UKSA
UK Shareholders' Association

Colonialism, pizzas and Wells Fargo -what's the connection?

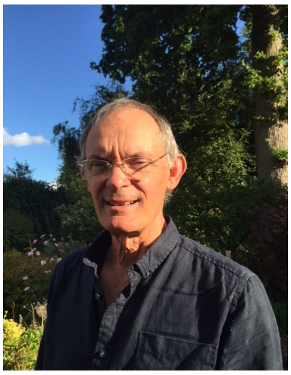
Investment Trusts - part 1 - a master guide to the sector!

No Depreciation without Representation - May's plans for our boardrooms

The Private Investor

This is our new format. It is meant to brighten things up, fall into line with our website and most of all provide a suitable home for our articles whose quality is making an ever-larger impact in the spheres where we have to make ourselves heard. I hope it meets with your approval. Editor

Chairman's Comment



John Hunter Chairman

An article this month by Professor Hill republished with permission from the Oxford Business Law Blog. I found this site by accident when googling on something or other, throwing up a post by Luca Enriques, Oxford Professor of Corporate Law, including much good sense about the counter-productiveness of so much mandated disclosure of business information – serving only to reveal less and less about more and more. This does not sound like a place to go for a light read but I've found it continually interesting and I hope we'll have more of it in future for those of you for whom the Web is not a natural habitat. www.law.ox.ac.uk/business-law-blog

Suddenly our issues are at the front of the political agenda, though not necessarily directed in quite our sweet spots. Theresa May's first speech as premier, majoring on corporate governance, was no doubt driven by the continuing and divisive cancer of executive pay, emblematic of the fault lines in society as a whole. The committee of the new ministry BEIS (pronounced 'bees', and the successor to BIS, pronounced 'biz') has called for evidence and nearly 100 bodies have responded. Thanks to James Murray for obtaining introductions for us to SNP MPs Michelle Thomson (vice-chair of the BEIS committee) and George Kerevan (member of the Treasury committee), who gave Peter Parry and myself half-an-hour over a cup of tea before our submission went in.

Incidentally, the Oxford Business Law Blog commented on the BEIS enquiry: '*While the outcome of the inquiry is not certain, it is clear that corporate governance in the U.K., in the U.S., and in the EU has again become a serious political issue. If companies and investors do not find a mutual path to governance that promotes long-term investment and accommodates employee, customer, supplier and community interests, legislation will result. That legislation may not be to the liking of either companies or investors.*'

Even the sacred cow of incentive pay for executives has come under the microscope, headlined by the award of the Nobel Prize for Economics to two professors for their work in the fields of executive reward and the laws of contract. Their work, needless to say, dates from the 70s and 80s, pre-dating the modern enthusiasm for corporate governance codes. Private investors – at least outside the US – have always questioned whether we want companies run by people who need financial incentives to do their jobs properly.

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In this issue…

On a whim I have registered with FTAdviser – the FT online news site for the financial advice industry. I have found it strangely addictive – it's like accessing a world which is recognisably human in substance but subject to different laws and modes of behaviour – like watching 'Game of Thrones'.

'.....too many people are ignorant of the basic principles of financial management'

The complexity of the regulations can't help – it makes advice even more expensive and effectively excludes potentially free (and un-conflicted) sources such as employers and pension funds.

Education is the answer. The fact that investment is so hedged around with regulation reflects the fact that too many people are ignorant of the basic principles of financial management. There is no call for heavy regulation of, for example, used-car sales because on the whole buyers understand what a car is and what it's supposed to do; and if they don't they have a friend who does.

There have been many well-meaning attempts to fill this gap. But the demise of the ill-fated Money Advice Service, which UKSA persistently criticised, shows what happens if you allow the foxes too much influence over the construction of the chicken-coop. It's an area in which UKSA will continue to take an active interest. It's fundamental to building a corporate governance system in which the individual has a proper voice. And it's not something which the advice industry will encourage, the appropriate avian metaphor here being of turkeys and Christmas.

Good Luck!

John Hunter

Roger Collinge

Roger is stepping down from the policy team.

We have all been very much aware that some company accounts have been seriously wrong on too many occasions recently; think HSBC, Cattles and even Tesco. UKSA's response has been to try to influence improvements in accounting in a number of ways. One way has been working with a group of very large city institutions which have had similar worries. It has been very encouraging that they have had concerns similar to ours: they too look at a longer time horizon than just the next quarter.

This has involved meetings with the various regulatory bodies including the International Accounting Standards Board who set the rules under which accounts are drawn up. In the UK the Financial Reporting Council has also been lobbied. There have been letters to the FT, meetings in Brussels and with the relevant government department (now 'Business, Energy and Industrial Strategy').

