The Quoted
Companies Alliance

The Quoted Companies Alliance's Proposals for the International Accounting Standards Board's Agenda 2011-2012

Introduction

The Quoted Companies Alliance is a not for profit organisation which works for small and mid-cap quoted companies in the UK and Europe to promote and maintain vibrant, healthy and liquid markets. The Quoted Companies Alliance is the only organisation dedicated solely to promoting and pursuing the interests and concerns of small and mid-cap quoted companies.

Through its Financial Reporting Committee, the Quoted Companies Alliance is committed to improving corporate reporting and to reducing the complexity of financial statements, which has greatly increased in recent years. It has developed a Corporate Reporting Charter (attached), setting out the principles which it considers should underpin good quality reporting.

Small and mid-cap quoted companies contribute significantly to the UK and European economy. In the UK, there are approximately 2,000 companies outside the FTSE 350 on the Main List and those quoted on AIM and PLUS, which comprise 85% of all UK quoted companies. The total market capitalisation of the small and mid-cap quoted company sector in the UK is £72 billion (as of November 2011).

Small and mid-cap quoted companies employ some 1 million people in the UK, representing 4% of private sector employment. Every 5% growth in employment in this sector could reduce unemployment by a further 50,000.

Summary of Proposals for the IASB's Agenda 2011 – 2012

1. IFRS and its impact on small and mid-cap quoted companies

- Allow small and mid-cap quoted companies to use a proportionate form of IFRS
- Undertake a project of how to simplify IFRS for small and mid-cap quoted companies
- Provide a detailed explanation as to why IFRS for SMEs not suitable for publicly accountable entities
- Examine IFRS 7 and IFRS 2 with the goal of simplification

2. The role of materiality in reducing complexity

- Consider materiality in the drafting of standards and include a statement in the disclosure section of any standard on materiality
- Highlight the importance of materiality in the new Leases and Revenue Recognition standards

3. Importance of impact assessments and post-implementation reviews

- Undertake cost-benefit impact assessments for all new standards and proposed changes to standards across a wide-range of preparers, including small and mid-cap quoted companies
- Undertake post-implementation reviews to consider how the standards are working in practice for a variety of preparers and users, including small and mid-cap quoted companies

4. Representation of small and mid-cap quoted companies on the IASB

- Ensure that board members of the IASB have recent practical market experience, which could be achieved through restructuring the requirement for full-time board members
- Ensure a greater representation of users, preparers and investors in the small and mid-cap quoted company sector on the IASB

Section 1 - IFRS and its impact on small and mid-cap quoted companies

The Quoted Companies Alliance believes that IFRS in its current form is too complex for small and mid-cap quoted companies, which is feedback we often receive from our corporate membership.

Proportionate form of IFRS for small and mid-cap quoted companies

We support the adoption of full IFRS for larger listed companies, but believe it is appropriate to recognise the difference in scale, and of resources available to small and mid-cap quoted companies, which may have a capitalisation of just a few million pounds compared to their global listed counterparts capitalised at many tens of billions of pounds.

We believe that it would be more appropriate for small and mid-cap quoted companies (both on regulated and MTFs ('exchange regulated markets') to be able to use a more proportionate form of IFRS. We believe this would lead to more meaningful accounts for investors/users and less administrative burden for these preparers.

This could be achieved, for example, through proportionate requirements in individual standards, especially those related to disclosure, greater consideration of the application of the materiality, or by allowing small and mid-cap quoted companies to use the IFRS for SMEs standard.

Another approach would be to set out the nature of information that is generally helpful on a given issue, leaving the preparers to decide on relevant disclosures that best take account of their specific circumstances - i.e. a principles-based rather than a rules-based approach to disclosure.

A specific project is needed on the application of IFRS by small and mid-cap quoted companies, which includes the input and views of both users and preparers. The Quoted Companies Alliance would be pleased to work with the IASB on such an initiative. It should be recognised that small and mid-cap quoted companies, by any definition, represent the vast majority by number of quoted companies.

We also fully support the Institute of Chartered Accountants of Scotland's (ICAS) and the New Zealand Institute of Chartered Accountants' (NZCIA) project, *Losing the excess baggage - reducing disclosures in financial statements to what's important*[1]. The project offers a practical, short-term solution to the problem of excessive disclosure. Development of a new principles-based disclosure framework is undoubtedly desirable in the longer-term, but this report acts as a stepping-stone towards achieving that goal.

