

## **An Open Letter**

When Magellan engaged PwC to undertake a "forensic" investigation, it was reasonable to expect that this investigation would be a thorough, objective, informed and independent investigation of the claims that I had made as a whistleblower. That was an issue right from the outset – Mr Dimma

According to "**A Guide to Forensic Accounting Investigation**" (Golden & others, Wiley 2005) *the bedrock of an effective audit are*

- 1. professional scepticism,**
- 2. knowledge and experience and**
- 3 independence and objectivity.**

One of our real concerns, from the very outset from the outset of the PwC "independent forensic investigation" (585), the terms of which were set by Mr Dimma, was that it would NOT follow the key recognised standards for a forensic investigation. These were, inter alia, outlined in a Network of independent Forensic Accountants (NIFA) editorial article, published during the time of the investigation on 14 March 2007: "**A healthy dose of common sense and scepticism. Does what you are being told tally with other evidence that you have been presented with? One of the key mistakes that had befallen many a forensic accountant is paying lip service to a client's claim – only for it to slowly disintegrate before their eyes, due to not carrying out some commonsense reasonableness checks.**"

Mr Dimma told the public court in his evidence, [that following his own "internal investigation" and report in late 2006](#) --- which found "**the matters you were raising were historic**" and that there is "**no substance to the purported concerns**" --- he instructed PwC to carry out an "independent forensic investigation", after I had met E&Y in December 2006, as in his view "**auditors are extremely risk averse**". It is significant to me and others that despite his apparent dismissal of my views in 2006, Mr Dimma saw fit to personally chair the PwC investigatory process in 2007, described, I remind you, as "independent" in order, I suspect, to retain control over its conclusions.

In January 2007 MAC's Audit Committee commissioned PwC ostensibly to produce a report providing a commercial, professional and neutral assessment of the beliefs I held in 2006. An impartial observer might think perhaps that it would be a good idea to ask me about them. Not only was I not asked by its main authors but I was deliberately denied comment on the findings of fact. It might have been more honest to have asked them to produce a report to prove me wrong and then cover up, which is, in brutal reality, the sole objective of their report. When we look at the employees PwC actually used to carry out this A340 program analysis, we find that the two main authors had virtually no aircraft manufacturing industry experience, as was the case also with the PwC Partner who led, signed off - and was ultimately responsible for the work.

The circumstances surrounding this report should, on their own, arouse your suspicions that my conclusions on it are correct, even without analysing its content. Firstly, the scope of the report was determined by MAC's Audit Committee and its' Chairman - who acting as a group decided that over 50% of my protected disclosures did not warrant investigation.

In such circumstances PwC were naturally forewarned of the need to build in processes within the conduct of their investigation to protect their reach and independence/neutrality and to avoid being compromised. I met PwC UK only initially and never met the PwC staff assigned to the A340-500/600

investigation at any point in those seven months. My taped recommendations and assertions in January 2007 were largely ignored. I was not allowed to see and comment on PwC's draft report on the grounds, apparently, that I had nothing material to offer.

In contrast MAC's management were allowed to scrutinise the draft report with consequent material amendments in MAC's favour, which only came to light when the UK court ordered MAC to divulge the PwC's final draft report in June 2007.

The "independent forensic" PwC Final Draft Investigative Report into Areas of Concern Raised by Mr Brian Little : Executive Summary (and implying by its title earlier drafts) circulated to the Board of Directors at MAC – and relied on in the Magellan Aerospace May 2007 earnings statement - [at PwC paragraph 2.40 \(doc 605/606\) recorded](#)

**"Financial Control within MAC and MALUK in relation to the areas we have examined is poor and needs to be improved: this is particularly acute given that MAC is a public company.**

Examples of poor financial control that we identified during our work include;

1. **Accounting adjustments made with insufficient supporting analysis and documentation;**
2. **Inadequate understanding or documentation of balance sheet provisions and insufficient documentation of the decision to release certain provisions**
3. **A lack of awareness of the program accounting requirements under either Canadian or UK GAAP....**
4. **Poor control over individual projects from an accounting perspective. Project sales volumes, revenues and costs are not reviewed with sufficient frequency or rigour."**

This MAC conclusion on **poor financial control** only became public following the UK Court Order on 6 June 2007 for the disclosure of the PwC report which MAC had relied and referenced in the MAC public statement above.

As a matter of record PwC also reported in this Final Draft Report (*para 8.58*) at the very time of Mr Dimma's alleged "internal investigation" the senior Magellan management (Aeronca, Mr Butyniec, Mr Dekker and Mr Neill) had failed to produce a quarterly A340 Program estimate to complete (EAC) for consideration/inclusion in their Q3.2006 published earnings statement. The reader may also wish to consider the commentary in website Part F (2) on the Boeing 737 Systems Integrator kits discounts and Revenue recognition at the same time (Q3.2006) as Mr Dimma's "investigation" and his report "conclusions" above.

It is significant that this critical comment is totally omitted from PwC's Final Report in August 2007, supporting my strong belief that this report was in effect an attempt to "whitewash" my concerns and vindicate the position already taken by Mr Dimma and Magellan Aerospace Corporation.