With regard to banks we have argued for greater prudence in making provisions against their debts. This is shortly to be introduced under the title IFRS9.We had argued that such greater prudence was a requirement under UK law, and to this end, were (very minor) sponsors of an opinion from a leading QC on the point.

We have supported the new corporate governance requirement that boards should show how they believe the company will stay in business throughout the next business cycle. We have supported the FRC in looking at ways in which companies can, and should, give a clearer picture of how much profit can legally be distributed to members under UK law. There is a lot more to do, such as pushing the FRC to take a harder line on accounting and auditing failures. The IASB will still be issuing edicts on accounting and it would be good to have input into these.

Does anyone want to take Roger's place? If interested contact him at uncleroger5@btinternet,com.

John Hunter

Colonialism, Pizzas and Wells Fargo

What do the 17th century colonial struggles between the Dutch and the English, and pizza delivery policies, have to do with the current management meltdown at the US bank, Wells Fargo & Co? As it turns out, quite a lot.

In his book, *Empire*, eminent historian, Niall Ferguson, points out that the scale of the Dutch East India Company's business in the 17th century far exceeded that of its English counterpart. One of the reasons for this was pay structure. The managers of the Dutch company (but not the British company) were rewarded on the basis of gross revenue. This encouraged them to undertake massive expansion and to maximise the volume of their spice trade.

Any economist will tell you that incentives matter in understanding human behaviour. The positive incentives provided to the Dutch managers confirm this – they helped to put the Netherlands ahead of the rest of the colonialist pack during the 17th century.

But organizational incentives are not always positive. Fast forward three centuries and the story of Domino's Pizza Inc provides a good example of how organizations can create perverse incentives. From 1973 onwards, a key part of Domino's pizza home delivery marketing strategy was a '30 minutes or it's free' guarantee. Although Domino's employees were instructed to drive carefully, the 30 minute delivery guarantee placed pressures on them that potentially overwhelmed the 'drive safely' message. Following several accidents involving Domino's drivers, the guarantee was finally dropped in 1993, after a jury awarded an injured St Louis woman US$78 million in mainly punitive damages.

> 'Unchecked incentives can lead to serious consumer harm.'
>
> ***Professor Jennifer Hill quoting Richard Cordray***

Which brings us to the Wells Fargo story. The unfolding drama at this US bank, which shares features of both the above scenarios, is a recent example of the role of incentives in creating/infecting corporate cultures. Wells Fargo is a household name in the United States. Founded in 1852, the bank has 40 million retail customers, US$1.9 trillion in assets and employs 268,000 people. It was also one of the few US banks to navigate the Global Financial Crisis relatively unscathed, and much of the credit for this feat went to its Chairman and CEO, John Stumpf.

The seeds of the current scandal were sown several years ago (at a time when Wells Fargo's management was being lionized), as a result of an aggressive growth strategy and remuneration policy. Although employees received plenty of ethics training, they were also subject to sales targets for new accounts, which quickly revealed themselves to be unrealistically high. Employees had downside and upside incentives to commit fraud. If they failed to meet the targets, they risked losing their jobs; if they met the targets, they received bonuses over and above their relatively low base pay.

It seems that these incentives were irresistible - they resulted in fraud on a stunningly broad scale. To inflate sales figures, thousands of bank employees created over 2 million sham bank and credit card accounts without customers' knowledge. Although an investigation by the Consumer Financial Protection Bureau ('CFPB') found that the illegal acts were committed since at least 2011, complaints from would-be whistleblowers date back as far as 2005.

Between 2011 and 2016, Wells Fargo sacked 5,300 employees for creating the fake accounts. After the fraud was revealed by the press in 2013, the bank kept the sales goals in place, thereby perpetuating the perverse incentives. On 8 September 2016, it was announced that Wells Fargo would pay US$185 million in fines, including a record US$100 million penalty to the CFPB.

The events at Wells Fargo raise acutely the issue of 'corporate culture' and the responsibility of a company's management and directors for that culture. In particular, the Wells Fargo scandal shows the role of incentives in creating corporate culture. It is also a textbook example of how corporate crime arises – it typically occurs at the level of lower to middle management, in response to unrealistic goal directives from senior management.

Yet, until recently, Well Fargo went to considerable lengths to deny that it had a poor corporate culture or any systemic problems, claiming 'that's not who Wells Fargo is'. The bank argued that the fraud was due to a 'few bad apples'. The beauty of this argument is that it deflects attention away from the top of the organisational totem pole (though its credibility was somewhat dented by the sacking of 5,300 people for fraud over several years). However, attention is now inexorably moving up the bank's hierarchy. The focus has shifted away from the incentives of lower level employees, and towards the incentives of senior management to turn a blind eye to the fraud. Another emerging issue is whether management should be able to profit from a poor corporate culture.

