

Memorandum by PricewaterhouseCoopers

17. That there has been no new entry since the five large firms became four is itself indicative that competition in the market is working successfully for the large company audit clients, and that the market is not sufficiently attractive to other potential suppliers of large audits in terms of the investment-risk-reward payoff to encourage investment. This is an indication that the market is working effectively, and that prices are not excessive in relation to the costs and risk of supply.

18. This pressure on prices leads to a need to ensure efficiency in the provision of audits. This in turn has to be balanced with the regulatory focus on the continuous improvement in audit quality. This was recognised in the AIU's 2010 public report on PwC⁵⁹ which stated:

"The firm's strategy includes quality as one of its main priorities. The leadership of the firm and audit practice continues to focus on initiatives to improve or maintain audit quality, whilst also aiming to achieve efficiencies on audits. Although there is no evidence to suggest that this has detracted from the focus on audit quality, continued care is needed to ensure the emphasis on efficiency does not adversely affect audit quality."

19. Following the collapse of Arthur Andersen in 2002, there have been a number of significant regulatory initiatives to improve the quality of audits, including the independent monitoring of auditors of public interest entities by the AIU and the development of rigorous ethical standards to ensure that auditors remain objective in their relationships with their clients. Further regulatory initiatives have addressed the need to provide additional transparency around the governance of audit firms, culminating in the adoption in the UK of an audit firm governance code⁶⁰ which incorporates the appointment of independent non-executives by the eight largest audit firms.

20. These initiatives are relatively new and it is too early to demonstrate how effective they are in developing market confidence in, and thus enhancing the competitiveness of, the next tier of audit firms. We believe that it would be helpful to monitor the implementation of these initiatives and to assess their impact before any further action is taken.

The role of the auditor during the financial crisis and potential areas for future development

21. Following the financial crisis, all participants in the capital markets have a responsibility to reflect on the causes of the crisis and to examine the potential for changes in the way the markets operate in future. In this context, the role of the auditors was addressed by the House of Commons Treasury Select Committee⁶¹ which stated:

"We have received very little evidence that auditors failed to fulfil their duties as currently stipulated. The fact that some banks failed soon after receiving unqualified audits does not necessarily mean that these audits were deficient. But the fact that the audit process failed to highlight developing problems in the banking sector does cause us to question exactly how useful audit currently is."

WE ARE PERTURBED THAT THE PROCESS RESULTS IN "TUNNEL VISION", WHERE THE BIG PICTURE THAT SHAREHOLDERS WANT TO SEE IS LOST IN A SEA OF DETAIL AND REGULATORY DISCLOSURES"

PwC quote is incomplete. FULL REPORT PART 211 STATES

⁵⁹ <http://www.frc.org.uk/images/uploaded/documents/Public%20Report%202009-10%20PwC.pdf> (section 2.2 page 9)

⁶⁰ <http://www.frc.org.uk/documents/pagemanager/frc/The%20Audit%20Firm%20Governance%20Code.pdf>

⁶¹ <http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/519/519.pdf> (para. 221 page 77) page 78.

EXTRACT FROM HOUSE OF LORDS WRITTEN EVIDENCE

Memorandum by PricewaterhouseCoopers → Sept 2010.

