

Financial Failures & Scandals: From Enron to Carillion
By Krish Bhaskar and John Flower
Online companions volume
Post Publication Comments: Tesco case update

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Tesco Update September 2019

(Mostly relates to events in 2018).

Tesco SFO trial collapses 6 December 2018):

Former bosses cleared of fraud and false accounting¹:

The last of three former Tesco executives was cleared of wrongdoing over Tesco's £250m accounting scandal by a criminal court on Wednesday, in a ruling that raises serious questions about why the company agreed a £129m plea bargain with the Serious Fraud Office since no one has been convicted.

For us this is more of a failure by the SFO than a misstatement of the profit manipulation. We discussed this in the cases book. The directors who were the subject of this case may not be guilty in that they were not the prime movers of the manipulation of the accounts. However, the accounts were manipulated, as we have shown, and as Tesco, as a corporation, has pleaded guilty. Now the question who is responsible. Here they may very well be a gap in the responsibility process, but for us it should be the Board including the NEDs. Ultimately, we argue, it is they who should accept responsibility and liability for the accounts, annual report and other public market sensitive messages. If this is too broad then the CFO, CEO and Chairman of the audit committee (perhaps), should be held liable for any mistakes/misconduct or those possibly labelled as crimes in the accounts and annual report. That, of course, raises the question of any responsibility of the auditors.

The SFO deferred prosecution agreement is available².

Continues

¹ Croft, J., and Eley, J., SFO case against Tesco directors collapses as defendants acquitted: Judges find Christopher Bush and John Scouler have no case to answer in £250m accounting scandal, *Financial Times*, 6 December 2019.

Available at:

<https://www.ft.com/content/672fdb88-f949-11e8-af46-2022a0b02a6c>

Accessed December 2018

² Available at:

<https://www.sfo.gov.uk/cases/tesco-plc/>

Accessed February 2019

A toxic culture was the real villain at Tesco³

Sir Brian Leveson, the judge who approved the DPA, said there was “clear evidence of what amounts to a serious breach of the criminal law” and that “Tesco Stores, through senior management, played a leading role in what was organised and planned misconduct”.

The DPA was published because Carl Rogberg, the last of three former Tesco executives to go on trial, was acquitted. The SFO told the court it had no evidence to present. The SFO’s pursuit of the other two, Chris Bush and John Scouler, collapsed last month when a judge said the prosecution case was so weak it should not be heard by a jury.

As Oliver Shah pointed out:

There was understandable fury from Rogberg, Bush and Scouler, who have lost four years of their lives. There was inevitable criticism of the SFO, which tends to make the Keystone Cops look sophisticated, and anger at Tesco boss Dave Lewis, who took over just weeks before the scandal broke and oversaw the DPA. There was also frustration from investors: if Rogberg, Bush and Scouler weren’t responsible for the misconduct at Tesco Stores, who was?

Our view in the book was clear. Tesco did overstate its profits by pulling forward revenue. The FCA watchdog fined Tesco’s for misleading the share and bond markets, and put the total in excess of £284m. We concluded that this was an *a priori* case of fraud. This is now reversed by the SFO case. Yet It is difficult to see how that is not fraud.

Oliver Shah made an interesting point which I (KB) agree with after the SFO failure:

Yet whichever Tesco Stores executives were involved acted out of fear rather than greed — they were desperately trying to hit targets. That is why the SFO’s prosecution of three people below board level was never going to provide satisfying answers. Philip Clarke and Sir Richard Broadbent, Tesco’s chief executive and chairman at the time, were ultimately responsible in the governance sense, even though they deny any knowledge of what was happening beneath them.

Clarke, Sir Terry Leahy’s successor, was temperamentally unsuited to leadership and resorted to bullying as Aldi and Lidl’s rise sent Tesco into a tailspin in 2013 and 2014. Desperate to meet the 5.2% margin target he had promised the City, he pushed the business until it cracked. Broadbent, a former Schroders banker, was out of his depth and failed to realise what Clarke was doing. The board was stuffed with high-profile non-executives — including Patrick Cescau, ex-boss of Unilever, and Liv Garfield of Severn Trent — but they struggled to grasp what was going on.

