



BAKER TILLY

Our ref: NATS/LH  
Your ref: DP FR Quality

25 Farringdon Street  
London  
EC4A 4AB  
United Kingdom

T: +44 (0)20 3201 8000  
F: +44 (0)20 3201 8001

[www.bakertilly.co.uk](http://www.bakertilly.co.uk)

Financial Reporting Council  
8th Floor  
125 London Wall  
London  
EC2Y 5AS

[danielle.stewart@bakertilly.co.uk](mailto:danielle.stewart@bakertilly.co.uk)

7 August 2015

Dear Mr Hadrill

**"Improving the Quality of Reporting by Smaller Listed and AIM Quoted Companies" - Discussion paper on the FRC's findings and proposals**

We welcome the opportunity to respond to the FRC's discussion paper "Improving the Quality of Reporting by Smaller Listed and AIM Quoted Companies" ("the Discussion Paper").

We support the FRC's efforts to improve the quality of reporting by smaller listed and AIM quoted companies, and agree that many of the proposed actions may assist in achieving this goal.

Limiting the ethical prohibitions to those entities that fall within the Statutory Audit Directive's definition of a public interest entity would permit AIM companies to access the relevant accounting expertise from their existing advisors (subject to the implementation of appropriate safeguards, such as the use of separate teams for accounting support) before the commencement of the audit engagement, which will improve the timeliness of reporting and ultimately, the quality of the entity's annual report.

For this reason, we ask that the FRC engages further with stakeholders regarding the application of the prohibitions in the Ethical Standards to AIM quoted companies. It is unclear how much outreach was performed in reaching your conclusion that the Ethical Standards are fit for purpose and that there was limited support for any changes, and that only clarification of the existing standards is required.

However, if it should emerge that, as you say in the Discussion Paper, there is indeed no appetite for relaxation of the ethical requirements in relation to accounting assistance for AIM quoted companies, we suggest that directors should be encouraged to engage the help of specialist financial reporting experts in preparing the annual accounts. The experts could either be external firms of accountants or

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internal specialists but either way the experts should be subject to minimum IFRS training and experience requirements, and hold a relevant professional qualification.

The experts could be 'light touch' monitored by their own professional bodies, starting with a desk top review of their CPD records. We suggest this as an alternative to the FRC's recommendation that AIM quoted companies should consider appointing a non-executive with relevant financial reporting experience. We believe this alternative will have a greater impact on the quality of reporting given that many smaller quoted companies seek to appoint non-executive directors for their commercial experience so they can assist in achieving the company's strategic objectives. In addition to this, their involvement in the reporting process is usually limited due to their infrequent involvement with the annual report preparation.

The requirement to involve an expert could be implemented as a 'comply or explain' provision in a new Code of Corporate Governance for AIM and smaller listed companies.

We also believe that making directors take greater ownership of the quality of the financial statements would help to address the issues identified by the paper. One way of achieving this would be to also add a declaration that the directors are ultimately responsible for the quality of the annual report to the new Code of Corporate Governance.

Please refer to Appendix 1 for further details of our responses to the questions posed in the Discussion Paper.

If you would like to discuss any aspect of this response, please do not hesitate to contact Danielle Stewart directly or by email at [danielle.stewart@bakertilly.co.uk](mailto:danielle.stewart@bakertilly.co.uk).

Yours sincerely

*Baker Tilly Tax and Accounting Limited*

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## **Appendix 1**

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### **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?**

We are pleased that the FRC has focused on the reporting by smaller listed and AIM quoted companies and that recognition has been given to both the number and the diversity of challenges they face.

We recognise a number of the issues identified in the Discussion Paper as potential barriers to high quality reporting. We agree that the lack of perception that the annual report is an important tool for communicating with investors is a major barrier to the delivery of high quality reporting, although all the other factors you mention, particularly the lack of resources, are important too. We also believe that ownership of the financial statements by the directors is an important factor in improving the quality of reporting by the smaller quoted company sector, and we expand on this point further below.

Whilst the frequency of changes to IFRS is not out of step with the constant development of ever more sophisticated business models, we welcome the FRC's support in influencing the IASB and other standard-setters to ensure that the impact of changes on smaller quoted companies is considered.

Whilst we acknowledge that the auditor has a role to play in ensuring that audited financial statements provide a quality deliverable to investors, we must make clear the fact that the auditor is not, nor should be, responsible for the quality of financial reporting by its clients. The auditor's role is to audit the financial statements prepared by the entity and report whether they show a true and fair view, and this does not absolve the entity of its primary responsibility to prepare high quality financial reports for audit and ultimately for submission to the market. There is a danger that highlighting the weaknesses in the auditor's internal procedures may imply that the auditor is a cause of poor quality reporting and this may widen the expectation gap of the auditor's role in the financial reporting process.

