



# **TPE 2023 – Case Study Part 1**

## **Southerwood**

### **History**

Examination November 2020. 2½ hrs am, 3 hrs pm. Pass rate 90.2% (90.8% first time sitters).

### **Technical Content**

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## Background notes

It is a Tuesday morning in early November Yr 27. You are Pat, a newly qualified chartered accountant working in London for Fitzroy, Young & Coughlin LLP ('FYC'); a large accountancy partnership. You have been assigned to work for Quentin Royce who has very recently been appointed a corporate finance partner.

"Good morning Pat. Please come in and sit down," says Quentin.

"I have an exciting opportunity for you. It is going to involve a great deal of hard work over a short period. I've heard that you come from a family steeped in rugby. Your elder brother played international rugby, isn't that right? When you were in audit, you must have worked in our Sports and Leisure section on a lot of sports clients?"

"No, I didn't actually. I'm not really that interested in sport," you try to say but a preoccupied Quentin isn't listening.

"Late on Friday afternoon last week as I was leaving the office, I took a phone call from Denise Fong, who has recently become the sole shareholder of a professional rugby club in the North of England. I thought to myself, why me? I know nothing about rough sports. I prefer the arts and more cultured pursuits and have never played or been to a sportsground in my life. Anyway, I listened to her politely and became excited about the idea of becoming involved. I need to build my client portfolio and there could be a lot of future work from this, if we perform well. That's where you come in.

"Denise is a successful businessperson and she lives in London. Denise's father, Peter Fong is a well-known sporting entrepreneur who has been involved with Southerwood United Ltd ('Southerwood'), one of England's leading professional rugby clubs, for several years. Peter was the sole shareholder but has recently gifted all his shares to Denise, his only child. She has also been appointed to the board of Southerwood as deputy chairperson.

"I arranged to meet Denise over lunch yesterday to find out what she might need FYC to help her with. She explained that her father fell in love with rugby when he watched an international rugby tournament in Hong Kong over 50 years ago. He moved to the United Kingdom around 40 years ago and built up several successful businesses. He took control of Southerwood in Yr 1 and since Yr 18 has been the sole shareholder, that is until he transferred the shares to Denise. He is now in his 80s, frail, and has not attended matches or Southerwood's board meetings for about three years.

"Yesterday our firm's research department pulled together some history and background information on Southerwood (Section 1) along with some recent press cuttings from our firm's information service (Section 2) for you to use to familiarise yourself with the client. I've not had time to read these myself.

"Denise told me that Southerwood's CEO, Robert Pickles, was – in her view – a bit 'unpredictable' but that her father had hired him years ago and thought highly of him. There has been an increasing level of human resources ('HR') issues and ex-gratia payments costing Southerwood a lot of money. Robert – 'RP' as he likes to be called – has had huge salary increases in the last three years despite the club's erratic performance.

“Denise is concerned about RP’s recent management of Southerwood and wants us to help her understand the issues and provide her with advice. She had been to the stadium on a fact-finding mission but found herself frustrated and believes that RP has been somewhat defensive – obstructive even – and so she thought it was time for professional advice. She is travelling to North America for a short time on other business and wants us to carry out some work for her while she is away.

“I want you to pull together a briefing paper for me that I can present to Denise covering a number of areas. Firstly, I want you to evaluate the business and prepare an analysis of the key issues within the business, with recommendations of steps to be taken to address them. Our paper should only cover the most critical points which Denise is able to do something about and should include recommendations so that she understands what needs to be done.

“Denise has given me a copy of the results for Yr 27 and the budget for the year ahead (Section 3) along with her notes following her visit to the club (Section 4). The budget was prepared by the financial controller, Simon Terry, before he quit in mid-October. Denise thinks the budget looks unrealistic given recent performances in the league and she would like us to rework the budget based on the information that she has provided. Denise would also like to know the breakeven revenue for the club once you’ve reworked the budget.