- 22. In response to this challenge, we are taking steps towards changing the role and responsibilities of auditors. [For example, we have committed to a closer working relationship with the banking supervisors and are actively participating in a number of other initiatives in conjunction with the FRC and the UK professional accounting bodies].
- 23. More recently, there has been a suggestion by the FSA and FRC in a joint discussion paper⁶² that auditors may have been insufficiently sceptical in their audits of banks in the run-up to the crisis. We do not accept this assertion.
- 24. Professional scepticism is fundamental to what auditors do. It is defined in auditing standards⁶³ 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." Whilst practical application of this requirement is judgemental and will vary according to circumstance, it is hard to evidence. Scepticism is inevitably applied in real time and is a cultural and behavioural issue. To reinforce the culture of scepticism, we have a robust system of internal quality control reviews and consultation procedures. We believe that this is working. It is our experience that, in the vast majority of cases, audits give rise to changes in the financial statements prior to issuance.
- 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.
- 26. As indicated above, however, the recent financial crisis has raised questions about the role of the auditor, particularly in the context of the audit of banks. We are already taking steps to address these questions. In the context of banks, we recognise that more regular bilateral and trilateral meetings with the supervisors of our audit clients will enhance both the supervisory and audit processes by encouraging greater dialogue and information sharing by all parties. We were active participants in the development of the proposals set out in the ICAEW Financial Services Faculty report⁶⁴ which also addressed the need for improved risk reporting by banks and the potential for increasing the level of assurance over these disclosures. We will continue to participate in developing more specific proposals in these areas in conjunction with other stakeholders.
- 27. More generally, we recognise that there is a need for significant improvements in corporate reporting and consequential changes in the role of the auditor. As a first step, we recognise that how auditors currently discharge their professional responsibilities is often opaque. To ensure investor confidence in company's financial statements we believe that it is essential that the audit process is made more transparent. One way to achieve this would be for audit committees to disclose more details about the dialogue between them and the external auditors. At the same time, there should be a wide-ranging public debate about the future of corporate reporting to identify ways in which the reporting model can be more integrated and less complex. This debate should include all stakeholders, including investors, government and regulators, and should incorporate a discussion of the role that independent assurance can play in enhancing public confidence in the reporting model.

①
TO CHALLENGE MANAGEMENT ASSERTIONS
↓
A340
PARA 8.62B
PARA 8.72
OVERLEAF

②
→ BACKED WITH EVIDENCE THAT IS APPROPRIATE SUPPORTABLE AND CAPABLE OF INDEPENDENT VERIFICATION
↓
A340
See summary on subsequent notes.

⁶² Financial Services Authority & Financial Reporting Council Discussion Paper DP 10/3 "Enhancing the Auditor's Contribution to Prudential Regulation", June 2010
⁶³ International Statement of Auditing (ISA) 200, para 13(i).

MANAGEMENT ASSERTION 1 - Extract from PwC report at Paragraph 8.62 (b)

August 2007

Investigation Report into Areas of Concern Raised by

Mr Brian Little

MAC: Aeronca - Airbus A340 non-recurring costs

8.62 (b) “The increased revenue for the remainder of the programme was due to management's assertion that a higher percentage of future sales will be generated in later years, when MAC can expect to benefit from the impact of compound price escalation. This has the impact of increasing the weighted average future sales price. This also meant that unit sales in the immediate future are projected to be lower. For example, in the Q2 FY2006 EAC, the volume estimates for FY2007 were 144 units and these were subsequently revised downward to 40 units in the Q4 FY2006 EAC. Similarly, unit sales in later years were forecasted to increase by an equal amount. The annual price escalation formula increases the sales price by 4.4% to 5.4% per annum from FY2008 to FY2012.”

Extract from my website www.fortfield.com Part D Exhibit 8.3 (a)

<BL: **The Q2/2006 EAC showed a Gross loss of \$5.220m** and by the Q4.2006 EAC had been uplifted to a miniscule Gross Profit of \$0.137m for >\$185m in future revenues . Crucially there was an addition to the PwC Final Report in August 2007 at para 8.61 {691}

“The Q4 FY2006 EAC was also used by EY for year-end audit testing purposes.”>

That move from a Gross Loss of \$5.220m at Q2 is analysed by PwC at para 8.62 - in an increase in revenues in Q4.2006 by \$8.47M over the life of the programme. PwC para 8.62(b) {692}, in referring to the Table at 8.62, and the increase in revenues to \$8470K states that *“The increased revenue for the remainder of the programme was due to **management’s assertion that a higher percentage of future sales will be generated in later years, when MAC can expect to benefit from the impact of compound price escalation. This has the impact of increasing the weighted average future sales price. This also meant that unit sales in the immediate future (2007) are projected to be lower.....”***”

8.3 Part A : Oral evidence from Mr Dekker on 10 June 2009

Mr Little It says management asserts future sales, whatever, there’s no reference to any change in assumptions and selling price, **when it’s worth \$6m - \$7m**, based on the figures I was given this morning {1830A) ... Pause

Mr Dekker That would certainly be an interpretation of what they’re saying.

