UK Shareholders' Association

The Private Investor Issue 172 · September 2014

A change in the leadership of UKSA

A message from our new Chairman

John Hunter

I am a passionate advocate of the (much neglected) rights of private shareholders, and have long been a firm believer in UKSA's mission as the foremost body in the land in pursuit of private shareholder interests.

A few weeks ago the Board invited me to become a Director and Chairman; and I was honoured to accept. Eric Chalker agreed to become a Director at the same time. My predecessor as Chairman, Chris Hulme, has stepped down from the Board but will continue to give time to UKSA as far as he can. Chris has for a long time been finding the conflict between his business and the demands of UKSA difficult. Malcolm Howard resigned as a Director in August. More on all of this appears on Page 3.

I have been in post now for a couple of weeks and have held my first Board meeting at which we began to discuss ways forward for UKSA. Those of you on email will have received a message from me and those of you who are not should just have received a letter. As I said in those messages, I believe that UKSA is entering a new phase of influence and activity based on the visible progress achieved of the last few years, provided we can effectively harness the energy and ideas of members. You are all welcome to email me with your thoughts, praise and complaint on chairman@uksa.org.uk.

John Hunter, Chairman

So a new era begins, and a new UKSA telephone number too - 01689 856691.

There is a bit more about these recent changes on Page 3; and whilst I am at it I must tell you that I make no apology for devoting such space to UKSA's Runnymede campaign for the rights of shareholders trapped in nominee accounts. Coverage starts on Page 4, but it has already reached the pages of the FT.

Also in this issue we welcome a contribution from long-term member and noted value investor Charles Breese. And from Carl Renner, Project Director at the Financial Reporting Lab we get the full rundown of the outcome of the project which involved UKSA's policy team. And as usual, much more besides.

Bill Johnston

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Published by the United Kingdom Shareholders' Association Limited
Registered in England no. 4541415

Directors: John Hunter (Chairman), Brian Peart (Deputy Chairman), Harry Braund, Eric Chalker

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Printers: **rap spiderweb Ltd.**
Clowes Street
Oldham, Lancashire OL9 7LY

In this issue...

The UKSA Board

The Board now consists of John Hunter, Brain Peart, Harry Braund and Eric Chalker. John is of course the Chairman, Brian is Deputy Chairman and Eric Chalker is now Policy Director.

Speaking of the former Chairman, Brian and Harry had this to say:

'For more than three years, Chris Hulme has led UKSA's board through some very difficult times for the association and to him goes the greatest credit for meeting organisational challenges head on and enabling the association not just to continue meeting the needs of its members but do so with a new vigour, as well as enabling us to increase our influence with public bodies and the boards of companies with which it engages. We owe him our very grateful thanks.'

And this is from John:

'Malcolm Howard also left the Board. In his brief time on the Board Malcolm brought great energy and application to a wide range of issues of importance to UKSA, particularly in finance and administration. He remains an active member of the London Region and I'm sure we will continue to benefit from his ideas and help.

There is one more thing to add to this, rather unusual in nature, but none the worse for that - indeed quite the contrary. It doesn't require a great deal of faith in sour old human nature on my behalf to believe that all of our members will join me as one in celebrating the news that our tireless Company Secretary, Elizabeth Baxter, is to marry our new Chairman next month. However, she will remain Elizabeth Baxter in name - and still will be the same 'Liz' who looks after us all.

Congratulations to you both!

Bill Johnston

IMPORTANT NOTE: On another matter, if any members hold shares in William Hill - or did so previously or are thinking of doing so - would you please contact Eric Chalker with dispatch.

Leading the way forward: UKSA's Declaration

by Eric Chalker, Policy Director

It has always been the object of the UK Shareholders' Association to ensure that private investors are able to have an identifiable influence on the companies in which they invest. The biggest obstacle to achieving this has been the growth of pooled nominee accounts. This growth has principally been driven by broker pressure. It has created opportunities to invest in shares more cheaply and efficiently, but it has also deprived such investors of the direct relationship with companies enjoyed by those who hold share certificates or (for a relative few) have personal Crest accounts. Because of pooled nominee accounts, private investor influence on the companies in which they invest has actually been diminishing.

The growth of pooled nominee accounts has also put an increasing number of investors at additional risk of loss. Not only are they not the legal owners of their investments, but shares purchased on their behalf are not even identifiable as such by company registrars and they are dependent on third parties to ensure that all their investments are properly maintained. This involves stockbrokers, nominees, custodians and sometimes sub-custodians. The failure of any one of these, through maladministration, negligence or fraud, or the intervention of its regulator as happened to stockbroker Pritchard last year (see *The Private Investor* September 2013), could reveal shortfalls in holdings for which compensation is currently quite limited.

