

CONSULTATION

FINANCIAL REPORTING COUNCIL

IMPROVING THE QUALITY OF REPORTING BY SMALLER LISTED AND AIM QUOTED COMPANIES

ABOUT AIA

The Association of International Accountants (AIA) was founded in the UK in 1928 as a professional accountancy body and from conception has promoted the concept of 'international accounting' to create a global network of accountants in over 85 countries worldwide.

AIA is recognised by the UK government as a recognised qualifying body for statutory auditors under the Companies Act 2006, across the European Union under the mutual recognition of professional qualifications directive and as a prescribed body under the Companies (Auditing and Accounting) Act 2003 in the Republic of Ireland. AIA also has supervisory status for its members in the UK under the Money Laundering Regulations 2007.

AIA promotes and supports the advancement of the accountancy profession both in the UK and internationally. The AIA exams are based on International Financial Reporting and International Auditing Standards and are complimented by a range of variant papers applicable to local tax and company law in key jurisdictions together with an optional paper in Islamic accounting.

AIA members are fully professionally qualified to undertake accountancy employment in the public and private sectors.

AIA RESPONSE

SUMMARY

AIA is pleased to respond to the FRC's request for comment on its Consultation Improving the Quality of Reporting by Smaller Listed and AIM Quoted Companies issued in June 2015.

It is widely acknowledged that investors require good quality financial reports on which to make reasoned and balanced decisions. Having high quality financial information will allow investors to assess the financial performance, financial position and the entity's ability to generate cash flows. Good quality corporate information is concerned with, not only the numbers which are included in the financial statements, but also the narrative reporting and disclosures which seek to elaborate on the information contained in the financial statements. Investors require transparent information which is entity-specific and hence the annual report produced by a reporting entity should be viewed as a tool to attract investors.

The FRC's findings indicate that while the standard of corporate reporting is generally good, there is still room for improvement for smaller listed and AIM quoted companies when compared to their larger counterparts. Implementing improvements in financial reporting will widen the scope for more investment as more transparent information will be at the disposal of investors which will enable a better understanding of the entity.

The FRC's findings cite 'boilerplating' as a continuing problem among smaller listed and AIM quoted companies. AIA would agree that boilerplating is of little use to (potential) investors and stakeholders and companies should be encouraged to make entity-specific disclosures rather than copying text from accounting standards or guidance. AIA also notes that the FRC suggests a possible reason for boilerplating is due to continuing professional development (CPD) issues, although AIA would not necessarily agree that this is the case across the profession as a whole.

QUESTION 1

TO WHAT EXTENT DO YOU RECOGNISE AND AGREE WITH THE ISSUES RAISED IN THE REPORT REGARDING THE QUALITY OF REPORTING BY SMALLER QUOTED COMPANIES?

The FRC's report suggests that boards of smaller listed and AIM quoted companies tend to view the preparation of the entity's annual report as a compliance exercise as opposed to a tool which they can use to attract investors. This is also accentuated by the findings that many annual reports tend to contain boilerplate policies and disclosures which have (allegedly) been copied from accounting standards in some cases.

Boilerplate policies and disclosures has been an ongoing issue over the last few years and AIA is aware that companies must be encouraged to do more to avoid boilerplating policies and disclosures and make them entity-specific.

The FRC have also suggested that boards are reluctant to remove immaterial disclosures for fear of being challenged by the FRC or other regulatory bodies. AIA is aware of this problem and feels that the reluctance by boards is not necessarily due to fear of challenge of non-disclosure, but being challenged as to their interpretation of what would be considered 'immaterial'. Boards are reluctant to remove disclosures which may be viewed by others as being immaterial on the basis that in some cases the disclosures are required by a specific IFRS, despite IFRS only requiring the financial statements to reflect material issues. AIA believes that more could be done by standard-setters to help boards understand how to apply the concept of materiality to disclosures to free up the financial statements from 'clutter'.

The FRC's findings in the consultation on page 11 at paragraph 3.2 indicate concerns have been raised by investors in key areas of the financial statements, such as the business model, principal risks and uncertainties; cash flow statements and certain accounting policies (such as revenue recognition). The FRC have also indicated that these areas in paragraph 3.2 are also where improvements are needed.

