UKSA
UK Shareholders' Association

Carillion plc – making tomorrow a better place?

If we must have Brexit, can we have UK GAAP back?

The work of the UK's Financial Reporting Council

The Private Investor

Chairman's Comment

You all know that we have been talking with ShareSoc to see what we can do together. I have attended the last two ShareSoc board meetings by invitation; the ShareSoc chairman – Mark Northway – attended our last board, which was followed by a joint meeting of the two boards to exchange beliefs, find common ground and expose potential areas of conflict. I speak for all our board when I say that each contact has only served to reinforce the belief that continued co-operation is the natural way forward and continued separation would be self-defeating.

I have already said, in a different context, that I will stand down as Chairman at our next AGM and I remain resolved in this. But I will continue to volunteer – initially almost as heavily as now but slowly withdrawing at my own pace. I am not planning to take up any serious substitute activity and will stay on the board for a time, if asked.

I have not been able to find a willing candidate for the Chairmanship from within UKSA. It is therefore an easy decision to recommend Mark Northway as first Chairman of the potential merged organisation. I would hope to be Vice-Chairman, or some similar title, to lead UKSA through the merger process.

There remain many practical details to settle. Rob McDonald, for UKSA, and Mike Dennis, for ShareSoc, will lead a project to identify these and make recommendations. Their progress will depend on volunteer assistance – if you have any particular constituency you wish to protect it is important that you contact them and work with them towards a solution. However, be sure that the membership will be consulted and you are welcome, as always, to express your views to me or any of the board, or in public to The Private Investor.

John Hunter
Chairman

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

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In this issue…

Editorial – Turning Tide?

I am grateful to Cliff Weight for drawing attention to comments made by Jay Clayton, who was nominated by President Trump as chairman of the US Securities and Exchange Commission in January 2017. They came in a speech on Governance and Transparency given to the Annual Institute on Securities Regulation in New York and included some standout remarks of particular interest to individual shareholders:

"Given the core role of the proxy process in public company governance, I believe the Commission should be 'lifting the hood' and taking a hard look at whether the needs of shareholders and companies are being met. How are shareholders of all types getting information, and what information are they getting? Even if well-informed, are shareholders able to effectively participate in the voting process? What are the costs and burdens of the proxy system on companies, and how are they borne by shareholders? How are proxy rules affecting the ultimate beneficial owners of public companies – a majority of whom are 'silent' retail investors?"

"I have become increasingly concerned that the voices of long-term retail investors may be underrepresented or selectively represented in corporate governance. For instance, the SEC staff estimates that over 66% of the Russell 1000 companies are owned by Main Street investors, either directly or indirectly through mutual funds, pension or other employer-sponsored funds, or accounts with investment advisers…. Yet it is not clear whether in our rulemaking processes the views and fundamental interests of long-term retail investors are being advocated fully and clearly, either by individual investors or groups that represent them."

Dare we hope that these remarks, made in the capital of capitalism itself, herald a shift towards recognition of the role and rights of individual shareholders?

Helen Gibbons

Actionaria in Paris

I am on my way back from the Actionaria shareholder fair in Paris. It was an opportunity for UKSA to renew contacts first made last year in London with Total and Air Liquide, two companies pursuing active policies of engagement with individual shareholders beyond their core French market.

The Paris event is a fixture of the annual trade fair calendar and Total first participated 18 years ago. The show has evolved over the years. The traditional large cap stands now vie for footfall with midcaps, biotechs/medtechs, start-ups and a trading academy. The two-day programme also includes no fewer than forty 15-minute interviews with directors of participating companies under the heading "Face aux dirigeants", with opportunities for members of the public to fire questions. Being Paris, of course, there is also a Champagne bar for an early evening drink (known as *l'afterwork*). Overall, the atmosphere at the event was brisk and professional – a good benchmark for us to aim for in the context of a future event in London.

Helen Gibbons

London South East is also a website

Eric Chalker

A new investor, Googling a company share price, might well be drawn to the website www.lse.co.uk, believing it to be the London Stock Exchange. The similarity of initials might be no coincidence, because this 'London South East', unlike the UKSA region of that name, sets out to be the source of a cornucopia of information about share prices and much more of a financial nature. The London Stock Exchange now provides readily accessible company information too, so investors can choose which 'LSE' they prefer, but this article is about what can be found on www.lse.co.uk.

It is a feature-rich website, well worth exploring by all investors in company shares. In addition to providing the 'current' (15 minutes delayed) share price for all quoted companies, it provides price charts, share trades (interpreting them as buy or sell), company announcements, company 'fundamentals' (figures from the last five years' accounts), its financial diary, directors' dealings and broker recommendations. This is by no means all, but all this is provided free of charge.