Tackling the issues associated with pooled nominee accounts is the single most important requirement for UKSA if our principal object is to have any chance of success. In this respect, the last few years have been a period of research, discovery and some surprising revelations. Much more is now understood about the disadvantages to investors of using pooled nominee accounts, built on my experience of personally challenging a takeover by scheme of arrangement in the High Court and discovering that nominee account users were excluded from voting.

UKSA's leading role to-date

We have been advising arms of government on these issues for many years now. My personal involvement began in 2011, when on behalf of UKSA I joined the Treasury's working party on dematerialisation. We gave evidence to the Kay Review and the Parliamentary Committee which reviewed the government's response. We have lobbied the Financial Reporting Council on

Eric Chalker

the matter and in July 2013 we became founder members of the Financial Conduct Authority's User Group concerned with shareholder' rights and protections in nominee accounts. Along the way, we involved ourselves with the ICSA Registrars Group as it worked to find a model to enable name-on-register to be preserved after dematerialisation.

Mandatory dematerialisation, originally seen as a threat but now potentially an opportunity, has given the issues a sharper focus and, although the timescale has slipped, there is a certainty of change which cannot be evaded. It won't be this government which decides how it is to be handled, but opinion is already being shaped among officials who will be advising ministers when the time comes. At the moment, a name-on-register solution appears to have the edge, but achieving this must not be taken for granted, not least because there is pressure, as we know, for a nominee account solution to dematerialisation; while some of that pressure is visible, driven by commercial interests, we should assume that some of it is not.

Fortunately, there appears to be a wider understanding now of the disadvantages of pooled nominee accounts. UKSA can claim credit for this and it gives us a position from which we can continue to lead. But we do need to give that lead and do so in a way which makes the best use of our necessarily limited resources. The time has come to take a further initiative in seeking the reforms we want; these are summarised in the tenth and eleventh UKSA Manifesto Objectives, but we need stronger language to create momentum. This conclusion has led to *The Runnymede Declaration for Shareholder Rights,* specific in its terms and very much to the point, which provides the foundation for a push in multiple directions to achieve what we want.

Launching the Declaration

The Declaration gives a target date of end 2015. To achieve a good result by then is a tall order, given that a general election will take place next May, but that election gives us the opportunity to address all political parties on the subject. And of course, 2015 is a good year to campaign for basic rights, being the 800th anniversary of Magna Carta, signed at Runneymede.

The Runneymede Declaration for Shareholder Rights will stand alone as the complete summary of what we want, but it will of course be supported by other material to explain and elaborate. One element of it may need explanation now and that is the inclusion of a demand that compensation for failure of an intermediary be raised dramatically. Its inclusion is to provide balance, to ensure that where investors don't enjoy name-on-register they do enjoy a meaningful compensation guarantee instead, but it is also necessary for reasons of equity – equity for equity investors.

Compensation must be raised

While our research to-date has not fully uncovered the mechanism by which the present compensation limit of £50,000 was set and how it could be raised, we know that the financial services industry itself will want to have its say. If a firm goes bust and compensation has to be paid, it is done by a levy on the relevant businesses, including of course regulated stockbrokers and custodians. It stands to reason that the financial services industry has no wish to face a bigger levy, but unless an alternative arrangement can be provided by government it should do so, because it is stockbrokers who have been cajoling and even bullying investors to give up their certificates and trust their wealth to intermediaries.

It must be an element in what we seek that every broker handling private clients must either provide a name-on-register alternative to its pooled nominee account, or be prepared to provide realistic compensation in the event of the latter's failure. This is only equitable. The fact that compensation is already offered means that a risk is already acknowledged; now the industry must be made to acknowledge that the risk for a significant body of investors is far, far greater than the compensation offered. Compensation for lost assets must match that available from insurance-based pension funds, which is 90% with no limit.

For investors using ISAs and SIPPs to build funds for their retirement – which is an ever-increasing number now that only a privileged few have the luxury of defined benefit pension schemes – the potential for even catastrophic loss is real. With a fund of more than £0.5 million required to provide just a single person's pension of only £20,000 pa, the present compensation limit is self-evidently wholly inadequate, clearly unjust and must be remedied.

***The Runnymede Declaration for Shareholder Rights* (which appears overleaf) is now in the public domain. Now begins the task of making those responsible for change aware of what is required.**

Eric Chalker, Policy Director

News Items

Roger Collinge

Corporate Governance Code

The UK regulator, the Financial Reporting Council (FRC), has just published its updated Corporate Governance Code. This guides the boards of companies in which we invest on the governance of their companies. There are some useful improvements.

In particular the way in which directors' remuneration is to be calculated and reported has been much tidied up. Also there is a new requirement for directors to make a statement in the accounts that 'they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment.' The directors have to select the period of assessment- and importantly – justify their choice of a period which must be longer than a year.