“It turns out that Simon Terry used the company’s confidential whistleblowing email system to report RP. RP found out and insisted that Simon be sacked. The HR manager persuaded RP to only give Simon a final written warning, but then Simon quit anyway. Southerwood have now received a letter from Simon’s lawyers seeking significant compensation for constructive dismissal and mentioning adverse effects on his mental health due to bullying by RP. Denise needs advice on what Southerwood should do now and what options they might have. Include a section in the briefing paper covering advice on any HR matters you have noted. This should include what Southerwood should do about Simon and the options available and what Denise needs to do about the actions of RP, explaining the issues involved.

“Finally, she has also asked that we make some recommendations as to how governance could be improved at the club. Add your thoughts on this to the briefing paper for me to present to Denise.

“This assignment could be really good news for me ... and for you, if you do it well. My numbers have been a bit down on budget recently and I’m feeling the pressure a bit as a new partner, with my annual appraisal coming up. Yours too, of course, so let’s get moving and don’t think about charging any overtime you work on this one. I want to show I can achieve good profitability on my assignments. That will look good on your record too,” says Quentin cheerfully.

“Have you set up a charge code and had the client acceptance procedures done yet?” you ask.

“Oh yes, that is all in hand. I’d like to read through your briefing paper later today and so please have it ready for me at lunchtime,” adds Quentin, as he ushers you out his office.

#### **Required:**

- Prepare the briefing paper for Quentin that he can present to Denise Fong.

In preparation for answering the case study question this afternoon, you will find it useful to read all the information carefully and note down any other points you feel are significant.

## SECTION 1

### Background

#### History, background and performance

Southerwood was formed over 150 years ago by a group of former school friends. The original royal blue and red-striped strip is still used today along with its world-famous 'lighthouse' crest which now also adorns all the club's merchandise and branding. For many years, the club had a policy that all players must be from Yorkshire.

Southerwood has prospered into one of the world's foremost rugby union clubs, playing at the top level of the English game throughout most of its existence. In Yr 3, a change in the rules resulted in rugby becoming a professional sport, with players being paid a salary by the club rather than playing as unpaid amateurs. Initially, this was a challenge for the club and its fortunes declined, being unable to attract enough first-rate professional players as the club stuck to its tradition of employing only Yorkshire men. That changed in Yr 8, when Peter Fong became the sole shareholder.

The English rugby season runs from September to May each year. Each team plays each other at home and away. There are 12 teams in English League 1 and so each team plays 11 home games and 11 away games. Clubs keep all income from home games and receive no income from away games.

The team that wins English League 1 gains entry to the European Cup competition for the following season. There is also a national English Cup competition each year. Both cup competitions are 'knock-out' competitions, where a team only progresses to the next round if they win. If a team reaches the final of either cup, they will play six games in total per cup competition but each game could be home or away, depending on the draw. Like the league, clubs only receive income from home cup games.

Rugby England is the national governing body for rugby and supervises both the league and cup matches.

Southerwood's fans became used to success as the team won the league title year after year until Season 21/22. The performance of the team dipped and they didn't win the league again until Season 25/26. In Season 26/27 they only managed to finish in third place in the league.

This disappointment was somewhat alleviated when they managed to win the English Cup in April Yr 27 and reached the semi-final of the European Cup, having won the league in Season 25/26. Both successes are reflected in the club's turnover for the financial year ended 31 July Yr 27. As a result of their success in both cups, they played five more home games in the Season 26/27 season.

A summary of recent league and cup performances of Southerwood:

Season	English League	English Cup	European Cup
22/23	3 <sup>rd</sup>	4 <sup>th</sup> round	3 <sup>rd</sup> round
23/24	5 <sup>th</sup>	3 <sup>rd</sup> round	-
24/25	4 <sup>th</sup>	4 <sup>th</sup> round	-
25/26	1 <sup>st</sup>	3 <sup>rd</sup> round	-
26/27	3 <sup>rd</sup>	Winner	Semi finals

## Women's team

Southerwood started a women's team, Southerwood Ladies, and began playing matches in Season 23/24. There are currently five professional female players who are employed by Southerwood and several other female players who play for the club that are amateur players and are not paid to play.