Also free of charge is a facility to register as a member, with just an email address, password and a self-selected nickname. With that, one can set up portfolios and watch lists to be automatically updated, as well as – for those so inclined – chat online with other members on general or specific subjects. Some of the share chats attract hundreds of posts a day, but the quality is often very poor and occasionally abusive – especially when someone expresses a contrary opinion, which rather reduces the facility's value. The website also carries a lot of news and, weekly, a recorded interview.

Throughout the day, the home page displays the six top risers and fallers, but there is also a facility to look at shares by industry sector and by index (although not the AIM), with those top risers and fallers displayed too. Sector and index constituent companies are listed and anywhere a name is displayed, clicking on it takes the viewer to the display for that company, showing market cap, PE ratio, dividend and yield, plus more besides. Premium services are available, from £10 a month to £40 ('level 2 professional'). Buying and selling shares can be done from the website too.

A relationship with UKSA

Two years ago, then UKSA director Harry Braund found himself in conversation with the founders of the lse.co.uk website at a London investor show. One of the website's features is the provision of 'Expert Blogs'. Harry asked if UKSA could contribute one of these, the offer was accepted and its authorship fell to me. Having written many articles for this magazine, principally as policy co-ordinator and director, writing for the blog has given me greater freedom to write on subjects of my own choice. These can be found at: http://www.lse.co.uk/blogs/expert/eric-chalkers-blog/.

There are now 23 articles on my blog, covering a wide range of subjects. Some have drawn from what I learned and did when representing UKSA, but in the main they are expressions of personal opinion on matters that interest me and I hope are of interest to private investors generally. In the last six months, I have written about managing portfolios and measuring performance, the need for diversification, searching for dividend yield and how long shares should be held, have asked '*Whose interests do directors put first?*', criticised the Government's response to its Green Paper consultation earlier this year, drawn attention to the Takeover Panel's bid to become an arm of Government and posted twice disparaging Venture Capital Trusts. In '*An insistent drumbeat of increasing intensity*' followed by '*How bad might it be?*' I have written about the looming market setback. I blog as a past director of UKSA. It would be good to see other UKSA members adding their thoughts, in the comment boxes provided.

Eric Chalker served as UKSA's Policy Co-ordinator & Director from 2012 to 2016

Investment Trusts

by Cliff Weight

The People's Trust launch failure got me thinking and I spent some time researching Investment Trusts and found a very good site http://www.theaic.co.uk/aic/find-compare-investment-companies with lots of useful information:

From this, I extracted this data on 10-year returns (the AIC does not seem interested in long-term returns and does not give 20, 25 years and longer returns data, sadly):

	10-year TSR	**Annualised**
Investment Trusts (all)	129%	9%
VCT	83%	6%
Investment Trusts - All World excl UK	144%	9%
Investment Trusts - UK Smaller Companies	198%	12%
Investment Trusts - Hedge Funds	151%	10%
Investment Trusts - Biotech	475%	19%
Investment Trusts - Tech	340%	16%
Comparative benchmark data		
FTSE 100	66%	5%
FTSE 250	149%	10%
FTSE Small Cap	93%	7%
AIM	1%	0%

Of course, past performance is not necessarily an indicator of future performance. However, I would like to make a number of observations:

1. VCT tax relief probably means that after tax VCTs have performed at about the same level as investment trusts as a whole. The high fees of VCTs have eroded their returns to their shareholders. The ShareSoc VCT Investors Group will continue to campaign on this issue.
2. Investment Trusts have done much better than the FTSE100 index.
3. The rest of the world was a better place to invest than the UK. (This is pre exchange rates. £ has lost value over 10 years. Versus Euro it has gone down from 1.43 to 1.12 over ten years and versus US$ from 2.05 to 1.30.)
4. AIM was truly awful. Yes, the 1% 10-year return for AIM is not a typo! This is why it is so important that UKSA and ShareSoc continue to press LSE to regulate AIM properly.
5. Investing in biotech and tech investment trusts was a good strategy. (I have not bothered to produce the figures for mining companies, as I suspect that there may be problem is such statistics' reliability as an indicator due to the survivor bias issue.)
6. There may be some survivor bias issues in looking at the AIC data.
7. Some investment trusts are charging higher fees than others. Or one could say some investment trusts are charging lower fees than others.

The AIC site also has a useful article on the costs of investing in investment trusts that readers may find useful (https://tinyurl.com/ycatxzek). There was also a very good article in the FT, by Merryn Somerset Webb, on The People's Trust (https://tinyurl.com/ycw8umhe).