Of course this is something the directors should always have been doing, but the fact that they have to make a public statement to that effect will concentrate minds.

The FRC always comments that the Code is on a "comply or explain" basis so that if a board do not feel it right to follow the Code they have to explain why. The full updated Code with supporting documents is available on the FRC website. www.frc.org.uk. Incidentally there is a bit more about this in the following pages.

Accounting Standards

Accounting standards are set by a body called the International Accounting Standards Board. We, with others, have been lobbying them to improve, in our view, what they do. As a part of their campaign to keep in contact with investors they have started to publish a newsletter called 'Investor Update'. Their latest edition has just been published and is available on their web site www.ifrs.org. Encouragingly they are actively inviting comment.

Roger Collinge

THE RUNNYMEDE DECLARATION FOR SHAREHOLDER RIGHTS

ISSUED BY THE UK SHAREHOLDERS' ASSOCIATION LIMITED on the matter of EQUITY INVESTOR RIGHTS & PROTECTIONS

Published September 2014

Shareholder Democracy

The UK Shareholders' Association regards the present arrangements under which increasing numbers of private investors are obliged to hold company shares as hostile to their own best interests and to the need for good corporate governance. Shareholder democracy is damaged when investors in company shares are denied shareholder rights and yet that is one outcome of the unrelenting pressure forcing investors to use intermediaries for holding their shares, in the form of pooled nominee accounts.

A direct relationship between investors and companies in which they are invested, which can only be achieved by investors' own names being placed on share registers, is the necessary means of achieving shareholder democracy. Such a relationship should be available for all who want it. It is the best protection for those who save by investing in equities, as it avoids all possibility of loss caused by an intermediary failing, with shareholdings that do not match its obligations. For those that do depend on an intermediary the compensation available must be raised to the same level as that available for pension schemes, because the loss of a portfolio could be similarly catastrophic.

The UK Shareholders' Association accordingly makes the following declaration, to be known as The Runnymede Declaration for Shareholder Rights, to reflect the foundation of all democratic rights signed on Runnymede Island in The Thames 800 years ago.

Declaration

It is inequitable and intolerable that investors whose own money is used to purchase shares in companies of their own choosing can be denied entitlement to the legal rights of ownership.

It is contrary to the public interest that those who by their investment decisions should, as equity owners, be able to hold company managements to account, can be prevented or hindered from doing so.

All citizens of the United Kingdom of Great Britain & Northern Ireland who invest in British companies that are listed on any public market must be able to enjoy identical rights of information, participation and voting as currently enjoyed by shareholders in certificated form.

When the UK Government decides to abolish share certificates (to comply with EU law), this decision must be implemented in such a way that the full shareholder rights associated with legal ownership of company shares are preserved.

UK investors holding their shares through an intermediary must be protected in like manner to pension funds provided by insurance companies, namely 90% with no upper limit.

The UK Shareholders' Association calls upon all political parties to address these matters as a priority, so that remedies can be found and implemented by the UK Government before the end of 2015, the 800th anniversary of the primary source of individual rights, Magna Carta.

Footnote

Ownership of shares by individuals has a number of benefits and should be actively encouraged by government, not least because it increases understanding of where wealth comes from. Quite apart from the well-recognised need for individuals to save more, especially for their own retirement, individuals managing their own assets are more natural and better owners of businesses in which they have invested their own money than are the institutional investors who invest other people's money without any direct interest themselves in the success or otherwise of the companies in which they have invested.

Direct investment in UK equities by individuals, much of which is for the provision of pensions, is insufficiently recognised as a public good. Statistics published by the Financial Times show that if overseas holdings of UK equities are discounted, private individuals hold 23% of the rest – which is almost equal to the share of pension funds and insurance companies combined. Statistically, private investors should count much more than they do.

The Financial Reporting Council and Top Pay

by Roy Colbran

Three of us, Eric Chalker, John Hunter and I, trotted along to the Saddlers Hall in Gutter Lane on 17 September for the packed annual meeting of the Financial Reporting Council (FRC). This is their equivalent of an AGM.

The proceedings were opened by the incoming Chairman, 73-year-old Sir Winfried Bischoff, replacing Baroness Hogg. He has previously been Chairman of *Lloyds Banking Group* and of *Citigroup*. Whatever his other qualifications he clearly demonstrated his low level of ability at public speaking – at least when using a prepared script. It seems from the annual report that the organisation has 14 ongoing non-executive directors and three executives. The total annual pay of the four people on the platform is in excess of £1¼ million and total staff number 164. Of course, as well as their functions in respect of corporate governance and corporate reporting they have responsibility for oversight of regulation of auditors and actuaries. Even so, one must wonder at the effectiveness of meetings of such a large Board.

