



TPE 2023 – Guide to Answer

Southerwood

The Test of Professional Expertise multi-discipline case study is designed to encourage students to provide alternative creative answers and there is no “right answer” at TPE level. This Guide to Answer illustrates the structure and the depth of analysis and explanation the examiners are seeking.

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BRIEFING PAPER

This briefing paper has been prepared for Quentin Royce (Partner) on Southerwood United Ltd ('Southerwood') and covers:

- An evaluation of the Southerwood business and an analysis of the key issues within the business, including recommendations
- An evaluation of the budget for Yr. 28, prepared by the former financial controller of Southerwood, and calculation of breakeven turnover
- Advice on HR matters
- Recommended improvements to governance

1 Analysis of Southerwood business – key issues

Key issue	Analysis	Recommendation
1.1 Budgeted results Yr28	<p>The 3-month actual figures to 31 October Yr27 show a loss of over £3.5m. This is due to no match day attendance and also no income being generated from corporate hospitality due to COVID restrictions. This reflects the financial impact of COVID.</p> <p>RP has asked for the budgeted figures for the year to 31 October Yr28 to be prepared based on the assumption that the fans would fully return to stadiums from November Yr. 27 and that all staff would move back to full pay from that date. It is likely that the continued financial impact of covid restrictions on the club are not being reflected and this could lead to going concern issues at the club.</p> <p>The longer Covid restrictions are in place, the bigger risk there will be for Southerwood to financial survive.</p>	<p>The budgeted figures for 31 October Yr28 should be prepared with sensitivity analysis to show the impact if the restrictions are not fully lifted by November Yr27.</p> <p>Given the inevitable impact on club finances, it will be critical for the board to regularly monitor the financial position of Southerwood, to understand how to act and to carefully consider the options available.</p>

<p>1.2 Allegations of discrimination – reputational damage</p>	<p>A key player has posted an alleged offensive tweet but has not apologised publicly. Another player has made claims to the media that derogatory comments about his background have been made by staff at the club, including directors.</p> <p>These matters are likely to have a negative impact on the reputation of Southerwood.</p>	<p>It is important that Southerwood treats this matter seriously. High-profile businesses, such as sports club, have a responsibility to show their players and supporters that they do not tolerate any form of harassment or abuse.</p> <p>Southerwood should ensure that the matter is investigated internally, and this player should not be made captain of the team until the club is convinced this behaviour will not be repeated.</p>
<p>1.3 Age and condition of stadium</p>	<p>The stadium is more than 40 years old. There has been an accident in one of the stands and the local council has indicated that there are safety issues with the stand.</p> <p>One of the main advertisers has also threatened to cancel their £1.2 million sponsorship deal due to the condition of the stand.</p> <p>There are reputational and financial risks to Southerwood concerning the state of the stadium.</p>	<p>This leads to legal, reputational, and financial risks for Southerwood. If the stadium structure does not comply with health and safety regulations, the club could face a significant fine and possible legal damages because of the accident.</p> <p>The loss of £1.2 million in advertising would also be a significant as this is around 2.5% of income. It is important that the condition of the stand is investigated promptly by an independent health and safety expert and any repairs deemed necessary are undertaken immediately, to avoid any further danger or accidents for staff and spectators.</p>
<p>1.4 Improper use of charitable funds</p>	<p>The funds of the charitable trust, SCT, are not being used for charitable purposes:</p> <ul style="list-style-type: none"> Southerwood are making SCT pay the salary of the seconded employee plus a markup of 50%. 	<p>Although SCT is a separate organisation, it is still related to Southerwood and any failure in complying with charitable regulations would likely also have a reputational impact on Southerwood. Charging a markup of 50% to second a staff member to the charity would be considered</p>

	<ul style="list-style-type: none"> The trustees of SCT are all taking annual fees of between £5k and £10k. Only three children, (including Robert Pickles' daughter) have had their school fees subsidised, rather than the 50 children that the fund is intended to support. SCT is also paying the salaries of the professional players in the Southerwood Ladies team.¹ <p>They are supposed to be used to promote health and wellbeing in Yorkshire and to subsidise school fees for financially disadvantaged children.</p>	<p>morally incorrect by many people as Southerwood is, in effect, taking charitable funds and using them to increase an already profitable position.</p> <p>The daughter of RP seems unlikely to meet the criteria of being from a financially disadvantaged family due to his level of salary and the charity is not supporting as many disadvantaged children as it had been set up to do.</p> <p>The salaries of the Southerwood Ladies should be paid by Southerwood and not the charity.</p>
1.5 Breach of bank facilities	<p>At 31 July Yr. 27, Southerwood had breached the bank facility of £18 million as there was an outstanding loan of £19.4 million and only £0.6 million cash on hand.</p> <p>The position has improved by the end of Q1 due to the upfront payment by season ticket holders at the start of the season but breaching the loan facilities could lead to going concern issues at the club.</p>	<p>The cash position should be carefully modelled and monitored to ensure there is no further breach of the covenants and this should be regularly reported to the board.</p> <p>Southerwood should also begin discussions with the bank about renewing the loan facilities as the bank is concerned about lending to sports clubs in general.</p>
1.6 Poor sporting performance	<p>The club is not performing well in Season 27/28 and the director of rugby and head coach, Scott Dawson, has recently been sacked. He still had two years remaining on his three-year contract.</p> <p>The club revenue is partly based on the sporting success. The club</p>	<p>Sporting performance is never guaranteed. However, recent performance has been particularly poor. Denise should ensure that she understands the position of the board and their plan to replace Scott Dawson. The financial implications of terminating his contract should also be understood, as they might be</p>