Mr Little **For fear of making a comment, and consulting speak, when I say management assertion, that’s what they were being told.** Can you confirm that there was a change in the selling price assumptions made between Q2 and Q4?

Mr Dekker There’s evidence in the bundle, we have two different schedules that show the breakout for the Q2.2006 and Q4.2006 numbers that the selling price for each quarter was different, the Q2 price was lower than Q4.

Judge It doesn’t look as if they’ve brought that into the equation in terms of the report?

Mr Dekker **They certainly haven’t documented it in that fashion.**

<BL observation The schedule referred to in the oral evidence that 10 June 2009 morning (Q2.2006.doc 1830A, after I had completed my own evidence in March 2009) allowed me to confirm what we instinctively and numerically knew (now factually precisely), [which was that PwC had the basic information AND document readily available to enable them to FULLY recognise that management were being “untruthful”, as reported by PwC in their assertion, at para 8.62b above.](#) Aside from the obvious fact that PRICING was overwhelmingly the primary reason for the “move to a positive gross profit” in the Q4.2006 EAC the reader should bear in mind that these are reputedly “forensic” accountants and naturally would themselves know (for a logical and numerically trained specialist person), **that the “management assertion” (Mr Dekker?) which they reported at Para 8.62 was untrue.**

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.* ” I return to this later in the website and A340 Report.

[In fact on PRICING when we had this data it took just a few minutes to produce the Excel spreadsheet WB1A.Q2.Q4 revenues comparing the changes in revenues and their reasons to demonstrate the precise pricing numbers](#) and Revenues impact from Q2 to Q4.2006. As the reader can see in this spreadsheet **\$761K (ONLY 9%)** of the \$8470K increase in the A340 EAC revenues from Q2. to Q4. 2006 were attributable to the management assertion of a deferral in the schedule to later delivery years.

Additionally the A340-500/600 pricing calculations made for the Q4.2006 EAC themselves were WRONG, when documented by PwC at para 8.79 - [obviously multiple numeracy errors as above the stated 10% BETA21 cost increase assumption by some \\$4.4m in unsubstantiated revenues.](#) Indeed it would have been self-evident to a numerate accountant in looking at the [escalation formula \(Appendix V1\)](#) together with the [stated identical % cost assumptions for each year from FY2007 that the table prepared by Aeronca and reported by PwC at para 8.79 for year – on –year price increases of 6.4% to 5.4% could not have been mathematically correct](#) – it should have reflected a consistent circa 3.9% increase per year from the FY2006 assumed price in the EAC. Furthermore there was no justification for the Q4.2006 + 10% BETA21S materials cost assumption, in the form of procurement documentation ex TIMET, sought by PwC for inclusion in their Report.

Crucially, of course, Mr Dekker, Mr Neill and the MAC Audit Committee and all the MAC Board had the opportunity to “correct” any of these “findings of fact” in the PwC report and the management “assertion” when they read the Final Draft Report from April-August 2007. THEY DID NOT. [We were denied that input by Mr Dimma / TORYS LLP – see evidence at Exhibit 8.3C below.](#)

The reader will already have noted that it was the impact of this MAC inflated pricing in Q4.2006 by more than the MAC-assumed +10% in their escalation formula which “enabled an outcome” of a \$137k gross profit in the submitted Q4.2006 EAC to E&Y/PwC.