Cliff Weight is a director of ShareSoc and a member of UKSA

Making tomorrow a better place
(strapline for Carillion plc's annual report)

by Peter Parry

In the last edition of TPI Malcolm Howard wrote about the recent debacle at Carillion. [There is more from Malcolm elsewhere in this issue, Ed.] The Annual Report and Accounts for 2016 was published in April with upbeat statements from the Chairman and directors only to be followed about two months later with an admission that, thanks to problems with a number of major contracts, the company was in dire financial straits. The share price crashed from over 190p to 57p. Malcolm's article questioned, amongst other things, what the auditors were doing at Carillion.

An UKSA member also asked whether the Policy team had made any representations to the FRC about Carillion and the failure of the auditors to raise concerns about some of the Company's major contracts. It is a pertinent question which has prompted me to summarise some of the work that the Policy team has been doing recently on financial reporting.

As far as the Carillion issue is concerned, we have not written to the FRC about it. The reason is that UKSA's relationship with the FRC is such that we are now working closely and regularly with the Regulator on a number of projects which address some of the wider issues surrounding reporting standards, investor information requirements and audit quality. Carillion has been discussed specifically in the context of at least two of these projects.

The Board and the Policy team have actively sought to build a closer working relationship with the FRC. This has included engaging in several Reporting Lab and other projects. Three recent and highly relevant examples are:

- **The FRC's project on Risk and Viability reporting**: Members had an opportunity to respond to an FRC survey in June canvassing their views on this topic. This was followed by interviews with investors (UKSA included) and a series of round table discussions with the FRC. Carillion was discussed quite extensively at the round table meetings. All present expressed concerns about the fact that only a month or two after Carillion had published an upbeat outlook in its annual report serious problems emerged which threatened the very viability of the Company. The Risk and Viability project is ongoing and we shall see what changes the FRC proposes on standards of reporting in this area. There will, however, be feedback on the membership survey at the event that the FRC is running for us at their offices on 21st November.

- **The FRC's consultation on its revised Guidance on the drafting of the Strategic Report**: A copy of the joint response from UKSA and ShareSoc to the consultation can be found on the UKSA website (https://tinyurl.com/y8edm5av). In Sections 7.24 and Appendix IV of the Guidance we referred specifically to the Carillion situation. It is worth mentioning that the FRC's update to its Guidance on the strategic report is essentially 'tweaking' to ensure that strategic reporting complies with the requirements of the Shareholder Rights Directive. The exercise has, however, opened a can of worms and has served to highlight the shambles that much strategic reporting represents. Information is scattered around in statements from the Chairman, the CEO, the CFO, and reports on the business model, the business strategy, sustainability issues and an analysis of key risks. Why can't we replace this often unhelpful, incoherent and repetitive jumble with something more like Warren Buffett's 'Letter to Investors'?

- **The Consultation by the FRC in June this year on its enforcement procedures and sanctions**: UKSA and ShareSoc responded comprehensively to this. A copy of the response and our covering letter can be accessed at https://tinyurl.com/y8srqkyp. Suffice it to say that we were not impressed by sanctions that relied on levying fines on auditors. Even quite large fines can represent small change for the major audit firms.

While the Board is keen to build a good relationship with the Regulator and contribute fully to the work that it does, we are aiming to build a relationship which is based on objectivity and constructive feedback. Sometimes that feedback needs to be critical. UKSA was a signatory to a recent position paper drafted by Natasha Landell-Mills at Sarasin and Partners. The paper expresses the serious concerns and reservations that we have about the funding and staffing of the FRC and the scope that this creates for 'regulatory capture'. Although the position paper (a form of open letter) does not pull its punches, we had no hesitation in signing up to it. The letter can be accessed via the UKSA website at https://tinyurl.com/ybpw4awl. The FRC strongly refuted the concerns expressed in the position paper at a meeting on 11th October. However, in a speech on 25th October, Stephen Haddrill (CEO of the FRC) struck a more contrite note, admitting that while corporate reporting standards had improved recently, they were still not as good as they could be. One would like to think that the tone and some of the content of this speech reflect the move by UKSA and other investors to hold the FRC to account. A transcript of the speech has been published on the FRC's website (https://tinyurl.com/yah4rfge).

The FRC held an event for UKSA and ShareSoc members on 21st November. This provided an excellent opportunity for members to raise questions about standards of reporting and auditing directly with the Regulator.

