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For the attention of: Mr P Fitzgerald & Ms A Colban

Emailed to: Pfitzgerald@frc.org.uk

Dear Sirs

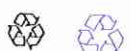
Discussion paper: Improving the Quality of Reporting by Smaller Listed and AIM-quoted Companies

We thank you for the opportunity to respond to the above discussion paper. We would like to state at the outset that we strongly support the focus on the quality of reporting in this sector of the market. As a leading firm of auditors to the mid-market, we consider the provision of accurate and relevant information to the market to be a key responsibility of boards of smaller listed and AIM-quoted companies and seek to encourage this throughout our work in the sector.

Benefits of good quality reporting

You have carried out research which confirms that investors do consider the annual report to be an important tool for communication and one that is relevant to investment decisions. Companies, however, appear to be unconvinced that this is the case and do not seem to be getting this feedback themselves from investors and potential investors. They seem to believe that the analyst briefings that they give are the key element to communication and that the annual report is only examined when something has gone awry. Perhaps this is indicative of poor communication between companies and their key stakeholders or perhaps further research might show that the views of investors are more varied. Increasingly, albeit anecdotally, we are hearing that smaller listed and AIM-quoted companies are even cancelling their analyst briefings on the advice of their brokers and NOMADs on the basis of a lack of investor interest in this sector of the market.

It would be helpful to resolve this apparent contradiction in views and, if the FRC has compelling evidence that a broad range of investors really do consider the annual report to be an important and useful document, to publish this evidence in full and share it directly with these companies, for which the FRC is an important regulator. In our view, this is a key factor in obtaining the essential engagement of preparers.



Improving the quality of reporting

We would concur with the view that the most significant challenge facing these companies is the inadequacy of resource to prepare an annual report to the standard required. We agree that any reinforcement of the continuing obligations for companies by reference to their requirements on an IPO is to be welcomed and we would also reinforce the need for good quality reporting within the governance framework of non-Code companies. However, we believe it would be unhelpful to mandate the adoption of a specific code for companies listed on markets such as AIM, as that could be an additional deterrent to companies seeking a listing in the first place, with the resulting wider negative effect on the attractiveness of the UK as a market for these companies.

We are surprised that unadjusted disclosure errors are not brought to the attention of those charged with governance, as you suggest, particularly as this is a requirement of auditing standards, but we agree that a frank assessment of the capabilities of a finance team is usefully shared by the auditors with audit committees.

We support the FRC's suggestion that Financial Reporting Lab projects and the Clear & Concise reporting initiative should include specific consideration of smaller listed companies but we are a little sceptical about the likelihood of getting quality feedback from such entities. Our experience has been that they are reluctant to engage with the Financial Reporting Lab because it is seen to be "putting their head above the parapet".

Reporting standards

Whilst we accept the contention that annual reports have become too long and unnecessarily complex, we would not support a move away from IFRSs for companies within the scope of this discussion paper. The complex accounting in the areas you cite, such as financial instruments and share based payments, often only reflects the fact that the transactions themselves are complex. It is certainly true that companies often do not appreciate how complex and nuanced the transactions they enter into are until sometime after the event when their accounting effect is being analysed. This point notwithstanding, we agree that the FRC should continue its work influencing the IASB and other standard-setters to ensure that the frequency of changes to standards is proportionate and that they consider the effect of those changes on all companies, including smaller listed companies.

We consider that it is possible to conflate the separate issues of accounting complexity, which reflects the fundamental nature of what the company is doing, and a sensible level of disclosure. If companies report those things that matter (and that may well include quite a lot of detail on transactions that are complex) that does not stop them being clear and concise and not including detail on matters that are not material to shareholders. We would not, however, suggest that this be done through the introduction of a reduced disclosure framework for "smaller" listed companies, because complexity and size do not necessarily equate. To introduce a reduced disclosure framework would, in our view, just lower the bar of quality.

In our view, a more appropriate way of achieving the aim of ensuring that annual reports are clear and concise would be through a more stringent consideration of the concepts of materiality and relevance when thinking about why one must make a disclosure in the first place. This approach, however, does require the support of all parts of the FRC in order to avoid the sort of 'kitchen sink' mentality that many companies have adopted to reduce the risk of regulatory intervention. For example, excepting the February 2011 Press Release on the disclosure of principal risks and uncertainties and some general references to the subject in their annual report, we have seen little from the FRC's Corporate Reporting Review Team suggesting that disclosures need not have been given. Similarly this is not a subject that comes up very often in discussions with Audit Quality Review Teams. Consequently, whilst we support the FRC's suggestion that it ensures the Financial Reporting Lab and the Clear & Concise reporting initiative include specific consideration of smaller listed companies, we would also urge it to seek a consistency of approach in its conduct activities.

The role of auditors

The role of auditors is clearly important in improving the quality of financial statements in smaller listed and AIM-quoted companies and we entirely support your contention that audit procedures should be rigorous in the areas you list and that only appropriate individuals, sufficiently trained, should have responsibility for such audits.

We would urge you, however, not to underestimate the challenges auditors face in terms of the quality and timeliness of receipt of the draft annual report. Currently, it is all too often the case that audit engagement teams must wait until late in the day for draft financial statements, which they know will be of very poor standard when they are eventually received. Those teams may then be engaged in an uphill struggle to persuade their client to improve the annual reports from a position of quite unacceptable quality to a position that can often be described as no more than just above the line of acceptability. This is an iterative process, carried out against a backdrop of a looming results announcement date or regulatory filing deadline, for which clients, by and large, do not have an appetite.

In the discussion paper, you make reference to ethical standards and suggest that there is something of a 'grey area' in how these can be interpreted. We have difficulty in seeing the ethical standards as anything other than very clear indeed. They expressly proscribe "assistance in the preparation of financial statements". Offering auditor feedback and observations on the financial statements, which is allowed, in our view does not have an equivalent outcome. This intervention is, by definition, too late in the process to have a significant effect on quality (as opposed to pure compliance) and is only effective where the initial drafting falls only marginally short of the 'bar' and management do not require 'advice' to remediate. Offering preparation or drafting 'advice' is, as noted above, not allowed.

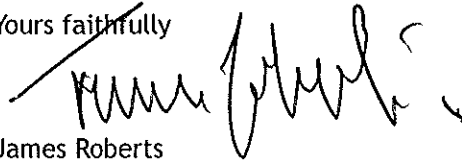
This raises, in our minds, the question of whether the public interest is best served by the ethical standards as currently drafted and whether, in a similar vein to the proportionality of Audit Standards recognised in the recent EU Audit Dossier, a marginal relaxation in permitting audit firms to give a degree of overt assistance to clients in terms of drafting aspects of their annual report might produce a better outcome. Such a relaxation (applicable only to a tightly defined population of companies) would allow auditors to be more proactive rather than, as they are now, reactive when dealing with poor quality annual report disclosures.

Conclusion

We do recognise and agree with the issues raised in the report regarding the quality of reporting by smaller listed and AIM-quoted companies and their main causes but we do call on the FRC to provide clearer evidence that these concerns have also been raised by investors, as it would useful leverage for engaging with preparers.

Subject to the comments above, we agree in principal with the proposed actions set out in Section 4 of the discussion paper. We consider them to be both appropriate and proportionate.

Yours faithfully

A handwritten signature in black ink, appearing to read 'James Roberts', is written over the 'Yours faithfully' text.

James Roberts
Partner
For and on behalf of BDO LLP