The FRC had chosen the day of the meeting to announce changes to the Corporate Governance Code. Those most likely to interest UKSA members relate to Directors' Remuneration. In particular greater emphasis must in future be placed on ensuring remuneration policies are designed with the long-term success of the company in mind, with the lead responsibility for this resting with the remuneration committee. Companies should also have arrangements to permit recovery or withholding of variable pay and consider appropriate vesting and holding periods for deferred pay. It seems to be taken for granted that substantial performance pay is effective although Anthony Hilton drew attention in the *London Evening Standard* the same day to academic evidence suggesting that bonuses do not work but actually damage businesses. He also pointed out that no one defines what is meant by performance nor by long-term.

Andrew Smithers* is convinced that present bonus arrangements make executives less likely to undertake long-term investment and so are actually causing serious damage to the economy. This is the main theme of his 2013 book *The Road to Recovery.* Edward Luce, writing in the FT a few days after the meeting, drew attention to the enormous amount being spent by US companies on stock buybacks which, by increasing earnings on the outstanding shares, lift the pay of the directors. This, of course, is money that could otherwise be used to invest for the future development of the company. There is little doubt that the extremes of pay between the top executives and the average worker are materially worse in the USA than here, even though we may think they are outrageous enough in the UK. Having got into this situation it is hard to see how the FRC or anybody else is going to get it back to what most people would regard as acceptable. Without a lead from the USA I do wonder how much we can achieve in this country. We must hope that eventually pressure of public opinion will force changes.

Roy Colbran

Andrew Smithers founded Smithers & Co in 1989. Before that he ran S G Warburg's asset management business for many years (now part of Merrill Lynch Investment Managers/BlackRock). He is a regular financial commentator and columnist, and author of several academic publications.*

There was more public support for investors this month, emanating from Brussels this time rather than London as Better Finance (formerly *EuroFinUse*) welcomed the new 'Trends, Risks and Vulnerabilities' report released by the European Securities & Markets Authority (ESMA). Alas, noted Better Finance the press release did not say a word about individual investors' trends and risks. Moreover, and of additional concern, the new report itself failed to identify and underline the mounting losses suffered by European savers and individual investors due to financial repression and imposed fees:

- **'Most bank savings accounts now deliver negative real (after inflation) returns and in some cases even nominal negative returns when banking fees and commissions are taken into account. Bank savings accounts are the number one financial saving products used by EU citizens.'**
- **Real returns for the second most popular saving product in Europe - life insurance - are also falling and are often negative, even before tax.'**
- **As will be shown in the 2014 Better Finance Research Report on the real return of pension savings - to be released on today - long term real returns for pension savings are often poor, with future trends more worrying still.'**
- **Although we could not find adequate data on returns for investment funds, recent reports demonstrate that the majority are still underperforming their benchmarks over the mid-long term, and that most money market funds are also delivering negative real returns.**
- **As for shares, bonds and low cost index ETFs, it is important to point out that EU citizens hold them less and less directly, due in part to the persisting lack of a level playing field for the retail distribution of these investment products.'**

Better Finance stresses the urgent need for the European Financial Supervisors to better comply with their legal obligation to collect, analyse and report on consumer trends. Amen to that. ***Bill Johnston***

Letter to the Editor

Dear Sir,

The Australian solution to nominee accounts

Eric Chalker notes (Issue 171) how hard it is for private investors holding their shares through a nominee account to get hard copies of annual reports. The brokers are reluctant to provide this service because of the costs involved, and as they are not really obliged to do so. May I suggest a simple solution? One should call or write to the companies in which one is invested, explain that he or she holds shares through a nominee account and ask for the reports to be mailed directly to their home address once they are sent to all other shareholders. This has worked perfectly fine for me so far, both in regards to small companies as well as larger ones.

On the wider issues that Eric is vehemently fighting on our behalf (thank you, Eric!), that is of granting shareholders rights to those who hold shares through a nominee account, I would suggest adopting the Australian system. In Australia, each investor is assigned a Holder Identification Number (HIN). Whenever a broker purchases shares on behalf of the investor, they notify the company's registrar. Following the first purchase of shares, the investor will get from the registrar (i.e. the company) a welcome letter, informing them of shareholders benefits if any (like a 10% off on the company's products) and asking for their reporting priorities, i.e. do they wish to receive company's communication (including the annual report) electronically or through the post. The registrar then sends monthly reports detailing all further purchases or sales of the company's shares by the same investor, showing the balance of shares held at the end of the month. When an AGM (or an EGM for that matter) is announced, the registrar will send all the necessary documents to the individual shareholder so she or he can vote their shares, either electronically (preferred) or by faxing or mailing the physical form back to the registrar.