These are just some of the examples in the body of evidence which leads to my conclusion of PwC “forensic deceit”. Please read [further findings of fact at para 9 in A.340.report .PwC.Forensic.Deceit](#)

When I use the term “Forensic Deceit” in my Final Report on A340, I mean that it is **NOT TRUSTWORTHY**, because the intention of the authors 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 work.

MANAGEMENT ASSERTION 2 : Extract from PwC report at Paragraph 8.71/8.72 -

open Magellan Hoax

8.71 In considering the requirement for spare units, an internal engineering report entitled ‘Durability Analysis on Aircelle A340-500/600 Exhaust System’ (exhibit 8.5) was prepared by Dr. Raj Thamburaj, Director at AM ES, Orenda (a subsidiary of MAC), which concludes on the estimated life of the product. The internal report states that “Actual life limit would be between 33,333h to 37,593h which means that repairs would be required after 6.6-7.5 years at the least”. MAC proposes that an estimated life of 8 years (i.e., 40,000h at 5,000h per annum) would be a reasonable assumption.

8.72 It is of note that the internal report also makes reference to the requirement for repairs in its conclusion and not explicitly to the need for spares or replacement units. Management acknowledges the unpredictability of repair work and has appropriately chosen not to consider repairs in its EAC analysis. Management believes that given the estimated life of the exhaust system, there will be a combination of spare units and repair work. Further, management asserts that the requirement for spare units will support and exceed the total number of units projected in the EAC.”

Extract from my website www.fortfield.com Part D Exhibit 8.5

Exhibit 8.5 [Internal Engineering Report entitled "Durability analysis on Aircelle A340-500/600 Exhaust system by Dr Ray Thamburaj \(Director at AMES\) and accompanying email dated 14 March 2007 from Rich Neill to Stephen Moore \(PwC\) \(UK document 3617 - 3624\) \(PDF\)](#)

PwC report para 8.72 “It is of note that the internal report (*Dr Thamburaj*) also makes reference to the requirement for repairs in its conclusion and not explicitly to the need for spares or replacement units. **Management acknowledges the unpredictability of repair work and has appropriately chosen not to consider repairs in its EAC analysis. . .**”

Separately I advised PwC on audiotape on 29 January 2007 (doc 586) “..there isn’t that many volumes of spares or production based on full spares” and then PwC recorded this in their report paragraph 8.5 as “... Brian Little explained to PwC that the allegation was mainly about production units since the volume for spare parts is not significant.”

Mr Neill oral evidence from 27 July 2009

Judge You are not asserting that there is a mandatory requirement --

Mr Neill Correct, correct.

Judge Yes.

Mr Neill **It is an estimate of the service life that we use to make the forecast.**

Mr Neill Going back to the reports I referred to earlier, we had a damage tolerance report that said a hundred thousand hours is the design life, when they did the damage tolerance report they built into it a scatter range of 5, because the engine time between overhauls was 20 thousand hours and therefore **the belief is that nozzles and plugs could start returning or needing repair from service** from 20 thousand hours on, we thought 20 thousand hours was much too low a number to use for this calculation, and at the same time, given the amount of wear and tear that we knew that would occur, based on our experience, a hundred thousand hours was too great a number. So we had as it were a floor and a ceiling. We made the decision to base it on 40 thousand hours, based on the work that Dr Thamburaj did, that said that if any units are exposed to heavy use in a number of hot and high airports and marine environments, corrosive elements in the air, et cetera, et cetera, there's every likelihood that we'll start seeing **heavy repairs from about 35 thousand hours on, and we chose the 40 thousand hours based on that fact, there was no other science behind the 40 thousand hours."**

Mr Little Okay, can I try and go back to the mathematically and logically, if we go back to the 8.75. **This calculation here is predicated on a replacement at 40 thousand hours, is it or is it not? That's the logic of PwC?**

Mr Neill **I would assume so but it doesn't actually say this --**

Mr Little **Just up to 8.74 --**

Mr Neill **I would assume so.**

This reference in evidence was that PwC had calculated, independently of MAC, an expected demand of **1572 spare and repair units**, as set out in paragraph 8.75. The number was based on some basic logic and maths errors – inflating potential revenues by perhaps \$100m. As I stated in my witness statement as part of para 224.4 “... I considered the mathematical spares calculation included in the report to be at best, misguided.”

