UKSA
UK Shareholders' Association

THE PRIVATE INVESTOR

ISSUE 195 | AUGUST 2018

Investor empowerment

Investor empowerment, financial education, financial literacy... Call it what you will, the objective is the same: to give investors – or savers – the tools and the confidence to challenge market practices that lead to mis-selling or unwarranted erosion of their assets.

In her excellent article in the June edition of The Private Investor, Susanne Teufel hit the nail on the head: "There is no clear plan on how to get the wider public interested in money matters, and financial education remains very much in its infancy." Initiatives are too fragmented, piecemeal and often misdirected.

Sharing best practices is one way forward. UKSA recently took part in a series of presentations to European shareholder groups on our efforts in the area of financial education. Our experience was mirrored almost exactly by that of the other groups. Common problems include how to address a group with disparate levels of financial knowledge and finding the right mix of 'bricks and clicks', striking a balance between 'classroom' style teaching and the use of digital platforms. UKSA will continue to work with ShareSoc and groups abroad to devise a common approach, particularly from the perspective of equity investors. Initiatives such as UKSA's 'Savers Take Control' can also play a vital underpinning role in empowering individual investors.

A Better Finance event held in July, pictured above, approached financial education from the need to bring more individual investors into share ownership. In many markets the proportion of individual investors is actually falling and the equity culture is fading rather than strengthening. Given that individual investors are key to healthy capital markets, their participation is not only in their own interests but also in the interests of economic growth and job creation – a benefit for the individual and for society as a whole.

In this issue

Published by United Kingdom Shareholders' Association Limited (UKSA)

Registered in England no. 4541415

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Note that the share-price graphs are courtesy of the leading investment website Digital Look www.digitallook.com.

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Editorial

A fresh look

As promised we've begun to update the design of The Private Investor. We want to make it as informative and engaging as possible. Above all, we want to make sure it's accessible and comfortable to read whether you take the hard-copy or electronic version. Please tell us what you think.

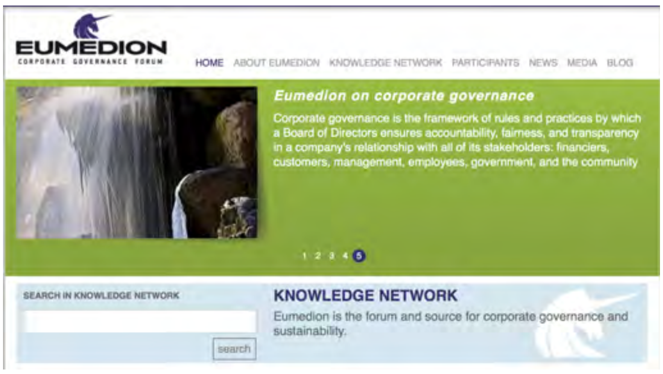
Transparency

I'm very pleased this month to include an article by Andy Agathangelou, Founding Chair of the Transparency Task Force, which is a collaborative, campaigning community dedicated to driving up the levels of transparency in financial services around the world. Starting on page 10 Andy provides a detailed account of the organisation's activities. The breadth of its coverage is truly impressive, in terms of both subject matter and geography. The principles advocated by the Transparency Task Force dovetail with many of UKSA's own tenets, especially in corporate governance. UKSA is active at European level through Better Finance and is pleased that the Transparency Task Force has now become an associate member of Better Finance.

Andy Agathangelou with Better Finance in Brussels

Stewardship

My interest in corporate governance was first sparked by work I did in the early 2000s for one of the leading exponents of shareholder rights and fiduciary duties in the Netherlands. The work involved comparing the recommendations of the 2001 Myners Report in the UK and those of the 2003 Tabaksblat Committee in the Netherlands chaired by former Unilever chairman Morris Tabaksblat. This brought me into contact with Eumedion, a Dutch non-profit organisation that represents the interests of institutional investors – especially pension funds – in the field of corporate governance. So I was grateful when Martin White drew my attention to a statement Eumedion had put out about the risk of stocklending being abused if voting rights were used against the interests of a listed company and its shareholders. This would conflict with Eumedion's new stewardship code, which requires that institutional investors recall any shares loaned ahead of a company's AGM if significant matters are on the agenda. The UK and the Netherlands have much in common in terms of their approach to corporate governance. The new stewardship code may therefore be of interest to UK-based readers. It was adopted on 20 June and can be found in English here.

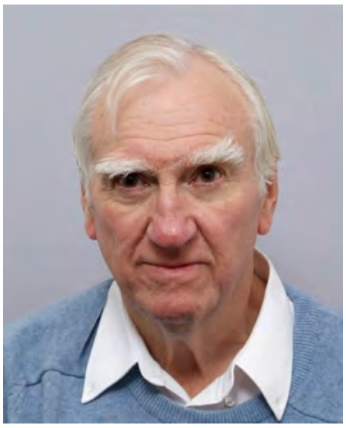


Eumedion's website in English

Helen Gibbons

Lack of clarity and imprudence – factors to consider

by Malcolm Howard



At the time of the UKSA visit to Photo-Me International plc I analysed their accounts, which, as usual, I picked up from their website. At the date of analysis, 22 December 2017, the shares were trading at 183.5p and my valuation was close at 175p. However, one thing bothered me and that was that at the last full year end, 30 April 2017, receivables stood at £20.6 million. Now, Photo-Me International is a cash business. Before you can have your photo taken or do your laundry you have to pay up front. There might be a few prepayments, but it was difficult to see how these could amount to over £20 million. Most companies give an analysis of receivables, but this company's accounts did not. So at the UKSA meeting, I asked for a breakdown of receivables. The speaker said he was the Finance Director, so he should know. He agreed with me that his was a 'cash before supply' company and as such had no trade receivables, but he could not tell me how this £20 million was made up. He seemed irritated by the question, so much so that the UKSA organiser of the meeting, I have been told, had to apologise to the host. But if we are to invest in a company, we are entitled to receive the information we need to make investment decisions. Luckily, I know that the law requires that companies post their full accounts with 'Companies House', so, having visited this site, we have the missing information:

	£'m
Trade receivables	11.4
Prepayments and accrued income	3.5
Amounts due from associated undertakings	1.0
Other receivables	4.7

We still don't know how this company has 'trade receivables', but as we did not even know they had any, at the UKSA meeting we could not ask a really penetrating question. The point is that I am always wary where companies are not willing to provide detailed financial information (you can always get this from 'Companies House', but companies have several months before they must file the information). The lack of detailed accounts was the sole reason in the decision not to invest. Just as well, as having a target price of 175p, the shares now trade at 107p (13 July 18).

A recent UKSA company visit was to Smiths Group plc. In contrast to Photo-Me International plc, the accounts on their website are extremely detailed. On top of this, I was very impressed by the management team, who gave the impression they were on top of the job. When I suggested to them that (at 31/1/18) inventory days at 96 and receivable days at 83 days were too high, they agreed and said they were working at it. The prior year figures suggested they had been for some time. At our subsequent visit to PwC we met a Partner, Andy Kemp, who signed off Smith Group plc's accounts. I told him I was concerned about the high level of intangible assets shown in the accounts, but he said he was very relaxed about it. The reason he is relaxed is that there is little doubt that the accounts comply with IFRS standards in every respect and as he has faith in the management team he feels that not much can go wrong.

Accounting has never been about exact known numbers. Judgement has always been called for, especially in valuing assets. But under UK GAAP judgement had to be prudent – accountants had to err on the side of caution. But IFRS abandoned 'prudence' and because of this the investor needs to be wary.

What has happened over the years is that Smiths Group plc has acquired several companies, paying, in my view, high prices along the way. When you acquire another company as well as buying tangible assets, you are buying technology, a customers list and an order book. If the company is profitable, you are also paying for discounted future earnings net of tax.

At the date the company bought Morpho Detection, the balance sheet was as follows:

	£m
Plant and equipment	8
Inventory	50
Trade and other receivables	49
Cash and cash equivalent	12
Morpho Detection explosive trace business	68
Deferred tax liabilities	(5)
Current liabilities	(48)
Total tangible assets	134
Technology	103
Customer relationships	137
Software	6
Total Net assets	380

But Smith's accounts state that Morpho Detection would have made a loss of £22m before tax in the financial year, so why did they pay an extra £210m on top of the goodwill of £246m accounted for?

Under IFRS intangible assets must be reviewed each year and amortised as appropriate. But we are always at the mercy of judgement and in most cases we see no amortisation relating to goodwill. Goodwill is something that can be bought (known as acquired goodwill, £246 million as above) or is the difference between the net assets bought (£380 million as above) and the price paid (£590 million, being £380 million + £210 million, as above). The point about goodwill is that to be valid it must generate revenue and profit growth. If it doesn't then it should be written off, because it simply means that the company taking over another has paid too much for the privilege.

A review of Smiths Group plc's accounts shows a pattern of increasing intangible assets with debt either increasing or falling slowly:

Balance Sheet (£'million) at	31/7/17	31/7/16	31/7/15
Goodwill	1,570	1,517	1,306
Development costs	150	136	116
Technology	101	11	16
Customer relationships	128	4	6
Software, patents and IT	66	74	74
Total intangible assets	2,015	1,742	1,518
Tangible assets	315	334	259
Inventories*	452 (94)	478 (109)	454 (106)
Receivables*	779 (87)	796 (98)	656 (83)
Net debt	(889)	(947)	(656)
Creditors	(583)	(757)	(812)
Total net assets/shareholders' funds	2,089	1,646	1,419
Intangible assets as % of shareholders' funds	96.5	105.8	107.0
Tangible assets per share	18.7p	(24.3p)	(25.1p)

* figures in (brackets) are inventory days and debtor days.

Smiths Group plc dutifully analyse their goodwill each year to justify the valuation in the balance sheet. For the year ended 31/7/17, this was the breakdown:

	£'million	Discount rate	Period covered by management projections	Long term growth rate
John Crane	111	14.9%	5 years	2.2%
Smiths Medical	561	12.2%	5 years	2.1%
Original Smith detection	429	14.1%	5 years	2.0%
Morpho Detection #	200	n/a	1 year	n/a
Microwave Subsystems	75	12.2%	5 years	2.2%
Connectors & Components	167	16.9%	5 years	2.1%
Flex-tex ##	27			
Total	1,570			

\# Valuation based on 'fair value' less costs to sell. All other valuations are based on 'value in use'.

\## No details given.

The above looks highly technical, but in most cases there is an assumption that the investment (in goodwill) will generate long-term growth, but despite the integrity of the management team, whatever they come up with is, at best, a forecast. Now, any accountant will tell you that for any forecast (assuming it is genuine) the odds are as follows:

Forecast betting odds:

Forecast betting odds:

	UK GAAP forecast	IFRS forecast
Actual better than forecast	1/2	10/11
Actual worse than forecast	15/8	10/11
Actual equal to forecast	25/1	25/1

On 18 July 2018, Smiths Group plc advised the London Stock Exchange of a pre-close trading update, which included the following paragraph:

"In advance of the new EU Medical Device Regulation in 2020, one of Smiths Medical's European Notified Body service providers has been decertified for some products. This has led to the temporary suspension of some of Smith Medical's products in Europe. As the result of this and the termination of two contracts in the US, the division now expects to deliver a (2)% revenue decline for the full year and margins similar to the first half. Excluding the impact of these one-off disruptions, the division is delivering good underlying growth underpinned by the growing contribution of new products launched in the year."

