

**Part 2: The Deception:**

**Part 1: The Accounts:**

**Patisserie Valerie** is a chain of cafés that operates in the United Kingdom. The chain specialises in cakes, and its menu included continental breakfasts, lunches and teas and coffees. The company went into administration in January 2019, prior to a management buyout.

Your transition work is to investigate the circumstances that led to the failure of this established

business.

You have a copy of an interim financial report for Patisserie Valerie from 2018 below. You should use this to comment on the apparent financial position of the company at that time. Some suggestions for items you could look for:

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Gross profit

Net cash Dividends Revenue growth

Read the 2 news articles about the decline of Patisserie Valerie. Can you find and comment on the items in their accounts that are referred to in the news story? Try to find and comment on at least 3 items from the news stories.

**Part 3: Ethics:**

Read the Code of Ethics for Accountants, particularly the ‘Fundamental Principles’ section.

(<https://www.ethicsboard.org/system/files/uploads/IESBA/IESBA-Fact-Sheet.pdf>)

Summarise **which of the 5** principles you believe have been broken by whoever produced the

accounts for Patisserie Valerie. *Extension: Why do you think these principles exist? What happens if they are broken?*

E.g. In the article it states…

“When the scandal was first revealed, Patisserie Valerie said an initial investigation of its

accounts showed that instead of having £28m in the bank, it was nearly £10m in debt.”

This would mean that the business accounts would show the business as being worth more than it is actually worth. This deceives investors, shareholders, employees and even board members about

the financial health of the company.

Now the company that owns Patisserie Valerie could be facing legal action from investors over the collapse of the cafe chain.

The first signs of trouble came back in October after accounting "irregularities" were

announced. [**That included "secret overdrafts"**](https://www.bbc.co.uk/news/business-45854817) unknown to Mr Johnson and the board.

KPMG said that 902 jobs will go due to the closure of 27 Patisserie Valerie stores, 19 Druckers

and 25 Patisserie Valerie concessions. However, KPMG said it is "business as usual" at the remaining 122 outlets. The administrator said it was "pleased" with the level of interest it had

received from potential buyers of the surviving parts of the business.

**Sources:**

*Article 1:*

**Patisserie Valerie reveals stores to close**

23 January 2019

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**Administrators of Patisserie Holdings have named the 71 outlets that will close following the**

**firm's collapse.**

Patisserie Valerie was forced into administration on Tuesday after it failed to reach a rescue deal

with its banks. Entrepreneur Luke Johnson, who bought the business in 2006, has committed

more money to ensure staff are paid this month.

Shares in Patisserie Holdings were suspended and finance director [**Chris Marsh was arrested**](https://www.bbc.co.uk/news/business-45833597)

[**and later released on bail without charge**.](https://www.bbc.co.uk/news/business-45833597)

Mr Johnson, who owned 37% of Patisserie Holdings, kept the business going by extending it a

loan, and money was raised from other shareholders. But earlier this month the company said the accounting scandal was worse than it thought.

A member of staff, who did not want to be identified, told the BBC that Patisserie Valerie's

collapse had come as a complete shock to them. "Apparently everything at work was fine since October. "I was always asking the managers, 'are you going to close the shop?' and they said no, no, no," said the employee. "I'm still in shock - I couldn't sleep last night."

Employees of stores that are closing were informed by phone on Tuesday evening, and asked to

attend meetings on Wednesday where they will receive further information. "Last Wednesday, they had a meeting with all the big managers and they were making plans to make the shops better. Everyone was quite positive last week."

In addition to Patisserie Valerie, the company's other brands include Druckers Vienna Patisserie,

Philpotts, Baker & Spice and Flour Power City.

Julie Palmer, regional managing partner at Begbies Traynor, is optimistic. She told BBC Radio 5's Wake Up To Money: "It is a good brand, it has got good High Street presence, it was making good profits over a long period of time. However, she said potential buyers would be sceptical about the company's figures.