According to **"A Guide to Forensic Accounting Investigation"** (Golden & others, Wiley 2005) **the bedrock of an effective audit are**

- 1. professional scepticism,**
- 2. knowledge and experience and**
- 3 independence and objectivity.**

The [Canada IFA Standard Practices at 600.04 published in November 2006](#) states that the “**IFA practitioners should present their findings and conclusions in an objective and unbiased manner**” and at [600.06](#) “**IFA practitioners should consider all relevant information that could impact their findings and conclusions.**”

Whilst the Forensic accounting teams in many Big Four firms regard themselves as the accounting elite, my own experiences have suggested that this is far from the case.

Prior to my personal involvement, most laypeople would assume that an independent forensic accountants’ investigation would ensure the following, consistent with their Code of Ethics:

- A comprehensive and thorough review of the facts
- An independence of thinking plus objectivity that did not allow any bias, conflict or undue influence whilst creating a report which should make conclusions that are justified in light of gathered evidence and not conclude on the basis of insufficient evidence or make determinations outside their competence or jurisdiction.
- A healthy professional scepticism that would ensure objectivity
- A rigorous review of all available information, gathered from a multitude of internal and external sources to ensure that appropriate, supportable and evidence capable of independent verification is gathered before reaching their conclusions
- Application of strong numeracy and financial analytical skills

In contrast, the independent forensic review conducted by PwC for Magellan failed these benchmarks on multiple counts:

- It contained a number of basic mathematical errors e.g. calculation of replacement aircraft cycles
- The final report contained factual inaccuracies in a number of key areas e.g. incorrect average annual flying hours which could have been easily capable of independent verification.
- It failed to use third party information commonly available in the aerospace market (e.g. from Airbus plus analyst reports) on production build expectations and instead used production forecasts from the only external source, that even then were lower than the Q4.2006 numbers in management’s own estimates, submitted to E&Y for audit and PwC for their investigation.
- It failed to obtain any third party support for management’s assertions regarding the cost increases that were fundamental to the future profit assumptions made by management
- It accepted an assumption on the total flying hours before replacement/repair that was inconsistent, to Magellan’s favour, with Airbus own internal technical guidance manuals, as were available to Magellan. Indeed, application of Magellan’s assumptions would have required a fundamental change in the EASA/CAA design certification life by Airbus for the components.
- Notwithstanding my whistleblowing status, I was not allowed to review/comment on the draft report for factual accuracy - *this was the draft report that had been produced by PwC solely as a consequence of my whistleblowing claims*. In contrast, it was subsequently disclosed that a number of unfavourable references to the Magellan internal financial reporting framework were removed between issuance by PwC of their draft and final reports.
- PwC ignored a number of observations/recommendations made by myself regarding information sources plus industry developments.
- In two key areas PwC relied upon “management’s assertions”, using this phrase almost as a defence, when ultimately either there were a number of external sources where they could

have tested these assertions, or they could have sense checked the underlying mathematical logic and found them, at best, to be flawed. It is insightful to also know that to those with forensic knowledge and experience when a remark "management asserts" is written in that way in such a Report it is "consulting-speak-code" for the writers understanding (PwC) that the assertion is wrong and they already have access to multiple pieces of information to conclude that. That was and is our view. In the A340 Section 8 PwC report PwC refer on two occasions to this "consulting-speak-code" Management asserts" – in PwC para 8.62b pricing comparisons between Q2.2006 and Q4.2006 (i.e as set out above) and then again from Mr Neill , in PwC para 8.72 – " Furthermore, management asserts that the requirement for spare units will support and exceed the total number of units projected in the EAC. ". Instead PwC knew them to be wrong.

In completing the report, PwC seemed **totally oblivious to the contradiction between its criticism of the** overall standard of MAC's project accounting procedures

**Poor control over individual projects from an accounting perspective. Project sales volumes, revenues and costs are not reviewed with sufficient frequency or rigour."**

as being poor and its **own standards, conduct, processes, findings of fact and conclusions in respect of the A340 project and the crucial fact that PwC accepted two management assertions which, they must have realized, had as their foundation the very project control processes that they had criticised at their client.** It is easy to sink into the detail of the PwC report and the legal case that has followed.

Whatever one might think about the individual merits of each of the claims/accusations made above, what is indisputable is that, as a collective, they paint a clear picture. The PwC exercise failed to display the thoroughness, independence and objectivity that are assumed to be the cornerstones of a forensic investigation. In my opinion, when so little apparent attempt has been made at meeting these cornerstones, the PwC exercise is most appropriately considered to be one of "Forensic Deceit". One is forced to the conclusion that all these coincidences can only be explained by PwC setting out to selectively misuse the material available to it and perpetrate an act of forensic deceit.

Individually, a defence could be made in isolation for any one of the pieces of misinformation – they are surely too blatant and serious to be termed mere mistakes – but collectively they cannot do other than represent a step-by-step strategy to reach a set objective – to absolve MAC in its cover up of a huge loss/mistake from its investors and the public record. It is hard to imagine any other series of steps that could be taken to achieve this particular 'truth' and the answer they first thought of, because each step is required to stretch that 'truth', it is impossible to believe this could occur without a plan. This was managed and contrived.

