

Tesco PLC**Tesco rocked by shift in power balance with suppliers**

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It was not the call a company executive wants to receive late on a Friday afternoon.

But that was when a member of [Tesco's](#) finance team chose to raise concerns about certain half-year figures with Adrian Morris, the UK retailer's general counsel.

He then passed it on to Dave Lewis, the new chief executive, who carried out a fast, preliminary investigation over the weekend and alerted the Financial Conduct Authority.

On Monday morning [Tesco told the City that it had suspended four executives](#), launched an accounting investigation and admitted that its half-year profit was overstated by £250m.

The supermarket chain has asked Deloitte to begin an independent review, along with Freshfields, its lawyers.

The shock admission is the latest challenge for Mr Lewis, who took over less than a month ago after Tesco issued its third profit warning of the year and ousted chief executive Philip Clarke as it struggles with the growth of discounters Lidl and Aldi.

The accounting errors relate to the commercial income that Tesco receives from suppliers, according to three people who know the business well.

When supermarkets, including Tesco, reach deals with suppliers, they agree a price for the goods they buy. But suppliers try to motivate the supermarkets to sell more of their products with payments known as rebates if they sell a certain amount of goods, or by helping the supermarkets fund promotions.

Lombard



Ever been stuck behind someone at a supermarket checkout who hasn't enough cash for their groceries? Embarrassing for them, as for Tesco, which says it will miss its first-half trading profits forecast of £1.1bn by £250m due to accounting issues.

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In recent years, the power balance between Tesco and big suppliers has shifted, with its sales growth weakening and margins at the big suppliers becoming fatter. That may have made it harder to estimate how big this year's rebates were going to be.

According to one person who knows the business well: "It becomes more of a negotiation [with suppliers]. At the half-year you always have to make an assumption about the element of the margin that will be earned. There is always a degree of estimation."

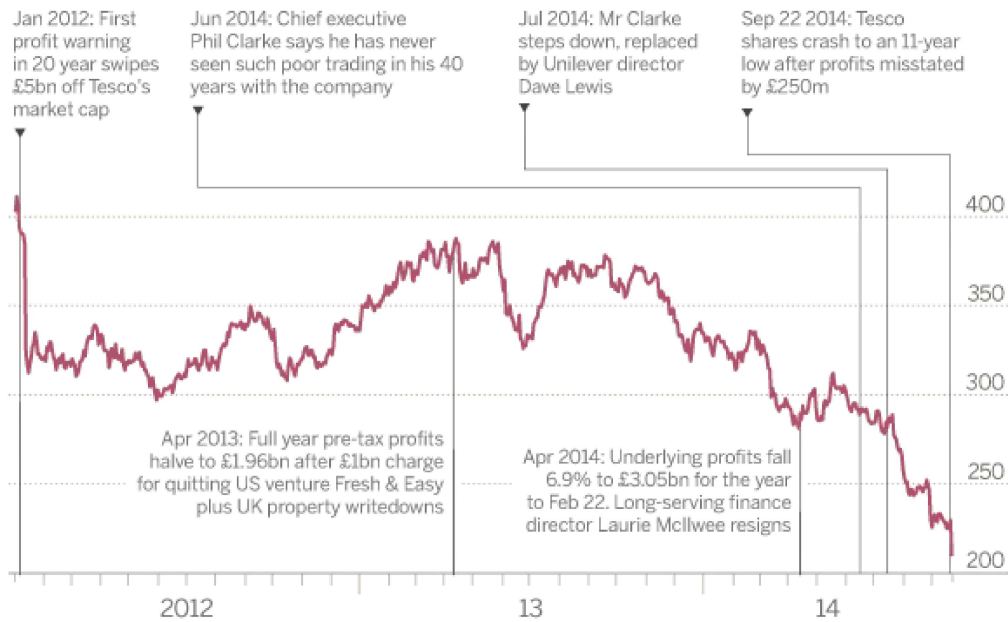
Dave McCarthy, analyst at HSBC, said Tesco "may have been booking promotional rebates based on historic precedent rather than on current volumes".

Mr Lewis has refused to be specific, but confirms that the matter relates to the income that Tesco receives from suppliers. He says it is too early to say if the issue involved fraud.

Either way, analysts and investors at Tesco are stunned by the extent of the overstatement. "Such an announcement is not the stuff of a well-operated FTSE-100 organisation," says Clive Black, analyst at Shore Capital.

Tesco

Share price (pence)



Source: Thomson Reuters Datastream

FT

Investors and accountancy experts say scrutiny should fall on PwC, Tesco's auditors since 1983. When PwC signed off the group's accounts in May for the 52 weeks to February 22, it highlighted commercial income as an "area of focus" due to "the risk of manipulation" in accounting for deals. The current restatement focuses on the next six months, which were not legally required to be audited.

PwC and Deloitte declined to comment.



Source: Thomson Reuters Datastream

FT

"Revenue recognition is always something which is of acute interest to shareholders and you would have thought it should be of acute interest to auditors. It's extremely disappointing that the auditor of the company didn't uncover anything of this nature and it appears to come to light via an internal whistleblower," said Robert Talbut, chief investment officer at Royal London Asset Management.

There is no guarantee that the current restatement is the end of the problem – the number is an early estimate and the final outcome could be higher, the company says.

It all adds up to more pressure on Sir Richard Broadbent, Tesco's chairman, who insisted on Monday that he would not step down despite the events of the past few months. "This is something completely out of the ordinary. Never mind the [Tesco] finance function – the auditors didn't catch it," he said. "Right now, I am going to continue dealing with the issues as they arise in this important company," he added.

So far, Tesco has asked four directors to step aside. They are: Chris Bush, managing director of the UK; Carl Rogberg, UK finance director who had worked with Mr Bush in Tesco's business in Thailand; John Scouler, food commercial director; and Matt Simister, who is responsible for sourcing.

The absences add to lack of leadership at a time when Tesco has a newly appointed chief executive and no finance director. Laurie McIlwee [resigned in April](#), and Alan Stewart, the [new finance director](#) does not start until December. Mr Clarke was ousted in July while Mr Lewis's start date was brought forward from October 1 to September 1.

Sir Richard rejects the suggestion that Tesco has been rudderless. "There has always been at least one executive on the board. It was either Philip Clarke or Dave Lewis," he says. "Phil was involved until the day he left. He stood down on September 1."

Mr McIlwee and Mr Clarke remain on the payroll, with Mr Clarke paid for 18 months, according to the announcement of his [departure in July](#). Mr McIlwee remains on the payroll until October 4, and then receives a year's salary, according to Tesco's report and accounts.

Mr Lewis says it is too early to say whether any salary or bonuses they received will be reviewed.

Letter in response to this report:

[*So much for the City knowledge base / From John R Precious*](#)

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