While all this sounds like a lot of work for the brokers it is not really so; their workload is done automatically by electronic means. The real burden falls on the companies and their registrars (like when mailing the annual report) but this is part of the cost of being a public company. The benefit to the companies is that they know exactly who owns their shares. I think that using such a system would allow us to continue to enjoy the benefits of the nominee account system while not losing control of our holdings.

Joseph Zarfaty

More letters to the editor appear on pages 20 and 21.

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SmartCos

by Charles Breese

SmartCos are for the patient and strategic investor - companies able to thrive in economic Armageddon

It was a great pleasure to be invited by Martin White and Bill Johnston to write for Private Investor. Some ten years ago, UKSA used to put on an excellent annual two day InvestFest in Banbury, for which I was tasked with selecting four smallcaps to make presentations – Martin generously says that this is what opened his eyes to the fact that there are some very attractive investment opportunities within the microcap universe for the patient and strategic investor.

For the last thirty years I have regarded step-change innovation as fundamental to both making society wealthier and also addressing society's key problems. However, over that time, the guiding mantra across the capital markets and the approach to regulation has been that 'bigger equals better' without any thought as to whether there are underlying principles supporting that view. There is a large body of evidence that very large businesses are very ineffective at handling step change innovation. Recent examples of the impact on investors of this fundamental weakness include Tesco (mkt cap of £18.7 billion - moved from a high of 454p in 2010 to 224p), ASOS (mkt cap of £1.7 billion - moved from a high of 7050p in early 2014 to 2033p) and Phones 4U, which has just been placed in administration having had sales of c.£1 billion.

In view of the importance of digital technology to our future wellbeing, it is telling that the FTSE 100 contains only two such stocks, namely ARM and Sage.

Contact with people in the 20-30 age group shows that getting fulfilling jobs is very challenging – seeing somebody with a 1st class degree working in a hotel reception because it is the only job he can get seems to me to be wasted resource! Accordingly, I believe that it makes sense for the patient and strategic investor to seek investments with the potential to deliver good returns <u>and</u> improve the job landscape for our children and grandchildren – if we don't, we will face the economic consequences of living in a more anarchic society.

In the early 1980s I had the insight that the recent economic Armageddon would come based on my belief that people behaving as though they were wealthy based largely on increasing house prices was unsustainable. So I developed an investment template as a tool for identifying companies likely to be able to thrive in economic meltdown (SmartCos) – the tool was based on analysing how successful business people build businesses to compete on value not price. Template conforming companies seek to:

- **commercialise game changing technology with the potential to provide solutions to global problems ie exporters.**

- **provide economic benefits to their direct and indirect customers ie improve customer productivity.**

- **pursue a 'product as a service' business model thereby generating a growing stream of recurring income, resulting in less resource needing to be deployed on lead generation (which provides no value to customers) and more resource on product development (which benefits customers).**

I have focused only on template conforming companies which a) require less than £10 million equity investment over a period of years to build a profitable international business and b) have the potential to be developed into businesses worth at least £100 million - such businesses are capable of continuing to be developed so as to be worth significantly more. The key attraction of this focus is that such companies are of little interest to mainstream City professionals because they don't generate sufficient fees to support their fixed overheads, thus providing an attractive opportunity for the patient and strategic investor. Despite being small at this stage, it is possible to find such companies with management which includes experience of P&L responsibility within a multinational – such people have entered the world of microcaps because they find the decision making processes within large corporates deeply unappealing.

I seek to build 80/20 portfolios, with at least 80% of the portfolio invested in SmartCos making a pre-tax profit in excess of £1 million and up to 20% in earlier stage SmartCos. This means that the chances of preserving wealth and achieving a real return are high, with the potential for transformational performance if the earlier stage companies succeed.

Martin White and I have collaborated on SmartCo investing over the last ten years and are currently looking at how to make this one of the areas of focus for UKSA members.

Charles Breese

UKSA and the LAB

From Carl Renner, Project Director, The Financial Reporting Lab

The Financial Reporting Lab (the Lab) published its project report "Accounting policies and integration of related financial information" in July 2014, which is freely available on the FRC's web site (see details in box below). UK Shareholders Association (UKSA) members contributed to the project by responding to an online survey, which enabled the Lab to incorporate retail shareholders' views into the report.

The Lab's project report examines which accounting policies are significant to the investment community; whether only significant policies should be included in the financial statements; whether the investment community would like access to non-significant accounting policies; content of significant policy disclosure; where in the financial statements policies should be placed; whether there is a preferred ordering of notes to the financial statements; and whether the management commentary on the results for the year should be integrated with the financial statements.

Fifty-two UKSA members took the time to provide the Lab with their views on the topics. It was encouraging to see that in many areas members had similar views to institutional investors, and interesting to learn where views differed. The following are some of the key findings from the UKSA member survey.

