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Dear Nicky

I have had the opportunity in the last week to catch up on your recent TSC correspondence this week in relation to the HBOS scandal. An approach which I support. And last night the letters in response published on the TSC website. It did strike me though that there was one piece of unfinished TSC business which I believe that the TSC membership should consider and have not covered, perhaps consciously, by those exchanges.

As background I know that my constituent Mr Brian Little forwarded the previously private copy of the two submissions made to the TSC by a group of six "expert" colleagues, including him, in December 2015 and 4 October 2017 as part of the submission to the Call for Evidence by the Kingman Inquiry on 3 June 2018. He told me that he had advised Treascom by copy of his email on Saturday 9 June 2018 and has for ease since published on his website.

26 July 2016 TSC website update re FRC

- The Financial Reporting Council (FRC) decided not to investigate the auditing of HBOS in 2013, well before the completion of the final HBOS report. This was a serious mistake. The process by which it reached its decision suggests a lack of curiosity and diligence. These failures are all the more concerning given the scale of the problems at HBOS, and the clear public interest at stake. It is extraordinarily unhelpful that the FRC has taken so long and has belatedly reconsidered its position, only after considerable pressure from Parliament and the Treasury Committee. Following its preliminary inquiries, the FRC has now finally commenced an investigation into the auditing of HBOS. (Paragraph 182)
- The auditing of HBOS is the one major element of the HBOS affair that has yet to be subject to adequate scrutiny. The Committee will expect the FRC to undertake an extremely thorough analysis of the HBOS case. Regardless of the outcome of the FRC's investigation process, it is likely that the Committee will want to consider its work and regulatory approach in more detail. The investigation announced on 27 June 2016 is better late than never. But the very tardy response by the FRC appears to be as inexplicable as it is unacceptable. (Paragraph 183)

On 19 September 2017 Chair of the Treasury Committee comments on the news that the Financial Reporting Council (FRC) has closed its investigation into KPMG's audit of HBOS. Rt Hon. Nicky Morgan MP said:

"As early as 2004, the FSA described HBOS as 'an accident waiting to happen'. As the PRA and FCA have since made clear, responsibility for its subsequent failure lies not with external market conditions during the financial crisis, but with the failure of its Board to instil an appropriate culture, and to provide the necessary challenge to the executive.

HBOS' corporate governance was, in the words of the PCBS, "a model of self-delusion".

The FRC initially decided not to investigate KPMG's audit of HBOS. The Treasury Committee concluded that 'this was a serious mistake' that 'suggests a lack of curiosity and diligence'. It was only after pressure from the Committee that the FRC decided to investigate the role of auditors in the bank's demise.

*When it publishes its detailed report next month, the Committee will expect the FRC to provide a full explanation of its decision not to take further action against KPMG. **It may take further evidence in due course.**"*

You may recall after the FRC CEO Mr Stephen Haddrill announced that they would not be pursuing any "serious misconduct" action against KPMG as HBOS auditors their Chairman Mr Win Bischoff was reported in The TIMES on Monday 16 October 2017 "MPs have demanded an explanation over the HBOS decision and the FRC has promised a response this month. However, **Sir Win Bischoff, its chairman, has already defended it, saying that decisions have to be taken on available evidence, "not on Political considerations or public clamour"**.

I am aware that the "Expert Group" had planned to send in a further and final substantial Submission (its third) in March / April 2018 to the TSC but decided with the Carillion Affair and Kingman announcement that they would not do so. HOWEVER I thought I should convey their primary proposition for the TSC consideration in light of the recent disclosures on

18 June 2018 : FRC Press Release - Big Four Audit Quality Review results decline

"The Big Four audit practices must act swiftly to reverse the decline in this year's audit inspection results if they are to achieve the targets for audit quality set by the Financial Reporting Council (FRC). Overall results from the most recent inspections of eight firms by the FRC show that in 2017/18 72% of audits required no more than limited improvements compared with 78% in 2016/17. Among FTSE 350 company audits, 73% required no more than limited improvements against 81% in the prior year.

Across the Big 4, the fall in quality is due to a number of factors, including a failure to challenge management and show appropriate scepticism across their audits, poorer results for audits of banks. There has been an unacceptable deterioration in quality at one firm, KPMG. 50% of KPMG's FTSE 350 audits required more than just limited improvements, compared to 35% in the previous year. As a result, KPMG will be subject to increased scrutiny by the FRC.

Stephen Haddrill, CEO, FRC, said,

“At a time when public trust in business and in audit is in the spotlight, the Big 4 must improve the quality of their audits and do so quickly. They must address urgently several factors that are vital to audit, including the level of challenge and scepticism by auditors, in particular in their bank audits.

