House of Commons

Business, Energy and Industrial Strategy and Work and Pensions Committees

Carillion: Government response to the Tenth Report of the Business, Energy and Industrial Strategy Committee and the Twelfth Report of the Work and Pensions Committee of Session 2017–19

Thirteenth Special Report of the Business, Energy and Industrial Strategy Committee

Fourteenth Special Report of the Work and Pensions Committee

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Business, Energy and Industrial Strategy Committee

The Business, Energy and Industrial Strategy Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department for Business, Energy and Industrial Strategy.

Current membership

Rachel Reeves MP (*Labour, Leeds West*) (Chair)

Vernon Coaker MP (*Labour, Gedling*)

Drew Hendry MP (*Scottish National Party, Inverness, Nairn, Badenoch and Strathspey*)

Stephen Kerr MP (*Conservative, Stirling*)

Peter Kyle MP (*Labour, Hove*)

Mr Ian Liddell-Grainger MP (*Conservative, Bridgwater and West Somerset*)

Sir Patrick McLoughlin MP (*Conservative, Derbyshire Dales*)

Albert Owen MP (*Labour, Ynys Môn*)

Mark Pawsey MP (*Conservative, Rugby*)

Antoinette Sandbach MP (*Conservative, Eddisbury*)

Anna Turley MP (*Labour (Co-op), Redcar*)

Powers

The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the internet via www.parliament.uk.

Publication

Committee reports are published on the Committee's website at www.parliament.uk/beis and in print by Order of the House.

Evidence relating to this report is published on the inquiry publications page of the Committee's website.

Committee staff

The current staff of the Committee are Chris Shaw (Clerk), Ben Sneddon (Second Clerk), Ian Cruse, (Committee Specialist), Becky Mawhood (Committee Specialist), James McQuade (Senior Committee Assistant), and Gary Calder (Media Officer).

Contacts

All correspondence should be addressed to the Clerk of the Business, Energy and Industrial Strategy Committee, House of Commons, London SW1A 0AA. The telephone number for general enquiries is 020 7219 5777; the Committee's email address is beiscom@parliament.uk

Work and Pensions Committee

The Work and Pensions Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department for Work and Pensions and its associated public bodies.

Current membership

Rt Hon Frank Field MP (*Labour, Birkenhead*) (Chair)

Heidi Allen MP (*Conservative, South Cambridgeshire*)

Jack Brereton MP (*Conservative, Stoke-on-Trent South*)

Alex Burghart MP (*Conservative, Brentwood and Ongar*)

Neil Coyle MP (*Labour, Bermondsey and Old Southwark*)

Rosie Duffield MP (Labour, Canterbury)

Ruth George MP (*Labour, High Peak*)

Steve McCabe MP (*Labour, Birmingham, Selly Oak*)

Nigel Mills MP (*Conservative, Amber Valley*)

Chris Stephens MP (*Scottish National Party, Glasgow South West*)

Justin Tomlinson MP (*Conservative, North Swindon*)

Powers

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Publication

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Evidence relating to this report is published on the inquiry page of the Committee's website.

Committee staff

The current staff of the Committee are Anne-Marie Griffiths (Clerk), Katy Stout (Second Clerk), Libby McEnhill (Committee Specialist), Rod McInnes (Committee Specialist), Tom Tyson (Committee Specialist), Jessica Bridges-Palmer (Senior Media and Policy Officer), Esther Goosey (Senior Committee Assistant), and Michelle Garratty (Committee Assistant).

Contacts

All correspondence should be addressed to the Clerk of the Work and Pensions Committee, House of Commons, London SW1A 0AA. The telephone number for general enquiries is 020 7219 8976; the Committee's email address is workpencom@parliament.uk.

Thirteenth Special Report of the Business, Energy and Industrial Strategy Committee and Fourteenth Special Report of the Work and Pensions Committee

The Business, Energy and Industrial Strategy and Work and Pensions Committees' report to the House on *Carillion* (HC 769) was published on 16 May 2018 as Tenth Report of the Business, Energy and Industrial Strategy Committee and the Twelfth Report of the Work and Pensions Committee of Session 2017–19. The Government's response was received on 16 July 2018 and is appended to this report.

Appendix: Government response

Committee conclusion and recommendation: We recommend changes to ensure that all directors who exert influence over financial statements can be investigated and punished as part of the same investigation, not just those with accounting qualifications. (Paragraph 148).

Following the publication of the Government's response to the green paper consultation on Corporate Governance Reform last August, the Financial Reporting Council (FRC), the Insolvency Service and the Financial Conduct Authority (FCA) have worked together to improve their current practices in respect of co-working to make sure that accounting failures at a company can be investigated and action taken in respect of any breach, including of directors' duties.