As a result of this announcement the share price fell 7% to 1,624.5p, the likely reason being that it could possibly adversely impact both inventories and intangibles. In my view, when a balance sheet has a very low tangible asset value per share (a mere 10.9p at 31/1/18) and a relatively high level of debt, then we are in the 'high risk' category.

Audit – is it fit for purpose?

by Peter Parry

On 3rd July UKSA and ShareSoc members met at PwC's Embankment Place office for an event which PwC had offered to run and host for us on the role of internal auditors, external auditors and audit committees. Since last September when we first started talking with PwC about a possible event, few would have foreseen the cataclysmic implosion of Carillion, the failure of Conviviality or the reprimand from the FRC over the Quindell audit. Nine months later, the issue of audit and the role of the external auditor were hot topics for investors.

The event was chaired by an audit quality partner at PwC. It was divided into two halves, the first being a panel session looking at different aspects of audit including the external audit, the internal audit and the role and perspective of the audit committee. The second looked at the how audit is evolving to include the use of emerging technologies in conducting the audit.

For the first session, an external audit partner and an internal audit director were joined on the panel by an Audit Committee Chair at a FTSE 250 company and a charity. After a short summary from each of the panellists of their own perspective on key audit issues, the debate was opened up to the audience. Some of the key themes to come out of the debate were:

- Auditor independence. Some members asked why it is very rare that annual reports are qualified by the auditor. The accounts are nearly always signed off. Are there never any issues over which an auditor might qualify the accounts or, in some cases, resign? Does this suggest a 'cosy' relationship between the auditor and the directors? Quite the opposite, as the external auditor partner pointed out. He said that the role of the auditor is to raise any concerns with management and, when necessary, persuade them to change their minds over the way in which the accounts are being presented. If the auditor qualifies an audit everyone loses.

- Report of the external auditor. One member pointed out that the audit report is utterly dull, there are never any exceptions to be addressed and everything is always compliant. In view of this, it is hardly surprising that many investors spend little time reading it. A further concern was raised that, unlike doctors, lawyers, surveyors and other professions, auditors do not give meaningful opinions. The surveyor tells you whether your house is likely to fall down; the doctor tells you that you will end up with Type 2 diabetes if you don't reduce your weight. The majority of members in attendance felt that the auditor simply tells you that the company's financial statements give a true and fair view of the state of the company's affairs at a given date. However, the external audit partner noted that the extended auditor's report now includes much more detail, such as information about the risks, materiality and audit procedures performed.

- Report of the audit committee. Questions were raised about the work of the audit committee and its report. One key area that members noted receives scant coverage in the audit committee report is the work of the internal audit team. How are their priorities set? What issues do they uncover, and what action is subsequently taken? Shareholders would benefit from more information about this.

- Dialogue between investors and audit committees. A member asked if there could be more direct input to the audit committee by shareholders. After all, the audit is performed for the benefit of the shareholders. The external audit partner said that he would like this if a suitable mechanism could be devised. An audience member suggested having an independent audit board which the external auditor would work to instead of reporting to senior management. The external audit partner agreed that this was an interesting idea which might ultimately point toward the system of supervisory boards which is used in some European countries. However, the panellists noted that by involving shareholders there is a risk of insider information being shared with only some, and not all, shareholders. Shareholders do have the opportunity to and could engage more with audit committees and auditors at AGMs, but currently this is very rare: a polling of the attendees before the event suggested that 75% have never asked a question at an AGM. Engagement with audit committee chairs is something which UKSA is discussing with PWC.

- The annual report. There was a suggestion that auditors should audit the front end of the annual report as well as the financial statements. The external audit partner said that this could be done but it could significantly increase the audit fee as a result. Shareholders in the audience were of the view that this would be worthwhile if it provided greater rigour in the way in which the narrative elements of the annual report are compiled. The external audit partner noted that the Companies Act currently requires the auditor to check that the front half is not inconsistent with the financial statements or knowledge obtained in the audit. He added that in some instances companies feel that the numbers required by accounting standards do not give the full picture. Hence companies will provide alternative performance measures (APMs), which one should be able to reconcile to the financial statements and which should be consistent from year to year. However, there is no regulatory requirement to audit these APMs, which creates a mismatch of expectations on the part of many investors and those of auditors with regard to what the audit can realistically achieve.

The overwhelming impression of the attendees was one of a serious mismatch between what investors want and what is being provided by financial reporting, the audit process and audit outcomes. Huge amounts of time, money and effort are being wasted providing information and assurance which is failing to meet the needs and expectations of, at the very least, many private investors and possibly professional investors as well. This is not for any lack of commitment, goodwill or expertise on the part of auditors. It simply reflects a system that is not fit for purpose. Too much of the work of the FRC focuses on technical and tactical improvements to accounting and auditing while overseeing a flawed system. Serious strategic thinking is needed. It is to be hoped that the Kingman Review will take note.

The second half of the afternoon focused on the use of technology to improve and streamline the auditing process. PwC pointed out that humans are good at:

- Understanding how businesses work;
- Making judgements of materiality and scope;
- Interpretation of data and understanding risk;
- Professional scepticism.

They also highlighted how technology can support human auditors in their endeavour by:

- Automating routine processes;
- Overlaying multiple data sets;
- Identifying unusual patterns and detecting anomalies in large data samples;
- Enabling the testing of all available data rather than just a sample.