¹ Do not need to mention all these examples to get credit

	<p>can only gain entry to the European Cup if they win the league. As they only came 3rd in Season 26/27, they will not play in Europe this season and current results suggest that they will not place in Europe next year either.</p> <p>Season ticket sales are also down on the previous year.</p>	<p>liable for his future salary costs until the end of his contract.</p> <p>Poor sporting performance will have an impact on game day revenue from corporate hospitality, retail, food, and beverage, etc. The budget for Yr. 28 should be monitored and amended if necessary, to account for the likely reductions in revenue.</p> <p>There has been a significant increase in both season ticket and match day prices this season. This has likely contributed to the reduction in the uptake of season tickets purchased. The board should consider the pricing structure given the current performance of the club.</p>
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2 Yr. 28 Budget

The budget for Yr. 28 is very optimistic and does not look likely to be achieved.

2.1 Revenue²

	Actual Year ended 31 Jul Yr. 27 £'000		Actual 3 months to 31 Oct Yr. 27 £'000		Budget Year ending 31 Jul Yr. 28 £'000	
Match day sales (league)	1,980	4%	-	-	4,678	8%
Season tickets (league)	12,600	27%	3,866	60%	14,175	26%
Cup games	8,100	17%	-	-	9,214	17%
Southerwood Ladies	35	0%	-	-	105	0%
Corporate hospitality	12,320	26%	-	-	13,500	25%
Advertising	3,200	7%	740	11%	3,600	7%
Retail	6,340	13%	1,840	28%	6,500	12%
Television rights	<u>2,615</u>	6%	<u>20</u>	1%	<u>2,695</u>	5%
	<u>47,190</u>		<u>6,466</u>		<u>54,467</u>	

Match day sales (league)

The budget for Yr. 28 has a 15%³ increase in revenue from the previous year. This includes a significant increase in revenue from match day sales, despite the current pandemic. As only 70% of the seats have been sold to season ticket holders, there are more seats available for match day purchase – an additional 4,500 seats from Season 27/28 but these are unlikely to be used due to restrictions in place.

The budgeted figures suggest around 9,450⁴ seats sold for each home game on top of the 31,500⁵ seats sold to season ticket holders. This is an increase in average attendance from the previous season but the results to 31 October shows the significant impact that COVID has had on professional sport. It is prudent to assume that there will be no match day sales for Season 27/28 as season ticket holders will be entitled to the 4,000 seats available.

Season tickets (league)

Budgeted season ticket revenue is for 70% of seats but this exceeds the 4,000 permitted by Rugby England. Season ticket holders may request refunds which could result in a reduction of revenue of £15.8 million⁶.

² Not expected to copy/ paste or reproduce from the paper – candidates will produce their own analysis

³ $(£54,467k - £47,190k) / £47,190k = 15.42\%$

⁴ $£4,678k / (11 \text{ games} \times £45) = 9,450 \text{ seats per game}$

⁵ $70\% \times 45,000 \text{ capacity} = 31,500 \text{ season ticket seats}$

⁶ $(31,500 - 4,000 \text{ seats}) / 31,500 \text{ seats} \times (£3,866k + £14,175k) = £15,750k$

Cup games

The budget shows an increase in revenue from cup games. In Season 26/27, Southerwood played five home cup games in addition to the 11 home league games. There has been an assumption that they will play five home cup games in Season 27/28 but they are not in the European Cup this season and lost an away game in the first round of the English Cup. Therefore, they will not receive any home income from cup games in Season 27/28. This reduces budgeted income by a further £9.2 million.

Southerwood Ladies

The budgeted revenue for Southerwood Ladies is triple the Season 26/27 revenue. Although still insignificant in terms of overall revenue, it is unclear what this increase is based on as the ladies' team already performed well and won the league cup in Season 27/28. It is also unclear what games will be played and how many fans will be permitted.

Corporate hospitality

The reduction in total home games and COVID restrictions being in place are likely to lead to a significant reduction in the corporate hospitality figure as well as there will be fewer home games for this to take place. Assuming revenue from corporate hospitality is spread evenly across the budgeted 16 home games and that only home matches from March to May Yr. 28 will generate income from corporate hospitality, revenue would reduce by £8.4m⁷.