We are not aiming to 'make tomorrow a better place' – a mind-numbingly silly, arrogant and meaningless statement on the part of Carillion's board which in itself tells us quite a lot about the Company's culture. However, we are trying to work with the FRC and other investors to try and ensure that all investors enjoy better standards of financial reporting and auditing than they do today.

UKSA and ShareSoc have just taken part in an event at the Financial Reporting Council in London entitled 'Lifting the Lid on the FRC'.

This was the first time that the FRC had presented to individual shareholders.

Around 50 UKSA and ShareSoc members attended the event and took part in lively exchanges, including some robust questioning. It was hailed a success by shareholders and the FRC alike. A full report will appear in the next TPI.

Carillion plc – An update

by Malcolm Howard

In the September issue of Private Investor, I wrote about the sad case of Carillion plc. The starting point of the story was that the Group Finance Director, Richard Adam, decided to retire on 24th August 2016, giving unconvincing reasons for his decision. The share price was 272p. Since my article was published much has happened:

11th September 2017: The Group Finance Director, Zafah Khan, who had said his priorities were to reduce debt and increase financial reporting transparency, left the company, presumably sacked. The share price was 43.16p.

29th September 2017: The company issues its half-year report to 30th June 2017. It declared half-year losses of £1.1236 billion, which included an additional £200 million provision for support services contracts, pointing out that this provision would have minimal impact on cash. However, it said that lessons had been learnt; there had been too much short-term focus, too much complexity, insufficient transparency and too much data leading to a lack of meaningful information. Importantly, it said that H1 covenants had been compliant **and H2 covenants were forecast compliant.** The market was buoyed by this information the shares shot up to 51.50p.

24th October 2017: The company announced that to preserve cash 'certain pension contributions' would be deferred, possibly until 1st January 2019. The price of the share was relatively unchanged at 46.50p.

17th November 2017: **The company was likely to be in breach of its (banking) covenants** at 31st December 2017 and the banks had agreed to take no punitive action but to review the position again on 31st March 2018. The shares collapsed to 21.50p and are currently just below 20p.

On 21st November 2017, a group from UKSA visited the Financial Reporting Council for a seminar entitled 'Lifting the lid on the FRC'. There can be little doubt that those employed at this organisation are highly qualified and knowledgeable. They are fully aware of the Carillion situation, but they are stymied by our legal system. In serious cases, such as this one, there may be prosecutions and until these are resolved (or are known not to be happening) they cannot do anything, by which time some of the evidence might have disappeared.

Investors need the law to be changed:

- FRC should be allowed to fully examine an audit immediately it is aware of a major problem, even if, for obvious reasons, it has to keep its findings confidential until it is given the all clear to go public; and
- Where an employee is found guilty of an offence, the auditor should be found 'guilty by association', unless there is proof that auditing standards had been met.

Bill Johnston

It is with great regret that we have learnt today that Bill Johnston has passed away. Bill was the editor of The Private Investor until this summer. Our condolences go to his wife Kateřina and all his family and friends.

Croydon and Purley Group

by Harry Braund

The Croydon & Purley group meets every second Tuesday of the month at the Spread Eagle pub in central Croydon. It has been in existence for more than 10 years and is currently established as the most active UKSA group in London. It is an independent group of investors who meet once a month to review the market and discuss company investment issues including financial analysis of specific companies. This is an experienced group of UKSA members who have been investing for many years and many of whom regularly attend company AGMs in the City and elsewhere in the London area.

Our members are not shy at voicing their opinions as shareholders at company AGMs: expressing satisfaction or otherwise on company performance and corporate governance issues. Not surprisingly, executive remuneration is often under the spotlight. The C&P group operates within the London & South East region, which represents around 50% of the total UKSA membership.

The Croydon & Purley group is open to members living in the London area, including those living in the Home Counties who are prepared to travel to Croydon. In the past a number of our members have served on the UKSA board and thus have an in-depth knowledge of the history of the Association, which has had its ups and downs over the years……

UKSA is always looking for new members, including younger people interested in investing, but it is not surprising that the Croydon group consists mainly of experienced retired people with the time and know-how to study the stock market. We all know that investing in stocks & shares entails a certain amount of risk, but by careful analysis of stocks the odds can be shortened considerably! The FTSE 100/250 market is of course seen by our members to be a safer bet than the AIM market, but that does not rule out an investment if the figures look right. Many of our regular members attend company AGMs, but better still, like to meet company executives face to face at UKSA-arranged briefings held during the year (totalling around 20), including such companies as HSBC, Whitbread, Legal & General, Pearson, Young's and Close Brothers. These briefings are seen as an excellent way to assess company performance as a good or bad investment.