The FRC have suggested that areas identified as requiring improvement are mainly down to omissions in the application of an IFRS or legislative requirement as well as a misunderstanding of the requirements for inclusion in the annual report which, in turn, gives rise to an error or non-compliance with an IFRS/legislative requirement.

AIA acknowledges that IFRS are based on principles rather than rules. The principles-based nature of IFRS will often result in ambiguity as they rely on professional judgement being applied, particularly in subjective areas of the financial statements (such as estimation uncertainty and principal risks and uncertainties). This can be specifically identified with the problem highlighted in paragraph 3.2 of the FRC's report in respect of accounting policies as boards might feel a reluctance not to disclose an accounting policy on the basis that IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors only requires disclosure of significant accounting policies. While many boards understand that only significant accounting policies need to be disclosed, some boards of smaller listed and AIM quoted companies might not understand the term 'significant' and hence choose to disclose more accounting policies than is required. This indicates a learning curve whereby accounting standards may benefit from additional application guidance in some key areas (such as in accounting policies).

Many smaller listed and AIM quoted companies might also rely on auditors to assist them in ensuring financial statements are compliant with the requirements of IFRS and legislation. There are specific Ethical Standards which auditors have to comply with in order to maintain independence and objectivity (such as the UK and Ireland ES 5 Non-audit services provided to audited entities). The Audit Directive and Regulation defines a 'public interest entity' as being fully listed, rather than smaller listed or AIM quoted companies. AIA believes that there is an opportunity to reduce the onerous provisions in the ethical standards and relax them for smaller listed and AIM quoted companies. This will enable audit firms to have more interaction with smaller listed and AIM quoted companies in the preparation of their financial statements. Audit firms may choose, however, to have a separate team assisting boards in the preparation of their financial statements and a separate team auditing those financial statements. However, this would be viewed as deregulatory and hence provide comfort for audit firms that they are not breaching ethical standards when assisting boards' in the compilation of their financial statements.

Allowing audit firms the opportunity to assist in the financial statements might also have a twofold benefit. Firstly the financial statements would be prepared on a timelier basis and hence give the audit firm the time they need to complete their audit procedures to the required standards (rather than an inappropriately short amount of time which will inherently increase audit risk). Secondly allowing audit firms the ability to participate in the financial statement process would reduce boilerplating as the company would have access to more technical knowledge or, alternatively, it would allow the company to understand how the auditor interprets a requirement of an IFRS or piece of legislation in the context of the company and its disclosure requirements to ensure correct application.

Time-pressure has been noted by the FRC where auditors are concerned; with some audit firms complaining that they receive draft annual reports too late to comprehensively review them. Indeed page 19 of the FRC's consultation indicates that the dates of the audit reviews were generally very close to the completion deadline. While AIA agrees that the quality of audit should not be allowed to suffer, auditors might be reluctant to defer issuing their opinion because where deadlines are missed the listing may be suspended which is something boards would not want.

Notwithstanding the suggestion by AIA of auditors having an involvement in the financial statement preparation process, boards have a responsibility to start the reporting process as soon as possible after the reporting date and should be reminded of this responsibility by auditors and, where possible, regulatory bodies. This will enable the company to address any difficulties in the preparation process more efficiently and will also allow the auditors ample time to complete their audit procedures to the required standards.

QUESTION 2

DO YOU CONSIDER THAT THE ACTIONS PROPOSED ARE (I) A PROPORTIONATE RESPONSE TO THE ISSUES IDENTIFIED; AND (II) AN ADEQUATE RESPONSE TO THE ISSUES IDENTIFIED?

AIA agrees that problems inherent in corporate reporting do need to be resolved, particularly the problem of boilerplating and misapplication of the requirements of an IFRS or piece of legislation. AIA believes these problems are borne out of fewer available resources in a smaller listed and AIM quoted company as opposed to a larger, fully-listed company which may have access to an abundance of technically-trained individuals who have the ability to interpret the requirements of IFRS and legislation and then take an objective view as to whether the financial statements meet the requirements which FRC and investors command.