A number of insightful questions were raised by members about:

- Problems of compatibility of different systems and platforms for analysing data;
- The problem of data accuracy and reliability – also known as GIGO (garbage-in-garbage-out);
- The risk of over-emphasising audit efficiency at the expense of providing useful insights;
- The cost of investment in new technology and the impact on audit costs.

PwC responded that the first two points are indeed areas that need addressing before technology can be used entirely across all audits, and noted that progress is being made. On the second two points, PwC noted that human judgement will always be required, with technology allowing the auditors to focus their attention on specific areas. They also noted that the cost of an audit depends on many factors, including the complexity of a business and the outcomes of risk assessment procedures.

The day finished with an informal networking session over drinks and canapés. It was the ideal opportunity to talk in more detail with our hosts and to catch up with other members of UKSA and ShareSoc.

Both UKSA and ShareSoc would like to thank PwC for running this excellent event and for their generous hospitality. There is plenty here for us to build on in terms of future events and a constructive on-going investor dialogue with PwC.

Stop Press - Save the date!

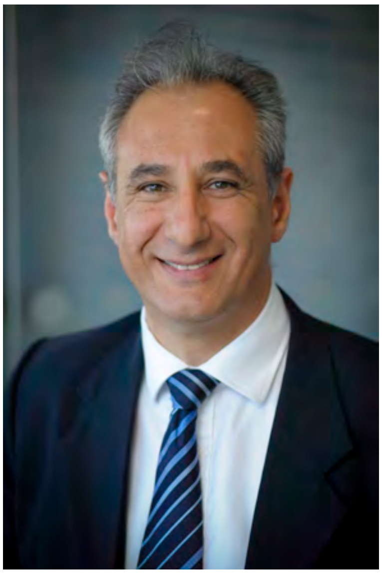
PWC has just issued an invitation to all UKSA members to attend its Annual Investor Update 2018 which will take place on Wednesday, 5th September. The event will be held at PWCs offices at 7 More London Riverside, London SE1 2RT. Lunch will be provided from 12.00 noon and the event will begin at 1.30p.m. for a 2.00p.m. start.

If you would like to attend, please contact Ellie Newton at PWC directly using the following e-mail address ellie.s.newton@pwc.com

An e-mail with details of the event was also sent to members at the beginning of August.

About the Transparency Task Force

by Andy Agathangelou, Founding Chair



The overall mission of the Transparency Task Force is to help consumers of financial services and products to get a fair deal; and in so doing to help rebuild trust and confidence in the financial services sector.

We are doing this because we believe that having a strong, healthy and fair financial ecosystem is profoundly important to the wellbeing of society, the global economy and political stability; but we also recognise that there's a great deal wrong with it that needs fixing. The sector is riddled with problems; so much so that it has virtually become "business as usual" to hear about shenanigans of one kind or another happening in the sector on an all-too-frequent basis.

Of course, every time something bad happens it erodes trust and the sector desperately needs to be trusted. It is easy to argue that the entire financial ecosystem simply cannot function if there is no trust; so every time there is misbehaviour of one kind or another it is one more cut in the "death by a thousand cuts" that financial services is experiencing.

Importance of trust

How important and serious is all of this? Very; because if we allow increasing distrust in the sector to continue unabated we are running the risk of jeopardising the very foundations that democratic, civilised and free society is built on; we must not forget how dangerously close we came to going past the point of no return in the last Global Financial Crisis.

We'll now take a look at the trustworthiness state of play, by drawing on the research and analysis of the Edelman Trust Barometer. As you may well know, the Edelman Trust Barometer is an annual global study now in its 18th year. The study is huge – it covers 28 countries and in the 2018 Study over 33,000 respondents were involved. It is a well-respected, academically robust study that can be relied on to provide meaningful insight.

The first piece of bad news from the 2018 Study is that the UK is a poor 24th out of 28 countries in terms of general levels of trust; Brits have a high predisposition to not trust our politicians, our media, our institutions and so on.

The second piece of bad news for everybody in the financial services sector is that our industry scores a very, very poor 15th out of 15 in terms of general levels of trust. So we're bottom of the pile compared to other industries such as manufacturing, retail, agriculture, automotive, the media and so on. Let's stop and think about that for a moment: a sector that by its very nature needs to be trusted to function effectively; a sector that is built on the premise of being trustworthy is trusted less than any other sector. That's a shockingly poor state of affairs.

Furthermore, when you dig into what the underlying causes are for the distrust the research findings are very clear - the top five factors decreasing trust in financial services companies are:

#5 Difficulty addressing problems
#4 Being unresponsive
#3 Unwanted selling
#2 Confusing products/services
#1 No product/cost transparency

The last two are very significant, because they tell us that the industry needs to provide greater product and cost transparency but in a manner that is not confusing. I think we're a long, long way away from that at the moment; there is a great deal more to be done and we shouldn't underestimate the challenge, because regaining trust once lost is inherently difficult to do.

So, how can we try to help rebuild trust in the sector?

Origin of TTF

Well, I created the Transparency Task Force because I believe there is a strong correlation between transparency, truthfulness and trustworthiness. I believe that that transparency leads to truthfulness; and that truthfulness eventually leads to trustworthiness; and nothing I have encountered since 6th May 2015 has done anything other than strengthen that world view.

I mention 6th May 2015 because that's when the Transparency Task Force started, at a meeting I held at Senate House, London University. I spoke to a room full of senior people from right across the financial services sector. I explained that the sector needs to be trusted to function effectively; that it isn't trusted; and that we have a choice – to either accept the appallingly low levels of trust in the sector as "business as usual" or look to do something about it; we can "stand up rather than stand by." I went on to explain that I thought if we believe ourselves to be honest and ethical that we have a duty to do what we can to help, even though we personally aren't the cause of the problem.