Southerwood Ladies play in the Yorkshire League and have consistently been placed 1<sup>st</sup> or 2<sup>nd</sup> in that league.

## Land and buildings

The club stadium seats 45,000 fans and has several corporate hospitality suites. The corporate offices for management and directors are also situated within the stadium as is the main club shop. The stadium was built nearly 50 years ago at a cost of £12 million.

The club training grounds are several miles away beside the Academy (see 'Players' below) and include training pitches, fitness rooms and physiotherapy facilities. These facilities cost £6 million.

The team of six groundskeepers work at both the stadium and the training ground ensuring that all the pitches are in prime condition.

## Funding

In Yr 8, Peter Fong bought out the remaining shareholders to gain 100% ownership of the club. He remained the only shareholder until he gifted his shares to Denise in early Yr 27. Peter also helped to arrange a significant loan from Fortnum Bank which is secured. Peter's short-term objective had been the flotation of Southerwood on the London and New York Stock Exchanges but the credit crunch of Yr 15 onwards put a stop to the planned flotation. Peter Fong's involvement was criticised heavily in the sporting and financial press at the time due to the high levels of borrowing.

Fortnum Bank has provided Southerwood with working capital facilities and long-term loans. Southerwood's gross indebtedness to the bank has grown over the years and at 31 July Yr 27 there was a bank loan of £19.4 million offset by cash on hand of £0.6 million. The facility is secured over the club's assets and has several financial and non-financial covenants in place. The facility limit on all net borrowings is £18 million and is due for renewal in Yr 29.

## Key management and directors

Peter Fong recruited RP, an aggressive former commercial director with wide industrial experience, as Southerwood's Chief Executive Officer ('CEO'). He also recruited former England international rugby captain, Scott Dawson, to be Director of Rugby and Head Coach.

The board of Southerwood comprised the following executives during the current year:

Name	Age	Employment information	Position	Salary £'000
Peter Fong	85	-	Chairperson	-
Denise Fong	43	Appointed October Yr 27	Deputy Chairperson	-
Robert Pickles	58	-	Chief Executive Officer	950
Scott Dawson	53	Resigned October Yr 27	Director of Rugby	400
Sarah Pickles	48	-	Non-Executive Director	50
Drew Pickles	23	Appointed March Yr 27	Academy Director	220
Alasdair Pickles	22	Appointed March Yr 27	Media Director	220
Gavi Giovanni	47	-	Commercial Director	95

In addition to his basic salary of £950,000, RP has a contractual bonus of 15% of this amount dependent on the club's revenue exceeding the previous year's amount.

## Revenue

Southerwood earns revenue from:

- Ticket sales
- Corporate hospitality
- Advertising
- Retail
- Television rights

### *Ticket sales*

Most seats in the stadium are purchased by season ticket holders. A season ticket allows the customer entry to each home game in the league and their chosen seat is 'reserved' for the season ticket holder. For Season 25/26 and Season 26/27, 80% of the seats were purchased by season ticket holders. However, advanced season ticket sales for Season Yr 27/28 are only around 70% of the total available. Season tickets are purchased at the start of the season and recognised in deferred income before being released to the statement of profit or loss over the nine months of the season.

The remaining seats are available for purchase on a game-by-game basis for each home match in the league. All tickets for both the English Cup and European Cup home games are sold on a game-by-game basis.

Southerwood Ladies matches are played at the club training ground. Tickets are £10 and around 500 spectators attend each match.

### *Corporate hospitality*

Southerwood, being Yorkshire's premier rugby club, has top-class corporate entertaining facilities and delivers extensive match day hospitality experiences at the stadium. RP believes that the hospitality is as good as anything in professional rugby or any other sporting venue in the United Kingdom and this has been backed-up with the hospitality winning multiple prizes in the Stadium Events & Hospitality Awards – the national benchmark for professional sports clubs.

## *Advertising*

Advertising space in the stands and around the pitch is sold to companies to allow them to promote their brands. Many national and international firms such as drinks companies, car dealerships, airlines, travel companies and telecommunications giants, have sought to be Southerwood's business sponsors, signing annual or two year-long deals and bringing in huge levels of commercial income to the company.