In addition, the scope of the FRC's enforcement powers is being considered as part of Sir John Kingman's independent review of the FRC which is expected to report before the end of the year.

Committee conclusion and recommendation: Government should provide the FRC with the necessary powers to be a more aggressive and proactive regulator . . . to provide a sufficient deterrent against poor boardroom behaviour and drive up confidence in UK business standards . . . and that such an approach will require a significant shift in culture at the FRC. (Paragraph 194).

The FRC and its remit have developed considerably since it was initially established; and it was last the subject of a review in 2011/12. Since then, there have been changes both in regulation, and in expectations of regulators and how they operate. As part of its response to the consultation on the Corporate Governance green paper, the Government asked the FRC, the FCA and the Insolvency Service to ensure they could work together in cases of corporate failure to make full use of their respective powers in support of each other's regulatory responsibilities. This resulted, at the turn of the year, in the conclusion of a renewed and comprehensive Memorandum of Understanding (MOU) between the FRC and the FCA and a new temporary arrangement between the FRC and the Insolvency Service, which we expect to develop into a full MOU in due course.

Finally, in May the FCA and the Insolvency Service also concluded a new MOU. These are important developments to ensure the most effective use of existing powers to sanction directors, while avoiding duplication of powers between the regulators, ultimately to ensure the integrity of corporate governance reporting.

Some stakeholder groups have called for the FRC to demonstrate greater independence from those they regulate. The time is right for a review and the Government looks forward to receiving Sir John Kingman's proposals before the end of the year, which will be aimed at making the regulatory system as effective and credible as it needs to be. The review will be looking at the structure, governance, powers and resourcing as well as whether there needs to be a culture change at the FRC.

Committee conclusion and recommendation: The current Stewardship Code is insufficiently detailed to be effective and, as it exists on a comply or explain basis, completely unenforceable. It needs some teeth. Proposals for greater reporting and transparency in terms of investor engagement and voting records are very welcome and should be taken forward speedily. However, given the incentives governing shareholder behaviour, and the questionable quality of the financial information available to them, we are not convinced that these measures in themselves will be effective in improving engagement, still less in shifting incentives towards long-term investment and away from the focus on dividend delivery. A more active and interventionist approach is needed in the forthcoming revision of the Stewardship Code, including a more visible role for the regulators, principally the Financial Reporting Council. (Paragraph 179).

As noted in the Committees' report, the FRC will be consulting on a revised Stewardship Code later this year. The FRC has already invited preliminary views on possible options to improve the functioning and impact of the Stewardship Code, as part of its consultation on a revised UK Corporate Governance Code earlier this year. These include a more explicit focus on asset owners and other parts of the investment chain, to go alongside the Stewardship Code's existing focus on asset managers. The FRC is also assessing whether and how the revised Stewardship Code could more explicitly address long term sustainability issues, as well as better hold companies to account over their legal duty (under Section 172 of the Companies Act) to have regard to employee, customer and supplier interests, and the impact of directors' decision-making in the long-term. The FRC is additionally looking at how a revised Stewardship Code could be better focused on outcomes of investors' stewardship activity, as opposed to processes and inputs.

On enforcement of a revised Stewardship Code, the 'comply or explain' basis of the Code provides important flexibility and helps mitigate against a tick-box approach to compliance. Its primary purpose is to push investors to consider how they can improve their investor stewardship, and then report on this. Nonetheless, it is important to note that UK asset managers are expected either to report on their compliance with the Stewardship Code under the terms of the FCA's Conduct of Business Sourcebook or explain their alternative business model.

Additionally, the transposition in the UK next year of the revised Shareholder Rights Directive will introduce a number of new statutory requirements on asset managers and asset owners to report on their stewardship activities. These include an obligation on asset managers and asset owners to develop and publicly disclose an engagement policy that describes how they integrate shareholder engagement in their investment strategy and sets out how the policy is implemented each year. Asset owners will also be required to disclose certain information regarding the mandates they give asset managers, including how the mandate incentivises the asset manager to make investment decisions about medium to long-term financial and non-financial performance of the investee company, and to engage with investee companies in order to improve their performance in the medium to long-term.

<u>Committee conclusion and recommendation</u>: There is merit in Government and regulators considering a minimum standard for bonus clawback for all public companies, to promote long-term accountability (Paragraph 73).

The circumstances in which executive bonuses and other variable pay can be withheld or recovered is ultimately a matter for a company's shareholders, who have a binding vote on the company's remuneration policy. The Government welcomes the increased adoption of malus and claw back provisions in remuneration policies, and a greater move towards specificity in such provisions.