Other income

The poor performance of the team may also have an impact on reducing retail and advertising income but that cannot be quantified at present. Income from TV rights will be determined by the contact negotiated between Rugby England and the broadcaster.

Based on this analysis, revenue for Yr. 28 is likely to be around £17m⁸ or possibly even lower which will impact on the overall profitability of the club.

2.2 Expenses

Operating profit was 10%⁹ in Yr. 27 but is budgeted to increase to 22%¹⁰ in Yr. 28. However, most costs are budgeted to remain static and this increase in profit is mostly due to the budgeted increase in revenue.

Staff costs are budgeted to remain the same. This probably requires some more investigation as some variation would be expected such as:

⁷ £13,500k/16 games x 10 games = £8,438k

⁸ £54.5m - £4.7m match day sales - £15.2m refunds - £9.2m cup sales - £8.4m corporate hospitality = £17m

⁹ £4.7m / £47.19m = 10%

¹⁰ £11.8m / £54.5m = 22%

- All staff have agreed to a 25% salary reduction.
- Two new directors were appointed in March Yr. 27, so only four months of their combined £440k salaries were charged in Yr. 27
- The budget shows an increase in revenue and, therefore, Robert Pickles' 15% bonus is likely included in the costs, although an increase in revenue is no longer likely.
- Following the departure of Scott Dawson, Southerwood might be contractually obligated to pay him for the remainder of his contract but will also need to recruit and pay another manager, leading to an increase in salary costs.
- Salary costs likely include the salaries for Dan Black (career ending injury) and Frans Smit (ineligible to play) which may no longer be required.

A slight increase in other operating expenses is budgeted. Match day costs for the 16 home matches accounted for £8.5m of the Yr. 28 figures. As the budget for Yr. 28 also includes 16 home matches but only 11 are likely to be played, then other operating expenses most likely have been overstated and will need to be reduced by approximately £2.7m to £5.8m¹¹.

Other operating expenses in Q1 appear to be a high proportion (30%¹²) of the total budget for the year which might indicate an overall increase in costs or there might be additional costs at the start of the season.

Should the stadium need significant repair, these costs would need to be built into the budget.

Issues with merchandise mean that customers need to be compensated at a cost of around £400k and some inventories will need to be written off at a cost of £500k. If these costs have not been included in the budget, which seems likely, then they will have to be added.

There has been a decrease in budgeted finance costs for Yr. 28 which would tie in with the budgeted decrease in the bank loan. There was no indication that the bank loan was due to be repaid as the facility is due to be renegotiated in Yr. 29. Given the poor performance of the club in the current season and the possible cash outflow on repair costs, early repayment of the bank facility might have an impact on the cash flow of the club. The budget shows a year end cash figure of £10.7m but the expected reduction in revenue means that this figure will likely be significantly lower.

Although the current budget shows a profit for the period, the Q1 position shows a £2.9m loss and the reduction in budgeted revenue alone would result in a loss for the year. The financial position of Southerwood appears to be poor for Yr. 28. A revised, realistic budget should be prepared and carefully monitored by the board over the season. Costs are likely to have to be reduced, especially staff costs as they are the highest cost to the business¹³.

¹¹ £8.5m/16 games x 11 games = £5.8m

¹² £3.2m / £10.6m = 30%

¹³ £8.5m of tax losses may be discussed if the candidate adjustments result in a revised profit.

2.3 Breakeven turnover

Denise has asked for an indication of the breakeven turnover of the club. Costs within a business are broadly either fixed costs or variable costs that vary with the level of activity. In the case of Southerwood, most costs are fixed costs such as salaries and depreciation and the variable costs are mainly match day costs. Effectively for Southerwood, breakeven turnover can be approximated at the point at which the club has made zero profit or loss or when revenue equal costs.

Expense	Comment	£'000
Staff costs	Staff costs in Yr. 27 were £26.7 million and these have been reduced by 25%, assuming that the salary cut lasts a full year.	20,025
Depreciation	Budgeted figure, no need to amend.	5,400
Match day operating expenses	Based on Yr. 27 figure for 16 games (£8.5 million), adjusted for the 6 expected home games from March to May Yr. 28	3,188
Other operating expenses	From Yr. 27 figure (£10.4 million - £8.5 million) plus £900k merchandise costs	2,820
Finance costs	Assumed to remain at Yr. 28 level	<u>3,650</u>
		<u>36,083</u>

Revenue of £36.1 million will cover the costs assuming COVID restrictions and that no home Cup games are played. Given that the revised budgeted revenue is only around £17 million, Southerwood are unlikely to breakeven in Yr28, and this raise serious financial concerns.

3 HR issues

3.1 Claims by former financial controller

The former financial controller, Simon Terry, has made a claim for constructive dismissal following his departure in October. Constructive dismissal is where an employer has committed a serious breach of contract, entitling the employee to resign in response to the employer's conduct. In this case Simon has reported RP through the club's whistleblowing process for bullying behaviour, with such behaviour constituting the breach of contract.

