QUOTED COMPANIES ALLIANCE

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5 February 2013

Dear Sirs,

**Financial Reporting Council – Thinking about disclosures in a broader context**

***Introduction***

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Financial Reporting Expert Group has examined your proposals and advised on this response. A list of members of the expert group is at Appendix A.

***Response***

We welcome the opportunity to comment on the above document. In line with our Corporate Reporting Charter, a copy of which is attached to this response, we are committed to fostering a culture of continuous improvement in corporate reporting.

We believe IFRS are currently in need of a major overhaul if they are to meet the needs of investors in small and mid-size quoted companies. Whilst supporting the development of ideas on a disclosure framework, we believe the reforms necessary go beyond disclosure issues and encompass restoring the concepts of stewardship, prudence and reliability/verifiability as core elements of a high quality reporting system. The substantial concerns of recent years have yet to be properly addressed.

In addition, accounting standard-setters still operate almost wholly in a paper-based world and have not properly addressed how reporting should be undertaken in the internet age, for example, considering what information should be available in hard-copy and which supplementary information could be made available just on the web. Work is also needed on the conventions that should govern how web-based reporting should be presented.

Another area where further work is needed is in considering when information should be published, for example, what information should be published by quoted companies at the time that the preliminary announcement.

*Response to specific questions*

**1. Key questions relating to development of disclosure framework**

**Would a disclosure framework that addresses the four questions identified below help address the problems with disclosures?**

- **What information do users need?**
- **Where should disclosures be located?**
- **When should a disclosure be provided?**
- **How should disclosures be communicated?**

We believe that developing a framework that answers the four questions above would help address the current problems with disclosures.

In supporting the above approach, we would emphasise the following points:

- In line with the stewardship approach, the primary focus should be on the information that the company's shareholders need. However, it may be appropriate, in relevant circumstances, to take into account the interests of other stakeholders as well if considered to be different.
- There should be an overriding principle that good corporate reporting is about communicating the company's performance, position and prospects effectively. Just complying with disclosure requirements by including the information somewhere in the financial statements or wider annual report is not sufficient.
- The needs of investors in small and mid-size quoted companies should be specifically considered when looking at shareholders' and wider users' needs. It should not be assumed that they are the same as investors in global listed companies.
- It is important to ask users how they use the information provided in practice as well as their views on information they desire from companies.
- Whether disclosures need to be audited should be considered when looking at where disclosures should be located in reports.

The development of a disclosure framework which is accepted by the International Accounting Standards Board (IASB) is likely to take a number of years. As a matter of urgency, we believe that the IASB should undertake a thorough review of its current disclosure requirements and those contained in projects in progress, for example on revenue recognition, lease accounting and accounting for financial instruments, with a view to significantly reducing them for small and mid-size quoted companies. In undertaking the review they should have regard to, amongst other papers, the ICAS/NZSA paper on Losing the Excess Baggage.

**2. Common disclosure themes**

**Do the disclosure themes set out on page 16 of this paper capture the common types of disclosures that users need?**

We are broadly supportive of the view that the themes set out on page 16 capture the common types of disclosure that users need. We would make the following specific points:

- Management commentary should be referred to as 'board or governing body commentary' as it should reflect the views of the whole board, which will include but extend beyond those of the executive team.
- On occasion, it may be appropriate for unrecognised amounts to come within the primary financial statements and for them therefore to be subject to audit.
- Within the heading of 'Corporate governance', there is overlap between the sub-headings 'Board composition and effectiveness' and 'Accountability to shareholders'. The work of the audit and remuneration committees is, for example, included under the first heading but is very much concerned with accountability to shareholders.

**3. Components of the financial report**

**Do you agree with the components of the financial report as identified on page 20? Are there any other components that should be identified?**

We broadly agree with the components of financial reporting as identified on page 20. In addition to our views above, we would raise the following issues:

- We do not believe that 'financial reporting' is the appropriate term to refer to the annual report as a whole as it includes both financial and non-financial reporting. We suggest that this should be called 'corporate reporting', and the wider category currently referred to as 'corporate reporting' should be changed to 'business reporting' or another relevant term.
- We would note that the explanation of the strategy and the business model could be afforded their own sections as opposed to forming part of management (or board) commentary.