Any deconstruction of its report demonstrates professional failure on a level beyond belief and unrecognisable in the Number 1 global auditing company. Extraordinarily, every single piece of misinformation must have passed PwC's internal third party quality testing. Standard operating procedures would demand this include peer reviews within PwC. Therefore, collectively, their approval and publication by PwC demonstrates an orchestrated corruption of the truth – **a forensic deceit.**

I believe that the business world - and the analysts who comment on and value companies - often are sleep-walking into a position where they accept the findings of audit firms such as PwC and E&Y as "gospel" - to be accepted at face value and without any evaluation of their methodologies and, indeed,

without investigation of any potential underlying motivation or interest which may have coloured their findings. Since, therefore, it is unlikely that their probity and accuracy *per se* will be challenged, audit firms can head off any criticism or suspicion by assembling a well-practised screen of words and concepts which enables them to disarm any critic by confining debate only to the issues of character credibility, lack of "specialist" knowledge and communications skills. However, through a personally-destructive process of attrition and perseverance, I have managed to penetrate this screen in the cases of PwC and E & Y. By examining the actual base material of contemporary documents - grudgingly provided to me through the tenuous British judicial system without Affidavits - and painfully analysing the processes by which these two firms produced the findings of fact and conclusions they did, I have been able, in my opinion, to cast serious doubt on those fundamental qualities of integrity and accuracy so valuable to the profitability of audit firms and their position in society and which seem increasingly and, to me, ingenuously, taken for granted by the financial markets, by UK tribunal members and by the public at large.

PwC knew what tune was wanted. They performed it. And the piper was paid C\$3m + +.

***"Truth? - forget it!!"*** – (Nov.2009)

*Please now view the video clip Answer (4 minutes) from Mr Paul Moore – the celebrated ex HBOS bank whistleblower – in response to a single question from Brian at his lecture in Belfast last month.*

At C\$3m, the cost of this exercise was significant and the defence cannot (and should not) be one of low materiality, either for Magellan or me, personally. Perhaps when PwC seek to take the moral high ground and make the assertion that the accounting profession needs to have "great skills in holding a mirror up" (per Ian Powell), they should first look in that mirror themselves.

I recognise that there is much detail available surrounding the matters detailed above, much of it to be found on my website Fortfield.com .

What is included there, though, together with all the linked documents is, I believe, some of the factual evidence underpinning what I have so far stated. I would not have the temerity to criticise PwC in these terms did I not believe this to be the case. There is, moreover, nothing which I have not already asked PwC or MAC to comment on or refute if they believe me to be wrong. And they have not done so.

Brian Little

December 2009/16 March 2011

**....True to type, innumerate accountants PWC {+E&Y} bent "reality" to suit client's "needs" ....**

1. Will Edwards stand by Magellan? Magellan accused of inflating project size  
Magellan sails into rough seas – stock pops, former executive threatens action  
PwC reported to accounting regulator after taking criticism of client from report  
Brian Little's turbulent battle with Magellan Aerospace

2.

**8.0 Accountancy/Auditors – perceptions of “independent forensic accountants”..**

*I understand from other people within Big 4 audit firms that Forensic accounting people consider themselves to be amongst the “elite” members in their accounting/audit profession. I also believe from my research that most lay people would attribute such roles in such people and firms as having the following characteristics:*

- 8A Numeracy / finance skills** – basic logic and mathematics – see paragraphs 9.1 and 9.2
- 8B Reliance on them – comprehensive/thorough = truth / trust** underpinned by independence / Objectivity –see paragraphs 9.3, 9.4 and 9.5
- 8C Access to information** – global knowledge management / other audit clients and public information underpinned by technology in access to documents and records – see paragraphs 9.6, 9.7 and 9.8
- 8D Professional scepticism , checking and validity:** audit testing and deep technical skills – paragraphs 9.9 & 9.10

"Both Ernst & Young and PricewaterhouseCoopers were comfortable with the manner in which Magellan Aerospace justified the quantity of units expected to be delivered. For the sake of clarity we also attach a document that Magellan has recently prepared, which shows at a glance the assessment that would have been carried out by the auditors in order to satisfy themselves that the accounting on this matter was appropriate." As at Feb 2007

When PwC asked Magellan to prepare projections based on my information on 29 January 2007 for a total A340 - 500/600 build of 135 aircraft Mr Neill instructed that the MAC 16 February 2007 Spares numbers be substantially uplifted by 500%+ to meet the EAC amortization quantities.