We note that the Discussion Paper does not recognise the value that auditors already contribute in the delivery of quality financial reports. It is our view that, within the parameters of the applicable Ethical Standards, auditors currently play a significant role in increasing the quality of financial reporting by smaller listed companies. The lack of IFRS financial reporting resource and expertise at the entity highlighted above can have a significant impact on the number of drafts seen by the auditor and the additional work created can often cause a delay in the audit process.





## **Appendix 1**

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### **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?**

We are broadly supportive of the actions proposed in the Discussion Paper, although we think that the FRC could go further, either through its own direct actions, or by lobbying/encouraging legislators and professional bodies, to try to address the quality of financial reporting in this market sector.

As set out in our response to the FRC's consultation "Auditing and ethical standards – Implementation of the EU Audit Directive and Audit Regulation" we do not believe that the FRC should extend the ethical requirements applicable to public interest entities (PIE) to listed entities that do not fall within the EU PIE definition. This would mean that AIM quoted entities would not be subject to the accounting prohibitions that they are currently subjected to. This would permit the audit firm, subject to relevant ethical safeguards, to assist those entities that do not have a sufficient level and quality of resource internally, with the preparation of the financial statements prior to the commencement of the audit. Appropriate ethical safeguards should include the use of separate teams, with the financial reporting team being specially trained and experienced in IFRS. We already operate this model in Baker Tilly for non listed companies. We would anticipate that allowing the audit firm to assist with the preparation of financial statements would reduce the causes of last minute pressures referred to in our response to Question 1 and referred to in section 2 of the Appendix to the Discussion Paper, resulting in an overall improvement in the quality of the annual report.

If, as you say in the Discussion Paper, there is indeed no appetite for relaxation of the ethical requirements in relation to accounting assistance for AIM quoted companies, then we suggest that directors be encouraged to engage the help of specialist financial reporting experts in preparing the annual accounts. The experts could either be external firms of accountants or internal specialists, but either way the experts should be subject to minimum IFRS training and experience requirements, and hold a relevant professional qualification. The experts could be 'light touch' monitored by their own professional bodies, starting with a desk top review of their CPD records.

We suggest this as an alternative to the FRC's recommendation that AIM quoted companies should consider appointing a non-executive with relevant financial reporting experience. We believe this alternative will have a greater impact on the quality of reporting given that many smaller quoted companies seek to appoint non-executive directors for their commercial experience so they can assist in achieving the company's strategic objectives. In addition to this, their involvement in the reporting process is usually limited due to their infrequent involvement with the annual report preparation and whilst this may be effective for larger quoted companies, we are aware, as this Discussion Paper highlights that they benefit from



## **Appendix 1**

technically stronger and on the whole, better resourced finance teams than smaller listed and AIM quoted companies.

The requirement to involve an expert could be implemented as a 'comply or explain' provision in a new Code of Corporate Governance for AIM and smaller listed companies. Given the ownership issue identified in our answer to question 1 above, we would also recommend that this be accompanied by a declaration that the directors are ultimately responsible for the quality of the annual report.

As you will appreciate from this last comment, we agree with the proposal to have a Corporate Governance Code for AIM companies and also concur with the FRC's views about the importance of the tone at the top of the company.

If our suggestion above about involving an expert is not taken up and should the FRC proceed with their recommendation that all companies should have at least one non-executive director with relevant financial expertise, we would ask the FRC to go one step further and require that their expertise should be technically up to date.

We recognise and support the FRC's effort to support finance staff in keeping up to date with changes to financial reporting standards through CPD requirements. However, we do not believe that training alone will facilitate these improvements. We would ask the FRC to further engage on a detailed level with preparers of IFRS accounts to better understand their perceived challenges in preparing high quality financial reports to present for audit and ultimately to the market. We suggest that the preparers of IFRS accounts for small listed and AIM quoted companies are ultimately the group that the FRC needs to engage with to promote high quality financial reporting. We would welcome the FRC opening a dialogue with preparers of IFRS accounts with a view to supporting preparers without perceived criticism.

Whilst we do not disagree that the proposal to reduce the reporting timetable might be a solution to improving quality in the long term, we believe that imposing this before resolving the issues mentioned above will have an adverse impact on the quality of reporting in the short term. As such, we would ask that the other initiatives to improve reporting quality are implemented first, with any reduction in the reporting timetable only to be implemented when there is clear evidence that the quality of financial reporting has been raised.