It was also not consistent with the much “lower spares numbers – “886” ” in a schedule provided by MAC on 14 March 2007 to PwC (doc 3605H). This MAC schedule representation was NOT mentioned or included amongst the 5 Exhibits (8.1-8.5) in either of the PwC reports.

Mr Neill oral evidence from 27 July 2009

Mr Neill : I think you want me through the ... to show you that there was an error in the second line of their (PwC) calculations which would reduce the number, so on the basis of that's what they did, you've interpreted it that way and I would have to agree with you right now, **but it still doesn't change the overall basis of the EAC, that we had more than the necessary 1250 or whatever the number was mentioned in this email to get all the amortization completed.**

Mr Little : Rich, just so we're both on the same wavelength, the evidence you've given is that the table, you didn't correct, and both of us believe that it's probably wrong. You've said independently in this email that you've done a calculation that suggests 800 units on a replacement basis on 40 thousand hours is what is in the EAC and what I'm saying is, if that is true and everything has changed at 40,000 hours, **purely for spares, that would meet the 1247, which is your point, but it's only in that situation that everything is getting replaced at 40 thousand hours without exception. No repairs, nothing, straightforward replacement.** That's what your emails are saying?

Mr Neill : I think we're losing sight of the purpose of this email. At that point in time, PwC were trying to understand how the numbers stacked up to justify us getting more than 1247 units that had been used at that time in the EAC. I must admit I didn't go back and check in detail every calculation that followed that. **All I was saying was that if you took Dr Thamburaj's 40 thousand hours it would generate a significant number which, on top of the production, would easily exceed the 1247 numbers needed to amortize out the recurring costs.** That's what I was trying to say in the opening paragraph. (of his email dated 29 March 2007 at document 3597)

Mr Little No, I'm suggesting to you you're lying, because that says to anybody, a replacement. The calculation of 800 stacks together with that, it only makes sense in that context. It can't mean anything else, and they then go off and say that's how they've done their calculations, but can't even get the maths right. (overspeaking)

Judge Wait, please. You're suggesting he's lied in the email?

Mr Little Yes, he's deliberately lied and given that impression.

Judge In the email.

Mr Little **In the email relating to the 800 and he then conditions --**

Judge No....

Mr Lynch Wait.

Judge In the email, what you're suggesting is that he's lying to PwC.

Mr Little **He's deliberately given the impression of that 40,000 hours replacement.**

Judge I hear what you say but I want to make a note of it. **I suggest that you are lying in the email. Not anywhere else, but in that email.** That's what's been suggested to you, I think. That that's a lie.

and Mr Lynch QC (Magellan Aerospace) counsel in his cross-examination of Mr Bobbi (June 2009)

(with Mr Lynch interpretation and his client/MAC instructions re Mr Neill's email -3597)

Mr Lynch We have Mr Neill's email to Mr Moore of PricewaterhouseCoopers. I know it's a bit compressed in its typescript. Tribunal, of course there is a bigger version in the bundle, if that's a bit small to read. (Pause).

Mr Bobbi, you can see, can't you, looking at the two substantive paragraphs -- it actually is a feature of both those paragraphs -- **that Mr Neill makes it expressly clear that Magellan is simply basing its calculations for accountancy purposes on spares or replacements, he's not included anything to do with repairs.**

Mr Bobbi That's right.

Mr Lynch Good.

Mr Lynch ... But do you agree that it is certainly right that if Magellan sells a new unit, whether as part of a new aircraft or as a new replacement unit, a spare, then they would all count for EAC purposes?

Mr Bobbi Of course.