We also expect improvements in group audits and in the audit of pension balances. Firms must strenuously renew their efforts to improve audit quality to meet the legitimate expectation of investors and other stakeholders.”

The increased FRC scrutiny of KPMG includes inspecting 25% more KPMG audits over its 2018/19 cycle of work; and monitoring closely the implementation of the firm’s Audit Quality Plan. KPMG agrees that its efforts in recent years have not been sufficient; the FRC will hold KPMG’s new leadership to account for the success of their work to improve audit quality.”

While later that week KPMG were reported on HBOS as saying that they have never seen the Masterton Report and refer for their defence **“to their audit working papers”** and **“the rules / regulations effective at the time”**

25 June 2018 . The APPG Fair Business Banking published the Sally Masterton report from

<http://www.appgbanking.org.uk/wp-content/uploads/2018/06/Statement-on-release-of-the-Turnbull-Report-21.6.18-1.pdf>

<http://www.appgbanking.org.uk/wp-content/uploads/2018/06/250318-Michael-Bancroft.pdf>

<http://www.appgbanking.org.uk/wp-content/uploads/2018/06/draft-Project-Lord-Turnbull-Report-part-1.pdf>

<http://www.appgbanking.org.uk/wp-content/uploads/2018/06/draft-Project-Lord-Turnbull-Report-part-2.pdf>

and were to request in their letter to the FRC that they undertake a further investigation.

As you will know the Dobbs TOR/review does not deal with the period until January 2009 and you will of course be aware that the current FRC Chair Mr Win Bischoff was Lloyds Chairman from April 2009 to April 2014 during the period included as part of her report.

Following a recent discussion Mr Little has provided me with part of their planned third submission (attached).

The TSC will have read that the Expert Group recommendation on 4 October 2017 was leading up to having a substantive independent review or an internal “Audit Inspection Unit” at the FRC review all the documents considered by the separate Enforcement group at the FRC and produce with two independent assessors appointed by the TSC to report in to same for 2006 to 2008.

Now that the AIU in the FRC have finally spoken up (or been allowed to?) on Audit quality (and you can read the prior reports summary from 2007 on KPMG which was the central part of that planned 3rd Submission in the Attachment to my letter) can I suggest that the TSC

members consider this again and get such a independent Review underway so that the TSC could be in receipt of that analysis / audit / report during the next Parliamentary session.

Those Terms of Reference, as a minimum, should clearly assess against the evidence held by the FRC Enforcement team (see para 2.33 in their Submission 2

- (a) available at the time in 2006 – 2008 and the AIU standards and law/regulations
- (b) and the same evidence against the AIU standards and law/regulations today

Only by doing so can we potentially identify what if anything is substantively different and what more HMG, Parliament and Regulators need to do. Also lets remember that at least Paul Moore and Sally Masterston stood up in their jobs / whistleblowers and either they did not understand what was right to do or they did and others failed. You may be aware a new APPG on whistleblowing is also being formed this month.

I understand from Brian Little that the Group deliberately did not recommend any independent assessors but I believe the TSC could consider Mr Iain Cornish, with his background on HBOS and deep involvement in the 2015 PRA/FCA Report as a prior independent TSC Assessor, and Professor Stella Fearnley, who I know was widely regarded by the House of Lords Economic Affairs Committee in 2011 in her evidence then and has prior experience as a Member of the FRC.

I hope you and TSC colleagues consider this a helpful suggestion and naturally would conclude the work begun in January 2016 by your predecessor and TSC colleagues. Those other letters together with this final piece of work by the TSC should help bring some final clarity to this public interest matter a decade on .

In part I thought it worthwhile to bring this to your attention as you will have had the opportunity to read Section 4 of our submission SME0025 to the SME Inquiry on the idea of a similar AIU type unit within the FSA which would look at the individual banks and report on same publicly on a regular basis. Likewise it could assess the effectiveness of the Supervisory teams within the FCA and similarly report. You will have had the opportunity to read what is said in SME0025 and will have seen that we think that is part of a solution to improving FSMA S348 aspects and the Transparency and disclosure to the TSC and public in terms of Governance.

As ever any queries / clarification or meeting to discuss welcome.

Very best wishes

Jim

PS I have copied our Parliamentary colleague Mr Kevin Hollingrake MP on my email given his role and substantive involvement in matters in the media in the last few weeks.

My constituent will be in Parliament on 10/11 July and 23/24 July if you would like to discuss with us or him at that time. Many thanks