**Some of the PwC steps in their act of A340 “Forensic deceit” Private Eye**

- 9.1 A340 500/600 Pricing** - numeracy and logic
- 9.2 A340 500/600 Volumes/ Quantities** - numeracy and logic
- 9.3 A340 Customer delivery projections from Airbus – totally excluded in PwC analysis / assessment**
- 9.4 A340 External Market forecasts from third parties – PwC not comprehensive / thorough**
- 9.5 Independence/Objectivity – professionally compromised**
- 9.6 A340 500/600 External market forecasts - failure to access global information**
- 9.7 A340 500/600 Data from other Publications – including the file provided by MAC CEO, Mr Neill**
- 9.8 Airbus Aircraft A340-500/600 “Website” Order Book** - wrong analysis / assessment
- 9.9 Airbus A340-500/600 Unit Delivery projections - failure to check and audit testing validity**
- 9.10 A340-500/600 pricing projections – failure to check and audit testing validity**

The day before the MAC FY2006 financial results were announced Mr Neill told PwC that despite his knowledge that the A340 500/600 upgrade programme had been cancelled from August 2006 in an email that

"The Forecast International Data assumes Airbus will be unavailable to further improve the A340-500/600 and yet history has seen the opposite and the example I would use is the A300 which first entered service in the early 1970s and production is only now ceasing. I hope this deals with points raised in the telecon tonight."

When the PwC/MAC cover-up/smokescreen disintegrates over time, due to the lack of commonsense and reasonableness checks , the “Truth will Out”?

By “**Forensic Deceit**” I mean that it is **NOT TRUSTWORTHY**, because the intention of PwC, and the effect of their **less than rigorous investigation or audit standards, was to mislead the reader in their “findings of fact” and conclusions from its “forensic investigation”.....Beyond Belief.**

As you can hear, should PwC with their assertion of “great skills in holding a mirror up” **actually firstly look in that mirror themselves**, prior to trying to credibly convene and participate in this important public debate?

You may also wish to reflect on their [Chairman's Speech, Mr Powell, in Oct 2010 on “Building Public Trust”](#) and his recognition, as PwC leader, of his “personal responsibility to imbue his organization with integrity and professionalism”. Also read [UK Financial Times letter](#).

### **3. ICAEW Code of Ethics - Fundamental principles**      [UK](#)   [CANADA](#)

**Integrity** : A professional accountant should be straightforward and honest in all professional and business relationships.

**Objectivity** : A professional accountant should not allow bias, conflict of interest or undue influence of others to override professional or business judgments.

**Professional Competence and Due Care** : A professional accountant has a continuing duty to maintain knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques. A professional accountant should act diligently with applicable technical and professional standards when providing professional services.

**Confidentiality** : A professional accountant should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper and specific authority unless there is a legal professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of the professional accountant or third parties.

**Professional Behaviour** : A professional accountant should comply with relevant laws and regulations and should avoid any action that discredits the profession.

The Canadian Institute of Chartered Accountants also has a Code of Ethics which is almost identical to that for the ICAEW. In Canada the **Ethical standards are based on five fundamental principles that govern the behaviour of all Chartered Accountants** - professional behaviour, integrity and due care, professional competence, confidentiality and objectivity.

### **4. “INDEPENDENT FORENSIC INVESTIGATIONS”**

**15 November, 2006 press release – “The Canadian Institute of Chartered Accountant’s Alliance for Excellence in Investigative and Forensic Accounting (IFA Alliance) today released new standard practices for investigative and forensic engagements that will protect the public by ensuring consistency to a standard of practice”.**

#### **(a) Independence and Objectivity**

I provide a number of [relevant extracts from these CICA.IFA Standard Practices for Investigative and Forensic Accounting Engagements](#)

- 100.04: IFA standard practices are needed to protect the public interest by ensuring consistency to a minimum standard of practice.
- 100.11: An “investigative mindset” requires a skeptical attitude in the identification, pursuit, analysis and evaluation of information relevant to each engagement, contemplating that it may be biased, false and/or incomplete. This is applicable in identifying and assessing relevant issues, assessing the plausibility of the underlying assumptions, assessing substance over form and developing hypotheses for the purposes of addressing the issues under investigation.
- 600.03: Prior to the issuance of the report, IFA practitioners should be satisfied that there is sufficient support for the content of the report, including any findings and conclusions reached.

- 600.04: IFA practitioners should present their findings and conclusions in an objective and unbiased manner.
- 600.05: IFA practitioners should confine their findings and conclusions to subject matter, principles and methodologies within their competence, including their knowledge, skill, experience, training and education.
- 600.06: IFA practitioners should consider all relevant information that could impact their findings and conclusions.

**(b) “Forensic” - comprehensive and thorough “evidence – based” research.**  
[Extracts from the Canadian CICA Investigative and Forensic Accounting Standard Practices 2006](#)

