



# ACCOUNTING MATTERS FOR LAWYERS

Royal Faculty of Procurators In Glasgow

22 January 2020

IDEAS | PEOPLE | TRUST



# ACCOUNTING MATTERS FOR LAWYERS

## Introduction

- Understanding Accounts
- Where and how this helps you:
  - Contentious valuations
  - Family Law
  - M&A transactions
  - Litigation including investigations
  - Independent Business Reviews
- Closing and Q&A



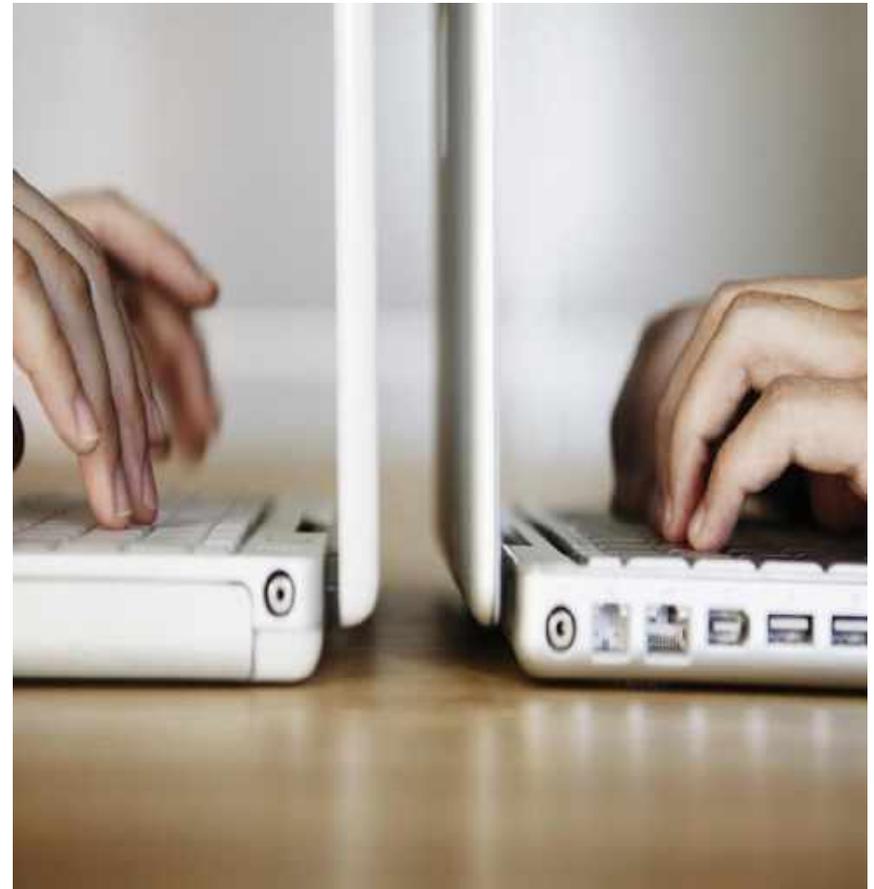
# UNDERSTANDING ACCOUNTS



# UNDERSTANDING FINANCIAL STATEMENTS

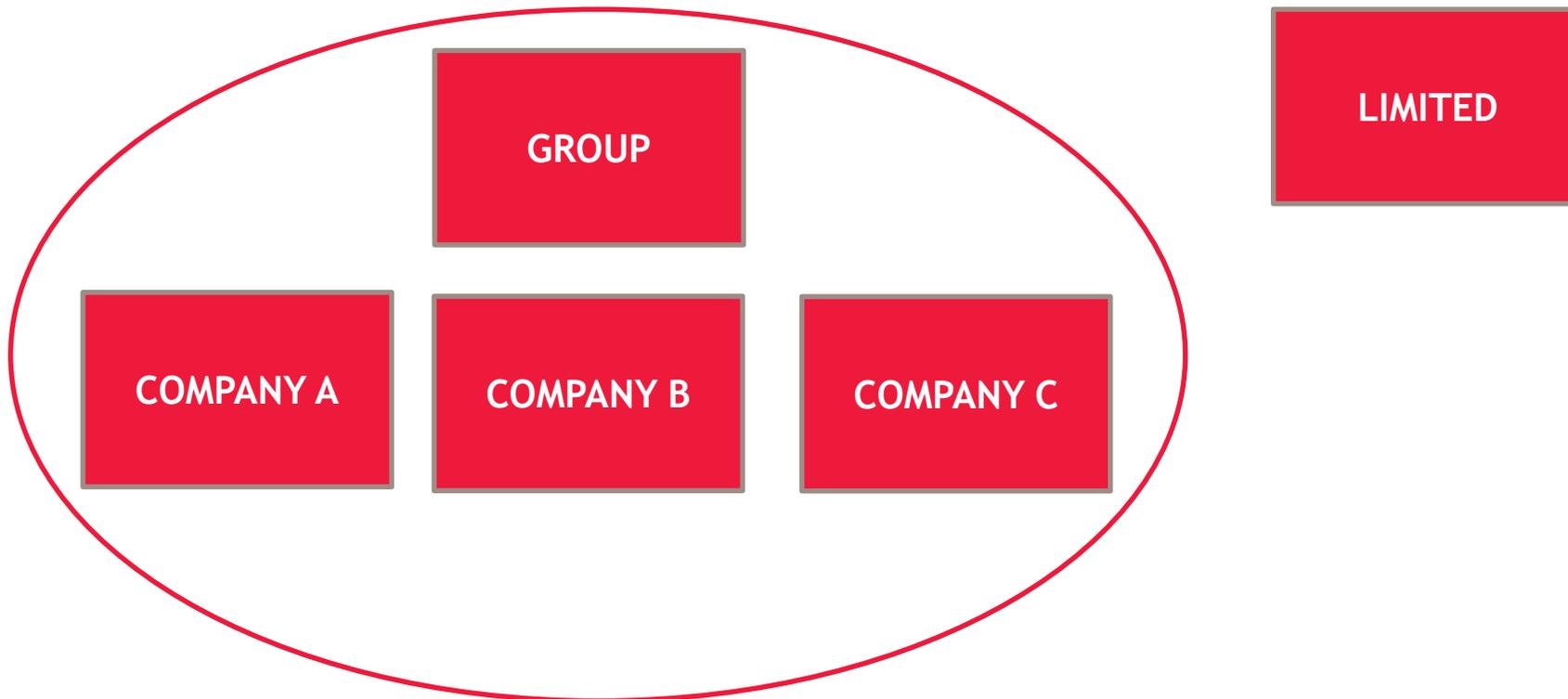
## Introduction

- Great deal of information included
- Full accounts vs. Abbreviated accounts
- Figures are historic
- Statutory accounts vs. Management accounts
- Example Accounts



# UNDERSTANDING FINANCIAL STATEMENTS

- The level of disclosure required depends on the size of the business.
- Companies in a group may prepare consolidated financial statements: small companies are exempt.



# UNDERSTANDING FINANCIAL STATEMENTS

## Report of the Directors

- Responsibility of the company Directors to draft
- Contains details on:
  - Results for the year
  - Any dividends paid
  - The principal activities of the company
  - Review of the business
  - The directors
  - The responsibilities of the directors
  - The name of the auditors
- Signed by the Directors
- Same date as the balance sheet