Jennifer G. Hill is Professor of Corporate Law at the University of Sydney Law School, where she convenes the Law & Business Program. Professor Hill publishes widely in the field of corporate governance. She is a Research Associate of the European Corporate Governance Institute (ECGI), and a member of the Australian Securities and Investments Commission (ASIC) External Advisory Panel. She has been a Visiting Professor at a number of international law schools, including Cornell, University of Virginia and Vanderbilt University Law School. In 2015, Professor Hill was a Herbert Smith Freehills Visitor at the University of Cambridge, and a Senior Global Research Fellow in the Hauser Global Fellows Program at NYU Law School.

On 12 October 2016, Wells Fargo announced the immediate retirement of its CEO and Chairman, John Stumpf, after he had received gruelling questions at two recent Congressional hearings. Although Mr Stumpf will not take a severance package, his estimated retirement benefits are around US$120 million. Senator Elizabeth Warren has been vocal in demanding that he should repay all earnings from 2011, while the fraud was ongoing. According to Richard Cordray, director of the CFPB, 'unchecked incentives can lead to serious consumer harm'. The Wells Fargo scandal highlights the danger of allowing bad conduct to flourish and proliferate, unchecked by corporate management and the board of directors.

The scandal raises important questions about the monitoring role of directors, particularly independent directors, and their responsibility for perverse organisational incentives. If boards are going to authorise performance-based compensation (and the Dutch colonial experience shows that there can be considerable benefits to doing so), it is critical that those boards select the right incentives, and have the ability to foresee, and control, any perverse incentives that are created.

Now that the spotlight has begun to shift upwards in Wells Fargo's structure, it will be interesting to discover how much (and when) the board knew about the wide-ranging fraud, and precisely how it responded to that information. If the board was left in the dark, this raises another set of other questions, given that whistleblowing attempts had been made at the bank many years earlier. The case law in the US as well as in other jurisdictions stresses the monitoring role of the board of directors, and a key issue as more facts emerge will be the board's role in the creation of, and failure to remedy, the perverse incentives. The Wells Fargo fraud is a multi-layered corporate morality tale with many governance lessons that are by no means limited to the United States.

Professor Jennifer Hill

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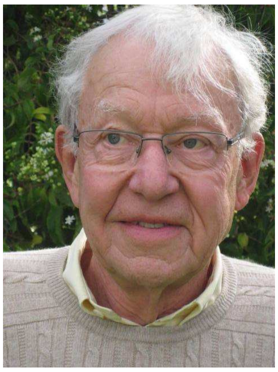
Investment Trusts - a Primer part I

by Roy Colbran



Roy Colbran

Dee O'Hara recently invited me to talk about investment trusts to one of his innovative and successful investment gatherings in Brighton. As a result of this experience I realised that understanding of the way these companies function and their potential benefits is, perhaps, not as widely spread as I thought. Accordingly I have turned my presentation into a series of articles for The Private Investor.

Although commonly known as investment trusts (and referred to as such in this article) they are not actually trusts at all but properly called investment companies. They are *plcs* like any other – except that their business is to run a portfolio of investments for the benefit of their shareholders – normally this is their only business and many of them are very long established. I first encountered investment trusts back in the early 1960s when I had a spell in the investment department of a life assurance company. At that time the idea of a life company buying equities was still exceptional and the one I worked for felt direct equities were a bit too adventurous for them but investment trusts were OK.

The normal pattern for these companies is to have a small board of directors, these will usually all be independent and mainly people with a considerable investment history. They then employ a manager to invest their portfolio at a fee, usually a percentage of total net assets. The manager will commonly be one of the large fund management houses such as Henderson, Baillie Gifford and JP Morgan. However, there will always be an individual within the management house with overall responsibility for the particular portfolio. A few investment trusts are self-managed; that is they employ their own in-house staff to manage their investments and the leader of the team is likely to be one of the directors.

The trust's investment portfolio will, of course, pay dividends which the company will collect and then distribute to their own shareholders by way of quarterly or half yearly dividends after deducting the expenses of managing and administering the company. Usually they keep back a small part of their income to build up small reserves so that they can even out fluctuations in their own income. It can only be a small part because by law they must distribute at least 85% of their income to their own shareholders. In return for meeting this requirement no capital gains tax is payable on sales by the manager within the portfolio. Naturally, a sale of the trust shares by a shareholder is subject to the normal capital gains tax rules.