## *Retail*

The Commercial Director, Gavi Giovanni, is responsible for corporate hospitality and advertising and is also responsible for the retail operations, which comprise four town-centre shops and a superstore on the ground floor of the stadium selling branded merchandise and replica kit.

## *Television rights*

Rugby England has negotiated a deal with a National television broadcaster which gives the broadcaster exclusive rights to televise the English League 1 and English Cup games to television audiences. The broadcaster works with Rugby England to agree which matches will be televised each week and then the clubs are informed. Not all matches are televised.

Southerwood and the other teams in English League 1 each receive an equal share of the television rights income from all games that are televised across the season. This income is received in June, after the end of the season. The current deal with the broadcaster runs until the end Season 29/30.

## **Players**

Southerwood has a squad of 35 professional male players. In rugby union, there are 15 players in each team, with up to eight players who can be substituted into the game during the match. As well as first team games, there are several reserve team games each season against other reserve teams in the league.

Shortly after his appointment, RP started a boys' Rugby Academy. This was intended to nurture young talent for the team and has generally been highly successful. Southerwood has under-21, under-18 and under-16 teams that play in the National Leagues. The current annual operating costs of the Rugby Academy are around £3 million to £3.5 million.

Southerwood also signs established players from other clubs. Southerwood has recruited some high-profile, high-salary player signings both from the United Kingdom and abroad which has contributed to their worldwide appeal.

## **Southerwood Charitable Trust**

In Yr 24, in recognition of the origins of Southerwood almost 150 years ago, RP established a charity: The Southerwood Charitable Trust ('SCT'). This created good publicity for the club. The aims of the charity are to motivate, educate and inspire via the power of rugby. SCT is a company limited by guarantee, separate from Southerwood. The trustees of SCT comprise only the Directors of the rugby club, excluding Peter and Denise Fong. SCT aims to support under-privileged children to attend a local fee-paying school which specialises in rugby by paying the annual school fees of up to 50 children. It also raises funds to promote health and wellbeing among the low-income families of the county of Yorkshire. SCT is not funded by Southerwood but, instead, runs several fundraising events during the year.



## SECTION 2

### Press cuttings from FYC's information service

#### The Yorkshire Sports website (1 October Yr 27)

"Southerwood first team player Chris Dixon has been reported to Rugby England, the governing body, for posting an offensive message on Twitter about the social background of some of his fellow players. He later deleted the tweet but no official apology has been made by Southerwood or the player himself. Our reporter has spoken to one of the current Southerwood squad – who did not want to be named – and alleged that he has been the subject of a number of comments about his working-class background, not only in the Southerwood dressing room but that even the CEO and the Commercial Director were involved in what they called 'banter'."

#### Rugby Monthly (5 October Yr 27)

"After their success in the Women's League Cup last season, Southerwood Ladies have had an excellent start to the new season and are currently sitting top of the Yorkshire League. Many had thought that after their cup success, against the fully professional Gleeforth Ladies, that Southerwood would expand their player base and apply for a place in the much more financially lucrative Professional Women's League. We approached the club for a comment but Southerwood Media Director, Alasdair Pickles, declined to comment. There have been rumours that the Southerwood board are unsupportive of the women's team."

#### Sheffield Examiner (10 October Yr 27)

"Southerwood United have sacked their Director of Rugby and Head Coach, Scott Dawson. After finishing third in the league last year, Southerwood United have started Season 27/28 badly losing away to Kildow in the first round of the cup. They have now lost three of the first four English League 1 games and are sitting in 10<sup>th</sup> place in the league table, following their loss to Shropshire Spectres on Saturday. Dawson, who has been coach since Yr 8 and is the longest reigning manager in the league, was reputed to be on a three-year contract worth £400,000 per year. The Examiner understands that his contract was renewed only last year. No-one from Southerwood was available for comment."