Mr Lynch Right. So it's plain, isn't it, **that PwC did indeed examine and accepted, for accountancy purposes, the validity of incorporation of Dr Thamburaj's calculations, yes?**

Mr Bobbi That was the only information that they had.

Mr Lynch Right. And that information would indeed, **because it related to lifespan, that information would indeed provide the basis on which PwC could rightly conclude that indeed these would involve new units that would be sold, that's right, isn't it?**

Mr Bobbi No, that's not. Because a component has a "lifespan" does not mean necessarily it will be replaced by something new, it can be repaired.

Mr Lynch **Yes. Well, no, I think the whole point is this, it's not, Dr Thamburaj's point was not a question that they will need repairs after that period, Dr Thamburaj's point was that around 40,000 flying hours was indeed the lifespan of the unit. That after that, its lifespan was spent and should be replaced. That was the point.**

For information: Dr Thamburaj is the Manager of Advanced Engineering Services at MAC and was neither interviewed by PwC during their independent forensic investigation nor either member of the UK legal team.

Furthermore the MAC/Respondents' UK solicitors (PinsentMasons) are "On the record" stating in PinsentMasons letter extract dated 27 August 2009 *"In regard to the likely need for spare exhaust parts, the Respondents case has always been (and remains) that Dr Thamburaj's work gave rise to a calculation of the **likely life span of the parts**. This allowed an estimate to be made as to the **likely demand of such parts**. Dr Thamburaj's work concerned this and not some regulatory, mandatory requirement, that the parts be replaced after 40000 flying hours. Indeed, Mr Neill made this expressly clear in his email to Mr Furbay at pages 3597/8 And then in PinsentMasons letter extract - 14 September 2009 – "As you well know, our view is that Magellan's position on the likely, predicted need for spares (based on Dr Thamburaj's research) is clear and consistent."* And then in PinsentMasons letter extract – 29 September 2009 *"The Respondents' views as to the need for potential spares and replacements has not changed"* And then in PinsentMasons letter extract – 6 October 2009 *"That case is and was that Dr Thamburaj's*

research allowed MAC to make commercial predictions as to the likely need for replacements.”

Given all the evidence and the continuing position stated in correspondence I wrote in an unprecedented action directly to Mr Lynch QC as a litigant-in-person on 30 September 2009 – see subject 2 on pages 5 – 10 and specifically the warning on page 8.

{BL Observation :

1. Subsequent to the October 2009 Tribunal hearing (after Magellan’s legal team reluctantly agreed to disclose the complete contents of doc 3597/3598 at that tribunal hearing) to disclose the [PwC Questions and Magellan answers \(Mssrs Furbay and Neill\) document in late March 2007 \(see doc 3597-3598/3598A-3598B\)](#) before the FY2006 Financial statements were published the reader will note **Question 5 posed by PwC “The engineering report prepared by Dr Thamburaj makes reference to repairs being required (not necessarily spares). What is management’s view on the distinction between spares and repairs and the implications for future revenues / costs? etc.** PwC then proceed at PwC para 8.75 to falsely calculate a likely demand of 1572 Spares and Repairs by FY2021 – see my A340 report and website parts D & E.

These are just some of the examples in the body of evidence which leads to my conclusion of PwC “forensic deceit”. Please read [further findings of fact at para 9 in A.340.report .PwC.Forensic.Deceit](#)

When I use the term “[Forensic Deceit](#)” in my Final Report on A340, I mean that it is **NOT TRUSTWORTHY**, because the intention of the authors 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 work.

Factually as at the end of October 2010, against the 1247 units used by Magellan in the A340 EAC, a total of 524 have been delivered for installation in A340-500/600 aircraft. This completes all the deliveries from Airbus to airline customers as 131 aircraft and no further are scheduled in the Airbus production plan.

From January 2007 – 31 October 2010 a total of only 11 units have been delivered for Spares.

This would leave a minimum theoretical mathematical balance of 712 units in the MAC assertion for A340-500/600 Spares by FY2021.....(Aircelle email .. HOAX)