- 400.01: **IFA practitioners should use an investigative mindset in the identification, pursuit, analysis and evaluation of information relevant to each IFA engagement, contemplating that it may be biased, false, unreliable and/or incomplete.**
- 400.02: Throughout an IFA engagement, IFA practitioners should use an investigative mindset to assess the timing, nature and extent of the approach (es), procedures and techniques to be used.
- 400.03: The type of information obtained may relate to the facts pertaining to the underlying issues of the IFA engagement as well as factors relating to motivation, intent and bias.
- 400.04: IFA practitioners should consider the relevance of all information that arises during the course of an IFA engagement.
- 400.05: **IFA practitioners should identify, analyze, assess, and compare all relevant information, assess substance over form, and develop and test, as needed, hypotheses for the purpose of evaluating the issues in the engagement.**
- 400.08: Where practical, IFA practitioners should maintain copies of all documents and other materials relevant to their findings and conclusions.
- 400.09: IFA practitioners should maintain an appropriate record of all relevant information received orally.
- 400.10: IFA practitioners should evaluate the reasonableness and consistency of all estimates and assumptions having regard to the IFA practitioners’ competence, expertise and other available relevant information
- 400.11: Where IFA practitioners receive estimates and assumptions that are outside of their competence and expertise, and IFA practitioners intend to rely on such estimates and assumptions, they should consider the reasonableness of those estimates and assumptions.
- 400.12: **IFA practitioners should review all information received during an IFA engagement, and consider its relevance, reliability, reasonableness, completeness and consistency with other known engagement information**
- 400.13: **IFA practitioners should consider and address reasonable alternative theories, approaches and methodologies that may be relevant to their work.**
- 500.01: **IFA practitioners’ working papers should contain or have a reference to all information used and relied upon in carrying out an IFA engagement, including the following documents or summaries thereof which would usually be retained on file:**  
[\(a\) research etc etc \(page 12\)](#)

**(c) “Investigation” - researching the body of evidence and facts from multiple public and aerospace/industry sources for information consistent with that expected from competent people with superior knowledge and experience.**

Returning now firstly to the [Canada Standard Practices for Investigative and Forensic Accounting](#)

- 200.04: IFA practitioners should have reasonable assurance that the IFA engagement team collectively has the necessary expertise, competencies, resources and time to perform the engagement.
- 400.04: **IFA practitioners should consider the relevance of all information that arises during the course of an IFA engagement.**
- 400.05: **IFA practitioners should identify, analyze, assess, and compare all relevant information, assess substance over form, and develop and test, as needed, hypotheses for the purpose of evaluating the issues in the engagement.**
- 400.12: **IFA practitioners should review all information received during an IFA engagement, and consider its relevance, reliability, reasonableness, completeness and consistency with other known engagement information**

- 600.03: Prior to the issuance of the report, IFA practitioners should be satisfied that there is sufficient support for the content of the report, including any findings and conclusions reached.
- 600.04: IFA practitioners should present their findings and conclusions in an objective and unbiased manner.
- 600.05: IFA practitioners should confine their findings and conclusions to subject matter, principles and methodologies within their competence, including their knowledge, skill, experience, training and education.
- 600.06: IFA practitioners should consider all relevant information that could impact their findings and conclusions.

5. [Extract from PwC written evidence to the House of Lords Economic Affairs Committee](#) – at para 24

**“Professional scepticism is fundamental to what auditors do. It is defined in auditing standards as “an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.”** and at para 25 **It is the job of the auditor, as established by internationally agreed auditing standards, to challenge management’s assertions and ensure that they are backed with evidence that is appropriate, supportable and capable of independent verification.** It is not the auditor’s job to develop alternative views and then try to persuade management to adopt them in preference to theirs.”

[FRC/APB](#) – “ Audit is essential to public and investor confidence in companies... The application of an appropriate degree of professional scepticism is a crucial skill for auditors. **Unless auditors are prepared to challenge management’s assertions** they will not act as a deterrent to fraud nor be able to confirm, with confidence, that a company’s financial statements give a true and fair view.”

In a [separate paper](#) I compiled and set out analysis of the PwC report and [management assertion](#) contained within in relation to **A340 quantities.**

I found that PwC made five errors which cumulatively represent “forensic deceit”

1. **PwC basic mathematics errors**
2. **PwC logic – failed to use aircraft in service dates**
3. **PwC use wrong average annual flying hours**
4. **PwC used only ONE production build forecast** (*consciously ignoring the [customer production plan](#), [6 other third party forecasts](#), [A340-600 cancellations from airline customers which PwC audit, general and specialist press publications and MAC Board approved 30 March 2007 Management Discussion and Analysis, at page 14 \(MD&A/AIF.p12\) which states “The Corporation relies on customers' delivery projections as well as external market forecasts to determine the number of units over which to amortize non-recurring costs. Should deliveries not reach the number projected, any unamortized balance that remains would then need to be charged to cost of revenues which could have a material adverse impact on the Corporation.”](#)*)
5. **Detail technical data for BETA21S materials**

In this paper I turn my attention to the **A340 pricing** and financial analysis done by PwC on the A340. Here I also identify four points which likewise represent forensic deceit and a failure to basically audit and test the documents and **management assertion at PwC para 8.62B.**

1. **Revenue increases from Q2-Q4.2006 of C\$8470K for FY2007-FY2012 could not support Magellan management assertion to PwC / basic analysis by PwC**
2. **PwC basic mathematics errors / audit testing failures in sales prices in Q4.2006 EAC**
3. **PwC fail to obtain BETA21A material quotes to support Q4.2006 independent verification and assumed increases from Q2.2006 – 10% p/a increase from FY2007 to FY2012.**
5. **Amortisation \$ per unit shipped in FY2006 –PwC analysis.. approval of MAC and E&Y prior conduct**

Point 4. Other information and Pricing status at August 2006 prior to my termination which is relevant in Q2.2006 and to my state of knowledge prior to my termination at Toronto Airport.