One administrative issue which exercises C&P members is the 'dematerialisation' of paper shares into electronically held 'nominee' accounts, which immediately removes the shareholders' direct link with the company, i.e. the shareholder is no longer listed on the company share register. The end result is that all company AGM information has to be requested via the broker whenever the shares are held electronically. The broker then becomes the 'intermediary' between the shareholder and the company, which in some cases can result in the request entailing a charge.

Harry Braund is Chairman of the Croydon & Purley group

Financial Reporting Council

In July of this year UKSA and ShareSoc members received an email inviting them to participate in a survey being run by the Financial Reporting Council (FRC). The survey was part of a wider study being carried out by the FRC into Risk and Viability Reporting. Over 190 members responded, which was an excellent result. The FRC agreed that it would provide feedback for members on the results of the survey. The following article from Patrick Leach at the FRC summarises the findings.

Those who attended the event that the FRC ran for us on 21st November, 'Lifting the Lid on the FRC', will be aware that the hand-out notes at the event contained a slide giving very brief headline comments on the results of the survey. The article below provides more comprehensive feedback which can also be read by those who were unable to attend the event. One of the outcomes of event was that it made clear just how much the FRC values and wishes to encourage involvement from private investors in the work that it does. I shall be looking at ways in which we can make it easier for this to happen in future by ensuring that those who have an interest in any subject being investigated by the FRC know that it is going on and know how they can participate. The aim will also be to ensure that member input is properly coordinated.

A full report on the Risk and Viability Reporting project should be published shortly on the FRC's website. The draft report has already been circulated to the participating organisations for comment.

Peter Parry - UKSA Policy Director

Risk & Viability Reporting

Since the financial crisis there has been an increasing focus on how boards of companies manage risk and assess their viability. Investors are also increasingly focused on how directors promote the success of a company and how it manages risks that might threaten this success. In 2014, the Financial Reporting Lab ("the Lab") of the Financial Reporting Council announced a series of projects to cover business model, principal risk and viability reporting. These projects seek to explore the areas of most interest to investors and consider where companies face challenges in deciding what disclosures to make and how best to present them.

Having released *Business model reporting* in 2016, the Lab carried out a project on risk and viability reporting and published its report in November 2017. This project examines the views of companies and investors on the key attributes of principal risk and viability reporting, their value and use. In seeking the views of retail investors, a survey was sent out to UKSA and ShareSoc members, and it is encouraging that almost 200 responses were received.

Overall, the results from this survey were consistent with the messages heard from institutional investors. Below, we have provided more detailed results, split between principal risks and viability statements.

Principal risks

The questions on principal risk disclosures were aimed at understanding how the disclosures are used, and what information is most important to understand. Highlights from the survey results are as follows:

- 59% think that the annual report and accounts is important for providing principal risk information
- 57% say that their investment decisions are influenced by the robust risk assessment process in the annual report and accounts
- 62% say that their investment decisions are influenced by the principal risk disclosures in the annual report and accounts

- The most popular source of information to identify risks to companies is financial analysis and media, for example analysts' reports and financial/business publications (including business sections of national newspapers).
- For principal risk disclosures in the annual report:
  - The most useful piece of information is the changes in the principal risks since the previous year
  - Respondents also find categorisation of risks useful, although had no preference between type or timeframe
  - There is no obvious preference for risks being presented as either gross or net.
- 61% find useful the quantification of the impact of each principal risk. The vast majority would like to see the quantification of monetary impact and likelihood. Some respondents also suggested quantification of the impact on stakeholders.

The Lab's report confirms that the annual report and accounts is an important document for all investors, and identifies the provision of specific risk information as a key need of investors. As well as changes in principal risks and categorisation, the report also highlights (i) information around the priority of risks and (ii) clear linkage to other areas of the annual report and accounts, as key information for most investors.

Long-term viability statement

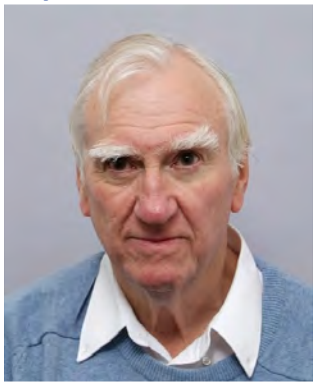
Following the outcome of the Sharman Inquiry, the viability statement was introduced in the 2014 version of the UK Corporate Governance Code in order to provide a means for directors to report annually on the long-term prospects of the company. The survey questions were aimed at understanding how useful information on long-term viability is to investors, and how aware they are of the viability statement disclosure. Key points are:

- The long-term viability of a company is important to 87% of respondents when making their investment decisions.
- However, only 43% of respondents are aware of the viability statement requirement in the Code. Of those that are aware, over half consider the viability statement useful.
- The most important information to include in the viability statement is: i) Length of period over which the company has assessed viability; ii) The assumptions and qualifications included in the assessment; and, iii) The sensitivity/scenario analysis conducted by the company.
- Respondents on average think that a 4 year time frame for viability is right. However, individual views ranged from 1 to 10 years, with several citing that it is dependent on the sector and business cycle.
- Almost all respondents think that disclosures on principal risks and uncertainties and long-term viability could be improved.