Over 90% of UKSA members utilise the financial review (management commentary) in evaluating company's financial performance (with 30.4% reading it as a whole), and 70% of members refer to the accounting policies (with 13% referring to them often).

When asked how the quality and usefulness of accounting policy disclosure could be improved, members indicated they want the removal of boilerplate language, a clear indication of where there is a choice of accounting policy made and why management have chosen one policy over the other(s), and a more detailed explanation of the level of judgement and estimation required in applying each policy, including where in the range of acceptable outcomes management's judgement sits. The most popular of these was the removal of boilerplate language with a response rate of 77.5%.

The Lab also asked members whether companies make it sufficiently clear when an accounting policy has changed. The survey showed that over 75% of respondents believed that companies did not make their accounting policy changes sufficiently clear. Members expressed an almost unanimous view that the traditional note order (where notes, generally, follow the order of presentation of line items in the Income Statement, Balance Sheet, and Statement of Cash Flows) was by far the most preferred ordering system. The majority of retail investors also believe that there should be consistency of note ordering among companies.

In response to the question of what criteria make a policy "significant," policies in relation to material balances/transactions, those where there is a policy choice, and policies which require significant judgement and/or estimation in their application were rated the highest overall. Interestingly, nearly 28% of UKSA members reported that they felt all policies were significant. This may be a result of over 70% of members having no formal accounting qualifications, leading to a need for policy disclosure to enable them to understand and analyse the data. However, almost 60% of members reported that they would be content with companies removing the policies deemed by the company as insignificant from the annual report, and placing them on the company website. This is a common opinion amongst institutional investors, many of whom prefer the benefits of a more concise annual report featuring only the significant policies, while still maintaining access to all the policies elsewhere.

From this study, the Lab has gained a valuable perspective of retail investors' thoughts on accounting policies and their placement in the annual report, which have been considered in its project report. The data collected suggests that company's reports do not contain the level of clarity necessary to effectively communicate with their retail investors, largely due to boilerplate language. Investors rely on companies to format their reports in a way in which information can be understood and located easily. The study also showed that investors value consistency in note ordering across companies. Improvements in language and entity specific disclosures should help to increase understandability and effective communication with shareholders.

Carl Renner
Project Director

The Lab was set up by the Financial Reporting Council (FRC) to foster good reporting by companies that answers the needs of investors (both big and small). We are always pleased to hear views and thoughts from the investor community. Please email the Lab at: financialreportinglab@frc.org.uk You can also keep up to date with the Lab's activities via the FRC's website: https://frc.org.uk/lab

Investment Metrics, Accounting Procedures Annual Reports and Boardroom Pay

by Richard Tavener

I've never understood the market's obsession with EBITDA (earnings before interest, tax, depreciation and amortisation) which seems to be shared by bankers using this formula for setting companies' loan covenants. Interest and tax HAVE to be paid (in almost all cases) so in order to get closer to cash profits which is what analysts and bankers quite rightly seem to want, why not simply use net cash flow or free cash flow. These numbers can easily be extracted from company accounts, are far more meaningful and are much more difficult to manipulate.

Richard Tavener

If it were up to me, I'd abolish the income statement or the P & L account as it used to be called; why the name change, likewise the balance sheet is now often called 'statement of financial position'?! A cash flow statement adjusted to include revenue, gross profit and earnings per share is surely all that's required. Everyone must be heartily sick of the statutory figures i.e. the deduction of share-based payments, amortisation of acquired intangibles, exceptional items etc. which distort the true underlying performance of companies. They do, of course, provide 'headline/normalised' figures themselves thus obviating users' need to calculate the numbers separately but why not make the underlying figures statutory with details of the ad hoc items given in a note to the principal statement? Naturally, any impairment provisions must be highlighted as these reflect the quality of assets or lack thereof.

I learned recently that some analysts ignore profits from joint ventures (JVs) when assessing a company's performance and that this is a directive from their banking superiors. This must be wrong and I can't understand their reasoning. JV income/profits are often an integral part of a company's earnings, especially for large construction/engineering concerns, and must surely be accounted for? I'm not an accountant but it seems to me that the new standard covering the treatment of JVs (IFRS 1) is more opaque than its predecessor. Using energy services company Kentz Corp as an example, the 012 annual report clearly shows revenue, operating profit, tax and net profit from JVs whilst last year's accounts simply condense everything into net profit.