**4. Identification of the placement criteria**

**Do you believe that the placement criteria identified in this paper are appropriate?**

We are not convinced that the guidance given for determining which information should be in the management commentary as opposed to the financial statements will help preparers, auditors and others make judgments in practice, especially around the margin, as it is expressed in high level conceptual terms. This may be unavoidable as there will inherently be difficult judgments to make.

The wording of the information to be included in the management commentary is also rather narrowly defined. The management commentary is said to include information about the firm's strategy and business model, which is vitally important in its own right and not just in terms of putting 'the financial statements into the context of the entity and its operating environment'.

**5. Proportionate disclosure**

**How should standard setters address the issue of proportionate disclosures?**

We believe the three routes identified to promote proportionality – simplifying the disclosure regime for all entities, setting principles-based disclosure requirements and developing a differential disclosure regime with different levels of disclosure – all merit consideration. It will, however, be important that each standard-setting body, especially the IASB, indicates how it is going to make the necessary changes to introduce a greater degree of proportionality into its requirements.

Going forward, we firmly support a principles-based disclosure approach, whereby the types of disclosure which may be relevant in a particular situation are outlined rather than detailed individual required disclosures being set out. There is probably also a strong case for drawing a clear distinction between financial services and general businesses when it comes to issuing disclosure standards - with separate standards for banks and insurance entities.

With regards to quoted companies, we do not believe that a ‘one-size-fits-all’ approach – with the same requirements applying to all quoted companies – works. The market capitalisation of a small quoted company may well be less than 1% of that of its global counterparts. Furthermore, standards appear to have been prepared mainly having regard to the circumstances of large quoted companies, which can add complexity for small and mid-size quoted companies and aggravate the situation.

**6. The framework for materiality**

**Do you agree with the framework for materiality set out in this paper? How could it be improved?**

We recognise that the issues of materiality and proportionality are inextricably linked. In terms of materiality, the framework set out in the paper provides a useful starting point. However behavioural change is absolutely critical if the necessary changes are to be successfully made.

At present preparers, auditors and regulators tend to blame each other for a lack of application of materiality in financial statements. A principles-based disclosure framework would help. But there also needs to be a greater willingness by everyone involved in corporate reporting to use their judgement in deciding whether or not a particular disclosure is material. It would also help for it to be clear in each IFRS that, not only are disclosures not needed where they are not material, but that providing them in such circumstances can be damaging by obscuring more important information that is material in the financial statements.

**7. Other ways in which disclosures could be improved**

**Are there other ways in which disclosures in financial reports could be improved?**

We would encourage standard-setters to develop their own Corporate Reporting Charters, setting out the high level principles which they are trying to achieve in corporate reporting and the processes they will adopt to secure them.

We also believe it would be helpful if there were a change in regulatory approach. For example, it could be helpful for the FRRP, when reviewing financial reports, to comment on disclosures which it considered not to be material and where it felt issues were not being communicated effectively (even though the information required was to be found somewhere in the financial report).

If you would like to discuss any of this in more detail, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive

**APPENDIX A**

**Quoted Companies Alliance Financial Reporting Expert Group**

| | |
|---|---|
| Anthony Carey (Chairman) | Mazars LLP |
| Matthew Stallabrass (Deputy Chairman) | Crowe Clark Whitehill LLP |
| Anthony Appleton | PKF (UK) LLP |
| Peter Chidgey | BDO LLP |
| Jack Easton | UHY Hacker Young |
| Ian Smith/Bill Farren | Deloitte LLP |
| Jonathan Ford | PricewaterhouseCoopers LLP |
| David Gray | DHG Management |
| Usman Hamid | Ernst & Young LLP |
| Matthew Howells | Smith & Williamson Limited |
| Nick Winters/James Lole | RSM Tenon Group PLC |
| Niraj Patel | Saffery Champness |
| Nigel Smethers | One Media Publishing |
| Chris Smith | Grant Thornton UK LLP |
| Paul Watts/Jonathan Lowe | Baker Tilly |