DIRECTORS' REPORT AND ADDITIONAL DISCLOSURES																																																		
<p><b>Directors' Report and additional information</b></p> <p>The Directors present these reports with the audited financial statements for the year ended 31 March 2017 (the "Report") and which is incorporated by reference in accordance with the UK Companies Act 2006 in the following information:</p> <p>Future developments of the business of the Company Risk factors and principal risks Internal controls – risk management objectives and policies Systems Sustainability/governance Director remuneration Validity statement Risk factors statement Governance arrangements Employment policies and employee involvement Capitalised structure Additional financial information</p> <p><b>Annual General Meeting</b> The Annual General Meeting of The British Land Group Limited (the "AGM") was held on 16 July 2017 at the Royal Opera House, London.</p> <p>The AGM is the principal decision-making body of the Board and the Board of Directors.</p> <p><b>Board of Directors</b> The names and biographical details of the Board of Directors are set out on pages 54 to 58.</p> <p>The Service Agreements of the Board of Directors are available for inspection at the AGM.</p> <p>In accordance with best practice, the AGM will also be held in electronic format.</p>	<p><b>Substantial interests</b></p> <p>As at 31 March 2017, the Company had been notified under the Disclosure and Transparency Rules (DTR) of the following interests in its ordinary shares:</p> <table border="1"> <thead> <tr> <th></th> <th>Interest in ordinary shares</th> <th>Percentage of ordinary shares as at 31 March 2017</th> </tr> </thead> <tbody> <tr> <td>Blackrock, Inc.</td> <td>86,222,399</td> <td>8.37%</td> </tr> <tr> <td>Paragon Bank</td> <td>11,439,040</td> <td>1.11%</td> </tr> <tr> <td>APB Asset Management, NV</td> <td>11,212,198</td> <td>1.09%</td> </tr> <tr> <td>UBI Private Limited</td> <td>41,121,133</td> <td>3.98%</td> </tr> </tbody> </table> <p>No changes to the above information were received during the period from 1 April 2017 to the date of signing this Report. No notification made in DTR 5 and under DTR 5 are available on the Investors section of our website.</p> <p><b>Articles of Association</b> The Company's Articles of Association may only be amended by special resolution at a general meeting of shareholders.</p> <p>Subject to applicable law and the Company's Articles of Association, the Directors may exercise all powers of the Company.</p> <p><b>Significant agreements</b> There were no significant agreements to which the Company is party that take effect, or have terminated upon a change of control of the Company.</p> <p><b>Payments policy</b> We recognise the importance of good supplier relationships to the overall success of our business. We manage this with our suppliers in a fair, consistent and transparent manner and have signed up to the UK Government's Prompt Payment Code.</p> <p><b>Events after the balance sheet date</b> There were no reportable events after the balance sheet date.</p> <p><b>Political donations</b> The Company made no political donations during the year (2016: nil).</p> <p><b>Health and Safety</b> We have retained formal recognition of our focus on health and safety through a successful audit of our OHSAS 18001 accreditation. We continue to improve our approach to health and safety through attention to our safety case compliance across all activities in the business. Our customers, managed portfolio and head office for deliver Public Health prefer to our employees and our customers.</p> <p><b>BISOM* Year ended 31 March 2017</b></p> <table border="1"> <thead> <tr> <th rowspan="2"></th> <th colspan="2">Total NETFCR (Headline)</th> <th colspan="2">Business Company Size</th> <th rowspan="2"></th> </tr> <tr> <th>2017</th> <th>2016</th> <th>2017</th> <th>2016</th> </tr> </thead> <tbody> <tr> <td>Construction</td> <td>2</td> <td>3</td> <td>0.08</td> <td>0.14</td> <td>per 100,000 hours worked</td> </tr> <tr> <td>Retail</td> <td>25</td> <td>23</td> <td>0.01</td> <td>0.01</td> <td>per 100,000 hours worked</td> </tr> <tr> <td>Offices</td> <td>8</td> <td>6</td> <td>23.51</td> <td>19.85</td> <td>per 100,000 hours worked</td> </tr> <tr> <td>Head Office</td> <td>0</td> <td>11</td> <td>0</td> <td>0</td> <td>per 100,000 hours worked</td> </tr> </tbody> </table> <p>* Reporting of Injury, Sickness and Dangerous to Life Incidents (BISOM) 2017.</p>		Interest in ordinary shares	Percentage of ordinary shares as at 31 March 2017	Blackrock, Inc.	86,222,399	8.37%	Paragon Bank	11,439,040	1.11%	APB Asset Management, NV	11,212,198	1.09%	UBI Private Limited	41,121,133	3.98%		Total NETFCR (Headline)		Business Company Size			2017	2016	2017	2016	Construction	2	3	0.08	0.14	per 100,000 hours worked	Retail	25	23	0.01	0.01	per 100,000 hours worked	Offices	8	6	23.51	19.85	per 100,000 hours worked	Head Office	0	11	0	0	per 100,000 hours worked
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<p><b>Auditor and disclosure of information</b></p> <p>Each of the Directors at the date of approval of this Report confirms that:</p> <ul style="list-style-type: none"> <li>- so far as the Director is aware, there is no relevant audit information that has not been brought to the attention of the auditor and</li> <li>- the Director has taken all reasonable steps to make himself/herself aware of any relevant audit information and to establish such information was provided to the auditor.</li> </ul> <p>PwC has indicated its willingness to remain in office and on the recommendation of the Audit Committee, a resolution to reappoint PwC as the Company's auditor will be proposed at the 2017 AGM.</p> <p>The Company confirms that it has complied with The Statutory Audit Scheme for Large Companies Market in the regulation (Mandatory Use of Complex Processes and Audit Committee Responsibilities) Order 2014 (Article 35), published by the CMA on 24 September 2014.</p> <p>The Directors' Report was approved by the Board on 16 May 2017 and signed on behalf of:</p> <p><i>[Signature]</i></p> <p><b>Elaine Williams</b> Company Secretary and General Counsel The British Land Company PLC Company Number: 38421920</p>	<p><b>DIRECTORS' REPORT AND ADDITIONAL DISCLOSURES CONTINUED</b></p>																																																	

# UNDERSTANDING FINANCIAL STATEMENTS

## Report of the Independent Auditors

- Some smaller companies do not require an audit
- Based on standard paragraphs
- The auditor's report declares:
  - Prepared in accordance with GAAP / IFRS
  - Free of material misstatement
  - Show a true and fair view of company's affairs
- Qualified vs. Unqualified

**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF THE BRITISH LAND COMPANY PLC**

**Report on the financial statements**

**Our opinion**  
In our opinion:

- the British Land Company PLC Company financial statements and fair view of the state of the affairs at 31 March 2017 and of the year then ended
- the Group financial statements accords with International Financial Reporting Standards (IFRSs) as adopted by the EU
- the Company financial statements in accordance with United Kingdom Accounting Practice
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006

**What we have audited**  
The financial statements, including:

- the Consolidated Balance Sheet
- the Company Balance Sheet
- the Consolidated Income Statement of Comprehensive Income for the Consolidated Statement of Financial Position
- the Consolidated Statement of Financial Position at the end of the year
- the Notes to the Accounts, including accounting policies and other information

Certain required disclosures in the Annual Report, rather than in the financial statements, have been identified as audited.

The financial reporting framework (the Group financial statements) is prepared in accordance with the European Union, and applicable framework that has been applied. The Company financial statements is prepared in accordance with IFRSs, as adopted by the United Kingdom Generally Accepted Accounting Practice and applicable law.

**Directors' Remuneration Report - Companies Act 2006 opinion**  
In our opinion, the Directors' Remuneration Report is prepared in accordance with the Companies Act 2006.

**Other Companies Act 2006 reporting**  
Under the Companies Act 2006 we are required to report in our opinion, certain disclosures of Directors' remuneration disclosed by the company. We have no exceptions to report arising from this responsibility.

**Corporate governance statement**  
Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to the provisions of the Code. We have nothing to report having performed our review.

**Responsibilities for the financial statements and the audit**  
**Our responsibilities and those of the Directors**  
As explained more fully in the Directors' Responsibilities Statement set out on page 71, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, unless otherwise expressly agreed by our prior consent in writing.

**What an audit of financial statements involves**  
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements and the financial information contained therein are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's and the Company's circumstances and have been consistently applied and adequately disclosed
- the reasonableness of significant accounting estimates made by the Directors
- the overall presentation of the financial statements

We primarily focus our work in these areas by assessing the Directors' judgments and available evidence, forming our own judgments, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain such evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is, or appears to be, materially incorrect based on, or inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent misstatement or inconsistency we will consider the implications for our report. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.

*John Waters*  
**John Waters (Senior Statutory Auditor)**  
For and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London

16 May 2017

# PROFIT AND LOSS ACCOUNT

- Financial information for a named period
- Generally based on 12 months trading - CHECK!!
- Statutory format vs. detailed accounts
- Look for references to Notes
- Turnover
- Cost of Sales
- Gross Profit
- Distribution Costs
- Administrative Expenses
- Operating Profit/(loss)

CONSOLIDATED INCOME STATEMENT							
FOR THE YEAR ENDED 31 MARCH 2017							
	Note	2017			2016		
		Underlying <sup>1</sup> £m	Capital and other £m	Total £m	Underlying <sup>1</sup> £m	Capital and other £m	Total £m
<b>Revenue</b>	3	556	33	589	569	21	590
<b>Costs</b>	3	(122)	(26)	(148)	(126)	(11)	(139)
	3	434	7	441	441	10	451
Joint ventures and funds (see also below)	11	132	(80)	52	135	262	397
Administrative expenses		(84)	–	(84)	(93)	–	(93)
Valuation movement	4	–	(144)	(144)	–	616	616
(Loss) profit on disposal of investment properties and investments		–	(5)	(5)	–	35	35
Net financing costs							
– financing income	6	2	42	44	5	65	70
– financing charges	6	(80)	(29)	(109)	(111)	(34)	(145)
		(78)	13	(65)	(106)	31	(75)
<b>Profit on ordinary activities before taxation</b>		<b>404</b>	<b>(209)</b>	<b>195</b>	377	954	1,331
Taxation	7		1	1		33	33
<b>Profit for the year after taxation</b>				<b>196</b>			1,364
Attributable to non-controlling interests		14	(11)	3	14	5	19
<b>Attributable to shareholders of the Company</b>		<b>390</b>	<b>(197)</b>	<b>193</b>	363	982	1,345
Earnings per share:							
– basic	2			<b>18.8p</b>			131.2p
– diluted <sup>2</sup>	2			<b>14.7p</b>			119.7p

All results derive from continuing operations.

	Note	2017			2016		
		Underlying <sup>1</sup> £m	Capital and other £m	Total £m	Underlying <sup>1</sup> £m	Capital and other £m	Total £m
<b>Results of joint ventures and funds accounted for using the equity method</b>							
Underlying Profit		132	–	132	135	–	135
Valuation movement	4	–	(93)	(93)	–	245	245
Capital financing costs		–	(6)	(6)	–	–	–
Profit on disposal of investment properties, trading properties and investments		–	18	18	–	18	18
Taxation		–	1	1	–	(1)	(1)
	11	<b>132</b>	<b>(80)</b>	<b>52</b>	135	262	397

<sup>1</sup> See definition in Glossary.  
<sup>2</sup> Prior year diluted EPS has been restated. See note 1.

# BALANCE SHEET

- Financial statement at a given point in time
- Summary of assets vs. liabilities
- Top half = assets and liabilities
- Bottom half = share capital and reserves
- Fixed Assets
- Current Assets
- Current Liabilities
- Net current assets/(liabilities)
- Long Term Liability - Creditors > 1 year
- Net assets/(liabilities)

Some international companies show information in a slightly different way.