While he had questions for the former directors, he also said there were questions for the banks

and the auditors. "We're very, very angry," he said. There are hopes the stores which continue trading might find a buyer.

It is not clear if the target of any action might be the company or its former directors, including

Mr Johnson. "This business has gone from half a billion [pounds] valuation to nothing in a matter of months," Mr Boxall said.

"What has he and the board been doing? What questions were they asking at meetings, what

things were they looking at, did they ever roll up their sleeves and have look at the heart of the business which you would expect from a so-called executive director which he was in this business," he said.

Chris Boxall, co-founder of Fundamental Asset Management, said he was "flabbergasted" by the situation. He told BBC Radio 4's Today Programme he was considering legal action as he had a "moral duty" to his clients. Mr Boxall questioned Mr Johnson's oversight of the business.

Article 2:

Patisserie Valerie says its accounts were

'significantly manipulated'

**Cafe chain says it has uncovered thousands of false entries in its ledgers**

[**Sarah Butler**](https://www.theguardian.com/profile/sarahbutler)

Wed 16 Jan 2019 18.36

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[Patisserie Valerie](https://www.theguardian.com/business/patisserie-valerie), the cafe chain which came within hours of financial collapse in

October after discovering a multimillion-pound gap in its accounts, has uncovered

“thousands of false entries into the company’s ledgers”.

In a statement to the Stock Exchange, the company, which operates 200 cafes and

employs 3,000 staff, said work carried out by forensic accountants had revealed that

“the misstatement of its accounts was extensive, involving very significant manipulation of the balance sheet and profit and loss accounts”.

The company said it was now clear that the cash flow and profitability of the business

had been overstated in the past and was “materially below” the numbers the

company provided when the accounting black hole first emerged in October.

Luke Johnson, the multimillionaire chairman of the business, was forced to put

£20m of his own money into the firm to keep it afloat after the uncovering of

potentially fraudulent accounting irregularities that left it teetering on the brink. Other shareholders later put up £15m, £10m of which was used to pay back half of Johnson’s loan.

The company was valued at £450m when the problem was uncovered, but the shares

were suspended and have yet to restart trading. The company’s finance director,

Chris Marsh, was arrested by Hertfordshire police, bailed and resigned.

The Serious Fraud Office has confirmed that it has opened a criminal investigation

into an individual but has not given further information. The Financial Reporting Council is meanwhile investigating accountancy firm Grant Thornton for its role as auditor to [Patisserie Valerie](https://www.theguardian.com/business/patisserie-valerie).

The group’s chief executive. Paul May, resigned in November and was replaced by

Steve Francis, a turnaround expert who previously ran the pork producer Tulip. Only

Johnson and the deputy chairman, Lee Ginsberg, remain of the original board.

On Wednesday, the company said it had hired accountants KPMG in an attempt “to

preserve value for its stakeholders going forward”.

It is understood that a number of options are being considered. However, KPMG is

known for its expertise in restructuring and insolvency, particularly a procedure known as a company voluntary arrangement. CVAs enable businesses to renegotiate rental agreements with landlords or close stores.

When the scandal was first revealed, Patisserie Valerie said an initial investigation of

its accounts showed that instead of having £28m in the bank, as the company had previously told the City, it was nearly £10m in debt.

In a 12 October statement it said underlying profits might have been only £12m in

the year to 19 September, compared with £26m reported a year before. The new update said that £12m was an overestimate.

Johnson has waived his £60,000 salary and pledged to give up some of his other

directorships as he tries to turn around the chain. He remains chair of at least 10

boards including the Almeida theatre in London, the Institute of Cancer Research,

the entrepreneurial campaigning group StartUp Britain and a number of companies held by Risk Capital – his investment company.

"The group has delivered a strong set of results in a sector which has well documented challenges. Our

vertically integrated and flexible business model enables us to deliver consistent profits with

our affordable treats remaining popular with our very diverse customer base. We remain focused

on organic growth and with a strong balance sheet continue to assess acquisition opportunities

which will have a strategic and cultural fit."

