

COMMENT

Having dealt with a misreported payment himself, **Simon Laffin** says Dave Lewis faces a difficult task picking up the pieces at Tesco

What was the weak link in Tesco's financial controls?



Simon Laffin, independent retail adviser and non-executive director

“ It was the phone call that no finance director ever wants to receive. Twelve hours before announcing our results to the City, the auditors were calling to tell me that they weren't going to sign off the accounts. And they weren't going to tell me why. In a truly Kafkaesque twist, they said that it was up to me to tell them why.

Eventually it emerged that a supplier payment that we had just booked in the accounts should belong in the following year instead. I was furious that all our controls to stop this sort of abuse had failed.

A buyer had felt under such pressure to deliver margin that he had brought forward the booking of this amount, and disguised it from both my finance team and the auditors by getting the supplier to sign a letter confirming the falsehood.

This happened a long time ago, and the amount was insignificant to group profits, but it shows the temptations for executives under pressure.

Lump sum commercial income from suppliers can add up to large amounts for retailers, sometimes double the annual profit. However, much of this is contractual and so not really an issue.

It is the discretionary sums that become the problem. A financial control nightmare, they are part of an ever-moving negotiation battle between buyers and suppliers. Both sides like to keep agreements vague, often verbal and reliant on various changing initiatives.

As promotions become more important and margin under pressure, such income tends to grow. So it

wasn't really surprising that Tesco had an issue here, but it was the size of the problem that was astonishing. How can financial control systems fail so comprehensively?

In the last annual report Tesco's auditors, PwC, listed recognition of commercial income as their first area of focus. They noted that they agreed booked sums to 'contractual evidence' from suppliers, just as I had.

Tesco said it overstated profit to the end of last year by £145m, and this year's profit expectations by a further £118m. This was due to "accelerated recognition of commercial income and delayed accrual of costs".

Unfortunately for the grocer, this affair is likely to drag on for years. Not only are regulators getting involved, but law enforcement too. None of these move quickly. They will no doubt be trawling through hundreds of thousands of emails, many of which will have been written in haste and will require careful explanation.

Incidentally, the reason my auditors wouldn't tell me what they'd found was that they wanted to find out if I was part of the conspiracy. They cleared me only when they heard the volume and tone of my subsequent discussions with the buying team.

Dave Lewis will have a similar problem; how to protect the innocent, while letting loose the guilty. He'll also be trying to contain the many investigations while, in his spare time, turning around the retail chain.

Spending time in stores will feel like a happy relief for him this Christmas.

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