#### **6. The A340-500/600 at Magellan Aerospace Corporation - largest NRC asset of C\$40M+ on MAC Balance Sheet – FY 2006**

**Judge** If the Q4 2006 EAC had continued with the **underlying gross loss of 5.22 million** *<as per the Q2.2006 EAC>* and the further £2.734 million costs increase by Q4 2006 had been recorded at circa \$10 million loss, would MAC senior officers have recorded from that EAC a circa \$10 million plus loss in Q4 2006 earnings and then stated that in the FY 2006 published accounts?

Mr Dekker **Yes.**

Mr Little Right

Mr Dekker But --

**Judge** But --

Mr Lynch Yes, please.

Mr Dekker But it's based on a lot of presumptions.

**Judge** Right.

Mr Dekker The final question is, would we post the accounts correctly, of course we would, if that was truly a loss we would post the accounts correctly and record a loss.

Mr Little *Can I just clarify something now, if we just look at document 1831 in the bundle, what you're saying, John, then, is, and this is for everybody else, if the number do you know here, \$137172, which is the very bottom of the sheet, marked D, I think, sir.*

**Judge** *Yes..... we have it*

Mr Little So, Mr Dekker, **if D was minus \$10 million**, I think you've just told the tribunal that you would then be posting 10 million loss to the accounts?

Mr Dekker If you're asking me if this schedule generated the number of minus 10 million in the bottom of the programme total, would we record it that way, no. Not solely on the basis of this schedule. This [schedule is an estimate at complete](#), and each quarter we do various scenarios of this schedule, there are three major variables that affect the outcome of this schedule, **sorry to bring it to such basic levels, but it's number of units, times revenue per unit, and the cost.** [If our best view, our -- let me identify best, our most reasoned view and most likely outcome showed a 10 million loss](#), yes, we would post that loss. Each of those three variables has a habit of changing on us. And as such, this schedule will change each time we do it. We also have uncertainty about the future, so our view as to what's going to happen into the future will also affect how this schedule is completed.

Mr Little **But the core question is, if as a result of doing all of that, that number became minus 10 million, would you be posting minus 10 million to the accounts?** *(BL : Note also the relevance to the Q2.2006 A340-500/600 EAC of (\$5.2m) etc etc)*

Mr Dekker **If our best view, our -- let me identify best, our most reasoned view and most likely outcome showed a 10 million loss, yes, we would post that loss.**

Mr Little And it is correct, Mr Dekker, that this document is the primary document which Ernst & Young would use in their audit process?

Mr Dekker We would give them this document in the audit process, plus the supporting detail, I can't say that this is the primary document but I have to believe it's one of the key ones.

Mr Little Right, and in the audit testing processes, which we're both familiar with, in terms of the primary part of their job, for want of a better word, that's what this Excel work sheet will become, and its backing paper, what they use to do their calculations of mathematics on.

Mr Dekker I believe so, I'm not present at each of the business units when the auditors are in but certainly that would be a logical assumption, I would expect nothing different.

Mr Little Right, and sir, just for factual record, in the final report at paragraph 8.61, PwC, it confirms that this was the document used for year-end audit testing purposes.

#### **7. A340 quantities --- "management asserts" – PwC para 8.72/8.76 – untruthful/ industry PwC logic+maths wrong**

**7A. Production:** The Teal Group A340 market forecasts reports were in fact already available to PwC. The March /April 2007 Teal Group A340 external market forecast annual report (2998/9) was headed **"Dead Plane Flying"** (April 2006 - Airbus's *Tragic Quadjet*) and was at least one of perhaps the other six "market consensus- 135 aircraft" forecasts available within PwC London for this forensic investigation. I was totally unaware until late 2008 that these Teal Reports were already freely available within

PwC via their annual subscription, throughout the entire 7-month period of the PwC Independent Forensic Investigation, to support exactly these types of audit/ investigatory work through their knowledge management processes for the global PwC firms.

I told PwC UK (587 and audio tape) on 29 January 2007 “ **I suggest what you do is you get two or three analysts to give their view, probably the guy who is best in the market is TEAL group, a guy called Richard Aboulafia , and everybody, all the others , may have different views but he is worth reading and getting. It would cost you a couple of thousand dollars but he is usually not that far away from reality. I think most people see it like this – this is the end of the line.”**

 [I told – click- PwC that they should obtain 2/3 external market forecasts \(at least 7 available\) inc. Teal in PwC London](#)

Although in common with all the other third party market forecasters Forecast International of the USA identified in its **written April 2007 Forecast Rationale (3616) the four main decisions which had been made and would lead to a wind down in the A340 programme** for an unknown reason (*the author has since died*) **the HIGH CONFIDENCE numerical forecast was for 41 aircraft deliveries for 2007 – 2009**. This 41 aircraft, **in a precedent for third party aerospace market forecasters, was almost 30% HIGHER than the planned Airbus delivery plan for 2007 -2009** (doc 3600 = 32 a/c) provided to the Airbus supply base. Furthermore the Airbus planned production rate of approximately ten aircraft per year was obviously documented (*doc 3600*) and known to Mr Neill, Mr Butyniec (*which he confirmed again in his oral evidence : see later in Part F*) , Mr Dekker, MAC/MALUK, E&Y and PwC.