The Lab's report observes that for most companies the introduction of the viability statement has resulted in greater focus on risk management at board level, but that this is often not reflected in the viability statement disclosures. The report encourages companies to communicate positive messages in the viability statement about the long-term future of the company and how it is managing its risks. You can find *Risk and viability reporting* at www.frc.org.uk/investors/financial-reporting-lab, as well as copies of previous reports and information on future work. Finally, our thanks go to all members who have participated in the project.

If we must have Brexit, can we have UK GAAP back, please?

by Malcolm Howard



In the January 2017 edition of TPI Peter Parry pointed out that with regard to 'banks' the IFRS accounting system is inadequate. He quoted a letter which included the following:

The fact is that bank accounts – drawn up according to IFRS accounting standards – showed "profit" and "capital" that overstated their true strength.

Well, the point is that IFRS is not an accounting system based on basic principles, but one drawn up based on financial economics. For thousands of years the basic principles associated with accounts were:

- accounts are prepared showing what actually happened (historical cost accounting).
- that for every debit, there must be a credit (the matching concept).
- that profits and assets must not be overstated and losses and liabilities must not be understated (the prudence concept).

Under IFRS all three of these basic principles have been abandoned. The first problem we have with this is that IFRS often overstates assets and understates liabilities and is therefore imprudent.

An example of such imprudence can be found in the accounts of Land Securities plc. On 3 November 2004 the company embarked on debt refinancing. It exchanged all outstanding bond and debenture debt for new medium term notes (MTNs) with a higher nominal value. It did this to reduce the interest rate paid, but, of course, to balance this out it had to increase its liabilities. The correct entry for this would be debit 'reserves on the equity side of the balance sheet' and credit 'creditors'. But the new MTNs did not meet IAS 39 requirements and accordingly the company could not show the increased debt in their books. Instead this increased debt is amortised, which is included in interest expense in the Income Statement. At 31 March 2016 this meant the Land Securities debt was understated by £368.3 million (will be slightly lower in 2017), which is a critical figure if you are valuing property companies on the basis of net asset value.

Under UK GAAP assets that had a current value in excess of historical cost would be revalued. The difference between such revaluation and historical cost would be debited to the asset and the associated credit would go to the equity side of the Balance Sheet, the exact opposite of what should have happened in the Land Securities case. But IFRS goes much further; the difference between revaluation and historical cost is taken as profit. It gets worse; revaluation under GAAP insisted upon a prudent valuation, but IFRS uses the concept of 'fair value'.

'Fair value' is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. The estimation of fair value does not assume the asset is saleable at the reporting date, nor is it the amount that a company would receive in a forced transaction, involuntary liquidation or distressed sale. So if a company knew it had to sell an asset at a distressed price to reduce its debt, such an asset would go into the books at the full market value. Even if there was no market for a particular asset, 'fair value' would still have to be estimated.

Financial derivatives are also valued at 'fair value'. Like assets, this would be acceptable in isolation. What is wrong is taking unrealised profit in the income statement and although unrealised losses are also taken into account it all leads to greater volatility and uncertainty. Under UK GAAP, increases in valuation were not taken into account, but a loss was taken in the income statement, where current value fell below historical cost. As 'fair value' is subjective, directors can effectively, within reason, choose what profit they want to declare.

Companies often spend a great deal of money in research to bring out new products. When they believe that their research is so advanced that they can actually produce a new product, the definition of research is reclassified as 'development'. Under IFRS, while research costs should be written off, development costs should be capitalised. Obviously, where development costs include marketing, companies have plenty of scope for imprudence.