The leak in the whistleblowing process is a serious issue. *The Public Interest Disclosure Act 1998* provides protection for the whistle-blower if the matter they have reported is a 'qualifying disclosure' such as a criminal offence or a breach of legal obligation.

No employee should be discriminated against for using properly constituted whistleblowing procedures.

Employers are responsible for preventing bullying and harassment behaviour. Employers must make it clear that such behaviour will not be allowed. In this case, the alleged bully is the CEO, who sets the tone of the whole organisation. There are several things that suggest that RP is a strong character who runs the club as he sees fit with little oversight and it is important for the board of Southerwood to consider the tone set by executive directors and staff morale at the club.

An employment lawyer should be engaged to act on behalf of Southerwood on this matter. Depending on legal advice, Southerwood might be able to agree an out-of-court settlement with a non-disclosure agreement with Simon Terry to avoid further reputational damage.

3.2 Alleged social media abuse

A current player has posted an alleged offensive message on Twitter, although this has subsequently been deleted. It is very likely that a screen shot of the message has been widely shared on social media, so deleting a tweet does not mean that the message is not in the public domain. He has not issued an apology.

There have also been allegations in the press of abusive behaviour from other players and staff, including executive directors. Southerwood are legally obligated to ensure that all employees have a right to work in a safe environment without discrimination or the fear of harassment or abuse. Southerwood have a responsibility to put policies in place that make it clear there will be zero tolerance in the workplace for any form of abuse or harassment whether from spectators or employees¹⁴.

A full investigation should be carried out to investigate the player who posted the tweet and alleged abusive behaviour from other staff members. Depending on the results of the investigation, advice from an employment lawyer should be sought.

¹⁴ Similar points covered in Section 1.1 will not get credit twice.

It is recommended that all staff receive anti-bullying and harassment training at work. All Southerwood staff, particularly the rugby players who are likely to have a significant social media following, should also receive social media training.

3.3 Right to work in the UK

Southerwood has failed to adhere to UK Border Agency regulations, as the South African player, Frans Smit does not have a valid visa and work permit. Employers are required to carry out document checks on people entering the UK to ensure they have the right to work in the UK. If Southerwood is found to have failed to carry out the proper checks, they might be fined.

Rugby England are also questioning the documentation that was submitted by Southerwood and appear to be alleging that this documentation might have been falsified. As well as having significant repercussions from the rugby governing body, this might also lead to further legal ramifications by the UK Border Agency. Legal advice should be sought urgently on this matter.

3.4 Player salaries

Legal advice should be obtained to determine whether Southerwood need to continue to pay the salary of Frans Smit if he is not eligible to play in the UK. Dan Black has sustained a career ending injury but has four years left in his contract. Southerwood should continue to provide medical support to the player but the termination of these contracts should be discussed with employment law specialists.

You should also check whether Southerwood has insurance in place to cover the costs associated with injured players.

3.5 Minimum wage

Match day stewards are being paid £50 in cash for 10 hours of work. This is well below the level of minimum wage and would appear to breach employment law.

It is unclear whether the stewards are classed as Southerwood employees and whether income tax and national insurance are being paid. This could lead to fines and penalties from HMRC.

4 Governance issues

4.1 General governance

Although Southerwood is not a listed company and has a single shareholder, it should still follow good governance procedures.

As a major sports club, Southerwood will have a lot of stakeholders who will be interested in the club and there could also be significant reputational damage if poor governance processes were uncovered, and these were publicised.

4.2 Board composition

The board composition is currently:

- three non-executive directors – Denise Fong, her father Peter (who no longer attends meetings) and Sarah Pickles
- four executive directors – Robert Pickles, Drew Pickles, Alasdair Pickles and Gavi Giovanni

There is no finance director or anyone who appears to have significant financial experience on the board and following the resignation of the financial controller, there would appear to be a significant gap in financial knowledge at Southerwood.

At a minimum, a new financial controller should be appointed but there should also be a board member with financial knowledge, either an executive or non-executive director.

It is unclear what knowledge or experience the two new directors (Drew Pickles and Alasdair Pickles) have for their roles as Academy Director and Media Director. Given their ages, it is reasonable to assume that these are probably their first roles as company directors.

The board composition could be strengthened by appointing some independent non-executive directors with skills to complement those of the existing board.

4.3 Excessive salaries

During Yr. 27, two young men with the surname Pickles have been appointed as executive directors. It is reasonable to assume that these are most likely relatives (sons?) of Robert Pickles. They are both earning salaries of £220,000, compared to the £95,000 salary paid to Gavi Giovanni (Southerwood's Commercial Director). This would suggest that above market rates are being paid to the family members. There is also a non-executive director, Sarah Pickles, who receives £50,000 salary. For a non-executive director, this seems excessive.

