



# ShareSoc

UK Individual Shareholders Society

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30 June 2011

The Sharman Secretariat  
c/o Financial reporting Council  
Aldwych House  
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LONDON  
WC2B 4HN

### Response to call for evidence by the Sharman Inquiry

Dear Sirs,

On behalf of the Society, I attach our submission of evidence to the Sharman Inquiry.

Please do not hesitate to contact me if you have any questions regarding this evidence.

Yours faithfully,

Marcus A. Bentley  
Director

### **About the UK Individual Shareholders Society (ShareSoc)**

ShareSoc represents and supports individual investors who invest in the UK stock markets. We are a mutual association controlled by the members with "not-for-profit" articles and incorporated as a company limited by guarantee. The organisation is financed by member subscriptions, donations from supporters and by its commercial activities. More information on ShareSoc can be obtained from our web site at [www.sharesoc.org](http://www.sharesoc.org) (our objects are fully defined on this page: [www.sharesoc.org/objects.html](http://www.sharesoc.org/objects.html) ).

# **SUBMISSION TO THE SHARMAN INQUIRY BY THE UK INDIVIDUAL SHAREHOLDERS SOCIETY**

30<sup>th</sup> June 2011

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## **Status**

1. This submission is made on behalf of the UK Individual Shareholders' Society<sup>1</sup> (ShareSoc), a not for profit organisation representing over 1,000 individual shareholders, from the perspective of investors in businesses listed or quoted in the UK. The author is a director of ShareSoc.
2. This submission is in response to the "call for evidence" issued by the Sharman Inquiry on 11 May 2011.
3. This submission specifically addresses issues relating to the transparency of going concern and liquidity risk, the first area on which evidence is sought, i.e. questions 1., 2. and 3. within the call for evidence. We do not have specific comments relating to questions 4. – 12. but do have further views as requested under 13. within the call for evidence.

## **Issues**

4. We have no desire to see the length and complexity of annual reports increased.
5. Our experience is that where going concern issues arise unexpectedly, this is more often to do with the quality, accuracy and timeliness of information released than with the quantity of data provided. An illustration of this is provided in Annex I to this submission. Further examples could be provided if required.
6. In addition to full and honest disclosure in annual and interim statements, prompt disclosure of material negative changes to the anticipated outlook for a company's liquidity position through a regulated information service (RIS) is important.
7. Given sufficient and timely information, and a reasonable expectation of improvement to a business's trading, investors such as ourselves may be prepared to provide additional equity capital. With the co-operation of creditors, this may allow a company to trade through temporary liquidity problems.

8. On many occasions, it is tempting for directors and senior executives to underestimate the potential seriousness of difficulties their businesses may face.
9. There is a fundamental conflict of interest for auditors appointed by, and who's remuneration is set by an audit committee that is itself appointed by the company board of directors.

## Proposals

10. In our opinion, the most important change required to current regulation and legislation is a stronger disincentive for directors to knowingly or negligently understate critical risks, or not to report them in a timely manner. The current regime makes it very difficult for directors to be brought to account when this happens.
11. Shareholders often have considerable knowledge of inadequacies in reporting by individual companies, yet there is no well publicised mechanism for them to bring such concerns to the attention of appropriate regulatory bodies.
12. When shareholders do report concerns, there is little feedback from authorities such as the FSA. Whilst there is clearly a need for confidentiality, there is also a balancing need for transparency to encourage reporting and to act as a deterrent against future undesirable behaviour. Progress and/or outcomes should be reported back to complainants in a timely manner.
13. Similarly, there is little opportunity for shareholders to bring concerns that ought to be investigated to the attention of insolvency practitioners in the early stages of an administration. This is particularly important in cases where it is proposed that management who failed in their duty are retained and suffer no penalty for their failure.
14. When problems do occur (as illustrated in Annex I), it is often due to imprudent critical accounting judgements by directors. To ensure that auditors have no conflict of interest when examining such judgements, we recommend that, rather than auditors being appointed by a committee that is itself appointed by the directors, their appointment and remuneration is governed by a shareholder-led committee<sup>2</sup>. Further, we consider regular rotation of auditors to be highly desirable.

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<sup>1</sup> The UK Individual Shareholders' Society. Registered in England Number 7503076, Chairman: Roger William Lawson, Website: [www.sharesoc.org](http://www.sharesoc.org) . PO Box 62, Chislehurst BR7 5YB, Tel: 020 8467 2686, e-mail: [sharesoc@btconnect.com](mailto:sharesoc@btconnect.com)

<sup>2</sup> Details of the operation of shareholder-led committees (as modelled on the successful Swedish system), with responsibility for appointment and remuneration of auditors are set out in the report "Tomorrow's Corporate Governance", obtainable from: <http://www.forceforgood.com/Tools/Tomorrows-Corporate-Governance-Bridging-the-UK-engagement-gap-through-Swedish-style-nomination-committees-199/1.aspx>

## Annex I

### Illustration of Failures in Reporting of Going Concern Issues

#### Aero Inventory Plc

Aero Inventory was a quoted company with a substantial market capitalisation. As at its last published interim results, dated 16<sup>th</sup> March 2009, it reported net assets of US\$311.1m and continued a strong track record of revenue and earnings growth over several years. Its major asset was an inventory of aircraft parts ascribed a value of US\$751.9m.

Shareholders and creditors could reasonably expect that the inventory would be regularly and rigorously audited.

However, on 26<sup>th</sup> October 2009 the company announced:

*"On the 30th September 2009 the Company announced a delay in publishing the Group's audited accounts for the financial year ended 30th June 2009 in order to prepare for a proposed move to the Official List.*

*In the course of these preparations, new systems have been introduced to reconcile and value inventory. These systems have raised certain issues regarding the valuation of a parcel of inventory acquired in the 2008 financial year. The directors believe these issues may have a material impact on the 2008 audited accounts and the 2009 accounts, although the precise impact is still being evaluated.*

*Whatever the outcome, the directors believe there will be no impact on either the physical amount of inventory held or upon the Group's cash flows. The issues raised are not believed to be a result of either fraud or theft...."*

On 11<sup>th</sup> November 2009 the company announced:

*"Following recent events and extensive discussions with the Company, the banks have not been prepared to provide additional short term funding to the Company to enable it to continue to trade.*

*Separately the Company has been actively exploring other financial options to secure working capital to continue to trade and protect value for shareholders. These options have also failed to reach a satisfactory conclusion in the time available.*

*It is therefore with deep regret that the board announces that it has today appointed James Robert Tucker, Richard Heis and Allan Watson Graham of KPMG LLP, 8 Salisbury Square, London EC4Y 8BB as joint administrators to the Company and its subsidiary Aero Inventory (UK) Limited under the Insolvency Act 1986."*

For these events to occur there must have been a very substantial failure of systems to value the company's inventory and a failure in the audit process to uncover the systems' inadequacies. Most significantly, shareholders have never received any explanation of the nature of these failures; what investigations were undertaken, whether any criminal activity may have occurred; nor what lessons could be learnt – either by directors or by auditors.

Without a publication of findings there is a clear risk that the same mistakes could be repeated, or if criminal fraud or negligence occurred that the same type of unacceptable activity could be repeated.