CONSOLIDATED BALANCE SHEET			
AS AT 31 MARCH 2017			
	Note	2017 £m	2016 £m
<b>ASSETS</b>			
<b>Non-current assets</b>			
Investment and development properties	10	9,073	9,643
Owner-occupied properties	10	96	95
		<u>9,169</u>	<u>9,738</u>
<b>Other non-current assets</b>			
Investments in joint ventures and funds	11	2,766	3,251
Other investments	12	154	142
Deferred tax assets	16	4	3
Interest rate and currency derivative assets	17	217	167
		<u>12,208</u>	<u>13,403</u>
<b>Current assets</b>			
Joint venture held for sale	11	540	-
Trading properties	10	334	325
Debtors	13	171	33
Cash and short term deposits	17	116	116
		<u>1,161</u>	<u>474</u>
<b>Total assets</b>		<b>10,447</b>	<b>13,877</b>
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Short term borrowings and overdrafts	17	(464)	(74)
Creditors	14	(459)	(238)
Corporation tax		(80)	(10)
		<u>(903)</u>	<u>(322)</u>
<b>Non-current liabilities</b>			
Debentures and loans	17	(2,817)	(3,687)
Other non-current liabilities	15	(79)	(122)
Interest rate and currency derivative liabilities	17	(144)	(127)
		<u>(3,040)</u>	<u>(3,936)</u>
<b>Total liabilities</b>		<b>(3,943)</b>	<b>(4,256)</b>
<b>Net assets</b>		<b>9,476</b>	<b>9,619</b>
<b>EQUITY</b>			
Share capital		260	260
Share premium		1,299	1,295
Merger reserve		213	211
Other reserves		(97)	(93)
Retained earnings		7,547	7,667
<b>Equity attributable to shareholders of the Company</b>		<b>9,222</b>	<b>9,362</b>
Non-controlling interests		255	257
<b>Total equity</b>		<b>9,476</b>	<b>9,619</b>
<b>EPRA NAV per share<sup>1</sup></b>	2	<b>915p</b>	<b>919p</b>

<sup>1</sup> As defined in Glossary.

**John Gildersleeve**  
Chairman

**Luctuin Bell**  
Chief Financial Officer

The financial statements on pages 100 to 143 were approved by the Board of Directors and signed on its behalf on 16 May 2017.  
Company number 421920

# ACCOUNTING POLICIES TO LOOK OUT FOR

- Depreciation
- Stock
- Intangible assets
  - Goodwill
  - Trademarks
  - Intellectual property
- Impairment
- Director's Remuneration

# DEPRECIATION

- Depreciation spreads the cost of an asset over its useful life to match costs to the expected benefit that the asset will give over time.
- The assumptions made will impact profit.
  - *E.g. An asset is bought for £100,000*
  - *If profit before depreciation is £50,000 then the effect of the depreciation adjustable might be:*

	A	B	C
Profit before depreciation	50	50	50
Period of Depreciation	5 years	10 years	50 years
Depreciation per year	(20)	(10)	(2)
Adjusted profit	30	40	48

# DEPRECIATION: A REAL EXAMPLE

## MANCHESTER AIRPORT GROUP

ACCOUNTING POLICIES	YEARS
Freehold and long leasehold property	10-50
Runways, taxiways and apron	5-75
Mains services	7-100
Plant and machinery	5-30
Motor vehicles	3-7
Fixtures, fittings, tools and equipment	5-10

## HEATHROW AIRPORT HOLDINGS

ACCOUNTING POLICIES	YEARS
Runway surfaces	10-15
Runway bases	100
Taxiways and aprons	50

# STOCK

- Main risk in relation to stock is that the valuation is incorrect.
- Particularly relevant here as the stock value will be volatile. The policy under UK GAAP is to value at the lower of the cost and the value at which the stock can be realised

*EXAMPLE: An item is bought for £175*

A	B	C
Market price £175	Market price £225	Market price £115
Record at £175	Record at £175	Record at £115

*Therefore in Example C you record a loss of £60 in the profit and loss account*

# INTANGIBLE ASSETS

- Can be a significant part of a company's value
- “Home grown” intellectual property / brands will not normally be reflected on the balance sheet
- Differences in accounting rules for UK GAAP and IFRS

# IMPAIRMENT

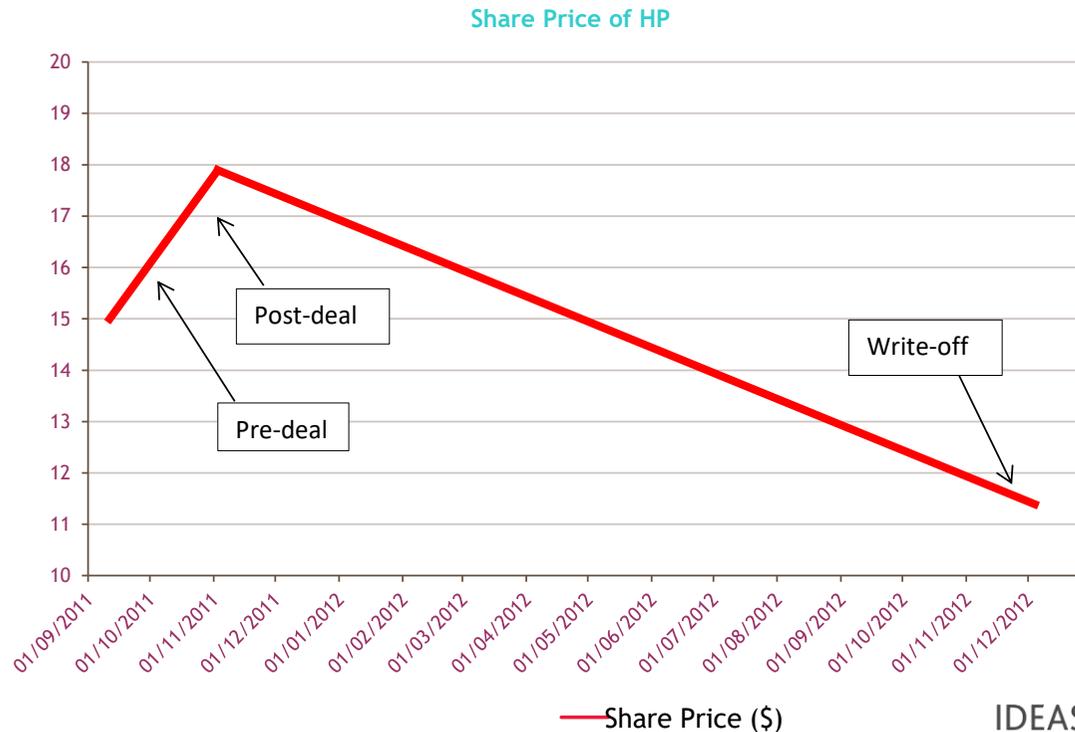
- If an acquisition loses value, the group balance sheet is adjusted to reflect the impairment and profits are reduced in that year to reflect the amount written off.

# IMPAIRMENT - REAL LIFE EXAMPLE

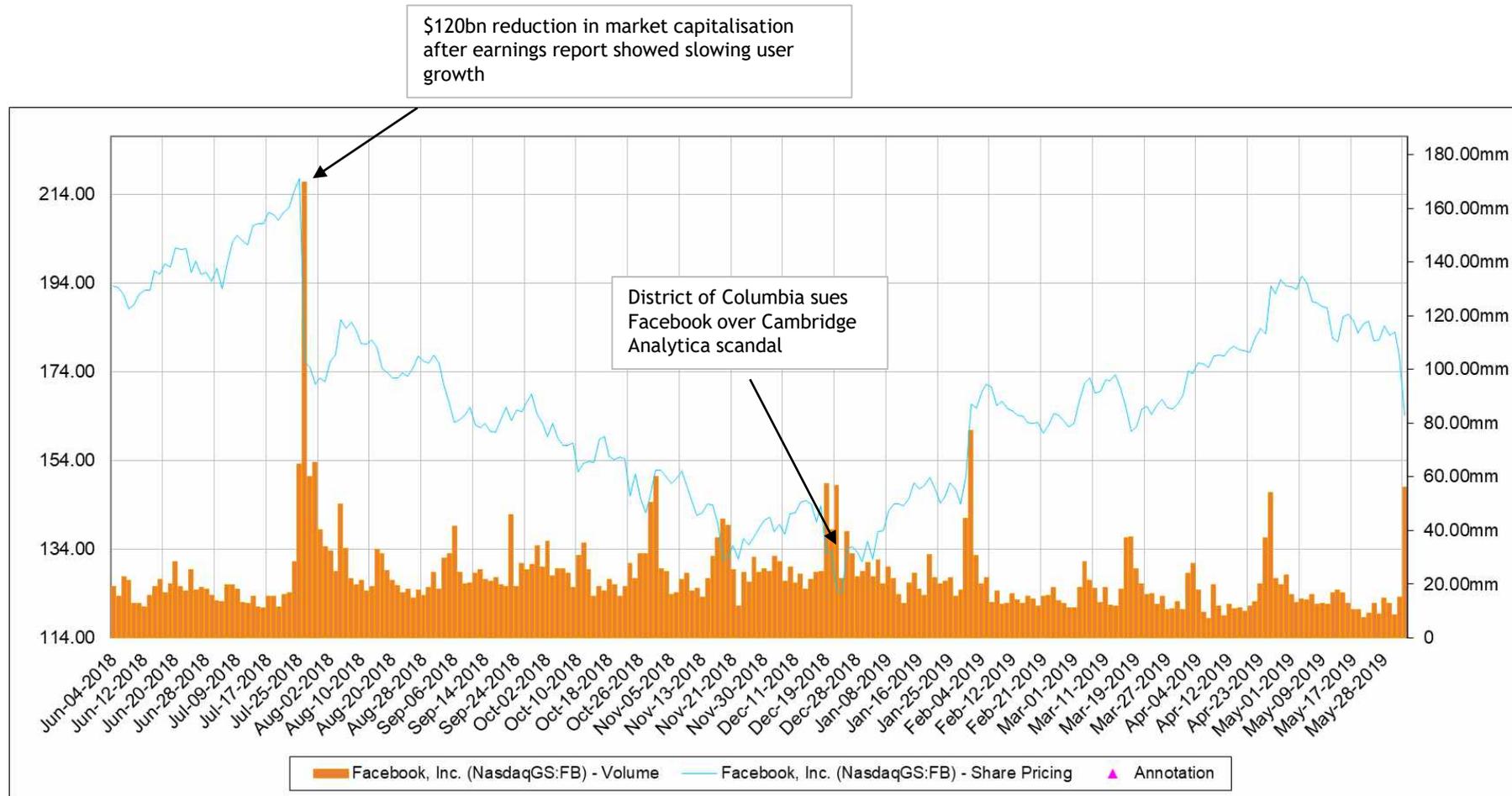
October 2011 Hewlett-Packard acquires Autonomy for a total of c. \$11 billion