PwC could have had the external forecasts from Teal and the other five third party forecasters from mid 2006 to early 2007. These were for a total production build of 130 -150 A340 -500/600 aircraft with a market consensus – excluding this Exhibit 8.4 from Forecast International – of 135 Aircraft>

Additionally and centrally PwC, as recorded at PwC para 8.3, were aware from my briefings/documents and filed Grounds of Complaint within the UK court process (PD23) that even the July 2006 Airbus internal sales/program scenarios of a further 60 (*total build 155 aircraft*) and 100 aircraft (*total build 195 a/c*) - which naturally tend to be higher/optimistic, as they are the manufacturers - \_exceeded by some 15 – 50% the remaining total aircraft build forecast of 117 made by Forecast Intl.in March 2007.

For its largest NRC project it is simply NOT credible that Magellan Senior management did not consider ALL the inputs (a) Airbus programmes (b) external market reports, (c) aerospace publications information and (d) their communications network they had on A340 from mid 2006 to early 2007. At its most simplistic a Representation document that MAC would manufacture the equivalent of 62 aircraft ([on 1 March 2007](#)) and 41 aircraft (14 March 2007) for the period 2007 to 2009, when they were all aware of a rate of about **10 a/c per year in the Airbus programme for 32 aircraft (3600) is simply absurd.**

#### **7B. [I warned PwC about Spares & full replacements at the outset of their investigation - click here](#)**

As Mr Little has consistently stated **PwC then proceeded to create an alternative view** (*completely contrary to professional audit practice and procedures*) in a process of “**Forensic deceit**” in their calculation of a 1572 potential demand for Spares and Repairs by FY2021. **That was completely false and not just the belated acknowledgment of an immaterial slip, as Mr Lynch QC submits. In fact at least six points are relevant as Mr Little sets out in his A340 quantities analysis at p 2 - 4 of this document.**

##### **1. PwC basic mathematics [errors](#)**

**2 PwC logic – failed to use aircraft in service dates** <used the supplier Tier 2 actual deliveries from Magellan>

**3 PwC use wrong average annual flying hours** (*apparently relying instead on Magellan management “hearsay”*)

When points 1, 2, and 3 are calculated properly (*whilst continuing to assume the erroneous 40000 flying hours before repairs (&BER repairs) together with the absurd PwC/FI total production unit build forecast (4) equivalent to 221 A340-500/600 aircraft -882- before production cessation in FY2015*)

about 650 units or MORE THAN 50% LESS ..... rather than the 1572 PwC had calculated.

**4 PwC used only ONE production build forecast** (*consciously ignoring the [customer production plan](#), 6 [other third party forecasts](#), A340-600 [cancellations from airline customers which PwC audit](#), [general](#) and [specialist press](#) publications and [MAC Board approved 30 March 2007 Management Discussion and Analysis, at page 14 \(MD&A/AIF.p12\) which states](#)*

"The Corporation **relies on customers' delivery projections as well as external market forecasts** to determine the number of units over which to amortize non-recurring costs. Should deliveries not reach the number projected, any unamortized balance that remains would then need to be charged to cost of revenues which could have a material adverse impact on the Corporation."

**. now falls to 500 Spares/replacements and Repairs by FY2021 rather than the 1572 PwC calculated**

 **I told – click- PwC that they should obtain 2/3 external market forecasts (at least 7 available) inc. Teal in PwC London**  
 **At the outset I told PwC about the Emirates cancellation of 18 A340 600 in late 2006 – click – PwC audit Emirates.**

**5 Detail technical data for BETA21S materials** - Magellan state they provided two of Dr Thamburaj's reports to PwC and E&Y. I had not seen or heard of these before and I agreed with the view [Mr Neill expressed on 27 July 2009 \(p96\) ... "I have no clear recollection of actually giving them the documents, I would not have seen the value of it."](#)  
... will **further reduce the 500 by FY2021.**

As per my w/s para.226.3 my view was a further **132 Spares/BER replacements** by FY2021: [Mr Bobbi estimated 82-112](#)

## **8. A340 PRICING** - "management's assertion" – [PwC para.8.62b – maths wrong/untruthful](#)

**Point 1 : Revenue increases from Q2-Q4.2006 of C\$8470K for FY2007-FY2012 could not support Magellan "management" assertion at 8.62(b) to PwC / basic check by PwC**

**Point 2 : PwC basic mathematics errors / audit testing failures in sales prices in Q4.2006 EAC**

**Point 3 PwC fail to obtain BETA21A material quotes to support Q4.2006 independent verification and assumed increases from Q2.2006 – 10% p/a increase from FY2007 to FY2012.**