Development costs, together with the excess of a price paid for taking over a company compared to the net asset value of that company (goodwill) are called 'intangible assets'. Under UK GAAP, intangible assets were written off over twenty years. Under IFRS, what is written off is down entirely to the judgement of the company directors. They are supposed to evaluate their intangible assets every year to determine their true value. This is, as you would expect, an almost impossible task, so quite often the decision is taken to do nothing. But IFRS does create some interesting discussions with regard to this method of accounting. For example, the value of intangibles is based on what is thought to be the future profits generated because of these assets. In their accounts for the year ended 31 December 2016, Carillion plc valued their 'Intangible assets' at £1.669 billion. But since then they have said that their 2016 profit was over £1 million lower than they previously thought. In other words, their intangible assets were generating a lot less profit than previously thought. It will be interesting to see what their valuation of intangibles will be in their 2017 accounts, due out in March 2018.

When the directors of the company declare a dividend, they state the amount to be paid, the ex-dividend date and the date the dividend will be paid. Under company law the dividend has to be ratified by shareholders at an AGM held prior to the ex-dividend date, but it is almost unheard of for shareholders to reject such dividend. Under UK GAAP the proposed dividend was charged to the income statement and credited to creditors. Under IFRS proposed dividends are ignored.

Where IFRS really do enter the realms of fantasy is the flawed concept of 'share based payments'. For example, the company might offer a director the option to buy 100,000 shares at £5 per share (the current market price in 2017) any time between 1 January 2022 and 31 December 2025. The company could go to their bank and ask to buy an option. The bank would weigh up the situation and would quote a figure. If they did that, then you would know the price of the option and the double entry would be debit 'options' credit 'cash'. In other words you have met the matching concept as you have a debit and a credit.

But companies do not buy an option, so do not incur any cost. If, for example, the company's share price in 2023 was £8 per share, the company would issue 100,000 shares for £5, if the director wished to take up his option. This would cause a minor dilution and the shares might fall back to £7.90, the price at which the director would sell his shares on the open market. In this transaction, the company has incurred no cost whatsoever; in fact is has benefitted from a cash injection of £500,000. Shareholders, as a body, have missed out slightly as the share price has fallen. But they are delighted; the director must have done a good job to get the price up in the first place.

But IFRS cannot understand this; remember, we have left accounting and have moved to financial economics. So the income statement has to be charged with a fictitious 'share based payment', often using the Black-Scholes model. This model assumes two things, neither of which holds true:

- Markets are perfect, every investor is equally knowledgeable and will act rationally.
- The historical volatility of a share is a good predictor of future volatility as it is constant.

So, having calculated an imaginary option cost to be charged to the Income Statement, what do we do with the corresponding liability? Well, we cannot do anything because there isn't a liability. What this means is that the equity side of the balance sheet remains the same regardless of whether a share based payment is charged or not. Now, where the share price falls and the option is therefore valueless, the income statement is still charged with a share based payment. Of course, the accounting firms charge for calculating the cost of share options, which reduces the amount of profit (and cash for that matter) which is available for shareholders. Shareholders are paying dearly for irrelevant information.

Taking all the above into account it can be seen that the income statement no longer shows what actually happened, but is simply a conglomeration of judgements, none of which shareholders can assess or challenge. Only the cash flow statement can be trusted these days.

So can we have UK GAAP back, please, modified to incorporate the one benefit that IFRS gave us - which is that net assets or liabilities in company pension schemes are included in the accounts?

Letter to the Editor

From Peter Bartram

Dear Editor,

I do feel impelled to congratulate you on John Hunter's piece in your latest Newsletter. Quite apart from the injustice of it, I feel that the Tories' failure to take effective action on the issue of top people's pay is adding significantly to social division and Corbyn's perceived legitimacy.

When working in the UK at the HQ of a major multinational corporation in the 80s, I was a member of its Remuneration Committee and could see how the ratchet effect worked, with comparisons always being made with the highest paid execs in competitor organisations. There was no countervailing restraint on the process. And since then it has got astronomically worse.

I do hope that your words on this issue will be heeded properly, and soon. Otherwise we really will have to look forward to Prime Minister Corbyn.

Independent Financial Advisors – how unbiased are they?

by Peter Parry

I find the rules surrounding pensions baffling. I have always used a financial advisor for my pension and been handsomely ripped-off for doing so. In one case this involved a trip to the Financial Ombudsman Service. I won, but that is another story.

For a number of reasons I decided in June 2016 to look for a new IFA. One of the routes I tried was to go to a website called 'unbiased.co.uk'. None of the firms listed took commissions (which are now outlawed anyway) but in many cases their charging structure was simply based on a percentage of funds under management. Underneath the veneer of simplicity and clarity it was opaque. I wanted more transparency. I wanted to know what I was getting and what it was costing. Essentially, I wanted a menu of services, an ability to pick the ones I needed when I needed them and then pay for them on an hourly basis. I spoke to about six firms in total, none of which offered what I really wanted.