I believe that true professionals should be happy to take collective responsibility for the conduct of their industry as a whole; and that we shouldn't just leave it to the government and regulators to sort things out. Regulation is extremely important and I believe that in general terms "you get the regulation you deserve". Every time a regulator regulates it is because the sector has failed to act proactively and professionally in looking after the interests of the consumer.

Question: what do MiFid 2, The FCA's Asset Management Market Study, PRIIPS, The FCA's Institutional Disclosure Working Group, The Competition & Market Authority's investigation into the Investment Consulting and Fiduciary Management Industry (and all similar regulatory interventions) have in common?
Answer: none of them should have been necessary. They are all about the regulator making the industry behave properly. That simply should not have been necessary and unless the sector starts to take collective responsibility we will end up with so many tens of thousands of pages of regulation that regulatory friction costs will make it almost impossible for consumers to get the value for money they need and we should want them to have.

The Transparency Task Force is simply my attempt to do my bit to try to make a difference, by bringing together like-minded people who are experienced enough to know what really goes on in the sector, ethical enough to admit there is a great deal that needs putting right and motivated enough to be bothered to try to do something about it.

TTF today

Today, we are recognised as the collaborative, campaigning community dedicated to driving up the levels of transparency in financial services, right around the world. We believe that higher levels of transparency are a prerequisite for fairer, safer, more stable and more efficient markets that will deliver better value for money and better outcomes. Furthermore, because of the correlation between transparency, truthfulness and trustworthiness, we expect that our work will help to repair the self-inflicted reputational damage the sector has been suffering for decades.

We are an informal but increasingly influential forum of ethically-minded people that care about the financial services sector and the people it serves. Our approach is to be collaborative, collegiate and consensus-building; focusing on solutions not blame.

Mission

Our mission is "To help Fix Financial Services by harnessing the transformational power of transparency". Here are the sorts of things we are looking to fix:

- The Trust Deficit

- The Engagement Deficit
- The Understanding Deficit
- Hidden costs
- Hidden risks
- Opportunistic opacity
- Opportunistic obfuscation
- Opportunistic complexity
- Short-termism
- Inadequate client-centricity
- Asymmetries of information
- Regulatory capture in some parts of the world
- Scams and scandals
- A ‘profit before principle’ mindset
- Reputational damage
- Conflicts of interest
- Financial instability
- Malpractice; lack of market integrity
- Harmful incentive structures
- Mis-selling; and so on

Our approach is to shine a bright light into the darkness. There is nothing new about that idea. The phrase “Sunlight is said to be the best of disinfectants; electric light the most efficient policeman” is from Justice Louis D. Brandeis in his book “Other People’s Money and How the Bankers Use It” published over a 100 years ago, in 1914.

The Transparency Task Force is much more than just a “talking shop”. We want to drive change and our Strategy for Driving Change is all about bringing togethor two groups of people:

#1, those with a sense of passion & purpose about what needs to be changed;
#2, those with the power & position to make change happen.

Special Events

We do this in many ways, for example through our Transparency Symposia; and through our Special Events. Here are three very good examples:

On 12th September 2016 at the Houses of Parliament we led the world's first Transparency Strategy Summit; the primary purpose was to begin to build consensus on the best way to protect the interests of the UK’s saving and investing public through full disclosure on all the costs and charges they are paying but not being told about. I co-chaired that event with Tom Tugendhat MBE MP.

On 26th June 2017 at the Houses of Parliament we launched our Banking Team’s White Paper all about sensible recommendations to deal with the lack of transparency around charges for “Free-If-In-Credit” personal current accounts. I co-chaired that event with Lord Cromwell.

On 7th February 2018 at the Houses of Parliament, an event all about “Ideas to help reduce the chance of another Global Financial Crisis;” a very special meeting at which our Financial Stability Team presented our White Paper on the topic. All the relevant regulators were in attendance including the Financial Conduct Authority, the Financial Reporting Council and the Bank of England. Several parliamentarians were also in attendance; Sir Vince Cable was a speaker. The event was so impactful that it has led to the creation of a new All Party Parliamentary Group on Financial Stability that 23 parliamentarians are getting involved with.

What else has happened since 6th May 2015?

Teams

We have recruited well over 300 volunteers who are organised and mobilised into 13 Teams:

- The Foreign Exchange Team
- The Banking Team
- The Market Integrity Team
- The Costs & Charges Team
- The Financial Stability Team
- The Scams & Scandals Team
- Team PISCES (Purpose, Impact Investing, Sustainability, CSR, ESG, SRI)
- Team PAM (Progressive Asset Managers)
- Team APAC (Asia Pacific)
- Team Americas (USA and Canada)
- Team EMEA (Europe, Middle East and Africa)
- Team GTI (Global Transparency Index)
- The Pensions Team

Our teams are made up of small groups of people working together because we believe that Margaret Mead was right when she said: "Never doubt that a small group of thoughtful, committed citizens can change the world; indeed, it's the only thing that ever has." Each team works on at least one campaign objective and each campaign objective is about helping consumers to be treated fairly whilst helping the sector to become more trustworthy.