Tesco’s 2014 scandal was the result of a toxic culture where employees scabbled to produce the numbers, compounded by poor corporate governance. It wasn’t the kind of scandal where any single individual set out to do wrong. That’ll be scant comfort to

³ Shah, O., 2019, Oliver Shah: *Sunday Times*, 27 January 2019.

Available at:

<https://www.thetimes.co.uk/article/oliver-shah-a-toxic-culture-was-the-real-villain-at-tesco-xqslr22mg>

Accessed January 2019

A toxic culture was the real villain at Tesco⁴ Continued

Rogberg, Bush and Scouler, but perhaps it goes some way to explaining how Tesco Stores can be guilty while they were acquitted. The real blame lies with the top brass who managed to avoid seeing the effect of their behaviour on the business — even if, in the legal sense, they are innocent too.

Ex-Tesco boss cleared over accounting scandal claims unfair dismissal

And now, of course, the three directors that were cleared can now claim unfair dismissal⁵. Ouch.

In fact the backlash gets worse⁶:

Carl Rogberg, cleared on Wednesday of fraud and false accounting, claims there was never a black hole in Tesco's accounts.

"We saw in court that it wasn't £250m, it was a maximum of £118m," he said. "And of that £118m, no fraud has been proven at all. Most of that, in my opinion, is just a different accounting judgement."

What's more, the accounts were "signed off by lots of independent parties". The problem was, he said, that new management came and decided to make "a different accounting judgement".

Mr Rogberg said: "The real story is that this [scandal] was a gateway to start kitchen-sinking by new management."

"It's a paradox that on the same day I was acquitted, a document is published that suggests the contrary. I'm seen as guilty, when I'm definitely not".

Continues

⁴ Shah, O., 2019, Oliver Shah: *Sunday Times*, 27 January 2019.

Available at:

<https://www.thetimes.co.uk/article/oliver-shah-a-toxic-culture-was-the-real-villain-at-tesco-xqslr22mg>

Accessed January 2019

⁵ D'Arcy S., 2019, Ex-Tesco boss cleared over accounting scandal claims unfair dismissal, *The Independent*, 6 February 2019.

Available at:

<https://www.independent.ie/business/world/extesco-boss-cleared-over-accounting-scandal-claims-unfair-dismissal-37750322.html>

Accessed February 2019

⁶ BBC, 2019, I was made a scapegoat, says ex-Tesco director, *BBC*, 24 January 2019.

Available at:

<https://www.bbc.co.uk/news/business-46981725>

Accessed January 2019

Aftermath of the Tesco fraud scandal undermines the fight against financial crime⁷

This is the apt title of another Times article and the article starts:

Criminal prosecutions brought after the 2014 Tesco accounting scandal are at an end – and the more than four-year saga has been a failure for the SFO.

...prosecutors' failure to secure a single individual criminal conviction in the case raises serious questions about how and why the SFO originally came to prosecute the directors.

The Shah viewpoint that it was senior management leaning on all staff to improve profits in the face of impossible competition by Lidl and Aldi. Such management pressure caused staff to try to cut corners, reduce costs and increase profitability. The Shah viewpoint is that it was culturally and pressure. The fact that the most senior management were unaware of exactly what was going on was irrelevant. They should have. Repeating this line from his article....

The real blame lies with the top brass who managed to avoid seeing the effect of their behaviour on the business — even if, in the legal sense, they are innocent too.

This Maria Cronin article also claims:

More damaging, perhaps, is the doubt now cast over the basis on which Tesco settled with the SFO, in circumstances where the three executives – unequivocally named and held culpable in the statement of facts that accompanies the DPA – have subsequently been vindicated by the criminal courts.

The Tesco saga is an urgent reminder that proper scrutiny is needed over the DPA regime – the present discordant tone struck between failed individual prosecutions and corporate settlements only serves to undermine the coherence of SFO investigations, and to defeat the important work undertaken by prosecutorial agencies in fighting financial crime.

⁷ Cronin, M., 2019, Aftermath of the Tesco fraud scandal undermines the fight against financial crime, The Times, 30 January 2019.

Available at:

<https://www.thetimes.co.uk/article/aftermath-of-the-tesco-fraud-scandal-undermines-the-fight-against-financial-crime-kp33s7wgm>

Accessed January 2019