RP receives a 15% bonus if club revenue increases each year. He already receives a salary of £950,000, which was more than twice the salary of the Director of Rugby before he left. An additional 15% is £142,500, which would give RP a gross salary of £1,092,500. The inclusion of this performance related pay element might lead to a temptation to overstate revenue.

A remuneration committee of independent non-executive directors should carry out a benchmarking exercise against other major sporting organisations for director salaries. As part of this, they should ensure that the any performance-related elements of remuneration are carefully monitored and cannot be manipulated by the executive directors.

4.4 Non-compliance with laws and regulations

There are several areas in which Southerwood do not appear to have been complying with laws and regulations which have been discussed above, such as health and safety of the stadium, harassment legislation, right to work legislation.

The board of directors have a responsibility to ensure that there are suitable processes and controls in place to ensure that the company complies with applicable laws and regulations.

4.5 Lack of board minutes

The CEO has been unable to provide details of any board minutes over the past three years. For a board to run effectively, it is important that meetings are held on a regular basis (e.g., every month). There should be an agenda for each meeting with standing items such as an operating and financial reports. The agenda and papers for the meetings should be issued in advance of the meeting to give all the directors time to read them and prepare any questions.

Minutes should be taken at every board meeting to ensure that a record of the discussions, votes and actions are recorded. The minutes should be approved by the board at the next meeting to ensure that everyone agrees they are a fair representation of what occurred at the meeting.

Due to the lack of meetings and lack of minutes from the meetings that have occurred at Southerwood, it appears that the executive directors – in particular, RP – have been making significant strategic decisions about Southerwood without proper board consideration and approval. The directors must all ensure that they are complying with their legal rights as directors.

REPORT ON SOUTHERWOOD UNITED LTD ('SOUTHERWOOD')

For the attention of: Denise Fong

Prepared by: FYC LLP

Date: November Yr. 27

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1 Introduction

This report has been prepared for Denise Fong to provide advice about her investment in Southerwood United Ltd, a professional rugby club.

The information in this report should not be shared with any other third party without our prior written consent.

2 Executive summary

- The East stand should be replaced as soon as funding can be obtained. Crowdfunding might be a possibility if the bank is unwilling to provide additional finance. You should consider the benefits that you could achieve from including additional revenue-earning features from the new stand.
- The hybrid pitch could provide a wide range of revenue possibilities such as hiring out to other sports clubs or to use for events. Repairing the stand and installing the new pitch are unlikely to be affordable in the same year.
- Streaming matches internationally may infringe on contractual arrangements with the existing UK broadcasters – legal advice should be sought before proceeding.
- Executive director salaries should be benchmarked against other professional teams to assess whether they are excessive.
- In the short term, the value of your shares is likely to be very low due to the poor financial performance of the club. However, if you can lead the board and oversee improvements, you may be able to attract a venture capitalist to invest in the club to release some of your investment.

3 Southerwood Stadium

The East Stand has been deemed to be structurally unsound and needs to be replaced. It should not be used until the work is completed. Due to COVID, this is not likely to impact revenue in the short term as a maximum of only 4,000 fans are to be permitted from March Yr. 28.

3.1 Timing of the work

The club must decide whether to commence work immediately or wait until the end of the season. This decision will depend on the length of time that demolishing and rebuilding the stand is expected to take.

It is likely that the works will cause considerable disruption to the rest of the stadium, the playing surface and the area surrounding the stadium. Therefore, it might be better to start the work toward the end of the season and aim to have the new stand completed before the new season starts in September Yr. 28 – especially when the number of fans permitted is drastically reduced for Season 27/28 anyway.

Southerwood should tender the work and invite construction companies to bid for the project. As well as design and costs, each bid should cover the timescales involved and how construction would be managed to minimise disruption to the club.

3.2 Impact on capacity

Season ticket holders who hold tickets in the East Stand will need to be given seats in one of the other stands. With COVID guidelines in place around social distancing it is likely that seats will be allocated by Southerwood complying with the guidance and fans will be sitting in seats throughout the stadium which may not be their allocated seat. This will be unavoidable.

If the restrictions lift to allow more fans to attend, having the East Stand closed during the season may restrict further how many season ticketholders can attend the matches. As these fans have paid a significant amount for their season ticket they will likely want to attend, and this would need to be carefully managed.

3.3 Funding the replacement stand

Southerwood would not be able to fund the new stand out of existing facilities and so alternative options will need to be explored. Fortnum Bank provides the existing £18 million secured facility. The loan documentation with Fortnum should be checked to determine the impact of demolishing one of the stands on the existing loan facility as the stand is likely to be part of the security pool.

There is a risk that replacing the stand might trigger a default in the loan contract with the bank and may result in the loan becoming repayable. Discussions should be held with Fortnum on this matter as soon as possible.

Initial estimates suggest a cost of around £22 million for the new stand, although the tender process might result in a range of possible prices. As the stadium building is over 40 years old, there is unlikely to be much collateral that could be used to secure an additional loan.