Group revenue of £60.5m up by 9.1% (2017: £55.5m)

Gross profit of £47.1m up by 8.7% (2017: £43.3m)

o Gross margin of 77.8% (2017: 78.0%) EBITDA of £13.6m up by 11.6% (2017: £12.2m)

o EBITDA margin of 22.5% (2017: 22.0%)

Pre-tax profit of £11.1m up by 14.2% (2017: £9.7m)

Operating cash flows of £11.9m (2017: £9.3m} with EBITDA cash conversion of 108% (2017:

96%)

Strong balance sheet position with net cash of £28.8m (2017:£16.2m)

10 new stores opened to date all funded from operating cash flow with a strong pipeline

Trading from 206 stores

Diluted earnings per share of 8.92 pence up by 13.2% (2017: 7.88 pence) Interim dividend up 20% to 1.44 pence per share (2017: 1.20 pence per share)

Interim Financial Report:

Patisserie Holdings PLC ('the Group')

Interim results for the six months ended 31 March 2018

Patisserie Holdings PLC, the leading UK branded cafe and casual dining group, today reports

its interim results for the six months ended 31March 2018

Financial summary

EBITDA IS calculated as operat1ng profit before deprec1a110n and amort1sa110n.

Highlights

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Luke Johnson, Executive Chairman, said

6 months ended

6 months ended

31 March

2018

31 March

2017

Change

£m

£m

Revenue

60.5

55.5

9.1%

Gross profit

47.1

43.3

8.7%

EBITDA\*

13.6

12.2

11.6%

Pre-tax profit

11.1

9.7

14.2%

Basic earnings per share

8.98 pence

7.95 pence

13.0%

Diluted earnings per share

8.92 pence

7.88 pence

13.2%

Interim dividend per share

1.44 pence

1.20 pence

20.0%

We continue to work hard to control our gross profit margin which remained at 77.8% {2017: 78.0%}.

We benefitted in the period from a number of contract renegotiations, and in some cases we

switched suppliers to mitigate inflationary pressures, along with production efficiencies from

investment in our bakeries in the prior year. We remain proactive in managing our cost base and in

some cases we have seen a reduction in some of our core ingredient prices.

The group achieved strong sales from our website of £2.6m in the period, up £1.0m or 62.5% (2017:

£1.6m}. This was driven by our social media strategy and the relaunch of our website in February

2018, which provides customers with an enhanced user experience, including video imaging of

our products, tablet/mobile compatibility and a streamlined checkout process. The revamped website

is proving successful.

The period started well with a good build up to Christmas with our new festive range, including the

limited edition Reindeer slice, selling well. Sales were slightly hampered by the adverse

weather conditions. However thanks to our vertically integrated] supply chain and the flexibility of

our workforce we were able to limit the impact on profit. We finished the period strongly with a

record Mother's Day weekend and a good lead up to Easter.

We established a new product development team towards the end of the prior year and are currently

trialling a number of initiatives in selected stores including a new menu, a new savoury range and

in store bake-off of morning goods. In January we also launched Slice of the Month which is

proving popular. All of these new product initiatives are helping to drive incremental sales.

Our partnership with Sainsbury's continues. We have a supply only agreement for a limited Patisserie Valerie range to be sold at Patisserie Valerie branded counters within Sainsbury's stores. We currently have counters in 31 Sainsbury's stores in addition to 14 click and collect locations. We will shortly be entering a further 10 Sainsbury's stores.

**Chief Executive's Review**

**Results**

I am delighted to announce our interim results for the six months ended 31 March 2018, during which

we continued to deliver growth in revenues and profit.

Revenue for the period was £60.5m, an increase of £5.0m or 9.1% {2017:£55.5m). Revenue from our

largest brand, Patisserie Valerie, was up £5.4m or 13.2% to £45.8m {2017: £40.4m). Due to a store closure in the prior year, revenue from our other brands was down £0.3m or 2.6% to £14.7m (2017:

£15.1m}.