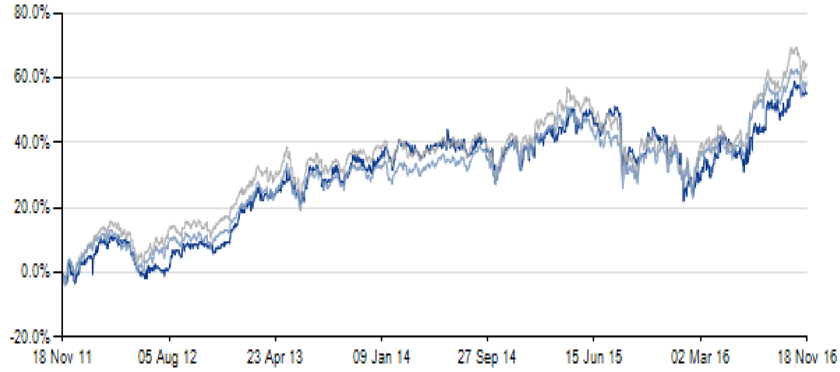
Each investment trust has its own style. Many are general, that is aiming to cover more or less the whole market, some with emphasis on UK and some looking to a worldwide basis. Some however are more specialist - concentrating, for example, on technology stocks or on one particular country's markets such as Japan or China. The latter can be useful for people who generally want to run their own portfolios but feel that they need specialist help with particular areas of the market. As a generalisation, specialist funds tend to have higher charges than general ones. All of these companies' shares are bought and sold via stockbrokers or other intermediaries in the usual way like any other publicly quoted ordinary share and the usual dealing expenses apply. There is a special section on the share prices page in the FT.

The market value of their total net assets is normally calculated daily and this figure, divided by the number of shares in issue, gives the Net Asset Value per share which figure is quoted in the FT. However, unlike open-ended funds, the prices at which one can buy or sell depend on the market. Most commonly you will find that the share price is a bit below the NAV (this is called standing at a discount) but in some cases the share price will be above NAV (standing at a premium).

Obviously there is a cost in investing in investment companies compared with running your own direct portfolio - management doesn't come free – and you have to consider whether this is acceptable to you for the other advantages it brings. For this purpose you should look at the managers' fee scale which you will find tucked away somewhere in the Report and Accounts. In there you will also find the Ongoing Charges Ratio which is the regular ongoing cost of running the company overall expressed as a percentage of average total net assets. I used to aim to buy only trusts where this figure was no more than 0.5%. While this has become more difficult there are still some companies that pride themselves on keeping the figure this low. After a period of increasing costs, there are now small signs of a reducing trend, possibly spurred on by greater attention to cost in the press. I am also pleased to see that performance fees are going out of fashion. These are where the manager is paid an additional fee if his results beat a certain pre-arranged formula. A lot of people now consider that these are simply paying twice for doing the same job and the manager should be doing his best anyway.

Investment companies have a number of advantages over open-ended funds:

1. Being close ended means the manager knows just how much he has available to invest and is untroubled by the need to run a cash float, or even sell stocks, if there is a run of withdrawals. For example retail investors with Hendersons were reported as having withdrawn £1bn in the three months following the Brexit vote. Hendersons themselves had to generate the cash to pay this out of their funds whereas selling an investment trust share in the market has no impact on the manager.



'They actually perform!'

Chart - Brunner Investment Trust

2. They can gear up, in other words they can borrow to fund extra purchases if they feel that is appropriate. Of course, they have to get it right for this to be a benefit but they are the experts and have very good security to back their loans and so should be able to borrow relatively cheaply.

3. Having an independent board means that the manager has to report regularly to a group who are mostly experts in investment. In the extreme they can sack the manager. Normally there is no corresponding body with open-ended funds and not the same close scrutiny of the results. This does not mean that the directors are a serious constraint on the manager; normally they set overall guidelines and very much leave the manager to run the show.

4. There is transparency with detailed annual reports showing the holdings, relating how the manager has operated in the past year and how he sees the future. Good half yearly reports are also provided. If you hold the shares direct you can go to the AGM and meet the manager and the board and ask questions.

5. The charges are usually less than with open-ended funds

6. They actually perform!

Next time I will discuss the impact of discounts and premiums and some figures about performance. In the third and final article I will provide some notes on a few selected investment companies with which I am familiar.

Roy Colbran

No Depreciation Without Representation

By Adrian Philipps

Adrian Phillips's book on the abdication crisis of 1936 *The King Who Had To Go* was released (see https://www.bitebackpublishing.com/books/the-king-who-had-to-go) on 13th October

In the shell-shock of post-Brexit vote political chaos, the proposal by Theresa May that worker representatives be placed on the boards of British companies attracted relatively little comment for a move that by past measures represents a radically new policy for the Conservative Party. Worse, it smacks of the sinister world of EU social legislation, which we though that we would all be able to escape from now. Predictably enough then, what comment that there has been has been unfavourable. Should investors now be terrified? They will certainly have plenty of time to make up their minds about this though, as it is unlikely that anything will actually happen until after the next election.

At one level the idea can be tagged as a last hurrah for Europhilia. Britain is one of "only" ten countries in the EU not to have legislation governing employee participation in corporate governance. Ten is, of course, still a significant number and when the stone is actually lifted to examine the crawling insects, the picture is even more innocuous. For the most part, representation is limited to one or two members of the board and, often enough, we see that only state owned companies feature at all. In practice, the one country in the non-Marxist-Leninist world where worker representation is practiced with rigorous and legally enforced seriousness is Germany, with its system of co-determination.

