

8 September 2017

## **Failure of KPMG's audit of Foresight 4 VCT for the years 2013-2017**

Dear Sir,

I write in my capacity as a long term private shareholder in Foresight 4 VCT. I wish to make a formal complaint to the FRC with respect to KPMG's audits of Foresight 4 VCT's accounts for the years ending 31 March 2013 to 2017 respectively and also against named individuals involved with accounts preparation, review and sign off.

I am most encouraged by your recent report on and actions against PWC on its audit of RSM Tenon.

<https://www.frc.org.uk/news/august-2017/sanctions-against-senior-auditor-and-pwc-in-relati>

Foresight 4 VCT is a publicly quoted company, has no large or institutional shareholders and is not covered by external analysts. Shareholders therefore rely totally on the integrity of the accounts produced by the company and verified by the auditor.

### **Executive Summary and the main complaint**

For 3 years running 2013-2015 the Foresight 4 VCT accounts significantly misstated several reserves by over £30m in a £50m fund (see correction in their 2016 accounts p3 & p59). The auditor, KPMG, missed these errors despite them being over 30 times their own audit materiality level.

Foresight 4 VCT's Board, Audit Committee, directors individually and Foresight Group as Company Accountant and Company Secretary have failed in their preparation and oversight of their Report and Accounts. In addition a possible illegal dividend has been paid.

### **Failure of Foresight 4 VCT's internal accounting and internal control**

The root cause of the problem was that the Foresight 4 VCT Board authorised an application to the Court to cancel share premium reserves to increase distributable reserves. When this was approved by the Court it was not properly reflected in the accounts. The filings by Foresight 4 VCT to Companies House clearly reflect these Court applications and approvals and thus were well known to the Board, the Manager and the Auditors by virtue of being recorded in Board Minutes and also by being referred to on p37 in the 2013 accounts.

Throughout this period the Foresight 4 VCT Board had appointed Foresight Group CI Ltd / Foresight Fund Managers as Company Accountant, administrator and

Company Secretary who were required to have an established system of financial control including internal financial controls to ensure that proper accounting records were maintained and that financial information for use within the business and for reporting to shareholders was accurate and that the company's assets were safeguarded.

Clearly this system of control broke down. As a result of the misstatement of distributable reserves the Board made dividend decisions in 2015 on the basis of incorrect distributable reserves data with significant financial consequences for Shareholders.

In the 2016 report, which identified the errors on p3 and p59 and made some but not all the necessary corrections, the Board and KPMG made no reference anywhere to the failure of internal controls or why the Board was re-appointing the auditor who had signed off these material errors in previous years.

### **Failure of the KPMG audit process**

The Board had appointed KPMG Audit Plc (later KPMG LLP) as Auditor for the years 2013 -2017. KPMG then set their materiality levels at £0.9m in 2014 and at £1.1m in 2015. Thus the errors in certain reserves of over £30m in the reported audited accounts from 2013-2015 were over 30 times their materiality level. Clearly their audits were inadequate, the audit management process was inappropriate and the internal partner review process was flawed.

Gareth Horner (2012-2014) and Philip Merchant (2015-2017) were the Senior Statutory Auditors signing the audit opinion and must take personal responsibility.

The KPMG audit opinion in 2016 made no reference to the material errors made by the Company Accountant in previous years and how or if the internal control system had been corrected.

### **Failure of the Foresight 4 VCT Audit Committee**

Over and above the accounting and audit breakdown was the failure of the Foresight 4 VCT Audit Committee to recognise the problems in 2013-2015 and then take corrective actions and explain to shareholders in the 2016 report what had been done and why KPMG was being re-appointed with the same Senior Statutory Auditor who had signed off the incorrect 2015 accounts.

The Chairmen of the Audit Committees that missed these material errors from 2013 to 2015 were Raymond Abbott to 2014 and Simon Jamieson thereafter. Each must take personal responsibility for their failure of oversight. Despite the known failures of these Audit Chairman, the Foresight 4 VCT Board inexplicably went on to appoint each as a subsequent Chairman of the Company.

The other members of the Audit Committee during the period 2013-2015 were Peter Dicks and Philip Stephens who also appeared to have failed in their roles by presiding over such material errors.

## **Failure of the Foresight 4 VCT Board and individual directors**

The Foresight 4 VCT Board and individual directors failed to exert proper oversight and stewardship over internal controls, accounting records and preparation of correct company accounts. They have also failed to document to shareholders what corrective steps have been taken and why KPMG are still deemed to be suitable auditors.

The Board Chairman during this period was Philip Stevens who resigned in March 2017 after 49.99% of votes were cast against him at the 2016 AGM.

The other directors during the period 2013-2015 were Raymond Abbott, Simon Jamieson and Peter Dicks who also appear to have failed in their roles by presiding over such material errors.