We have also:

- Run 20 Transparency Symposia; 18 in London, 1 in Boston MA, 1 in The Hague. These are thought leadership events designed to galvanise support for the idea that there ought to be greater transparency in financial services
- Published our online monthly magazine, The Transparency Times, which goes to many thousands of people completely free
- Awarded 19 Transparency Trophies, recognising the work of pro-transparency campaigners
- Responded to 12 formal Government/Industry consultations
- Had dozens of meetings and calls with regulators and government officials
- Produced six Thought Leadership White Papers
- Gathered over 100 Transparency Statements
- Had hundreds of articles/comments published; including being on the front page of the Financial Times
- Been on Radio 4 three times; including extensive involvement with the programme "The Transparency Detectives"
- Been growing our presence in 18 countries – we have spoken at dozens of conferences and events in the UK and overseas
- Recruited 38 Transparency Task Force Ambassadors; these are high-profile individuals who publicly stand up for the cause of greater transparency. We are extremely grateful to and proud of our Ambassadors. They are individuals who are particularly well aligned to the overall purpose and mission of the Transparency Task Force and have agreed to do what they can, when they can, to further the cause of greater transparency. We have 19 in the UK; 11 in the USA; three in Australia; three in the Netherlands; and two in Canada.

Honesty is always the best policy, so I'll close by being as transparent as possible about what I would now like you to do having read my article.

If you relate to the ideas I have tried to get across, and if you like the idea of working collaboratively with like-minded people in an unselfish attempt to make the financial services sector fairer, please contact me through andy.agathangelou@transparencytaskforce.org… because we need all the help we can get.

Or, if you would just like to be added to our invitations and updates list, please get in touch.

Thank you.

Current audit practice is valueless

by Eric Chalker

This article is reproduced, with permission, from the website www.lse.co.uk provided by London South East Ltd. It is one of a series written by Eric Chalker, a past director of UKSA. Eric's blog is written solely on his own behalf, on a range of subjects which interest him and he hopes will be of interest to private investors generally. All previous posts are still accessible at www.lse.co.uk/blogs/expert/eric-chalkers-blog.

"The evidence suggests that audit quality is not up to the level expected by private investors." These were my words, in response to a brief survey of UK Shareholders' Association members prior to a recent half-day presentation by PwC on how its audits are conducted. These and similar comments by other members were reported, but not addressed, in PwC's presentation.

It is to PwC's credit that it was prepared to meet some fifty or so private investors and invite questions. It is unfortunate, though, that the presentation was defensive in nature and sidestepped the challenging issues raised by those present. Unfortunate, but not really unexpected. Auditors do not see themselves to blame for company failures, even when the quality of their audits is found wanting by the Financial Reporting Council, resulting in fines.

Since the presentation referred to, I have read two things which have gripped my attention. The first was a letter in the Financial Times. The writer, in response to an article in the FT ("*Watchdogs need to remind auditors of their proper role*"), sought to exonerate auditors entirely from valuations which turn out to be false. The example he gave was this:

> *"Had an auditor in 1635 confirmed that 40 Dutch tulip bulbs were worth 100,000 florins at a time when a ton of butter cost about 100 florins, he would have been entirely justified."*

My response to this, which the FT kindly published, was that if this would indeed have justified a clean audit certificate, then all audit certificates are valueless.

Intangible Assets

I followed this up at the recent Premier Foods' AGM by putting a question directly to the auditor, KPMG. I drew attention to the fact that the reported values of key intangible assets came to 110 per cent of total equity. Quite a small mistake in judging the value could therefore put the company into negative equity. KPMG had told us these values were "acceptable", so I wanted to know whether this meant they were "true". The answer sidestepped the question, by asking us to take the accounts as a whole, but if a key element of the balance sheet is in doubt, as in this instance it surely is, the auditor's certificate should be qualified.

Premier Foods is not unique in this respect. It is now a common feature of many balance sheets, routinely given a clean certificate by their auditors. Audit certificates now give more information, but they continue to be supportive of management when they shouldn't be.

Auditors forget that they are supposed to serve the interests of shareholders, not those of management. In financial reporting, as in other matters, the two are not necessarily aligned. Auditors should not be afraid of stating this when it becomes apparent, but all the evidence suggests that they value their commercial interests more than the interests of those they pretend to be serving.

The 'Big Four' Condemned

The second thing that has gripped my attention is a recently published book which every investor should read. It is *"Bean Counters: the triumph of the accountants and how they broke capitalism,"* by Richard Brooks. It is the phenomenal story of the 'Big Four' accountancy firms, who are of course the big four in auditing too: PwC, Ernst & Young (now EY), KPMG and Deloitte. You will be horrified. The author's conclusion is, *"History shows that the Big Four accountancy firms have prospered by avoiding accountability for their part in false accounting, financial crises and the plundering of economies while paying attention to ever-expanding commercial opportunities."*

The Companies Act puts responsibility for appointing a public company's auditor into the hands of its members, the shareholders. Private investors who attend AGMs or vote by proxy will be familiar with the standard resolution inviting them to approve an auditor chosen by the directors. Nominally, therefore, shareholders do appoint the auditor, but in reality this is little more than a fiction.

Auditors' certificates invariably include words to limit their liability. Some are more restrictive than others, but it is common to see that the report is made "solely" to the Company's members. This may seem fair enough, but then the words, "as a body" are added, which makes one think. One has to assume that, in claiming this limitation, the auditor thinks it gives the basis for refusing to answer questions from individual members, except at general meetings which all shareholders have the right to attend. So, we should ask questions of the auditors at AGMs, challenging any figures supported by the audit certificate for which justification may be in doubt.

Auditor Obligations

Auditors are required to comply with Chapter 3 of Part 16 of the Companies Act 2006, which can be found here: https://www.legislation.gov.uk/ukpga/2006/46/part/16/chapter/3. The primary obligation is to tell shareholders "*whether, in its (professional) opinion, the annual accounts give a true and fair view*". This is the crux of the matter. There are additional obligations to say whether the accounts have been properly prepared, but investors should regard the "true and fair" requirement as paramount.