The *Financial Times* was first out of the traps to present its readers with the ill-effects of German co-determination. Conveniently, the fortieth anniversary of the law being passed had just been celebrated with appropriate medium-scale lavishness. The FT has, of course, long been an enemy of the German corporate and economic model as the antithesis of the growth-driven, efficient market world in which it finds its ideal. The system was blamed for stifling innovation, albeit with a conspicuous lack of hard examples. Younger workers, ah, them, apparently prefer share ownership.

Inevitably, the great bogey of Volkswagen was trotted out as the emblem of all that is wrong with co-determination. It is an easy target given the numerous oddities in its governance, but these are due to far more than the fact that worker representative smake up half of the supervisory board. Volkswagen was privatized in 1960 with a special law all to itself, which gave the Federal State of Lower Saxony a role in the company's management. VW's main assembly plant is at Wolfsburg in that state and protecting employment there is a major political consideration. Parallel to this, the Piëch family has shown remarkable ability to trade off one set of interests against the others, so that at its nadir the company was an "autocracy tempered by codetermination". This culminated in a board seat for Ferdinand Piëch's wife, whose chief, if not sole, qualification was in child-care.

None of these shenanigans held VW back from a programme of aggressive international growth, involving the investment in new manufacturing plants around the world, supposedly the kind of thing that worker-representation sabotages. VW now vies with Toyota as the world leader of the industry. The emissions scandal cannot be blamed on the worker directors.

In the twenty years that the author spent researching German companies he came across no single instance of management complaining about co-determination, although he encountered many complaints about union bargaining power. The system is tempered by the presence amongst the worker representatives of a "managing worker" and it is usually possible to arrange another tame one.

'There is nothing like the deference attached to a board seat to draw the fangs of a trade unionist'.

The British left has also been quite muted about the idea. Mrs. May has quite accurately been accused of stealing Labour's clothes, albeit not in these terms. Here the German model suggests that she might simply be applying a bit of shrewd calculation. There is nothing like the deference attached to a board seat to draw the fangs of a trade unionist. With the political leadership of the Labour Party firmly in the hands of the radical left, a quieter and more predictable life must have its appeal.

It is not as though labour representation would hobble a system in which non-executive directors have done public shareholders in quoted companies much good. The present regime of "safe pairs of hands" and all-round placemen has little to recommend it.

Adrian Phillips

Meeting with Pearson PLC

Pearson plc - 6-month share price graph

Just over a month ago education titan **Pearson** issued a trading statement which confirmed expectations for the current year and 2018 – meaning a return to earnings levels last seen about five years ago.

That apart, the good news is that the group is poised to enjoy a huge benefit from sterling's dive against the dollar. But some analysts aver that all that does is to make what are actually very weak US sales (a key element of the business) look a bit better – and that the major prop to the shares price is just the forecast 6.5% yield.

So, what an opportunity for UKSA members to grill Coram Williams (Chief Financial Officer) and Tom Waldron (Investor Relations) - an opportunity of a type almost unique to UKSA. Getting it from the horse's mouth is nothing like getting it from a newspaper or indeed even the Regulatory News Service. Of course, like most investment swords it is double-edged. But surely if the dividend is not in jeopardy, the prospective yield forms a rock-solid platform for capital appreciation - if the management team's plans for growth are to be realised.

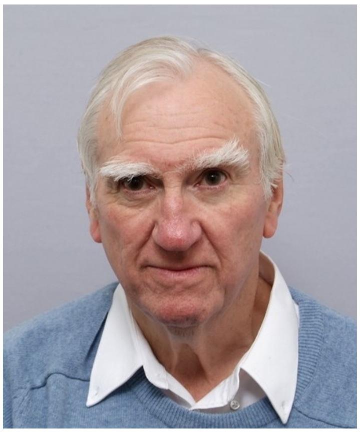
The meeting is to be held in London on Friday 2nd December. Interested members are to contact Amy Baker on 020 7010 2392 - but you had better be quick.

Bill Johnston
Editor

The law must change – auditors must be responsible to the company's shareholders and not the company.

By Malcolm Howard

Investors believe that audited accounts give them assurance that the company's accounts have been audited (checked/reviewed) and must therefore be accurate. After all, the auditors do state "In our opinion the group's financial statements give a true and fair view of the state of the group's affairs at the year end stated and of its profit for the year then ended." The reality is often not the case and the sad story of *Stanley Gibbons Group plc* emphasises that the law needs to be changed.



Malcolm Howard

In their audit report for the company for the accounts for the year ended 31 March 2015, *Nexia Smith & Williamson,* Chartered Accountants, stated: "This report is made solely for the company's members, as a body, in accordance with Article 113A of the Companies (Jersey) Law 1991. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed."

