auditor in office immediately before that time is deemed to be re-appointed at that time, unless—</th>
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<td>(a) he was appointed by the directors, or</td>
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<td>(b) the company's articles require actual re-appointment, or</td>
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<td>(c) the deemed re-appointment is prevented by the members under section 488, or</td>
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<tr>
<td>(d) the members have resolved that he should not be re-appointed, or</td>
</tr>
<tr>
<td>(e) the directors have resolved that no auditor or auditors should be appointed for the financial year in question</td>
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So were PwC auditors by default? Were Grant Thornton appointed auditors? Did the new directors of Bhs Limited neglect their duties? Which auditor, if any had received any requests for information or comment from the pension regulator?

7. If Grant Thornton were the new auditors of Bhs Limited then under the professional rules the firm should have written to PwC (outgoing auditors) to request information about Bhs Limited which would have enabled them to appreciate materials aspects of their new audit client. This request could only be made after Grant Thornton had formally been appointed as auditors. Were they? If yes, then they would have considerable appreciation of the problems at Bhs. Of course, as advisors to Retail Acquisitions Limited for its purchase of Bhs Limited they would already have considerable knowledge of the problems. What were they? Which party was going to make good the deficit on the pension scheme?

May 2016
Appendix 1

Concerns about auditor independence are a recurring feature of corporate scandals. A 1976 report by Department of Trade and Industry (DTI) inspectors criticised auditors of Roadships for their failure to adequately check the amounts for creditors, accruals, purchase and profit forecasts. The inspectors (one of whom is usually a partner from a major accountancy firm) argued that:

"Independence is essential to enable auditors to retain that objectivity which enables their work to be relied upon by outsiders. It may be destroyed in many ways but significantly in three; firstly, by the auditors having a financial interest in the company; secondly, by the auditors being controlled in the broadest sense by the company; and thirdly, if the work which is being audited is in fact work which has been done previously by the auditors themselves acting as accountants" (para 243).

After examining the quality of audits performed by auditors who also provided non-auditing services, the inspectors concluded:

"We do not accept that there can be the requisite degree of watchfulness where a man is checking either his own figures or those of a colleague. . . for these reasons we do not believe that [the auditors] ever achieved the standard of independence necessary for a wholly objective audit".

The 1976 DTI report on Hartley Baird found that the company was having difficulties in repaying loans. But the financial problems were covered-up by manipulation of the account. The report stated that the auditors were ineffective because of their close connections with company directors and suggested rotation of auditors.

The 1979 Department of Trade and Industry (DTI) inspectors' report on Burnholme and Forder was critical of audit work and once again felt that auditor independence was compromised by the provision of non-auditing services to audit clients. They concluded:

"in our view the principle of the auditor first compiling and then reporting upon a profit forecast is not considered to be a good practice for it may impair their ability to view the forecast objectively and must endanger the degree of independence essential to this work".

In 1978, the collapse of the Grays Building Society reminded people of the ineffectiveness of external auditors. The resulting investigation found that the same firm had been auditing the building society for nearly forty years. Its partners became friends of directors and frequently took holidays together. The auditors failed to perform the simplest of checks and did not spot frauds of more than £7.1 million, carried out over a period of some forty years. The frauds only came to light when the chairman committed suicide. The report was highly critical of auditors and noted that their "independence" had been compromised by the longevity of their term in office.
and the personal relationships with company directors which had developed as a consequence.

The 1981 DTI report on Kina Holdings criticised auditors and noted that the same firm had been providing auditing and non-auditing services to a major quoted company for a number of years. This relationship resulted in a considerable part of the firm fee income coming from one client and created difficulties with perceived independence of auditors.