Southerwood should discuss the issue with Fortnum Bank and explore the possibility of extending the facility with the lender that knows them. However, recent reports have indicated that Fortnum is increasingly worried about the risk of lending to sports clubs so there is a reasonable chance that they will not provide the additional finance.

Some less traditional finance models should be considered. Southerwood had average attendances around 40,000. Could the fans 'crowdfund' to provide the necessary finance?

This could merely be donations, or the club could offer incentives to donate such as corporate hospitality, match tickets, club merchandise, etc. Fans could also donate to have their name engraved on the wall of the new stand.

The key risk to this type of model is that construction could not start until all, or substantially all the funds had been raised and it is not possible to guess whether this method would be able to raise the significant funds required.

3.4 Opportunities from replacing the stand

Replacing part of the new stadium with a modern stand might also result in an opportunity. Southerwood should consider the design of the new stand and whether additional corporate hospitality suites could be included in the design given the success of the current corporate hospitality service.

The club might be able to incorporate a restaurant or public gym facilities to generate additional income.

It may also be possible to increase the number of spectator seats available to increase the overall capacity of the stadium.

4 Profitability improvements

You have asked us to consider how to improve the profitability at the club, either by increasing revenue or by reducing costs. We have appraised the suggestions that you made as well as adding some others.

4.1 Hybrid pitch

Replacing the grass pitch with a hybrid pitch is an interesting idea. Some points you should consider further are discussed below.

A hybrid pitch is much more durable than a grass pitch in bad weather. A grass pitch can become rutted and muddy, particularly during period of wet weather.

A hybrid pitch could be used for other events, not just the men's first team. Any reserve team games, or the Southerwood Ladies' games could be played on the pitch in the main stadium which might increase attendances at these games.

However, the increased revenue would have to be considered against the costs of using the stadium more frequently (e.g., stewarding costs).

Southerwood could rent out the stadium to other sports teams – perhaps other sports such as football – or to community clubs for major matches. Again, there would be costs associated with allowing other users to access the stadium which would have to be considered. Allowing community organisations to utilise the facility for a small fee would be a good way to assist the local community.

Southerwood would have to consult the governing body, Rugby England, to ensure that any hybrid pitch would be to the required standard.

During the summer, when the rugby season has finished, the stadium could be used to host concerts or other festivals. Concerts could even be hosted during the season on weeks where there were no home matches. This could potentially be a significant source of additional revenue.

The grass pitch needs to be replaced every two years at a cost of £100,000. Therefore, within 14 years, the cost incurred would be greater for grass than for the hybrid pitch, assuming it lasts for at least that period.

The hybrid pitch could even be used for team training – both men's and ladies' which might result in less land being required at the site of the training pitches/ Academy. That land might be able to be sold.

There are a significant number of benefits that could be obtained by installing a hybrid pitch and the cost, although significant, is not prohibitive. However, funding in the current climate may prove challenging and you must ensure that Rugby England approve the surface and you should make sure that the risks of using a hybrid pitch (e.g., injuries) have been well researched. It should also be considered whether the repair of the stand (to take priority) and the new pitch could be achieved in the same short period.

4.2 International streaming of live matches

Streaming matches from your home stadium is a possible source of income. However, there are several legalities you would have to check. For example, you currently earn revenue from selling the rights to stream games in the UK. You would have to check the contractual detail of these arrangements to ensure there is nothing to prohibit you streaming the same matches abroad.

It is likely that not all Southerwood's home games are televised by the UK satellite broadcaster. The broadcaster may have different conditions around streaming games which they do televise, compared to those which are not televised.

The men's first team only has between 11 and 16 home games on an average season, and these are a mixture of English League, English Cup, and European Cup games. The different governing bodies that run these games may have different requirements and conditions around sharing the content (i.e., Rugby England might organise the TV rights for English games but TV rights to any European Cup games might be managed by another body).

You may be able to increase revenue by also showing non-first team games such as under-21 games and Southerwood Ladies matches as these are unlikely to be included in the current TV rights agreement.

You would obviously also have to have the agreement of the opposing team when streaming matches and you may have to pay them a proportion of any revenue that you earn.

We would encourage you to seek legal advice from an expert in this area as ensuring you do not breach any existing contracts will be key.

You also need to consider whether you have the equipment, resources, and knowledge to set up a streaming arrangement or whether you might be able to use the services of another organisation to do this for you.

There are several large UK football clubs who have their own TV channels where supporters can watch additional matches and training and so there is precedent for this type of arrangement. However, you would need to work with Rugby England and the existing broadcaster to ensure compliance with the existing arrangements.

4.3 Other improvements¹⁵

Benchmark directors' salaries

The salaries of the executive directors, particularly Robert Pickles, appear to be unusually high. Executive directors' salaries and bonuses account for around £2 million of staff costs. We recommend that you perform a benchmarking exercise against the salaries of other professional rugby club directors.

¹⁵ Awarded for other valid and well explained points.