The law in the UK in this respect is exactly the same as that in Jersey; auditors have no responsibility at all in relation to individual shareholders of the company, whether existing or proposed. What this means is that shareholders cannot sue auditors when they have signed off fraudulent accounts.

There are two ways that directors/senior managers can 'bend' the accounts; they are taking sales too early and/or valuing inventory that should be written off. The reason they do this is usually they are being pressurised to perform either by 'the market' or by directors of their parent company. The problem for investors is that the law is framed in such as way as to encourage such fraudulent accounting to be concealed. To give an example, the company's auditors discover that sales are being taken early and they point this out to management. Those responsible for the fraud promise that in return for the auditors staying quiet they will promise to fully rectify the situation by the following year end. This puts the auditors in a dilemma; if they report the fraud and the company is harmed as a result they could find themselves being sued by the company if the subsequent statement made by them is not wholly accurate. If they do nothing, the auditors face no risk; it is the employees not them who have committed the fraud. This is why, many fraudulent accounts go undetected,.

There is a simple way to find out if some fraudulent activity might be taking place. I call it my 'prime test'. I simply compare 'cash inflow from operating activities' in the Cash Flow Statement with 'net profit' from the Income Statement. With the exception of a few type of companies (for example house builders who show land as a current asset, rather than a fixed asset) cash generated must always be higher than profit as profit is calculated after taking into account non-cash items such as depreciation, amortisation and share based payments. In well run companies cash generated will be 120% to 125% of net profit. I have researched this over several years and the conclusion is that where cash generated is lower than net income for three consecutive accounting periods there is a 50% probability that the company will go effectively bust. Where this happens it will indicate there is a problem with inventories, debtors, the pension scheme or a combination of all three. The word 'might' is used because the test failure might be the result of incompetent managers, rather than fraud.

The 'prime test' for Stanley Gibbons plc clearly indicated that there were significant problems.

	Cash generated/ (expended)	Net profit/(loss)	Difference
	£'000	£'000	£'000
Year to 31 Dec 2012	414	4,667	(4,253)
Six months to 30 June 2013	2,066	1,030	1,036
Six months to 31 Dec 2013	(1,289)	2,428	(3,717)
3 months to 31 March 2014	(5,118)	(1,075)	(4,043)
Six months to 30 Sept 2014	(8,429)	3,221	(11,650)
Six months to 31 Mar. 2015	404	(2,440)	2,844
Six months to 30 Sept 2015	(4,170)	200	(4,370)

Out of seven accounting periods the prime test had failed five times and there were three consecutive failures. By the end of 2014 when the six months accounts to 30 September 2014 were out, alarms bells should have sounded. There were none and the shares traded at around 300p.

An analysis of the company's full year accounts is illuminating.

	Year to 31/3/15	15 months to 31/3/14	Year to 31/12/12
	£'000	£'000	£'000
Revenue	56,865	51,772	35,599
Cost of sales	24,600	28,937	20,031
Distribution & Admin	28,693	20,481	10,205
Interest	424	141	208
Tax & other	2,367	(170)	488
Net profit	781	2,383	4,667
Inventories	53,822	42,118	20,728
Receivables	19,604	14,144	11,897
Fixed assets	46,174	38,865	3,868
Creditors	(26,865)	(21,350)	(11,367)
Cash/debt	(10,331)	10,168	6,578
Total	82,404	83,945	31,704
Share capital	64,153	63,031	11,421
Other	18,251	20,914	20,283
Total	82,404	83,945	31,704

Given the prime test failure, we need to calculate inventory days and debtor days.

	Year to 31/3/15	15 months to 31/3/14	Year to 31/12/12
Inventory days	**799**	**531**	**378**
Debtor days	**126**	**100**	**122**

We can now see at a glance the major cause of prime test failure. It was bad enough at December 2012 with over a year's worth of stock, but in just 27 months stock had more than doubled to well over two year's stock. (Inventory days are calculated by dividing inventory by cost of sales and multiplying by 365, so at 31/3/15 the calculation is: 53,822/24,600 x 365 = 799 days.)

Why were the auditors not asking some serious questions?

Stanley Gibbons was in level flight until about four years ago

At the end of December 2012 the company was in a relatively strong position, because although inventories were high they had plenty of cash. Then on 21 November 2013 they acquired Noble Investments and on 31 January 2014 they acquired Murray Payne. These transactions resulted in taking in additional inventories of £11,110k and intangible assets in the form of goodwill increased £23,894k. These purchases totalled £47,394k with £35,274k paid in cash and the balance of £12,120k in shares. The company issued more shares to pay for these transactions, so by 31 March 2014 everything seemed OK. But the directors in working to integrate these acquired businesses took their eye off the ball and inventories went through the roof. If alarm bells hadn't rung when the half-year accounts to September 2014 came out, they should have been sounding loud and clear six months later as in a year over £10 million in cash had become over £10 million in debt.