November 2012 HP writes down its investment by \$8.8 billion due to accounting Improprieties, disclosure failures and outright misrepresentation at Autonomy

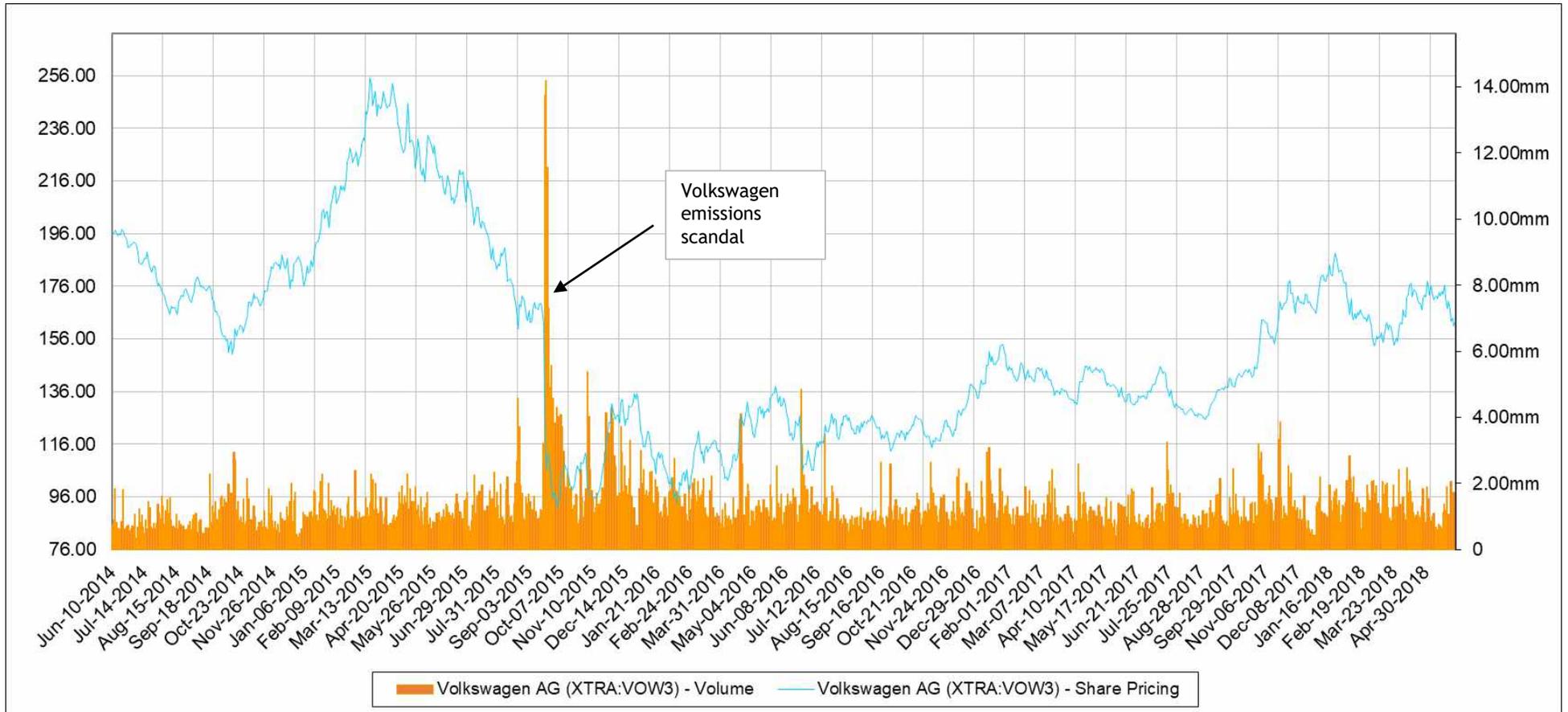
## HP share price fell to 2002 levels



# FACEBOOK SHARE PRICE MOVEMENTS



# VOLKSWAGEN SHARE PRICE MOVEMENTS



# RESERVES

- Not all reserves can be distributed to shareholders
- Companies may make distributions only out of profits available for that purpose which is basically determined as accumulated realised profits less accumulated realised losses. This reserve is commonly called 'Retained earnings / Profit & Loss Account'.
- Examples of **undistributable** reserves;
  - Share premium account
  - Capital redemption reserve
  - Revaluation reserve
- However, it is sometimes possible to re-categorise to distributable reserves
- It is the duty of the Directors to assess whether the Company will remain solvent following a proposed distribution. Care will therefore need to be taken that sufficient funds remain for the purpose of settling debts when they become due.

# FINANCIAL STATEMENT ANALYSIS

- Historical results: sales, costs, expenses, profits, fixed assets
- Performance in the past / change over time
- Changes in the product and the market
- Future plans and forecasts
- Funding arrangements
- Market report
- Competitor activity

# WARNING SIGNS OF GENUINE BUSINESS FAILURE

Deteriorating debtor collections

Increasing WIP value that is not billed on time

Cash at bank is reducing/the overdraft is steadily increasing

Rising stock levels and static/deteriorating sales

Slow or late payment or suppliers' invoices

Clearing debts by lump-sum payments on account

Increasingly making payment by post-dated cheques

Leave paying old invoices until you need delivery of a new order

Using disputes to delay payment to suppliers

Increasing number of final demands and writs from suppliers

An ever-widening search for new suppliers who will make more credit available

Escalating VAT and PAYE arrears

Receiving a statutory demand for payment

# Key Accountancy Terms - Brief Explanations

## Profit and Loss Account terms

- **Profit and Loss Account**
  - A statement presenting the trading income less operating costs and expenses to show the operating profit or loss over a specific period, usually a year
  - Interest and taxation is then applied to this figure to present the retained profit or loss that is transferred to the balance sheet
- **Turnover**
  - The total value of goods or services sold by a company during a particular period of time net of VAT
- **Cost of Sales**
  - The cost of obtaining or creating the products or services
  - Includes stocks, components, raw materials, labour time and other production costs
- **Gross Profit**
  - Turnover less Cost of Sales = Gross Profit
  - This is profit before deduction of expenses
- **Administrative Expenses & Distribution Costs**
  - Expenses related to the running of the business such as employee costs, general administration, property costs, transport and professional services
- **Operating profit**
  - Gross profit less Admin Expenses & Distribution Costs = Operating Profit
  - Operating profit is also called Earnings Before Interest & Taxation (EBIT)
- **Net profit after tax**
  - Operating profit less interest and taxation = Net profit after tax

## Balance Sheet terms

- **Balance Sheet**
  - A statement of the total assets and liabilities at a certain date
  - The top section of the balance sheet presents the fixed and current assets and the liabilities - the net assets
  - The bottom section of the balance sheet shows how these net assets have been financed by share capital and retained profits and other reserves
- **Fixed asset**
  - Asset usually with a useful life over 1 year, not readily convertible into cash e.g. property, land, tangible and intangible
- **Current asset**
  - Asset expected to be sold or used within 1 year e.g. stock, debtors, cash
- **Current liability**
  - Liability expected to be settled within 1 year or on demand e.g. trade creditors, overdrafts
- **Long-term liability**
  - Liability due to be paid in over 1 year e.g. bank loan
- **Net current assets/liabilities**
  - Current assets less current liabilities. A negative result equals net current liabilities
- **Total net assets/liabilities**
  - Total assets less total liabilities. A negative result equals net liabilities
- **Balance sheet insolvent**
  - Net liabilities, where total liabilities exceed total assets

# CONTENTIOUS VALUATION

# BASIS OF VALUATION

- Fair (Market) Value
- Market Value
- Loss to Owner
- Hypothetical loss
- Permanent v Temporary

# VALUATION METHODOLOGIES

## Methodologies applicable to value equities

### 1. DCFs

EV or Equity models

Forecast Profit & Loss Accounts Year	2014	2015	2016	2017	Terminal Value
EBITDA	(81,414)	37,547	433,408	944,108	2,124,761
Depreciation	(86,800)	(91,663)	(102,672)	(112,988)	(46,366)
Operating Profit / EBIT	(170,214)	(54,116)	330,736	731,120	2,078,395
Add Depreciation	86,800	91,663	102,672	112,988	46,366
Tax Rate	25%	22%	20%	20%	20%
Capital Expenditure	(21,438)	(72,317)	(109,109)	(116,497)	(46,366)
Movements in Working Capital	(226,247)	(352,228)	(489,784)	(269,777)	(15,880)
B/F Tax Income	-	(170,214)	(223,950)	-	-
Taxable EBIT	-	-	131,186	731,120	2,078,395
Tax on EBIT	-	-	(26,237)	(146,224)	(415,679)
Free Cash Flow	(401,056)	(206,258)	88,776	311,420	1,646,811
Discount period	0.5	1.5	2.5	3.5	-
Monthly cash flow	12	12	12	12	-
Cumulative discount months	12	24	36	48	-
Periodic period adjustment	100%	100%	100%	100%	-
Cumulative discount years	0.5	1.5	2.5	3.5	11.5
Discount factor	0.54	0.84	0.75	0.67	0.27
Discounted Cash Flow	(407,348)	(206,361)	51,155	209,471	4,473,441
Net Present Value	7,400,541				

### 2. Multiples

Quoted companies or private transactions

Frequency

- EV/EBITDA
- Price/Earning
- EV/Revenue
- Price/Book
- Price/Tangible Book
- Industry specific multiples/ratios (EV/MgW, EV/"clicks")