## **Shareholder reaction**

Foresight 4 VCT shareholders were incensed by these governance and accounting failures alongside continued poor investment performance and high charges. ShareSoc, a leading private shareholder campaigning group, led a revolt and wrote to about 200 out of an estimated 4000 private shareholders.

ShareSoc recommended shareholders to vote at the 2016 AGM against the accounts (34.2% achieved), against the reappointment of the auditor (42.7% achieved) and against all the directors; Stephens, Chairman (49.99% achieved), Dicks (48.3% achieved) and Jamieson (47.3% achieved).

<https://www.investegate.co.uk/foresight-4-vct-plc--fff-/gnw/foresight-4-vct-plc---agm-statement/20160930160553H5937/>

## **Foresight 4 VCT's response**

The Foresight 4 VCT Board promised shareholders changes as a result of the above votes. The Chairman and the one non independent director belatedly resigned, as their position was untenable. However their replacements were chosen by the discredited Board members themselves without an independent 3rd party present at every interview despite them employing an external recruitment consultant.

Their choices are self-evidently unsuitable; the newest director, Raymond Abbott, (appointed after the merger with Foresight 3 VCT in June 2017) and immediately appointed Chairman was a previous board F4 director and Chairman of the discredited Audit Committee when the problems first occurred and the other new outside director, Michael Gray appointed in February 2017, is a non-resident, has no VCT experience or any previous Foresight 4 VCT shareholding.

I have previously requested the new Board to conduct a third party independent (ie external lawyer & accountant) inquiry into the past systematic control failure of Foresight Group, KPMG, the Audit Committee and Board. No such inquiry has been announced in this year's annual report. Even more surprisingly, the Board have

reappointed KPMG as Auditor yet again without explanation as to its past errors. It is as a result of this situation that I turn to the FRC, having exhausted other avenues.

### **Financial loss to Foresight 4 VCT shareholders**

The financial consequence to Foresight 4 VCT shareholders in 2015 was that the Board determined that it was unable to pay-out any more dividends to the C class shareholders after a major investee sale due to, inter alia, inadequate distributable reserves.

The dividend paid to C Class shareholders was £4.7m (25p/share) in August 2015. The underlying distributable reserves were £4.9m as shown on p44 and p51 of the 2015 report as filed with Companies House. Thus the directors paid out almost the maximum permitted by Company Law.

After shareholder protest, the Board supported their argument that no further dividends could be paid by bringing in a 3rd party auditor, BDO, who was provided with the erroneous 2015 report and accounts, to provide further back up to support the Board's decision.

Due to the reporting error in distributable reserves, the Board found themselves prevented from paying C class shareholders an extra £5m dividend from available free cash. C class shareholders, under pre-existing timing terms, were consequently obliged to merge their C shares with Ordinary shares on an inequitable ratio of cash to unquoted investments. Furthermore instead of receiving extra C dividends as cash they received Ordinary shares which immediately traded at a 40% discount to the conversion NAV costing them an immediate £2.0m impairment.

### **Possible Foresight 4 VCT illegal dividend**

The Board, having constrained themselves over the C class dividend as noted above, then bizarrely decided to pay a £2.3m (4p/share) dividend to Ordinary shareholders (with the undistributed Foresight 4 VCT C cash). At the time the payment was made in Dec 2015, Foresight 4 VCT had not deposited any further audited accounts at Companies House showing sufficient distributable reserves. They thereby appear to be in contravention of CA2006.

I brought this to the Board and Manager's attention in writing in June 2017. Foresight 4 VCT responded at the end of August that they agree the distributable reserve number in 2015 was incorrectly reported but that the underlying number of distributable reserves was sufficient. This might be technically true but the Board and Manager clearly made a totally flawed dividend decision ignoring their own published accounts.

### **Errors in the 2016 & 2017 Accounts**

While errors were not as substantial in this period, nevertheless further mistakes were made by Foresight 4 VCT and not picked up by KPMG. In the 2016 report the

distributable reserves for 2016 were shown as £20.9m on p42 but as nil on p48. Further in the 2017 accounts p51 note 6 identifies the prior year (2016) distributable reserves as £20.9m without comment that this was restating their p48 note 6 of the 2016 report which erroneously showed nil.

### **Request to FRC**

I therefore request that the FRC take immediate steps to examine this situation, take corrective action, impose penalties and apportion blame where and if appropriate.

I would be happy to help your staff in understanding the issues in greater depth and by providing more detailed documentation and briefing notes.

It is possible that some issues are beyond your remit. I would appreciate any guidance on where any such complaints might be better addressed.

Yours faithfully,

(signed)

Attachment: Accounting and auditing errors in the 2013 to 2017 accounts and list of Board members and dates, Audit Committee and dates and Statutory Auditors name(s).