#### Sports Weekly (16 October Yr 27)

"Frans Smit, the South African player that Southerwood signed in Yr 24, was today sensationally suspended by the governing body, Rugby England. A Rugby England spokesperson says that an investigation is being carried out to determine if he has a valid visa and work permit. There appears to be some doubt over the authenticity of the documentation submitted by Southerwood. Smit has played in all their fixtures in the last two seasons. The potential implications for Southerwood appear serious, with the possibility of a hefty fine, points deduction or relegation from English League 1. CEO, Robert Pickles, said this was all a misunderstanding and that the matter would be resolved."

### **Rugby News (22 October Yr 27)**

“Yet another English League 1 club has successfully replaced their grass pitches with hybrid turf, which is a combination of natural grass and synthetic reinforcing fibres. The Northern Kestrels are the fourth club to do so in as many years. After the initial installation, the upkeep costs are like those of a grass pitch but the surface is much more hard-wearing, meaning more games can be played on the surface without it suffering damage. The jury is out, however, on the impact on whether injuries increase because of the harder surface. We contacted Rugby England who said that they hadn’t received any further applications from English rugby clubs to move to a hybrid pitch.”

### **National Rugby Monthly (31 October Yr 27)**

“COVID continues to have a significant impact on professional rugby across the United Kingdom. In England, as we reported back in June, all English League 1 players agreed to take a 25% salary cut from 1 August Yr 27 as did other club staff, including directors. This is expected to continue after official comments from Rugby England stated that it will be ‘some time’ before we see a significant number of fans in stadiums again – their best estimate is that stadiums must be no more than 50% full, up to a maximum of 4,000 fans from March Yr 28. There is at least some hope for professional rugby clubs, as advertisers and the television networks have agreed to continue payments at the previous seasons’ rates.

Corporate hospitality may return at reduced capacity from March Yr 28, providing social distancing and other measures are in place.”

## SECTION 3

### Results for the year ended 31 July Yr 27 and budgeted figures for Yr 28

	Actual Year ended 31 Yr 27 £'000	Actual Three months ended 31 October Yr 27 £'000	Budgeted Year ending 31 July Yr 28 £'000
Revenue:			
Ticket sales – league match day sales	1,980	-	4,678
Ticket sales – a league season tickets	12,600	3,866	14,175
Ticket sales – cup games	8,100	-	9,214
Ticket sales – Southerwood Ladies	35	-	105
Corporate hospitality	12,320	-	13,500
Advertising	3,200	740	3,600
Retail	6,340	1,840	6,500
Television rights	<u>2,615</u>	<u>20</u>	<u>2,695</u>
	47,190	6,466	54,467
Staff costs	(26,700)	(5,325)	(26,700)
Depreciation charge	(5,370)	(1,350)	(5,400)
Other operating expenses	<u>(10,420)</u>	<u>(2,430)</u>	<u>(10,600)</u>
<b>Operating profit/ (loss)</b>	4,700	(2,639)	11,767
Finance costs	<u>(3,650)</u>	<u>(1,030)</u>	<u>(3,000)</u>
<b>Profit/ (Loss) for the period</b>	<u><u>1,050</u></u>	<u><u>(3,669)</u></u>	<u><u>8,767</u></u>
Property, plant and equipment (carrying amount)	8,940	7,640	3,600
Cash at bank	638	6,264	10,670
Bank loan	(19,400)	(19,400)	(15,000)
	<b>No.</b>	<b>No.</b>	<b>No.</b>
Number of home games	16	3	16
Average attendance at home games	40,500	-	40,950
	<b>£</b>	<b>£</b>	<b>£</b>
Season ticket price	350	450	450
Average match day ticket price	40	N/A	45

## Notes

1. In Yr 27, included in other operating expenses are match day running costs of £8.5 million for 16 home games. All other costs are fixed. There will be one home game in November Yr 27 and then two per month until the end of the season in May Yr 28.
2. Estimated tax losses available for set-off against future profits amount to approximately £8.5 million on 31 July Yr 27.
3. COVID restrictions since rugby's 'restart' in August Yr 28 have meant that no fans were permitted to attend games. Season ticket holders have purchased tickets under the promise from Southerwood that any permitted stadium capacity will be allocated to them first. RP requested the budget be completed on the basis that fans would fully return to stadiums from November Yr 27 and that all staff would move back to full pay from that date.