In describing the value placed on Premier Foods' intangible assets as "acceptable", I could interpret this as meaning "fair". But these assets are crucial to the strength of the balance sheet, so I also wanted to know whether they were "true". My Oxford Dictionary defines "true" as *"in accordance with fact or reality"*.

At issue are questions of value. Are values "true" as the law requires? The more significant they are to a company's "going concern" statement, on which its auditor is expected to comment, the more critical are the auditor's opinions. A tangible asset with an obvious function in the real world is one thing, but an intangible asset whose value wholly depends on fashion, or an obvious passing craze like tulipmania, or reputation (e.g. brands and goodwill), cannot properly be given a "true" value at a single moment in time. Accountancy standards – which are of course set by the accountancy profession itself – say how such values are to be assessed, but auditors should not seek refuge in them.

An auditor's opinion ought to be *"in accordance with fact or reality"*, not based on some clever formula divorced from reality. Truth is required, not fantasy.

Eric Chalker, UK Shareholders' Association Policy Co-ordinator & Director, 2012-2016

Report by the Chairman of the London & South-East Region presented at the regional AGM of 12 June 2018

John Hunter stepped down as UKSA Chairman in April. Our thanks to him and the Board for their due diligence in promoting the cause of private shareholders, including the policy group led by Peter Parry, which is important in an investment world dominated by the voice of 'intermediaries' and big institutional interests. Helen Gibbons is to be congratulated for doing an excellent job having taken over as editor of TPI this year: she deserves our support.

The London & South-East region (L&SE) represents more than 50% of the total UKSA membership. Informal meetings of L&SE committee members took place at company AGMs and at the monthly C&P meeting during the year.

On 27 February a formal meeting of the committee discussed the L&SE reaction to the UKSA board proposal for a merger with ShareSoc.

L&SE continued to promote and organise company briefings for UKSA members throughout the year led by Nick Steiner, backed up by Phil Clarke and Gerald Roberts. A major contribution to UKSA's activities.

The Croydon & Purley Group is the most active group of UKSA members in the region with regular monthly meetings. It comprises an experienced group of members, most of whom have been investing for many years and many of whom attend company AGMs in the City and elsewhere in the London area. They are not shy at voicing their opinions and commenting on company performance and corporate governance issues. The next meeting of the Croydon & Purley group will be on Tuesday 11 September at the Spread Eagle in Croydon.

In an increasing number of cases private shareholders are required to act as 'corporate representatives' through nominee accounts, requiring a 'letter of representation' to the company registrar in order to attend the AGM.

Harry Braund

UKSA on YouTube

Earlier this year Harry Braund gave a presentation on UKSA at the Master Investor Show in London at the invitation of the LSE website, one of the sponsors of the event. To view the video go to https://youtu.be/Os_RfiCyIQw

The investment platforms market – pay attention class!

by Peter Parry

One of the problems for private investors is that topics regularly come up which at first sight look as though they ought to be labelled like some types of medication: 'Warning; this product may cause drowsiness'. Often, however, these are of vital importance to investors and need to be understood and taken into account when making investment decisions. This is true of the issue of charges levied by platform providers for the use of their platforms and any exit fees when switching platforms. Following publication of the FCA's interim report and consultation on the subject, Roger Lawson of ShareSoc has recently written an excellent blog on the subject. As I cannot improve on it, Roger has given kind permission for us to reprint his blog in full below.

In its consultation the FCA poses a number of questions. Many are complex and technical. UKSA and ShareSoc are considering how best to respond but plan to make appropriate joint representations to the FCA. If you have any comments or thoughts of your own, please let us know.

Roger Lawson's blog and advice to investors

The Financial Conduct Authority (FCA) have just published an interim report on their study of "investment platforms". It makes for very interesting reading. That is particularly so after the revelations from Hardman last week. They reported that the revenue per assets held on the platform from Hargreaves Lansdown (HL) was more than twice that of soon to be listed AJ Bell Youinvest. HL is the gorilla in the direct to consumer platform market with about 40% market share. HL earns £473 per £100,000 invested while Youinvest earns only £209.

That surely suggests that competition is weak in this market. Indeed the FCA report highlights that investors not only have difficulty comparing the charges of different platforms, but they do not seem too concerned about high charges as they focus more on other aspects of the service provided. It also says on page 23 of the report: "Our qualitative research also found that consumer satisfaction levels are sometimes linked to satisfaction with overall investment returns, which tend to be attributed to the performance of the platform. This suggests some confusion about consumers' understanding about platforms' administrative function as opposed to the performance of investment products. So it is possible that consumers' relatively high satisfaction levels with platforms could be influenced by the positive performance of financial markets in recent years". In other words, the consumers of such services are very complacent about the costs they pay at present.

Another piece of evidence that this is not a competitive market obtained by the FCA was that they found that when platforms increased or decreased prices it had no significant impact on flows in and out of the platform. No doubt some platform operators will read that with joy, but others despair! Indeed when I made some comments on Citywire effectively saying I thought it suspicious that there were so many positive comments about Hargreaves Lansdown in response to an article reviewing the Hardman news, particularly as they were clearly much more expensive than other platforms who provided similar effective services (I use multiple ones) I was bombarded with comments from lovers of the HL service. Bearing in mind that platform charges can have a major impact on overall returns in the long term from stock market investments, you would think investors would pay more attention to what they are being charged.
One particular problem is that switching platforms is not only difficult and a lengthy process but can also incur charges. This is clearly anti-competitive behaviour which has been present for some years and despite complaints has not significantly improved.

The FCA summarises its findings as:

- Switching between platforms can be difficult. Consumers who would benefit from switching can find it difficult to do so.