In 2015 the company appointed new auditors who concluded that the previous auditors had failed to meet the appropriate accounting standards. As a result, in the year to 31 March 2016 the company's assets were substantially written down and methods of accounting treatment were significantly altered. Despite this, the new auditors still 'qualified' the accounts illustrating where they were unable to verify certain figures.

It is sad that an iconic company famous for postage stamps, coins and medals and established for decades has been effectively ruined. At the time of writing the shares stood at a mere 8.62p having been nearly 400p three years earlier. But any qualified accountant could have worked out what lay ahead when the shares were trading at 300p. So why were investors not warned? The answer is straightforward; the law is not designed to do this. It has to change; auditors must be accountable to the company's shareholders, not the company.

Malcolm Howard

Financial Reporting Council Annual Open Meeting 19 October 2016 Report from Mohammed Amin, Policy Team Member

by Mohammed Amin

Every year the FRC holds an open meeting at the Saddlers Hall near St Paul's for all interested stakeholders. I have gone before and this year again attended as a representative of UKSA. The attendance list had about 130 names from professional services firms, institutional investors, public sector bodies etc.

Mohammed Amin

The meeting opened with a short address on the general environment for companies from the FRC Chairman, Sir Winfried Bischoff. Those who do not know him, his career background was in banking. Then the FRC CEO Stephen Haddrill (previously Director-General of the ABI) gave a short overview of what the FRC has been doing for the last year. Its operating budget was exactly on track, with an underspend on investigation cases as there were fewer than budgeted. I expect the speeches to be on the FRC website soon.

The main part of the event was a panel discussion, facilitated by Stephen Haddrill with the following panellists:

Helen Morrisey CBE, Non-Executive Chair, The Newton Investment Management Board

Paul Johnson, Director, Institute for Fiscal Studies

Julia Unwin, CEO, Joseph Rowntree Foundation

Philippa Foster Back CBE, Director, Institute of Business Ethics

Each panellist spoke for a few minutes with questions following from the floor. The subject matter was heavily influenced by the Prime Minister's speech at the Conservative Party Conference, which had indicated some unhappiness with the UK corporate sector and indicated an intention to bring in worker directors for example.

I was able to ask the first question. Standing up to do so, I plugged UKSA as the voice of private shareholders. I asked the panel what could be learned from the continental European experience with worker directors. The only other point from the floor that I remember is a company director pointing out that the only investor questions he recalls about his company's tax charge was why it was so high rather than asking why it was "too low."

Overall, I believe it is worthwhile UKSA attending these events to stay informed and to increase our influence.

Mohammed Amin

FRC Conference: 'Culture to Capital: Aligning Corporate Behaviour with Long-Term Performance'.

by Peter Parry

In the last edition of TPI I wrote about the increasing interest in corporate culture. The Financial Reporting Council (FRC) has been an advocate of reporting on corporate culture and it has published a report on the subject. It followed this up with a conference on 20th September which I attended.

Peter Parry

A full transcript of the conference can be accessed by going onto the UKSA website which contains a link to the transcript. What follows are my own notes and comments on the conference.

Conference structure

The conference consisted of a brief introductory talk by Sir Win Bischoff, Chairman of the FRC, followed by an opening address from Conor Kehoe, a senior partner at McKinsey. This was then followed by two panel sessions. The final summing up was by Philippa Foster Back, Director of the Institute of Business Ethics.

Opening address

Conor Kehoe raised a number of important points focusing primarily on short-termism and the role of non-executive directors. The expectation that companies will keep delivering ever better results over each successive quarter is clearly not realistic and is widely recognised to be unhelpful in terms of longer term business planning and investment. The role of non-executive directors (NEDs) is work in progress. In some companies NEDs have added considerable value. There are too many cases, however, in which their knowledge of the industry is weak and the time they spend in the business is too limited for them to grasp the finer intricacies of how it and its culture work. Too often a non-executive directorship looks more like a sinecure for the recently-retired on the old boys' network. Kehoe is a little kinder but he recognises the problems. If members have time to read only one section of the transcript I recommend that they read Conor Kehoe's Opening Address.

Panel Sessions

The first session was chaired by Dina Medland, writer, editor and commentator with a panel of two – Justin King, late of Sainsburys, and Sacha Romanovitch, CEO of Grant Thornton. A number of good points were raised by both members of the panel during the discussion. There were interesting observations about recent problems at Serco and G4S and how essentially good people can fall prey to bad behaviour. As the panellists noted, there was a chain of events at Serco and G4S. These were businesses that were used to generating premium returns by taking significant inefficiencies out of client organisations. The City expected these returns to continue, or even increase, in perpetuity even though this was unsustainable. Both organisations employ a significant number of ex-military people – people who are used to delivering the impossible. When their boards applied pressure to them to continue delivering ever-increasing returns without scrutinising too closely how it was being achieved the scene was set for a disaster.