The majority of the actions proposed by FRC are supported by AIA. The proposal to issue reminders to boards which set out the key areas of interest to investors is strongly supported by AIA as this will help boards understand exactly what investors are looking for as well as how they improve their corporate reporting (which will immensely benefit the entity). This will help boards in tailoring narrative disclosures to be entity-specific because they will be aware of what interested stakeholders are specifically looking for in the company's annual report. It should also discourage boards from viewing the annual report preparation as a compliance exercise.

AIA is not supportive of the proposal to have roundtable discussions with investors and smaller quoted companies as AIA does not believe this would necessarily have any benefit. The majority of many smaller listed and AIM quoted companies are still owned by directors and management and hence AIA suspects the take-up of roundtable discussions would not be high and other courses of action (such as additional application guidance in accounting standards and enabling auditors more opportunity to assist in the financial statement process) may be more beneficial to such companies.

AIA does not support the proposal to place additional pressures on investors or rating agencies to provide more feedback to companies as AIA feels that some investors or rating agencies may not be best placed to provide such feedback. While there are some needs common to all users of financial statements, certain investors may only look for certain aspects in the annual report. Companies receiving feedback from a wide-range of external sources may take on board that feedback and hence produce financial statements which may conflict with requirements in an IFRS or legislation or even dilute the meaningfulness of the financial statements for other investors or stakeholders.

The proposal to encourage participation in the practical work of the Financial Reporting Lab (the Lab) is supported by AIA. AIA believes that involving smaller listed and AIM quoted companies in the work of the Lab would give such companies insight as to what investors and other external stakeholders actually want, and expect, in annual reports. The fact that such feedback has been tested would enhance the credibility of that feedback and help boards immensely in understanding what information should be included in their annual reports and how this information should be conveyed.

AIA recognises that CPD is crucial for accountants and professional bodies make available a wide range of activities which can serve to fulfil an individual's CPD requirements. Professional competence is pivotal in the profession and while AIA recognises that many accountants undertake CPD which is relevant to their role, some may not necessarily comply with their professional body's requirements (for which sanctions will usually be brought against the individual concerned). However, AIA are of the view that these individuals are in the significant minority and would disagree with the FRC's citation of an auditor claiming it is 'too easy for accountant's to tick off CPD requirements' as AIA believes this to be somewhat a sweeping statement which is not substantiated.

As a result, AIA would disagree that problems inherent with corporate reporting for smaller listed and AIM quoted companies is due, in part, to CPD. AIA would suggest that the problems are generally as a result of a misunderstanding of the principles-based nature of IFRS and the requirements in complex legislation. CPD activities relating to financial reporting (in particular IFRS) generally focus on the technical requirements of an IFRS – they would not focus on entity-specific application of an IFRS because every company is different, and this is where AIA feels that the problem has been derived.

CONCLUSION

AIA agrees with the majority of the FRC's findings in the consultation document and would also agree that corporate reporting for smaller listed and AIM quoted companies does need further improvement. In summary, AIA agrees with:

- the need for smaller listed and AIM quoted companies to improve their financial reports and to avoid boilerplating;
- the need for financial statements to be made available much earlier than completion deadlines so as to enable problems to be resolved more timely and allow the auditors to complete their work in accordance with auditing standards;
- the need for boards to be more transparent about information contained in their annual report and to not view the annual report as a compliance exercise;
- the proposal to assist boards by reminding them of key areas of interest to investors, common errors and suggestions for improvements; and
- the proposal to encourage more participation in the practical work of the Financial Reporting Lab.

AIA does not agree with:

- the view that it is 'too easy' for accountants to tick boxes confirming their CPD activity;
- having roundtable discussions with investors and smaller listed and AIM quoted companies as many such companies are owned by directors and management;
- creating additional pressure on investors and rating agencies to provide more feedback on annual reports; and
- the notion that the problem lies with approaches to CPD, however, AIA would be happy to engage with the FRC to promote better member engagement on technical issues such as these.

FURTHER INFORMATION

The above replies represent our comments upon this consultation document. We hope that our comments will be helpful and seen as constructive. AIA will be pleased to learn of feedback, and to assist further in this discussion process if requested.

If you require any further information, please contact:

AIA Policy & Public Affairs Department
The Association of International Accountants
Staithes 3
The Watermark
Metro Riverside
Newcastle upon Tyne
NE11 9SN
United Kingdom
T: +44 (0)191 493 0269
E: consultations@aiaworldwide.com