### 3. Adjusted Net Assets

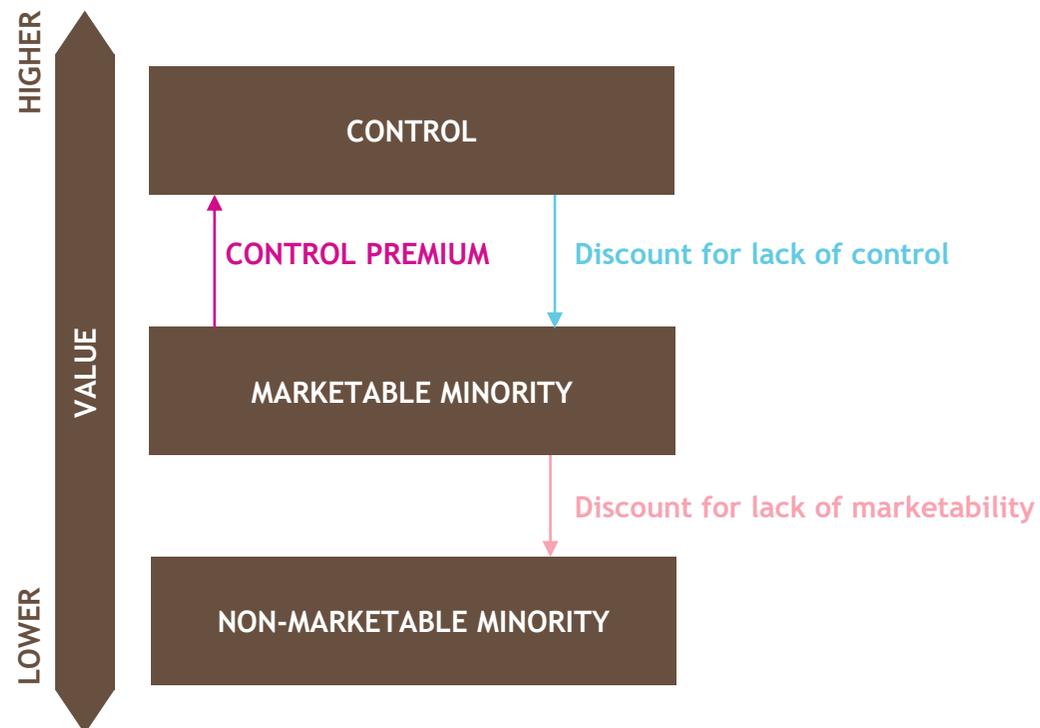
Form S-1  
Facebook, Inc.

	2015	2014	2013
<b>Assets</b>			
Cashed assets			
Cash and cash equivalents	\$1,783	\$1,352	\$1,312
Marketable securities	—	2,356	2,356
Accounts receivable, net of allowances for doubtful accounts	373	549	547
Prepaid expenses and other prepaid assets	21	148	25
Total cashed assets	2,177	4,395	4,240
Property and equipment, net	374	1,477	1,475
Goodwill and intangible assets, net	36	342	342
Other assets	34	81	81
Total assets	\$2,981	\$6,315	\$6,438
<b>Liabilities and stockholders' equity</b>			
Current liabilities			
Accounts payable	\$29	\$40	\$43
Platform partners payable	73	211	171
Accrued expenses and other current liabilities	137	206	206
Deferred revenue and deposits	42	90	90
Current portion of capital lease obligations	106	179	179
Total current liabilities	387	666	689
Capital lease obligations, less current portion	117	308	308
Long-term debt	120	—	—
Other liabilities	12	133	133
Total liabilities	\$636	\$1,007	\$1,130
Commitments and contingencies			
Stockholders' equity			
Common stock, \$0.0001 per share	413	413	—
Common stock, \$0.0001 per share, 4.3B shares and outstanding, including 1 million shares issued 2011 and per share, respectively	—	—	—
Additional paid-in capital	147	2,526	4,207
Accumulated other comprehensive loss	(8)	(6)	(6)
Retained earnings	893	1,656	967
Total stockholders' equity	\$2,345	\$5,308	\$5,308
Total liabilities and stockholders' equity	\$2,981	\$6,315	\$6,438

# VALUATION METHODOLOGIES

## Discounts & Premia

- Benefits of Control and Marketability



# “DIFFICULT” ASSETS

# SOLE TRADERS

What value does the business have without the key individual

Things to consider:

- How has the business operated historically
- How long might the business operate going forward
- Can the business run without the proprietor
- Could the sole trader's skills be replicated/acquired elsewhere
- Possibility of sale/realisation

# PROFESSIONAL PRACTICES

What value does the business have without the key individual

Things to consider:

- How has the business operated historically
- How long might the business operate going forward
- How many professionals in the business
- Exits/ new admissions in the past
- Amounts owed to/from business owners and likelihood of settlement
- Level of recurring income

# PROPERTY DEVELOPMENT

The apparent value will depend on the progress of the project

Things to consider:

- The nature/location of the project
- Status of development
- Finance provider and level of debt in the business
- Expected time to completion and expected returns
- Project valuation
- Related projects and group indebtedness

# COMPLEX GROUPS

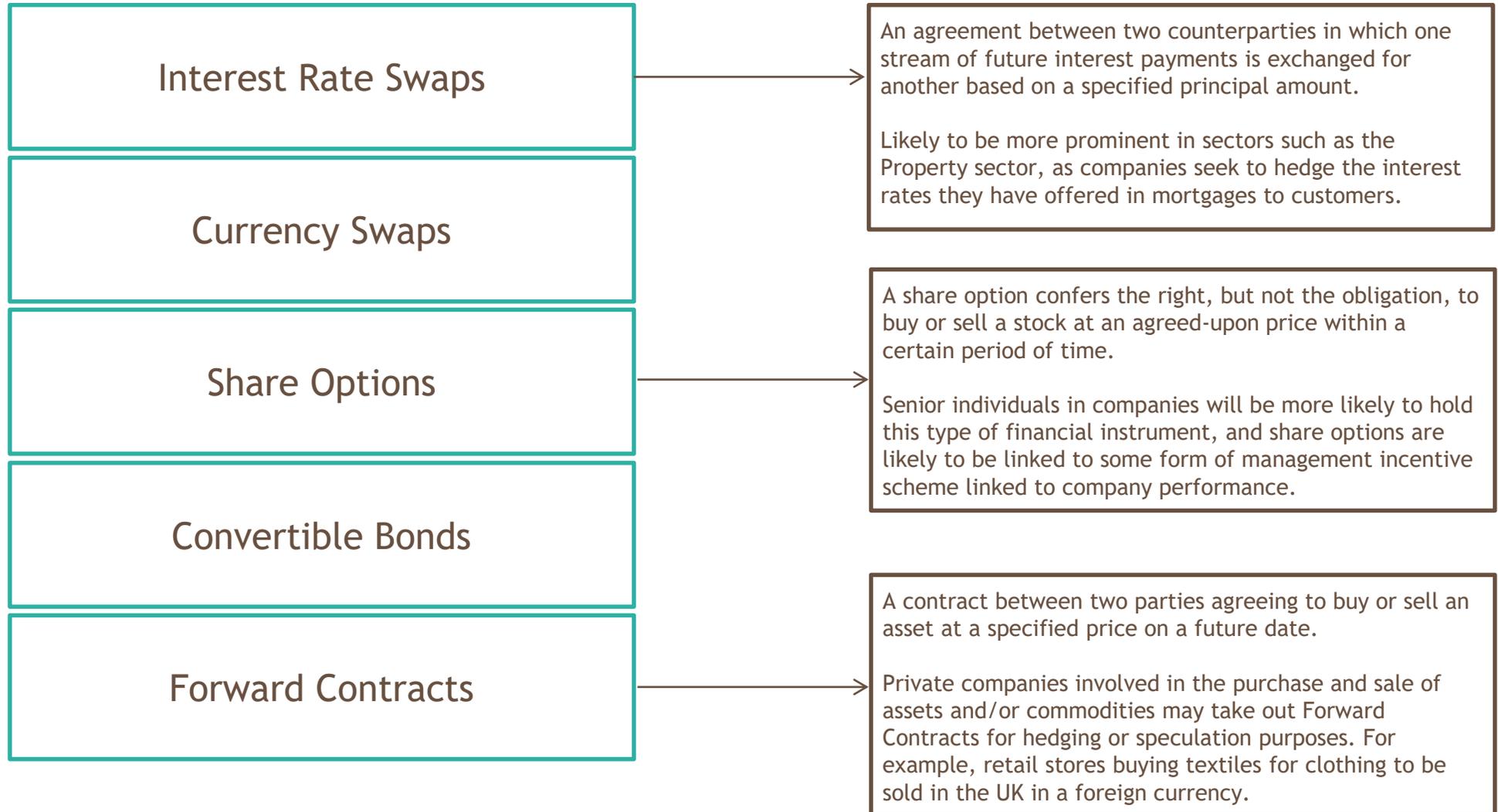
What is really going on?