Not long ago, I got hold of Standard Chartered's annual report; 342 pages!! who on earth is ever going to read this? Most FTSE-100 companies have annual reports containing between 150 and 200 pages, many of which are never read so surely these reports could be drastically reduced saving valuable time and money. I realise that corporate governance reporting is mandatory but why not order companies to provide a blueprint, both in hard copy and on their web sites, of all the legally required items thus enabling ready access for those wanting this information, leaving the annual report a much smaller, more concise and readable publication. Clearly, accounting policies are crucial but these could form part of the blueprint with any changes being highlighted in the FCO's review without the need to repeat all the policies still adopted. companies should also be dissuaded from making meaningless statements like 'trading is in line with budget' (unless the budget is disclosed!) and 'we're well positioned to take advantage of any opportunities which may arise' which really means that the board has no idea where the business is heading!! I doubt if this could be law-enforceable, hence my suggestion that it should only be severely frowned upon. To be fair, these sort of statements are increasingly rare as companies now effectively report 4 times a year with forward guidance released in between interim and final results, a headache for management concentrating on maximising long-term shareholder value but necessary for all market participants. As we've seen in recent months, the market is brutal to companies announcing even mildly disappointing news with the decimated share price failing to mirror longer term fundamentals in preference to short term hiccups.

The latest furore over boardroom pay must be Philip Clarke's leaving bonus of £10 million for presiding over Tesco's recent demise. No doubt this was written into his contract but surely there's a way to stop these ridiculous rewards for failure? Whether or not he was really responsible for the supermarket's poor performance - and Tesco's problems probably go right back to the era of rapid out-of-town expansion - but as chief executive he has to carry the can and should have been dismissed with just a token compensation. I've never been privy to any directors' contracts but these must be overhauled with remuneration/bonuses linked to the company's performance be it net profit, cash flow or net assets. Share price level should not be used for various reasons, one being that Q.E etc. has clearly driven prices higher in recent years rather than some businesses' operational achievements.

Richard Tavener

342 pages forsooth! Richard, and anyone else that can get aboard should hot-foot it to the Spread Eagle in Croydon on 7th October where Richard Meddings, former Finance Director of Standard Chartered will be giving the kind of insight that you couldn't get if you paid for it into the risks and opportunities in banking. And if you want more of the same you can get it a week later. See Page 24.

Letters to the Editor (continued)

Dear Sir,

Are you happy with you broker?

I would like to respond to Eric Chalker's and Marshall Summers' letters in the last edition of the PI. Eric asks, "Are you happy with your broker?"

The answer is yes, I am more than happy with my broker. Eric seems to believe that we must all think the way he does an act accordingly. My shares are held in a nominee account and as far as I am concerned I do not need a share certificate; a contract note is good enough for me.

I used to have share certificates and thought they were a good idea until one got lost in the post after I had sold some shares and it took six months to get the proceeds of the sale. Another advantage is now that I do not hold share certificates I don't get scammers knocking on my door! Mr Summers, nominee accounts will resolve your problem.

I do not want my house cluttered up with Annual Reports running to one hundred or more pages. For every share I hold I am on an e-mail 'alert', so I know when a report is out. I download the report, read the odd comment and print off the five pages (the accounts and relevant notes) that of are interest to me. I can then make the decision to hold or sell at least a week before anyone can receive a hard copy of the Annual Report.

I know that my holding is absolutely irrelevant as far as voting goes, so if it doesn't affect me I am usually not interested. If I want to attend an AGM and vote, then my broker will arrange this by writing a letter. There is no charge for this, nor do I pay any 'rent' for the broker holding my shares. I pay commission at the standard rate; I don't use a cheap on-line service. However, when a particular vote will affect me, such as a takeover, rights issue etc, my broker always informs me and votes as I instruct.

Dividends get paid direct into my bank account, I receive regular statements and an annual summary showing all transactions and tax deducted from dividends etc. So I have no complaint, but can understand Eric's concerns as not all brokers offer such a comprehensive service.

Malcolm Howard

Dear Sir,

The future of UKSA

It is indeed pleasing to find in your July issue our Finance Director telling us that we have turned the corner financially. Being a non-accountant, I was a little surprised he could be so positive based on only six months' figures. I always understood that half-year figures really only served as a comparison with the same period in the previous year because of the possible uneven incidence of income and costs. However, I am sure that Malcolm knows more about these than he has told us and that enables him to be so positive.

Even so, it would seem that the improvement in the financial position comes more from a reduction in costs than an increase in income. To really turn the corner I suggest that we need a substantial increase in membership with associated income. Last year's accounts showed that the membership had dropped in the year from 528 to 501 i.e. a loss of 5%. Malcolm's figures for the six months show subscription income of marginally less than half of last year's total and so I must express the hope that more comes in the second half and the numbers are really on the rise.

These thoughts lead naturally on to the question of whether we are making ourselves attractive to potential new members. The impression given by the contributions that you receive for publication is that we have become almost entirely a campaigning organisation. *Responsible Investing* on the other hand claims that we offer communication between members to compare views and formulate opinion, that we contribute to investor education and that we conduct research into savings, investment and related matters. If we are to get back to our one-time level of activity in these areas we obviously need far more member participation aided by a strong push from the Board.