- Shopping around can be difficult. Consumers who are price sensitive can find it difficult to shop around and choose a lower-cost platform.
- The risks and expected returns of model portfolios with similar risk labels are unclear.
- Consumers may be missing out by holding too much cash.
- So-called “orphan clients” who were previously advised but no longer have any relationship with a financial adviser face higher charges and lower service.

That’s a good analysis of the issues. The FCA has proposed some remedies but no specific action on improving cost comparability and the proposals on improving transfer times are also quite weak although they are threatening to ban exit charges. That would certainly be a good step in the right direction. Note that a lot of the problems in transfers stem from in-specie transfers of holdings in funds and shares held in nominee accounts. Because there is no simple registration system for share and fund holdings, this complicates the transfer process enormously.

One interesting comment from the AIC on the FCA report was that it did not examine the relative performance of different investment managers, i.e. suggesting that lower cost investment trusts that they represent might be subject to prejudice by platforms. They suggest the FCA should look at that issue when looking at the competitiveness of this market.

In summary, I suggest the platform operators will be pleased with the FCA report as they have got off relatively lightly. Despite the fact that the report makes it obvious that it is a deeply uncompetitive market as regards price or even other aspects, no very firm action is proposed. But informed investors can no doubt finesse their way through the complexities of the pricing structure and service levels of different platform operators. I can only encourage you to do so and if an operator increases their charges to your disadvantage then MOVE!

The FCA Report can be found here: https://www.fca.org.uk/publication/market-studies/ms17-1-2.pdf

Savers Take Control – an update

Readers of the April 2018 edition of The Private Investor will recall that Martin White set out the essence of this new approach, which is that savers themselves must take control of the investment chain.

Our website now includes a dedicated 'Savers Take Control' tab. Here readers can find the presentation which Martin gave to a September 2017 symposium of the Transparency Task Force.

Martin's PowerPoint presentation, together with the full presenter's notes, can also be downloaded ***here***

Alternatively, a PDF of the presentation (without notes) can be viewed ***here***

Letters to the Editor

From Ian Jessiman

Dear Editor

Mr Murray has my sympathy over the matter of action groups. I was caught out a good few years ago when someone attempted to set up such a group after the demise of Queens Moat Houses – after money had been collected we heard no more!

However, notwithstanding the arguing and litigation currently surrounding the RBoS Shareholder Action group, a large part (?) of the 'members' have already received 30p per share (the legal settlement was for 82p) with the promise of more to come (depending on the litigation).

So it can work - though possibly bad for the nerves!

From Eric Chalker

Dear Editor

A consuming error

While it was pleasing to see a guest article from the Financial Conduct Authority in the June issue of TPI, I could not help being struck by the number of times (21 in all) the writer, Nisha Arora, used the word ‘consumer’. This is a particular *bête noire* of mine, as investors are not consumers, but providers.

To some, this may seem no more than a semantic distinction, but to me it explains why the FCA pays so little regard to the particular problems of investors. The calamity of Beaufort Securities is the most recent and most shocking example. The FCA does not recognise investors as owners of capital, but insists on treating them solely as purchasers (“consumers”) of services. It sees its role as an enforcer of consumer protection, not as an enforcer of ownership rights. I have had personal experience of this, as I suspect have many others.

Clearly, as an investor, one may also be a consumer of services to assist the process of investing, but to treat the surrender of one’s capital in the same context is wrong. Buying shares involves two things: the purchase of a stockbroker’s services on the one hand and the transfer of capital in exchange for shares on the other. For the former, one is a consumer of services, but for the latter one is not. It should be immaterial that in a nominee account the shares are held by the nominee, because the money used to purchase the shares comes from the investor; it is the owner’s capital, not the nominee’s. The capital is not being consumed; it is being provided.

When something goes wrong, the FCA makes no distinction between the consumption of the services and the provision of the capital. It applies the same principle to both when it looks for a resolution of the matter – the consumer principle of fairness. It looks for what is relatively fair, not for what is absolutely right. It cannot be right for an investor’s capital, placed in another’s hands for safekeeping, to be treated as though it were money to purchase something for consumption. Until the FCA learns to make this distinction, or is instructed to do so by the government or Parliament, it will continue to be of little use to private investors.

CURRENT UKSA EVENTS

A photo ID is requested, please bring it with you!

Shareholder meeting with Chesnara PLC – Monday 17 September 2018

Location	**Panmure Gordon, 1 New Change, EC4M 9AF** **(Note: the entrance to 1 New Change is in Watling St.)**
Start	**10.45 for 11.00**
Room capacity	**50**
Company contact	**Lisa Kenniford**
Group leader / UKSA organiser	**Gerald Roberts – Tel: 07764 614937 E-mail: gerald.roberts@uksa.org.uk**

PWC Annual Investor Update – Wednesday 5 September 2018

Location	**PWC Offices, 7 More London Riverside, London SE1 2RT**
Start	**12.00 (lunch) for 12.30. Main sessions 1.30 for 2.00 start**
Room capacity	**--**
Company contact	**Ellie Newton**
Group leader / UKSA organiser	**This is an open event for all members of the investment community.** **Contact ellie.s.newton@pwc.com for further details**

UKSA BRANCHES – If no contact name or number is given, please contact UKSA office

Branch name	**Leader**	**Administration**	**Main purpose**	**Description**
London & South East Region	Harry Braund 020 8680 5872 harrycb@gmail.com	Andrew Girvan 020 8788 1665 agirvan247@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	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 669120 ahbirks@btinternet.com	Social meetings to discuss investment issues	Meetings in Croydon monthly Next meeting 11 September
South West	Peter Wilson 01453 834486 07712 591032	Peter Wilson 01453 834486 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	Julian Mole 07870 890973 julian.mole@btinternet.com	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
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