Things to consider:

- Circular finance arrangements and cross guarantees
- Is it a “house of cards”
- Different levels of share ownership in different companies
- Preference shares and priority return
- Liquidity

# FINANCIAL INSTRUMENTS

## Common Financial Instruments



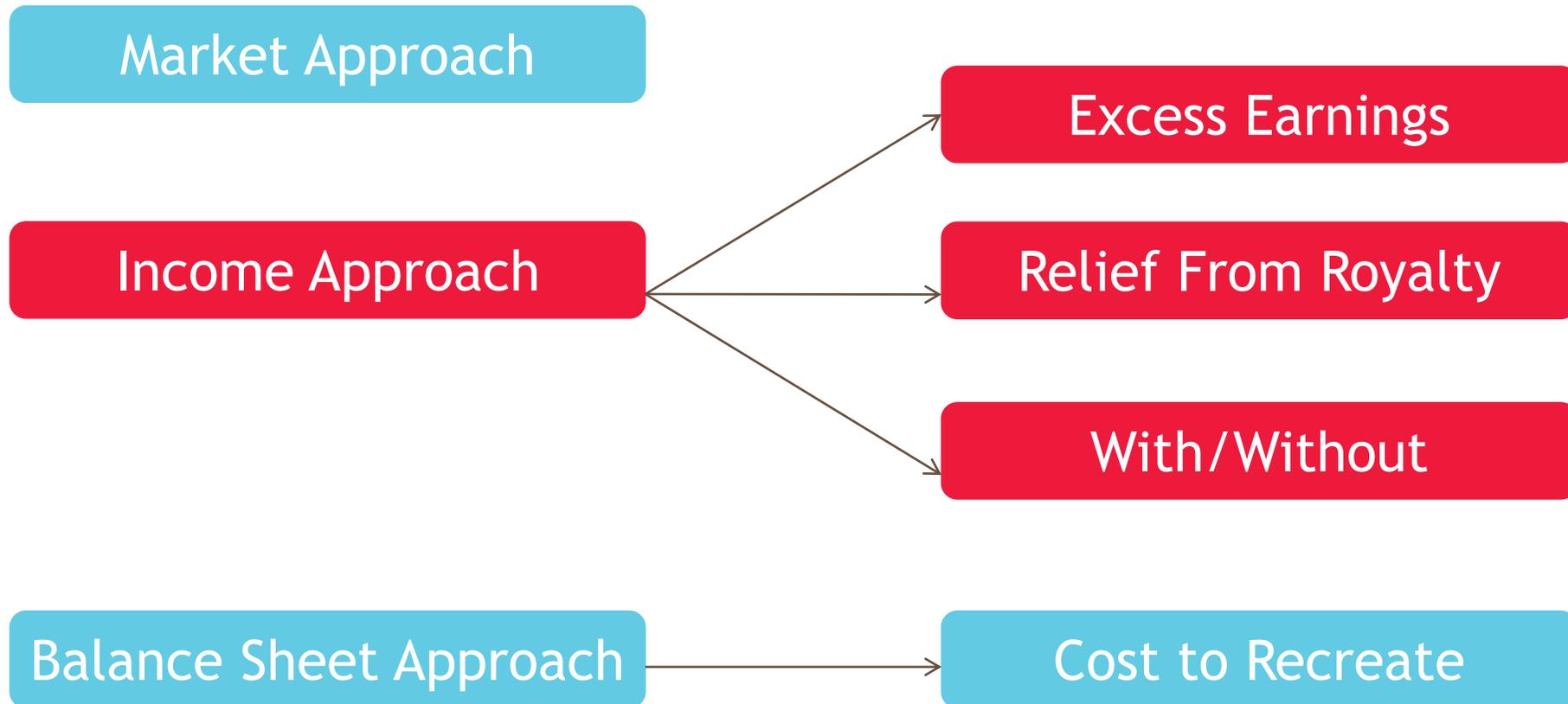
# FILM/LITERARY/MUSIC LIBRARY RIGHTS

We are valuing the expected income stream over the life of the asset

Things to consider:

- Remaining copyright (UK - life plus 70 years)
- Is there active management/protection
- Has the project been published
- Other rights - marketing/licensing/territorial sales
- Historical income stream and available forecasts
- Has the subject matter become obsolete/ “out of fashion”
- Is there a new market - social media/ YouTube etc.

# INTELLECTUAL PROPERTY - VALUATION APPROACHES



# BRAND VALUATIONS

## Example of Potential Valuation Approach

- The concept and quantification of ‘brand value’ is a highly subjective topic, not least because definitions will vary between individuals based on personal perceptions, awareness, prior experience or associations with the products/services provided.
  - Typically valued using a relief from royalty methodology
  - “The relief from royalty method assumes that the value of an intangible asset is equal to the present value of the amount the business would be prepared to pay to lease or rent that asset under a contract if it did not own the asset.”
1. Forecast revenues associated with brand
  2. Select Royalty Rate – comparable royalty agreements, margin analysis
  3. Discount Rate – IRR, WACC, adjusted WACC given specific risks of brand
  4. Useful Economic Life – history of brand, industry

# IFRS 16 - LEASES

## Valuation Implications

# IFRS 16

- Leasing is a form of ‘off-balance sheet’ financing
- Under FRS 16, most leases now need to be valued and treated as a finance lease asset and liability - this has a major impact on the accounts.
- The P & L comparison of an operating lease vs finance lease looks like this (in generic terms!)

	Operating Lease	Finance Lease
Turnover	10,000,000	10,000,000
Expenses	(5,000,000)	(5,000,000)
Lease rental	(1,000,000)	-
<b>EBITDA</b>	<b>4,000,000</b>	<b>5,000,000</b>
Other depreciation	(500,000)	(500,000)
Lease depreciation	-	(820,039)
<b>Operating profit</b>	<b>3,500,000</b>	<b>3,679,961</b>
Other interest	(100,000)	(100,000)
Lease interest	-	(287,014)
<b>Profit before tax</b>	<b>3,400,000</b>	<b>3,292,947</b>
Difference		(107,053)

- Key points to note:
  - EBITDA is £1,000,000 higher
  - Profit before tax is c. £107,000 lower (same difference as before)
- Impact on valuations of unlisted companies if multiples are based on listed ‘comparable’ companies



# SAT PLAHA

National Regional Forensic Partner

22 JANUARY 2020

# MATRIMONIAL

# ACCOUNTING INFORMATION IN MATRIMONIAL DISPUTES

## Where does it come in?

Usually instructed to calculate the business valuation and consider liquidity in the business with a view to potential cash extraction

### Business valuation:

- ▶ Assess historical performance, generally for the last three or four years depending on the specific case
- ▶ Consider required add backs/deductions, for examples in respect of the market rate of directors' remuneration, bad debts or non-commercial rent
- ▶ Statutory accounts do not always provide sufficiently detailed information and often do not include the most up to date information. Therefore, management accounts and forecasts are usually required, particularly for the period since the date of the last statutory accounts
- ▶ A detailed review of the profit and loss accounts is required to determine maintainable earnings, which will then be multiplied by a multiple to produce an earnings based valuation
- ▶ Assess surplus assets or debt. For example, investment property or large directors' loan balance

# ACCOUNTING INFORMATION IN MATRIMONIAL DISPUTES

## Where does it come in?

### Liquidity:

- ▶ Assess levels of surplus cash and debt in the business
- ▶ Also consider excess working capital
- ▶ Review of monthly cash/working capital balances to establish 'normal' levels and assess seasonality

### Extraction:

- ▶ Consideration of possible cash extraction methods usually also forms parts of our instructions. We use all the knowledge gained from the earlier stages of our work, which were informed by the accounts, to discuss tax efficient methods of extraction with experts from BDO's tax department.

# SIMPLE ILLUSTRATION OF A MATRIMONIAL VALUATION

	Year 1	Year 2	Year 3	Total
EBITDA per accounts	1,500,000	1,600,000	1,700,000	
Our adjustments:				
Directors' remuneration above market rate	(75,000)	(80,000)	(85,000)	
Exceptional bad debts	-	50,000	-	
Adjusted EBITDA	1,425,000	1,570,000	1,615,000	
Weighting	1	2	3	
Sum	1,425,000	3,140,000	4,845,000	9,410,000
Weighted average (maintainable earnings)				1,568,000
x Multiple of 4 (based on benchmark analysis)				6,272,000
Add: Surplus cash				500,000
Valuation of company				6,772,000
Husband's 33% shareholding				2,234,760

# M & A TRANSACTIONS

# ACCOUNTING INFORMATION IN M & A TRANSACTIONS

## When is it used?

### Pre Deal

- ▶ Due diligence - accounting and tax
- ▶ SPA review

### Post Deal

- ▶ Completion Accounts
- ▶ Earn out Accounts
- ▶ Expert Determinations
- ▶ Warranty claims

# ACCOUNTING INFORMATION IN M & A TRANSACTIONS

## Case study

### Expert Determination

- ▶ SPA provided hierarchy for preparation of the Completion Accounts
- ▶ Included consistency with the accounting policies, procedures, treatments in the Last Accounts
- ▶ The Buyer and Seller had a dispute over the treatment of certain items in the Completion Accounts
- ▶ Expert had to review accounting information from the Last Accounts to see how each item was treated in the Last Accounts

# ACCOUNTING INFORMATION IN M & A TRANSACTIONS

## Case studies

### Warranty Claim

- ▶ SPA included a warranty from the Sellers that the Last Accounts showed a true and fair view and were prepared under FRS 102
- ▶ Following Completion, the Buyer found some problems with the Last Accounts which indicated they were incorrect
- ▶ We reviewed the items to assess whether they were incorrect
- ▶ We considered if the errors were large enough to make the Last Accounts materially incorrect
- ▶ We prepared an Expert Report on the claim
- ▶ Case went to mediation

# LITIGATION

# ACCOUNTING INFORMATION IN COMMERCIAL LITIGATION

## Where does it come in?

Might be instructed to calculate quantum loss or consider liability on accounting issues

### Quantum of loss:

- ▶ Generally difference between actual and “but for” position;
- ▶ Typically based on difference in gross profit - so sales and gross profit figures are key
- ▶ Loss of opportunity / chance? new contract, customer, market

