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The Quoted Companies Alliance

European Securities Market Authority
103 rue de Grenelle
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France

30 March 2012

Dear Sirs,

ESMA - Considerations of materiality in financial reporting

INTRODUCTION

The Quoted Companies Alliance is a not-for-profit membership organisation working for small and mid-cap 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 Committee has examined your proposals and advised on this response. A list of committee members is at Appendix A.

RESPONSE

We welcome the opportunity to respond to this consultation. The issue of materiality has been at the centre of our campaigning for the past few years. We believe that materiality is an important aspect to consider in reducing the burden on companies when producing accounts and making companies' reports more meaningful and less complex.

Overall, we believe that ESMA should be encouraging national and international standard setters to develop appropriate guidance on materiality, rather than issuing guidance itself. We would also stress the need for guidance to avoid a 'one-size-fits-all' approach - the risks attached to the largest companies, and the range of their stakeholders, are different to those of small and mid-cap quoted companies and any guidance should assist in ensuring that financial reporting is proportional.

We have responded to the specific questions below.

Q1: Do you think that the concept of materiality is clearly and consistently understood and applied in practise by preparers, auditors, users and accounting enforcers or do you feel more clarification is required?

In our experience the concept of materiality is not consistently understood and applied, particularly in the context of accounting disclosures, and this is one of the factors that have led to the increasing length of financial statements. These factors are described in the recent paper, Cutting Clutter: Combating Clutter in Annual Reports[1], issued by the Financial Reporting Council in the UK.

We would welcome additional clarification in this area but would stress the need for this clarification to be consistent with existing IFRS references and in particular IAS 1. We note the trend for existing guidance to focus on what to include rather than what to exclude and would encourage any additional guidance to assist in ensuring companies make adequate and comprehensive disclosure of material matters and reversing the trend

[1] http://www.frc.org.uk/images/uploaded/documents/Cutting%20clutter%20report%20April%2020113.pdf

of over disclosure of immaterial matters which can obscure more significant information. We would also welcome any guidance reiterating the fact made in the Conceptual Framework that general purpose financial reporting cannot provide all of the information that users might require and that they should also consider pertinent information from other sources.

As noted earlier, we would also stress the need for any additional guidance to avoid a 'one size fits all' approach and to 'think small first'. The risks attaching to the largest companies, and the range of their stakeholders, are different to those of small and mid-cap quoted companies and any guidance should assist in ensuring that financial reporting is proportional.

Q2: Do you think ESMA should issue guidance in this regard?

To properly compile guidance preparers, auditors, users and accounting enforcers there will have to be engaged debate in each country and the demands of the capital markets in each country will have to be considered. As such we would rather see ESMA encouraging national standard setters to issue appropriate guidance.

Q3: In your opinion, are 'economic decisions made by users' the same as users making 'decisions about providing resources to the entity'? Please explain your rationale and if possible provide examples.

No comment.

Q4: Is it your understanding that the primary user constituency of general purpose financial reports as defined by the IASB in paragraph 13 includes those users as outlined in paragraph 16 above? Please explain you rationale and if possible provide further examples.

The users outlined in paragraph 16 are wider than the primary users identified by the IASB, in particular the reference to employees and compliance with regulatory requirements would not seem to be covered by the definition of existing and potential investors, lenders and other creditors.

Q5a: Do you agree that the IASB's use of the word 'could' as opposed to, for example, 'would' implies a lower materiality threshold? Please explain your rationale in this regard.

Q5b: In your opinion, could the inclusion of the expression 'reasonably expected to' as per the Auditing Standards, lead to a different assessment of materiality for auditing purposes than that used for financial reporting purposes. Have you seen any instances of this in practice?

Whilst we acknowledge that there are subtle differences identified here we do not believe that this has any significant practical impact.

Q6a: Do you agree that the quantitative analysis of the materiality of an item should not be determined solely by a simple quantitative comparison to primary statement totals such as profit for the period or statement of financial position totals and that the individual line item in the primary statement to which the item is included should be assessed when determining the materiality of the item in question? Please explain your rationale in this regard.

We agree. A consideration of materiality includes the presentation of an item and this could well include the individual line item in which an item is included. Presentation in the Income Statement, for example, could materially alter gross profit or revenue trends without impacting the profit for the period and this could result in the financial statements being materially misstated.

Q6b: Do you agree that each of the examples provided in paragraph 21 a-e above constitute instances where the quantitative materiality threshold may be lower? Are there other instance which might be cited as examples? Please explain your rationale.

We assume this question refers to paragraph 22 a-e and have answered accordingly.

We do not agree that each of the examples constitute instance where the quantitative materiality threshold may be lower. We do not agree, for example, that regulatory breaches with immaterial consequences require assessing against a lower materiality threshold than other items in the financial statements.

Q7: Do you agree that preparers of financial reports should assess the impact of all misstatements and omissions, including those that arose in earlier periods and are of continued applicability in the current period, in determining materiality decisions. Please explain your views in this regard.

We agree. Errors from prior periods can impact a current period and hence will need to be reassessed.

Q8: Do you agree that preparers of financial reports should assess the impact of all misstatements and omissions as referred to in paragraphs 23 to 26 above in determining materiality? Please explain your views in this regard and provide practical examples, if applicable.

We agree.