**Point 4 : Other information and Pricing status at August 2006/Q2 and prior to my termination**

**Point 5: Amortisation \$ per unit shipped–PwC analysis.. approval of MAC and E&Y conduct**

<For information : Magellan Aerospace Corporation used only a fixed amortization amount of \$30,000 per exhaust unit in FY2006 – which if continued at \$30000 per exhaust unit would lead to only 65% recovery of the circa C\$40m+ (USD 38.25M) inventory on the December 2006 MAC Balance Sheet. PwC set this out further in their para 8.117 : Current production costs per unit are such that at present the pre-amortisation margin generated per unit is not sufficient to absorb an amortization of USD 30,000 per unit and still break-even. In order for MAC to report an overall breakeven position, while at the same time amortising NRC inventory, it has been capitalizing that amount of production costs that is necessary to achieve the break-even position each year. For this reason, "production inventory" for the A340 programme has been increasing".

If MAC were to maintain the amortization at \$30,000 per exhaust system, as in FY2006, only \$3.30 million would have been reduced from the total A340 programme asset for the 110 units delivered by MAC in the three years between January 2007 and the end of December 2009/FY2009. (Updated 18 January 2011: With aircraft production exhaust units now all delivered a total of 110 production – to 131 A340-500/600 - production aircraft and 11 spares were delivered by MAC in the four years between January 2007 and the end of December 2010/FY2010, or equivalent to \$3.63m). PwC continues at para 8.118 "PwC believes that MAC's NRC and production inventories should be considered collectively (for a total inventory of USD 38.2 million) and then amortised from this basis onward. Aeronca should also review the NRC amortization factor. We believe that this factor should vary with the profitability of each unit. As increasing labour and material cost efficiencies are realized in the production process, furthermore, the amortization rate should increase."

This policy does not appear to be a logical and mathematically sound approach on A340 as PwC recognised earlier in their report at PwC 8.94 – 8.95 that the current escalation formula – under any interpretation – would not lead to increased profitability per unit once BETA21S materials costs exceeded 31% of the cost. Those relevant PwC paragraphs are

*8.94 The price escalation formula currently in effect (as per the SA dated 11 March 2005 between Aeronca, MAC and HH) directs that the total sales price for exhaust system units will increase by 0.31% for every 1% increase in the cost of Beta 21S. In*

effect, MAC is protected for increases in the cost of Beta 21S, providing that the cost of Beta 21S per unit remains equivalent to or below 31% of the total cost of production per unit.

8.95 Given the volatility in the cost of Beta 21S (a titanium compound), there is a risk that in future years the cost of beta 21S could exceed 31% of the total cost of production. Indeed taking into account the existing assumptions in the EAC model, the cost of Beta 21S per unit would represent approximately 35% of the total cost of production per unit by FY2012.

This rising profit/contribution year on year subject is dealt with in some detail at website Exhibit 8.1. PwC failed to apparently integrate and challenge themselves, E&Y and MAC on this varying profit per unit policy in its specific implications for A340 amortisation with the escalation formula in place. I should also add that it has not been my experience elsewhere that such an approach was countenanced either by management or auditors.

As above MAC continued to add Labour learning costs – after 400+ A340 nacelle sets/5 years of production to production inventory (and E&Y as their auditors accepted the further US \$1.5m to US \$8.63 million added in the FY2006 Balance sheet to sustain the “break-even”) whilst the Inventories Exposure Draft (3031) which would end this capitalisation was issued by the CICA in August 2006. The subsequent introduction of that Canadian Accounting Inventories Standard 3031 in MAC from 1 January 2008 permitted some C\$40m of inventory assets to be written off against retained earnings (approx C\$10m of which was for these A340 -500/600 program labour learning costs).

## **9. A340 COSTS -**

For completeness, COSTS – throughout my attendance at the FY2006 MAC weekly staff meetings which Mr Edwards attended (e.g 25 April 2006, 1 Aug. 2006, 15 Aug. 2006-2021, 12 Sept. 2006-2179) we discussed on multiple occasions that Mr Butyniec and we were failing to meet our operational budget/EAC targets in FY2006 in the factories. Unsurprisingly therefore following an examination of the 2006 costs and Q4.2006 EAC PwC record their analysis of further increases in cost for FY 2007 and subsequently in (para 8.62 (c) “The increased costs for the remainder of the programme result from increased investment in tooling and development initiatives (approximately USD940,000) aimed at reducing the unit costs of production and the application of a higher overhead absorption percentage (approximately USD1,860,000).”

In the Table prepared by PwC at para 8.62 (c) showing that \$2,734k increase in costs over the Q2.2006 EAC PwC should also have properly adjusted for the costs of the 843 (in Q2.2006 EAC) versus the 833 projected delivery of units in the Q4.2006 EAC. Had that adjustment been recorded then this would have further increased the PwC projected costs of \$2,734K over the Q2.2006 EAC by approx \$1,700K to an increased costs total of circa \$4.5m over the Q2.2006 EAC from January 2007/FY2007 for the remaining 833 units represented by MAC for delivery by FY2012.>

Brian Little - 16 March 2011