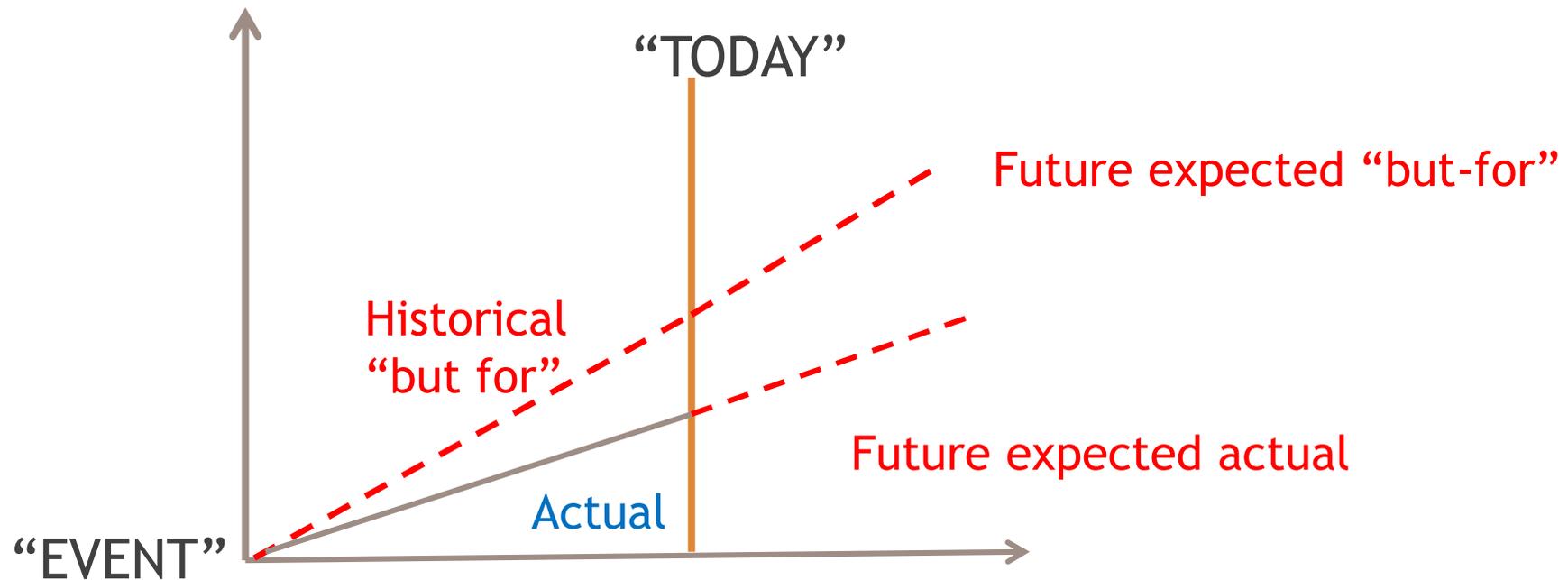
### Liability on accounting issues e.g:

- ▶ Material adverse change (MAC clause)
- ▶ Accounting covenants

We typically use the Claimant’s own accounting information supplemented by market data (sector, geographic, comparable companies) to evidence our calculations and support assumptions

# TYPICAL LOSS CLAIM

<p><b>Historical actual</b> From the event until Today Stat accounts, management accounts</p>	<p><b>Future expected actual</b> From Today into the future Current forecasts</p>
<p><b>Historical “but-for”</b> From the event until Today Contemporaneous forecasts</p>	<p><b>Future expected “but-for”</b> From Today into the future Contemporaneous forecasts</p>



# TYPICAL LOSS CLAIM

## Calculating the loss

- ▶ Generally difference between actual and “but for” profits. Key figures are usually:

### Sales / turnover

- ▶ Price x volume
- ▶ Volume might be most important if price is volatile (e.g. commodities)

### Gross profit margin (%)

- ▶ Change in gross margin would need to be explained

### Overheads - Consider:

- ▶ Change in scale
- ▶ Non-recurring costs
- ▶ One off or new overheads incurred as a result of the event
- ▶ Any overheads saved?

# TYPICAL LOSS CLAIM

## Calculating the loss

Actual £	But-for £	Loss
Actual sales revenue	Expected sales revenue	= Loss in revenue
		@ gross profit margin %
		= Loss of gross profit
Less	overhead	(x)
Add	Additional costs of mitigation	x
	Net Loss of profit	X

# ACCOUNTING INFORMATION IN COMMERCIAL LITIGATION

## Sources of accounting information

	Benefits	Limitations / issues
Historical financial statements	<ul style="list-style-type: none"><li>▶ Audited (probably)</li><li>▶ Used by market</li><li>▶ historical trends</li><li>▶ Evidence based</li></ul>	<ul style="list-style-type: none"><li>▶ Out of date</li><li>▶ Changes in accounting treatment</li><li>▶ Is extrapolation appropriate?</li><li>▶ Assumptions open to challenge</li></ul>
Management accounts	<ul style="list-style-type: none"><li>▶ Most recent historical</li><li>▶ More detail and movements identified</li><li>▶ Used by company for decision making</li></ul>	<ul style="list-style-type: none"><li>▶ Not audited</li><li>▶ May not be consistent</li><li>▶ Ditto other limitations above</li></ul>
Contemporaneous forecasts	<ul style="list-style-type: none"><li>▶ Expectations at the time</li><li>▶ Not tainted by the event</li></ul>	<ul style="list-style-type: none"><li>▶ Depends on purpose</li><li>▶ Who prepares?</li><li>▶ Track record?</li><li>▶ Based on assumptions</li><li>▶ Not always prepared!</li></ul>
Company specific data (e.g. ticketing info)	<ul style="list-style-type: none"><li>▶ Specific to case</li><li>▶ Capacity</li></ul>	<ul style="list-style-type: none"><li>▶ Must be clear financial link</li></ul>
Market data	<ul style="list-style-type: none"><li>▶ Sector specialist</li><li>▶ Publically available</li></ul>	<ul style="list-style-type: none"><li>▶ Relevance</li><li>▶ Comparability</li></ul>

# ACCOUNTING INFORMATION IN COMMERCIAL LITIGATION

## Common issues

1. Period of loss - how long should the claim be for?
2. Lack of trading history?
3. Unrealistic forecasts /projections
4. Reliance on assumptions
5. Use of hindsight
6. Other costs - investment in staff, assets, stock etc.

# INVESTIGATIONS

# ACCOUNTING INFORMATION IN INVESTIGATIONS

## Where does it come in?

The accounts will usually be starting point in cases where financial fraud is suspected or where there are allegations of money laundering or hidden assets

### Financial statement fraud

The main types are:

- ▶ an overstatement of assets, profits and revenues; or
- ▶ an understatement of liabilities, expenses and losses.

However, sometimes the opposite can be found, for example if a company wants to downplay performance to minimize tax liabilities or reduce over-budget performance to make up for shortcomings in the coming year.

### Money laundering or hidden assets

The accounts may help to identify:

- ▶ the flow of funds between different entities, potentially in different jurisdictions; or
- ▶ relationships between different entities in order to identify the ultimate beneficial owner of a company.

# ACCOUNTING INFORMATION IN INVESTIGATIONS

## Where does it come in?

A review of accounting information enables us to identify trends and variances and assists us to focus our detailed testing.

Areas of accounting information we may review linked to typical red flags includes:

- ▶ long-term revenue and profit trends, identifying rapid growth or unusual profitability out of line with expectations for the industry;
- ▶ accounts receivable balances, looking for unusually large and long overdue items;
- ▶ significant transactions with related parties;
- ▶ recurring negative cashflows from operations;
- ▶ a significant increase in sales to entities whose ownership or substance is unknown;
- ▶ point of revenue recognition in long term contracts or sales with conditions;
- ▶ the accounting period in which transactions are recognised;
- ▶ valuation of assets and inventory.

# ACCOUNTING INFORMATION IN INVESTIGATIONS

## A case study

We were engaged by a client in the health sector to undertake an investigation into grant funding offered to a third party provider

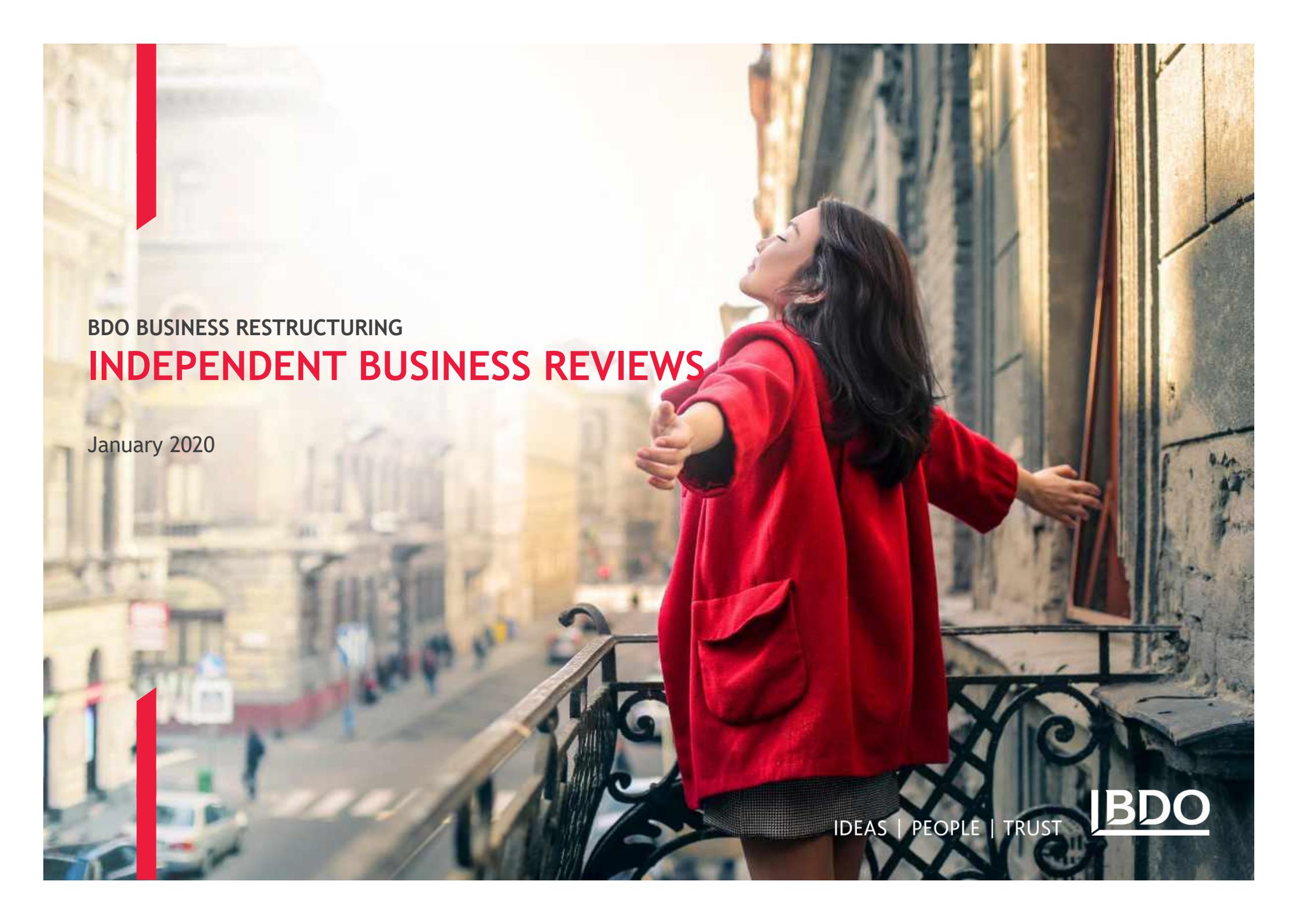
There were two main strands to our work:

- ▶ Assist the client in understanding the complex and evolving group structure and the ultimate owners, including highlighting any leakages of grant funding to related parties; and
- ▶ A detailed review of how the grant funding received has been used utilised.

Examples of how accounting information was used include:

- ▶ Tracing fund flows between various entities;
- ▶ Assessment of whether transactions were recorded in the correct accounting period;
- ▶ Appropriateness of accounting treatment of grant income;
- ▶ Variance analysis on specific categories of income and expenditure in order to guide sample selection;
- ▶ Detailed testing of invoices and payroll records to assess how transactions were valued and categorized for the purpose of recording in the financial statements; and
- ▶ Solvency of the provider in case of a formal proceeding to recover over-claimed funding.

**Our knowledge and experience of financial statements enabled us to produce an efficient and targeted investigation plan. We identified various concerns including related party issues and potential misstatement and misallocation of costs. As a result, the client is now considering a potential legal claim.**

A woman with long dark hair, wearing a bright red coat, stands on a balcony with an ornate black metal railing. She is looking upwards and to the right, with her arms slightly outstretched. The background shows a city street with buildings and a clear sky. A red vertical bar is on the left side of the image.

BDO BUSINESS RESTRUCTURING

# INDEPENDENT BUSINESS REVIEWS

January 2020

IDEAS | PEOPLE | TRUST

**BDO**

# BDO BUSINESS RESTRUCTURING

## Independent business reviews

Path to insolvency

End of the road

Waste of time

Box ticking

Too late!

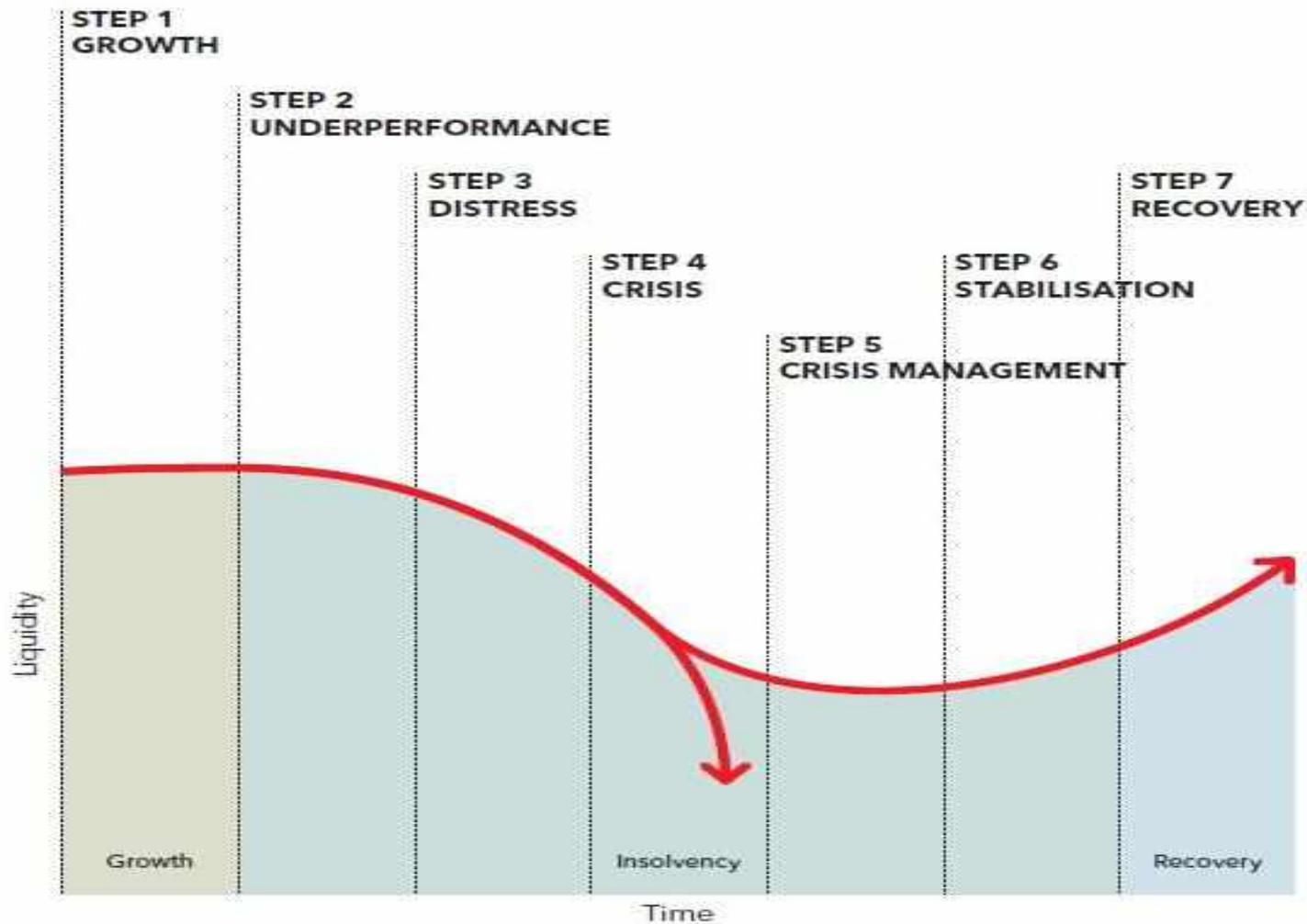
Time consuming

Insightful

Valuable

# BDO BUSINESS RESTRUCTURING

## Why have an IBR?



# BDO BUSINESS RESTRUCTURING

## Why have an IBR?

- ▶ Event driven
  1. Declining profit
  2. Cash flow difficulties
  3. New loan request
  4. Facility extension or renewal
  
- ▶ IBR seeks to answer a question - normally for a lender
  
- ▶ BUT - also adds value

# BDO BUSINESS RESTRUCTURING

## What is involved?

- ▶ Analysis of recent trading performance
- ▶ Current financial position
- ▶ Short term cash flow forecast
- ▶ Business plan and projections
- ▶ Recovery estimate
- ▶ Recommendations and conclusions

# BDO BUSINESS RESTRUCTURING

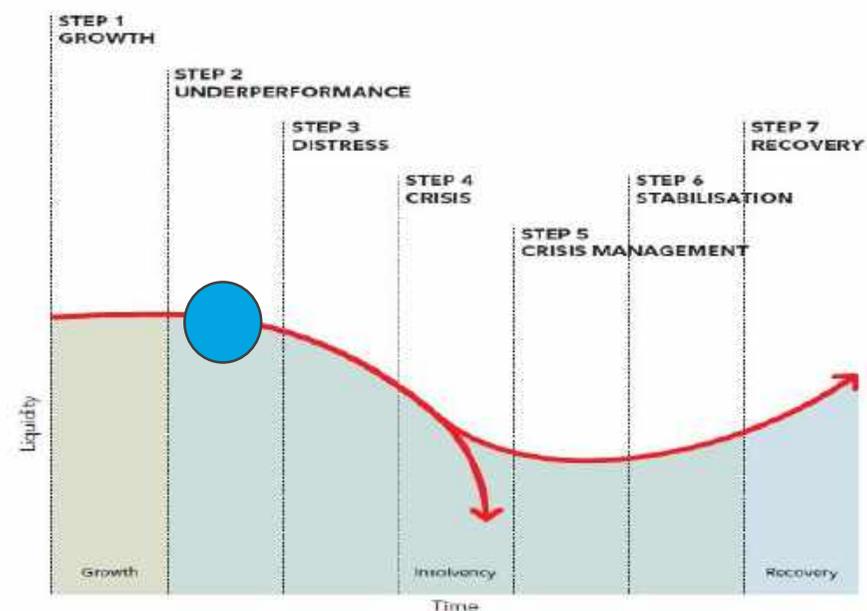
## Recurring issues for the legal profession

- ▶ Time recording
- ▶ Work in progress
- ▶ Debtor collection
- ▶ Asset verification
- ▶ Forecast accuracy
- ▶ Credit score

# BDO BUSINESS RESTRUCTURING

## Summary

- ▶ IBRs need not be a negative process
- ▶ Tap into best practice
- ▶ Early action can move the narrative
- ▶ Seeks to identify benefits for the target
- ▶ Self financing



# THANK YOU FOR YOUR TIME

## Any questions.....



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