- **The Quoted Companies Alliance is committed to working with boards, investors, regulators and standard-setters to promoting high quality corporate reporting by quoted companies, especially small and mid-size quoted companies.**

We will encourage the boards of quoted companies to be aware of the importance of high quality reporting in order that the market can have confidence in their businesses and in the information provided by companies generally. In order to undertake our work effectively, we will work with investors to better understand their information needs. We will also encourage standard-setters, regulators and others to set standards and other requirements that meet the genuine needs of investors in a practical way.

- **We seek to foster a culture of continuous improvement in corporate reporting.**

We will encourage companies to keep their corporate reporting under regular review and to seek ways of responding to changing market needs. Information provided should be understandable, avoid unnecessary complexity, be presented in a timely fashion and in a format that makes use of modern technology where appropriate. We will similarly encourage regulators and standard-setters to remain responsive to marketplace changes and to provide information to preparers on good practice and on reporting issues which companies generally need to address. Standard-setters should also take a strategic rather than a piecemeal approach to their work and should periodically seek to eliminate requirements which have not been found to provide useful information.

- **We believe the concept of stewardship lies at the heart of good corporate reporting.**

Directors are responsible to the shareholders for the long-term success of their businesses and this will have a bearing both on what they are expected to report on and the most suitable method of measurement in financial statements. It is likely to have implications, for example, for the circumstances in which fair values are used and for what is considered to be the most appropriate means of measuring fair value in particular situations.

- **Corporate reporting requirements should be subject to robust cost-benefit tests.**

Standard-setters need to carefully assess the costs compared to the benefits of introducing requirements and to avoid unintended consequences wherever possible. To do this, they need to be conscious of the risks of a 'one-size-fits-all' approach since quoted companies encompass both global companies with a market valuation of tens of billions of pounds and small and mid-size quoted companies with one of a relatively few million pounds. Moreover, there should be a clear and public consensus between boards, investors, standard-setters, regulators and auditors on how materiality is to be applied in practice by companies when preparing their financial statements. A proportionate approach to corporate reporting that focuses on significant disclosures and avoids clutter in the financial statements with immaterial disclosures will both improve the quality of corporate reporting and reduce the costs of providing relevant information.

- **We press for accounting standards which properly reflect economic reality when implemented.**

Standards when applied, as well as when written, should focus on principles and not rules, enabling appropriate judgement to be exercised, and in their drafting should take account of practical concerns raised when they are being prepared. In measurement terms, a theoretically optimum solution may turn out to be sub-optimal if, for example, the assumptions of active markets are not met in practice. A mission to reflect economic reality also calls for post-implementation reviews of issues arising. Furthermore, investors may well wish to distinguish between those profits that have between realised in cash and those that have not. Moreover, how best to reflect economic reality may be impacted by the time horizon over which performance is being measured. Further work on what is meant by, and how best to capture, economic reality in financial statements would be helpful. There should be a pre-eminent emphasis on economic reality when standard-setters agree on convergence programmes.

- **Standard-setters should be in close touch with their marketplace.**

In a fast-changing modern market economy, if standards are to reflect economic reality and to be practical, the standard-setters need to be fully in touch with their marketplace. Standard-setters as a team should have substantial current or recent practical experience of operating in the marketplace as a user, preparer or adviser. They should also be drawn from a broad range of backgrounds, including those related to small and mid-size quoted companies as well as to global corporations.

- **We emphasise the importance of good narrative reporting as an integral part of corporate reporting.**

Whilst the focus on narrative reporting is increasing, it has traditionally tended to be the 'Cinderella' of the corporate reporting model. To enable the development of a business to be seen in its proper context, it is essential that high quality information be provided on its strategy, its key risks and how they are being managed, the KPIs used to manage the business, current performance and future prospects, and its corporate governance.