In the end my accountant, who is extremely dismissive of financial advisors, put me in touch with a firm that another of her clients was using. 'I am not recommending them,' she said, 'but I have met them and they seemed OK. You'll need to make up your own mind.'

I arranged a meeting with one of the directors; let's call him Tim. He visited me and listened to what I had to say, asked plenty of good questions, took copious notes and gave some free advice about recent changes to pensions – particularly those concerning inheritance tax. He sent a good proposal based on providing the sort of service I wanted. I was impressed and agreed to set up a SIP with his firm. At last, I seemed to have found someone who appeared to be independent and offered what I wanted.

In July of this year and shortly after I had signed up with Tim's firm, I read an article in the Money section of the FT on Saturday. The title was 'Jet setting with journalists must come to an end'. Basically, it said that independence amongst financial advisors of all types was still being widely compromised by the acceptance of lavish hospitality from fund companies. Oh dear! I thought. I wonder how my new IFA scores on this aspect of independence. There was only one way to find out: ask him. So I did. By return I received the following email – which I have edited slightly to preserve confidentiality:

Dear Peter,
Thank you for sending a copy of the article you refer to, much of which I have to say we as a company wholeheartedly agree with. I do not know XYZ's policy (the platform provider) in respect of gifts and hospitality but I am able to answer on behalf of my firm. I would point out that XYZ only act on instructions from the adviser community so their influence from inducements is likely to be a lot less than for advisers.

We keep a gifts and inducements register which is used by all staff to record such things as gifts and hospitality invitations. We do take a common sense approach in that anything less than £10 we do not require the staff to declare; this avoids the need for the advisers to declare perhaps a cup of coffee a particular company has purchased them in a meeting. All entries are signed off by a director to ensure they are not influencing our decision-making process.

Looking back at the register in the current and last year we have had one of the directors attend a dinner with Artemis and they provided a book to all of the delegates, last year Schroders took the adviser team to a local Indian restaurant for a meal following a fund manager presentation, another director was invited to a cricket match but declined the invite and we received two bottles of whiskey from clients as a thanks.

I remember when I first entered the industry the offers of hospitality were certainly more than they are today, I think the Bribery Act 2010 removed the majority of the invites we used to receive. We also used to run a staff Christmas raffle where any gifts received (such as the whiskey mentioned above) would be raffled off to the staff at Christmas time at no cost. However due to the quantity of gifts we now receive being very minimal we no longer have sufficient to support the raffle.

I think the industry is slowly being 'cleaned up' and I can't 100% assure you there aren't still some companies who are influenced by providers but I can assure you that all of our advice is supported by independent research and we do not want to compromise that going forwards.

Coming as quickly as it did, I thought that this was a good and reassuring response. It answered my question and it didn't seek to obfuscate or waffle. I suggested to Tim that his firm ought to mention their no-gifts policy in their sales brochure. 'It's a good point,' mused Tim. 'I'd never thought about it before.' I don't suppose he had; but then I don't suppose anyone had ever raised it with him before.

There is more to being independent in financial services than avoiding payment based on commissions. There are plenty of other factors that can affect the objectivity of advice given. Accepting lavish hospitality is one of the potentially more pernicious and damaging ones. It is up to us as consumers to ask the right questions and make sure that we are satisfied with the answers.

CURRENT UKSA EVENTS

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

SHAREHOLDER MEETING WITH VODAFONE plc - Thursday 30 November 2017

Location	**1 Kingdom Street, London, W2 6BY**
Assembly	**11:30 onwards**
Meeting start 12:00	**Room capacity 30**
Company contact	**Victoria Garnham**
Group leader / UKSA organiser	**Nick Steiner 020 8874 0977 e-mail: n.steiner@btinternet.com**

SITE VISIT & PRESENTATION BY SEGRO - Tuesday 19 December 2017

Location	**Navigation Park, Morson Rd, Enfield, EN3 4NQ**
Assembly	**13:30 onwards**
Tour start 14:00	**Room capacity 24**
Company contact	**Harry Stokes**
Group leader / UKSA organiser	**Nick Steiner 020 8874 0977 e-mail: n.steiner@btinternet.com**

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	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 669120 ahbirks@btinternet.com	Social meetings to discuss investment issues	Meetings in Croydon monthly (see article on page 9)
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
Brighton	Dee O'Hare 07568 156725 dfohare@ hotmail.com	Dee O'Hare 07568 156725 dfohare@ hotmail.com	Education on basic investing, and discussion with local UKSA members	Monthly evening meeting - presentation, Q&A, then socialising