Should you determine that the salaries paid are excessive, we would recommend that you consult with an employment lawyer about how to proceed based on the terms of the executive directors' contracts.

You should also consider whether you want to continue to include an element of performance related pay in directors' salaries and, if so, how that performance-related element could be determined and measured.

Corporate events

Currently Southerwood only offers corporate hospitality on match days. As a prize-winning hospitality facility, there might be scope to offer conferencing facilities on non-match days.

Southerwood could provide meeting or conference facilities, including catering to corporate customers ranging from hire of a meeting room to a full conference event. Although it is unlikely that these events can take place soon, it may be something for the medium term.

The commercial director should be asked to carry out some preliminary market research to understand what other facilities exist in the area and if there might be a demand for such a facility. There would be very little capital cost to Southerwood but there would be additional staffing costs to organise and run the events.

Regular income from fans

Southerwood have a large and loyal fan base. It might be possible to encourage fans to regularly give income to the club (e.g., through a weekly prize draw or raffle).

5 Southerwood Ladies

5.1 Professional women's league

Southerwood Ladies is a very successful team, winning the Women's League Cup last season, despite only playing in a regional Yorkshire League.

There is an opportunity to increase potential revenue earned from the ladies' team by increasing the number of professional players and applying for a place in the professional women's league.

However, there are currently only five professional players and a full squad of players would be required to play in the league. The team captain earns a salary of £28k and so employing 22 players (15 in the team and 8 substitutes to match the male first team squad) may increase annual salary costs by over £0.6 million assuming similar or slightly lower salaries.

Many of the existing team are amateurs, working in other jobs. It would be sensible to approach these players to determine whether they want to turn professional before attempting to sign other players.

Women could also be developed through the Academy.

Currently revenue earned from Southerwood Ladies matches is very low, with only £35k in Yr. 27, which only just covers the salary of the captain (although this is currently being paid by the charitable trust).

If matches were played in the main Stadium, rather than at the training grounds, there is the opportunity to attract more spectators and to potentially charge a higher entrance fee. Alternatively, the ladies' matches could be played on the same day as the men's matches for an additional fee to watch both.

A move to a professional league is also likely to generate higher crowds, including away fans.

You should speak to other clubs in the professional women's league to understand the possible income streams and benefits but also the additional costs involved.

You have stated that you think it is important for the club to focus on being family-focussed. Encouraging female participation in a traditionally male-dominated sport could be a real boost for women's sport. You might be able to attract more girls to the Academy and encourage local schools and amateur clubs to get involved in women's rugby.

6 Assurance engagements that FYC LLP could provide (7 marks)

At our recent meeting you asked for an outline of how FYC could assist you in reviewing business arrangements which Southerwood has with suppliers and asked for our initial thoughts on areas where improvements could be made. Obviously, until we do any work, our thoughts on improvements would be subject to verification and are heavily caveated.

6.1 Agreed upon procedures

In each of the examples quoted, it is most likely that FYC could undertake for you agreed-upon procedures. In this type of engagement, the procedures will be specified in our letter of engagement with you.

We will report to you our findings from the agreed work, and it will then be up to Southerwood's management to interpret these findings and draw your own conclusions. We do not offer any form of opinion or conclusion on our work.

6.2 Grassland

The revenue you have received from this supplier to date is £500. You are entitled to receive 5% of the gross margin of the product, but this is a low value product which retails at £15 and so the revenue per product is small.

FYC could check the monthly sales figures and validate the gross margin. However, the cost that we would charge for performing this work is likely to outweigh the revenue received.

6.3 Netlocker

You earn considerably higher levels of commission from Netlocker selling replica shirts, at £6 per shirt sold. Commission received has halved since Yr. 26, but no figures have been received to explain this decrease from Netlocker.

To provide assurance over the commission due, we would insist that there are regular inventories counts (e.g., each month) and we could provide staff from our Channel Islands office to attend as an observer.

An examination of the accounting records relating to the sales of Southerwood shirts would be required and a reperformance of the commission calculations undertaken.

We would also recommend that formal reports are received each month and that all requests for replenishment are committed to writing rather than done informally by telephone to avoid any disputes.

6.4 Spook Gin

Southerwood receives 250 cases of Spook gin in exchange for corporate hospitality with a market value of £105,000. The difference between the sales value of the gin and value of corporate hospitality used is compared on an annual basis to determine if there is an outstanding balance.

FYC could also calculate the fair value of the gin sold by Southerwood by checking sales and inventories records for any gin remaining in stock.

We could provide assurance over the amount and value of corporate hospitality used by Daniels by examining the corporate hospitality records and costs.

We could provide this information in a format suitable for both Southerwood and for Daniels including a calculation of the balance owed and owing between the two parties.

We would not, unless specifically engaged to do so, express our opinion.

7 Options to realise your investment

You have asked us to provide some suggestions as to how you might be able to realise some or all your investment in Southerwood.