However, some of the comment was less insightful. An UKSA member, Mohamed Amin, asked very pertinently how Grant Thornton rewards partners who turn away clients that would pose excessive risk for the firm. And what was Sacha's answer?

'It is really important for us. It is reflected through all of our partners and given a quality score. That quality score reflects the risks. No partner can get an overall assessment grading higher than their quality score. That is fairly entrenched in our systems and how we approach things.'

Was that clear? Well, not to me… And whilst I don't like to rain on anyone's parade unduly, aren't Grant Thornton the auditors at Sports Direct, a pariah in the eyes of many for poor standards of corporate culture?

The second panel session was chaired by Chris Cummins, CEO of the Investment Association. The panel members included Sir Roger Carr, Chairman of BAe Systems and Amanda Mellor, Company Secretary of Marks and Spencer. But wait a moment! Isn't the Investment Association the very organisation that recently fired its previous CEO, Daniel Godfrey, for trying to reform culture within the investment industry by arguing that members should always seek to do what was in clients' best interests rather than their own? And BAe Systems? Weren't they in the news some years ago (how time flies!) for using bribery to win defence contracts in the Middle East? This led to much comment and debate about reputational risk to businesses which are caught transgressing as a result of deficiencies in standards of corporate culture.

No, no, this picture has not strayed from Adrian Phillips' article, on Page 8. This is Daniel Godfrey (see text) who has now emerged as a champion of consumers' rights.

Conclusions

Many interesting and valuable points were raised in each of the Conference sessions. However, I struggle somewhat when an organisation with the pedigree of the Investment Association is asked to chair a panel session on 'Delivering Long Term Value for Stakeholders'. I also wince a little when I feel that arguments for promoting sound corporate culture are being conflated with the commercial imperative of avoiding reputational risk. That is a by-product of excellence in corporate culture and the risks of ignoring it belong in the risk report - which is another topic altogether!

Peter Parry

T Clarke plc

Coincidentally, on another page there is a mention of the Regulatory News Service (RNS). A week or so ago T Clarke, the electrical engineer, made an investment presentation to UKSA members. So far par for the course but it is a pretty prestigious course which I have often put forward as a unique, perhaps the unique benefit of membership.

What was unexpected was the RNS announcement which is reproduced below.

'T Clarke plc *('the Company'), is today hosting an event for members of the UKSA (UK Shareholders Association) which will allow its members to meet with Senior Management and one of our project teams to witness, first hand, the workings of a live construction project.'*

This is a first and a priceless piece of good publicity. The first of many such I trust. Congratulations to Eric Ingledew who organised the visit (his first for UKSA) with the help of the regular London team. T Clarke also put a report on the visit with pictures on their website www.tclarke.co.uk

John Hunter

UKSA Branches

Where no contact name or number is given contact the UKSA office

Branch name	Leader	Administration	Main purpose	Description
London & South East Region	Harry Braund 020 8680 5872 harrycb@ gmail.com	Tony Birks 01322 669 120 ahbirks@ btinternet.com	To co-ordinate activities in London and the South-East	Meetings in Croydon three times a year
London company visits	Nick Steiner	Individual meeting organisers	To arrange private meetings with companies	20/30 meetings per year individually arranged
Specialist company visits	David Lowe Adrian Phillips	Under review	To arrange and/or participate in events in conjunction with investor service companies	Meetings with small -company management, for experienced investors only
Croydon & Purley	Harry Braund 020 8680 5872 harrycb@ gmail.com	Tony Birks 01322 669 120 ahbirks@ btinternet.com	Social meetings to discuss investment issues	Meetings in Croydon monthly
South West	Peter Wilson 01453 834 486 07712 591032	Peter Wilson 01453 834 486 07712 591032	To arrange and develop activities for members in the region	Company visits and social events as arranged
North East	Brian Peart 01388 488419	Julian Mole 07870 890973 julian.mole@ btinternet.com	To arrange and develop activities for members in the region	Company visits and social events as arranged
North West	Paul Waring 07754 725493 paul@xk7.net	Paul Waring 07754 725493 paul@xk7.net	To arrange and develop activities for members in the region	Company visits and social events as arranged
SmartCo	Charles Breese	Charles Breese	Arranging access to 'Smart Companies' - those with the potential to make good investment returns from benefiting society at large	Programme awaiting start-up
Brighton	Dee O'Hare 075 6815 6725 dfohare@ hotmail.com	Dee O'Hare 075 6815 6725 dfohare@ hotmail.com	Education on basic investing, and discussion with local UKSA members	Monthly evening meeting - presentation, Q&A, then socialising