Roy Colbran

Dear Sir,

I enjoy your well researched articles in The Private Investor but could you in future spare us from terms such as *panjandrums* and *fissiparous!!!*

Yours Aye,

Tim Shoosmith

(Editor's Note. Does he mean me?)

Regional Information

These events are open to members from all regions, and their guests, unless otherwise indicated. For 'waiting list' events all places are taken but there is a waiting list for cancellations.

LONDON & SOUTH-EAST

All events must be booked in advance via the specific organiser. Future events are shown in this magazine and on the UKSA website. Members from other regions are very welcome. For more information please contact Harry Braund on 020 8680 5872 or email harrycb@gmail.com

Within this region there is a separate Croydon and Purley Group which meets in Croydon, usually on the second Monday of each month, at the Spread Eagle pub, next to the Town Hall. Please contact Tony Birks on 01322 669 120 or by email ahbirks@btinternet.com ,who will confirm actual dates. There is no charge and no booking necessary.

MIDLANDS

For general information, contact Peter Wilson 01453 834486 or 07712 591032 or petertwilson@dsl.pipex.com

At the present time no meetings are being arranged specifically for the region, but members are cordially invited to attend meetings in the North or South West regions where they will be made very welcome; or indeed London if that is more convenient.

SOUTH-WEST AND SOUTH WALES

All South-West events must be booked in advance, and are open to all members and their guests subject to availability.

Didmarton: The King's Arms, Didmarton: cost is £22.50, including coffees and lunch. Events are at 10 for 10.30am. To book, contact Peter Wilson 01453 834486 or 07712 591032 or petertwilson@dsl.pipex.com

SCOTLAND

For information on Scotland please contact Mr George Miller at g.miller1010@btinternet.com

NORTH-EAST

Advance notice is required for all company visits and lunches. Knaresborough: venue is the Public Library, The Market Place, Knaresborough. For more information (except where stated otherwise), please contact Brian Peart, 01388 488419.

NORTH-WEST & NORTH WALES

For details of events, please contact D. L. King, 01829 751 153

UKSA's Rising Public Profile

Readers of the *Daily Mail* will have seen a well-written piece by Danielle Levy on the sad decline in the number of private shareholders; even more so their failure to exercise their voting rights; and the barriers which inhibit them from doing so. Who wouldn't, she asked, want to prevent failed executives walking off with millions if they could do anything about it?

This is vintage UKSA territory and she paid tribute to this both in her references to our group, and in allowing our Chairman to nail the issue fair and square. OK, there's a long way to go yet, but another Chairman once said, even a journey of a thousand miles starts with a single step. And the exposure which comes from UKSA being the organisation of choice when it comes to the seeking of comment both impartial and well informed by the organs of mass communication are the milestones which mark our progress.

And like many others last Monday morning I goggled in amazement as I saw the new *Tesco* head announce that a fresh look at his company's income recognition policy and at which column costs were entered into in accounting terms meant that the P&L account would have to be amended - downwards of course. But it was good to know that our Director Brian Peart was interviewed on this by ITV the same day - an interview that appeared twice over.

And on our Declaration of Rights (see Page 8) just have a look at what last Saturday's *Financial Times* had to say!

Other members wanting to join the fray - or better yet, those who know of well-informed investors that are not yet members - join our crusade against abuses of power by management, or more shameful yet, those who are paid (overpaid?) to represent our interests. Don't hide your light under a bushel.

Bill Johnston

UNITED KINGDOM SHAREHOLDERS' ASSOCIATION
CURRENT UKSA EVENTS

Standard Chartered plc Richard Meddings Former Finance Director	Croydon	Tuesday, 7 October 11:30am	**Presentation**	Tony Birks 01322 669 120 (after 2pm) ahbirks@btinternet.com
Standard Chartered plc James Hopkinson Global Head Investor Relations	London	Wednesday, 15 October 11:00am	**Presentation**	Phil Clarke 01689 834 479 pjejclarke@tiscali.co.uk
London Investor Show	London	Friday, 24 October From 9:30am	**Exhibition**	**Free tickets for UKSA members. See Page 13.**
Wolseley Group ***Mark Fearon*** Director of Communications and Investor Relations ***Julia Henderson*** Investor Relations Analyst	Deutsche Bank 1 Great Winchester Street London EC2N 2DB	12 November, Assembly and Refreshment 10:45am Meeting 11:00 -12:30	**Presentation**	**30 places only** David Lowe 020 8398 4058 Mob.:07751 127 586 djmlowe@btinternet.com

UKSA members who have not attended one of these meetings may not appreciate how valuable they are. They are invariably addressed by one or other of the three principal directors and the information presented is the same as that given to City analysts. For some of those who do attend, these occasions are UKSA's most valuable membership benefit and, for this reason, there is often competition for places.