7.1 Current position

The adjustments made to the Yr. 28 budget in our earlier work suggest that the club will be significantly loss making in Yr. 28. Therefore, it is difficult to attach a value to the club based on earnings. If we were to use the Yr. 27 results with the profit of £1,085,000 and an earnings multiple of 8, the valuation would be £8.68m at most, particularly as Southerwood played in both the English and European Cups in Season 26/27.

These figures are extremely subjective and given the poor current financial position of the club you are unlikely to find many investors willing to invest at the current time.

The reputational issues, high level of management costs, poor performance of the team, stadium issues and level of debt are all areas which could potentially put off an investor – not to mention the ongoing COVID pandemic.

If you were able to work with the executive management to improve the financial position of the club, then it is likely that not only would the club become a more attractive investment, but the value of your shareholding would also increase.

7.2 Potential investors

There are several potential investors who might be interested in a well-known professional sports club such as Southerwood. However, sports clubs are notoriously difficult investments as the sporting performance can have a significant influence on the financial performance.

A wealthy fan (or group of fans) may be willing to purchase some of your shares. Southerwood has a long history in the area and has a significant fan base; it is likely that there are fans who would be willing to purchase a proportion of your shares.

These fans may also have expertise which they can bring to the board, particularly if they have other successful business interests.

It might also be possible for you to sell shares to a wider grouping of fans, with each fan only holding a few shares. This would dilute the ownership of the club significantly but that is unlikely to cause an issue if you retain control through a majority shareholding.

A venture capitalist might be interested in a future investment. However, they usually required a good annual return, through capital growth or dividends and so might only be interested when results have improved. A venture capitalist would also be looking for an exit route at an agreed point in the future. This could come from the club buying back the shares or by encouraging another investor at that later date.

Trading shares on a market would allow you a much easier route to disposing of your shares. However, there are a lot of regulatory requirements surrounding a listing on a market such as the Alternative Investment Market ('AIM') which would have to be carefully considered. Given the current financial performance, it is highly unlikely that Southerwood would be able to obtain a listing in a market such as AIM as some other professional clubs have. However, again, if you were able to improve the financial position, this is something that might become possible in the future.

You should also consider whether any of the existing directors of Southerwood would be interested in purchasing shares.

If you do realise part or all your shareholding, a capital gain will arise in the tax year (a period which runs between 6 April and the following 5 April) of the disposal. This gain will be based on the actual cash received from the sale of the shares less the cost that you father paid for the shares.

It is possible to reduce the value of your capital gains by the annual exempt amount which is currently £12,300. It is also possible to elect to claim 'Entrepreneur's Relief' on the disposal of the shares which would allow the capital gain to be taxed at 10% rather than the usual 20%. This relief is only allowed on capital gains up to the value of £10m over your lifetime. Any capital gains tax liability will be due for payment by 31 January after the tax year in which you dispose of the shares.

If you do decide to dispose of some of your shareholding in the future, we can provide you with advice on the calculation of the gain and look at the final capital gains tax liability.

ETHICS MEMO

To: ethicspartner@fycllp.com
 From: PatAccountant@fycllp.com
 Date: November Yr. 27
 Subject: Southerwood assignment

Dear Ethics partner,

I have been working on the Southerwood engagement for Quentin Royce and several matters have come to light that I feel I should share with you. Quentin is presently on holiday.

Internal concerns

- I am concerned that both Quentin and I have no experience of sports clubs. Quentin has stated that he wished to continue with the assignment as he needs to expand his portfolio of clients. This gives us risks of integrity, objectivity, and competence.
- In addition, I am being asked to give a draft report directly to the client, without supervision. This must be sent to the client tomorrow. I ask that someone from the Sports and Leisure Division reviews the work before the draft report is issued.
- Undue pressure was put on me in the conduct of the assignment by Quentin in respect of my time-charging and his unspoken assertion that my annual appraisal may be adversely impacted if I did not do his bidding. Although I feel that my objectivity was not influenced by this, it is another reason for a review.

Concerns with the client

- Southerwood supports a charity which is being run in breach of its charitable objects. Trustees are being paid and relatives are receiving benefits. We need to consider whether we must make a formal notification to the Charity Commission, although the charity is not a client.
- A member of staff followed whistleblowing processes at Southerwood which were leaked to the CEO, whom the complaint was about. The whistleblowing function needs to be improved and staff should never be victimised or punished for using internal whistleblowing mechanisms.
- The tone at the top is disturbing if the allegations of one of the Southerwood players are true that the senior management were involved in abusive and offensive behaviour. Some Equalities training and a reinforcement of the club's social media policy to all staff would appear necessary.
- Southerwood's financial performance is likely to be poor this year. We should protect our position with fees in advance, at least for any further work.
- The matters of concern were brought up by the sole shareholder and she does not seem to be involved. However, this is a company with a high profile, and we should consider whether we wish to continue to act for it.

Kind regards,

Pat Accountant