## SECTION 4

### Notes prepared by Denise Fong in October Yr 27 following her visit to Southerwood

#### Stadium condition

Due to ill health, my father hasn't been able to visit Southerwood for several years now. I'm very concerned that the club have not invested in stadium infrastructure. I heard that there had been an accident in one of the stands' stairwells and, when pressed, RP admitted that the local council had written to the club that they were unhappy with safety standards. However, RP's view on such expenditure is that money should be spent on players and the wages bill, including his own pay, rather than on buildings.

One of the main brands that advertise at Southerwood, Bellucci Bet, has threatened that they will cancel their sponsorship deal due to breach of contract because of the poor condition of the stadium. RP says that they are just bluffing. The current advertising deal means that it pays Southerwood £1.2 million each year as one of the principal advertisers. Their board is discussing this and we'll know in January Yr 28 if we will retain this advertising money.

#### Finance department

Simon Terry, Southerwood's financial controller, left the company abruptly during October Yr 27 without a new job. He has not been replaced and the company's accounts department is operating with only a trainee accountant, a purchase ledger clerk and a part-time credit controller – all of whom now report to RP.

#### Relationship with Fortnum Bank

I was aware that Fortnum Bank has become concerned over what it considers to be an increased risk associated with its lending to sports clubs in general and is reassessing its lending criteria. The bank has not formally notified the Directors of Southerwood of any intention to restrict the company's facilities below the existing levels.

#### Board meetings

Board meetings appear to have been sporadic in the last three years and my father has not attended any of them. RP was unable to locate the board minutes for these meetings.

## Key player costs

I asked RP to provide me with details of salaries and contracts of key players:

Player name	Annual salary (£'000)	Contract term remaining at 1 November Yr 27	Comment
Dan Back	400	4 years	Current captain of the men's team. Sustained a serious neck injury at training in August Yr 27. Medical advice is that he should not play professional rugby again.
Chris Dixon	350	3 years	Chris is extremely popular with most of the other players and is the favourite to become captain.
Shaun Mackie	300	7 months	Shaun is a star player but has stated he intends to leave at the end of the season as he is unhappy with the direction of the club.
Frans Smit	225	4 years	Currently ineligible to play.
Mandy Jones	28	2 years	Mandy is the captain of the Southerwood Ladies.

## Merchandise issues

Southerwood, like other sports clubs, sells branded merchandise to fans such as replica club shirts. Gavi Giovanni told me that there had been an issue with defective replica club shirts Season 27/28 after a change in supplier. Customers required compensation, costing around £400,000.

Inventories at 31 July Yr 27 included replica shirts from previous seasons, which have now been superseded by the new Season 27/28 shirts. He believes that inventories have been overstated by around £500,000 since the out-of-date replica shirts can no longer be sold.

## Payments in cash

RP always insisted on paying match-day stewards, who were all largely supporters or foreign students, cash in hand for their duties. On match days, stewards worked a 10-hour shift and were then paid £50 in cash, handed to them in a brown envelope by the stadium general manager.

## SCT

SCT prepares its own financial statements annually to 31 March. The accounting staff of Southerwood are used for all bookkeeping, accounts preparation and dealing with the auditors. A senior member of the commercial department of Southerwood has been seconded to the charity to act as chief executive with his salary and other employment costs being charged by Southerwood to the charity with a markup of 50%.

RP, as the chair of the board of trustees of SCT, has taken a fee of £10,000 and paid the other trustees £5,000 each for their services to the charity. RP's youngest daughter has been sponsored by the charity to attend a fee-paying school, with her school fees of £33,000 per annum being paid for the last two years. Only three children, including RP's daughter, have been sponsored to attend the school since the charity was established.

SCT also funds the cost of the women's rugby team, including the salaries of the five professional players.

**END OF PAPER**