Q9a: Do you believe that an accounting policy disclosing the materiality judgments exercised by preparers should be provided in the financial statements?

Q9b: If so, please provide an outline of the nature of such disclosures.

Q9c: In either case, please explain your rationale in this regard.

We do not agree that this is required. The concept of materiality is sufficiently well understood by the users of financial statements that it would appear to make additional disclosure superfluous. As is noted materiality contains both qualitative and quantitative elements and hence any disclosure would tend to merely restate the existing definition in IAS 1 as opposed to providing greater insight into the level of materiality used.

Q10: Do you agree that omitting required notes giving additional information about a material line item in the financial statements constitutes a misstatement? Please explain your rationale in this regard.

We agree. Failure to provide required disclosure concerning a material item constitutes a misstatement. We would, however, point out that failure to provide disclosure about an immaterial element of a material line item would not constitute a misstatement. Whilst share options, for example, might be material failure to provide the detailed disclosure on one, immaterial, scheme would not necessarily constitute a misstatement provided adequate disclosure was made concerning the other schemes in existence.

Q11: Do you believe that in determining the materiality applying to notes which do not relate directly to financial statement items but are nonetheless of significance for the overall assessment of the financial statements of a reporting entity:

(a) The same considerations apply as in determining the materiality applying to items which relate directly to financial statement items; or

(b) Different considerations apply; and

(c) If different considerations apply, please outline those different considerations.

The same considerations apply as in determining the materiality applying to items which relate directly to the financial statements, namely would omission or misstatement influence the economic decisions that users make on the basis of the financial statements.

Q12: In your opinion, how would the materiality assessment as it applies to interim financial reports differ from the materiality assessment as it applies to annual financial reports?

Materiality for interim reports is assessed in accordance with IAS 34 and is different from the assessment used for annual reports as users will, rarely, be able to take economic decisions with reference to interim financial reports alone without the additional information provided by the annual financial reports.

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

Yours sincerely,

Tim Ward
Chief Executive

APPENDIX A

Quoted Companies Alliance Financial Reporting Committee

Anthony Appleton	PKF (UK) LLP
Nigel Bostock	Crowe Clark Whitehill
Anthony Carey	Mazars LLP
Peter Chidgey	BDO LLP
Ian Davies	UHY Hacker Young
Jack Easton	Victoria PLC
Bill Farren	Deloitte LLP
Jonathan Ford	PricewaterhouseCoopers LLP
David Gray	DHG Management
Kate Jalbert	Quoted Companies Alliance
Shalini Kashyap	Ernst & Young LLP
Nicole Kissun	PKF (UK) LLP
James Lole	RSM Tenon Group PLC
Jonathan Lowe	Baker Tilly
Kern Roberts	Smith & Williamson Limited
Nigel Smethers	One Media Publishing
Chris Smith	Grant Thornton UK LLP
Ian Smith	Deloitte LLP
Matthew Stallabrass	Crowe Clark Whitehill
Jacques Sultan	Quoted Companies Alliance
Tim Ward	Quoted Companies Alliance
Paul Watts	Baker Tilly
Nick Winters	RSM Tenon Group PLC

APPENDIX B

THE QUOTED COMPANIES ALLIANCE (QCA)

A not-for-profit organisation funded by its membership, the Quoted Companies Alliance represents the interests of small and mid-cap quoted companies, their advisors and investors. It was founded in 1992, originally known as CISCO.

The Quoted Companies Alliance is governed by an elected Executive Committee, and undertakes its work through a number of highly focussed, multi-disciplinary committees and working groups of members who concentrate on specific areas of concern, in particular:

- taxation
- legislation affecting small and mid-cap quoted companies
- corporate governance
- employee share schemes
- trading, settlement and custody of shares
- structure and regulation of stock markets for small and mid-cap quoted companies;
- political liaison – briefing and influencing Westminster and Whitehall, the City and Brussels
- accounting standards proposals from various standard-setters

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

Quoted Companies Alliance's Aims and Objectives

The Quoted Companies Alliance works for small and mid-cap quoted companies in the United Kingdom and Europe to promote and maintain vibrant, healthy and liquid capital markets. Its principal objectives are:

Lobbying the Government, Brussels and other regulators to reduce the costing and time consuming burden of regulation, which falls disproportionately on smaller quoted companies

Promoting the smaller quoted company sector and taking steps to increase investor interest and improve shareholder liquidity for companies in it.

Educating companies in the sector about best practice in areas such as corporate governance and investor relations.

Providing a forum for small and mid-cap quoted company directors to network and discuss solutions to topical issues with their peer group, sector professionals and influential City figures.

Small and mid-cap quoted companies' contribute considerably to the UK economy:

- There are approximately 2,000 small and mid-cap quoted companies
- They represent around 85% of all quoted companies in the UK
- They employ approximately 1 million people, representing around 4% of total private sector employment
- Every 5% growth in the small and mid-cap quoted company sector could reduce UK unemployment by a further 50,000
- They generate:
    - corporation tax payable of £560 million per annum
    - income tax paid of £3 billion per annum
    - social security paid (employers' NIC) of £3 billion per annum
    - employees' national insurance contribution paid of £2 billion per annum

The tax figures <u>exclude</u> business rates, VAT and other indirect taxes.

For more information contact:
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