EBITDA for the period was £13.6m, an increase of £1.4m or 11.6% (2017:£12.2m) and pre-tax profit was £11.1m, an increase of £1.4m or 14.2% (2017: £9.7m).

Basic earnings per share were 8.98 pence per share (2017: 7.95 pence per share) and diluted earnings

per share were 8.92 pence per share (2017:7.88 pence per share), an increase of 13.0% and 13.2%

respectively.

Our business model converts profit to cash efficiently and delivers consistent and predictable cash

flows. The Group continues to be funded from operating cash flows and reserves, and with a

cash balance of £28.8m at the period end, is well positioned to make strategic acquisitions

should appropriate opportunities arise.

Cash flow & Financing

In the period we generated operating cash flows of £14.7m, up £2.9m or 24.9% (2017: £11.7m). We

paid £2.8m in corporation tax and spent £5.0m in capex on our estate leaving free cash flows of £6.8m,

up £1.9m or 40.0% (2017: £4.9m). We returned £2.4m to shareholders in dividend payments

and generated £2.9m of proceeds from the exercise of employee share options resulting in net cash at

the end of the period of £28.8m (2017: £16.2m).

Our experienced Estates team continues to deliver high quality new stores at an average expenditure

of £0.25m per site, which continue to deliver payback in less than 24 months.

The final dividend for the year ended 30 September 2017 of 2.4 pence per share or £2.4m in total was

paid to shareholders in the period. The Group remains cash generative and the Board has declared an interim dividend for this financial year of 1.44 pence per share representing a 20% increase year on year. The interim dividend will be paid on 13 July 2018 to shareholders on the register at the close of business on 1 June 2018.

INTERIM CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE SIX MONTHS ENDED 31MARCH 2018

Six months ended

31March

2018

£'000

Total

Unaudited

Six months ended

31March

2017

£'000

Total

Unaudited

Year ended

30 September

2017

£'000

Total

Audited

Notes

Continuing operations

Revenue

Cost of sales

60,522 (13,465)

55,488 (12,188)

114,197 (24,931)

Gross profit

Administration expenses

47,057 (3S,983)

43,300 (33,599)

89,266 (69,121)

Operating profit

11,074

9,701

20,145

Finance income

1

44

(36)

Finance expense

Profit before income tax

Income tax expense

11,075 (2,020)

9,701 (1,756)

20,153 (3,789)

4

Profit after tax and total comprehensive income for the period attributable to equity holders

9,055

7,945

16,364

Earnings per share

Basic earnings per share (pence) Diluted earnings per share (pence)

6

8.98

8.92

7.95

7.88

16.36

16.20

INTERIM CONDENSED CONSOLIDATED BALANCE SHEET

31MARCH 2018

31March

2018

£'000

Unaudited

31March

2017

£'000

Unaudited

30 September

2017

£'000

Audited

Note

ASSETS

Non-current assets Intangible assets Property,plant and equipment

17,722

42, 68

17,773

38,373

17,747

39,674

7

59,890

56,146

57,421

Current assets

Trade and other receivables

Corporation tax

Inventories

Cash and cash equivalents

11,654

2,489

5,990

28,840

11,059

2,537

4,901

16,176

12,327

1,668

5,980

21,525

48,973

34,673

41,500

Total assets

108,863

90,819

98,921

EQUITY AND LIABILITIES Equity

Capital and reserves attributable to the equity holders

Ordinary share capital

Share premium Other reserves Retained earnings

1,019

36,947

767

63, 86

1,000

33,661

550

49,152

1,003

34,084

708

56,537

Total equity

101,919

84,363

92,332

Non-current liabilities

Deferred tax

1,477

1,924

1,422

1,477

1,924

1,422

Current liabilities

Trade and other payables

5,467

4,532

5,167

5,467

4,532

5,167

Total liabilities

6,944

6,456

6,589

Total equity and liabilities

108,863

90,819

98,921