The FRC's UK Corporate Governance Code already stipulates that performance-related executive pay arrangements should include provisions that would enable the company to recover sums paid or withhold the payment of any sum, and specify the circumstances in which it would be appropriate to do so. The FRC's consultation on a revised Code earlier this year highlighted in guidance the circumstances in which pay could be withheld or recovered, for example following mis-statements by directors to shareholders. The FRC will be publishing its revised Code and guidance soon, including a new emphasis on requiring non-executive directors to exercise independent judgement and discretion when authorising bonuses and long-term incentive payments and to ensure that the design of remuneration schemes and policies enable rather than prevent the use of discretion to override formulaic outcomes.

<u>Committee conclusion and recommendation</u>: We recommend that the Government refers the statutory audit market to the Competition and Markets Authority. The terms of reference of that review should explicitly include consideration of both breaking up the Big Four into more audit firms, and detaching audit arms from those providing other professional services. (Paragraph 213)

The Competition and Markets Authority (CMA) is actively considering this issue. This includes working closely with the FRC, whose role it is to regulate the quality of UK company audits, to see what more needs to be done to drive up standards. As part of this, it is monitoring the impact of the remedies put in place following the Competition Commission's 2013 market investigation. There are a range of options likely to be available to the CMA, including launching a market study and subsequently a market investigation at the completion of which the CMA, depending on the findings, has powers to impose remedies on the market. The CMA remains open to looking further at the audit sector and will work with the FRC in support of any action it chooses to take.

The CMA is an independent competition authority. There are limited backstop powers under the Enterprise Act to enable the Secretary of State to refer a matter to the CMA for a market investigation in circumstances where he is not satisfied with the CMA's decision not to refer a market for investigation, or where he has brought relevant information to the CMA's attention but he is not satisfied that a decision to launch a market study (preliminary to a reference) will be made within a reasonable time.

Performance and Remuneration of the Special Manager

The below responses have been provided by The Insolvency Service

Committee conclusion and recommendation: We are concerned that the decision by the court not to set any clear remuneration terms for PwC's appointment as Special Managers, and the inability of the appointees to give any indication of the scale of the liquidation, displays a lack of oversight. We have seen no reliable estimates of the full administrative costs of the liquidation, and no evidence that Special Managers, the Official Receiver or the Government have made any attempt to calculate it. We have also seen no measures of success or accountability by which the Special Managers are being judged.

As advisors to Government and Carillion before its collapse, and as Special Managers after, PwC benefited regardless of the fate of the company. Without measurable targets and transparent costs, PwC are continuing to gain from Carillion, effectively writing their own pay cheque, without adequate scrutiny. When the Official Receiver requires the support of Special Managers, these companies must not be given a blank cheque. In the interests of taxpayers and creditors, the Insolvency Service should set and regularly review spending and performance criteria and provide full transparency on costs incurred and expected future expense. (Paragraph 162)

A protocol had been agreed between the Official Receiver and PwC setting out the work that the special managers carry out and the governance that applies.

Milestones include the completion of sales processes and the transitioning of the company contracts to new suppliers. There are however difficulties in setting firm or detailed targets given the dependency on third parties and the difficulties in concluding a large and complex liquidation, in particular where litigation is involved. As has been recognised in the report, this is a liquidation of unprecedented scale with many uncertainties and as a result it would not have been possible to accurately estimate the likely professional fees for the appointed special managers or solicitors.

In terms of monitoring of reviewing costs and performance, PwC are required to provide regular reports to the Official Receiver covering a range of areas such as financial performance, employees, contract performance and health and safety showing progress on both a daily and weekly basis. Progress on this is very closely monitored, including via a number of meetings each week with the Official Receiver and special managers, and weekly meetings with officials from the Insolvency Service, HM Treasury, Cabinet Office, the Official Receiver and a Special Manager.

The Official Receiver assesses the work carried out by PwC, including the costs incurred in carrying out this work. The special managers are producing weekly breakdowns of their time costs and regular breakdowns of disbursements, which are also scrutinised by the Official Receiver. This has included a review of PwC's time reporting database to determine how time is logged, categorised and approved.

It is important to note that the special managers' remuneration must be considered and agreed by the court, prior to which the Official Receiver must be satisfied that the application to court is appropriate. The remuneration is therefore subject to judicial scrutiny, independent of both the Government and the Official Receiver. The court, following this process, has agreed a payment of £22.9m (net of VAT) for the special managers' costs in the period from 15 January to 31 March 2018.

Turning to future costs, and as set out in the National Audit Office report, the expected net cost of the liquidation is around £148m. It is expected that PwC's final bill will be in the region of £50m for the special managers' work.