We would encourage the IASB to issue the ICAS/NZICA report for public consultation. This would enable the disclosure issue to be moved along quickly in relation to the existing standards, it would be helpful to obtain the views of all of those involved in financial reporting, and the feedback obtained would provide useful input to the longer term EFRAG and FASB projects as well as informing the IASB.

IFRS for SMEs and publicly accountable entities

We also do not consider that a comprehensive case has been made as to why the IFRS for SMEs standard is not appropriate for use by publicly accountable entities or companies with a listing on a public market. It is not clear in what way the information provided does not meet the needs of users and investors of small and mid-cap quoted companies.

Specific standards that present complexity – IFRS 2 and IFRS 7

In January 2011, we undertook a survey of our corporate membership to understand more about which IFRS standards are overly complex for directors of small and mid-cap quoted companies.

[1] http://www.icas.org.uk/site/cms/download/AA/2011/Jul_11_Losing_the_excess_baggage.pdf

Out of 21 respondents who were finance directors of small and mid-cap quoted companies:

- 72.2% noted that **IFRS 7 – Financial Instruments Disclosures (for non-financial companies)** were 'complex' or 'very complex'; 50% also believed that this standard added any value to their accounts.

- 57.1% noted that **IFRS 2 – Share-based Payments (accounting)** were 'complex' or 'very complex'; 33.3% believed that this standard added no-value to their accounts.

- 42.8% noted that **IFRS 2 – Share-based Payments (disclosures)** were 'complex' or 'very complex' – with a further 42.9% classing it as 'somewhat complex'; 30% explained that these disclosures did not add any value to their accounts.

In rating the standards directors' found most complex, open-ended comments noted that often it is not just purely about 'complexity', but also about the volume of information that must be produced in relation to a standard and the lack of perceived benefit.

IFRS 2 – Share-based Payments (accounting) *and* ***IFRS 2 – Share-based Payments (disclosures)***

Directors noted some of the following reasons for complexity with IFRS 2:

- "Amounts charged do not necessarily relate simply to amounts paid. Non finance staff find it difficult to understand the application of a notional non-cash charge."

- "Achieving a meaningful measure of volatility which is consistent in its relative impact from one year to the next.

- "Decision on which financial model to use. The assessment of the assumptions underlying the model. The calculation of the charge using the model."

- "Measuring the value of the option."

- "Volume of disclosure required about relatively simple grants makes the note incomprehensible to most."

Most comments on the accounting aspect of this standard focused on calculating models and assumptions used. Most comments on the disclosure aspect of this standard noted that there were a vast amount of disclosures, which are difficult for most to understand, thus questioning the benefit of them.

We note that this project has been identified already in the IASB's Agenda Consultation 2011 as a suggested project. We support this suggestion and believe that the IASB should undertake a broader-scope project that explores re-examining the principles that underpin the standard and simplifying disclosure.

IFRS 7 – Financial Instruments Disclosures (for non-financial companies)

Directors noted some of the following reasons for complexity with IFRS 7:

- "...calculation of the fair values of simple forward exchange contracts (because derivatives)"

- "Detailed disclosures about even the most simple instruments."

- "Currency risk sensitivity..."

- "Classification of financial instruments and hedging accounting..."

By far, the main comments explained that the sheer volume of information disclosed presented the most problems with the standard for non-financial companies.

We would suggest that for IFRS 7 some of the complexity should be removed by creating two standards – one for financial institutions, which have complex instruments, and one for companies. In IFRS for SMEs, the financial instruments standard is split like this and we believe that this could decrease complexity for the majority of small and mid-cap quoted companies, which do not have complex financial instruments.

Section 2 - The role of materiality in reducing complexity

We believe that materiality could be used more to reduce complexity in reports and accounts and provide more meaningful reports to users.

We would propose that the IASB should include a statement about materiality in the disclosure section of each standard, emphasising the need for material disclosures which will vary for each business. The goal would be to ensure that preparers understand that the disclosures proposed in various IFRS standards are not 'requirements'.

We believe that this is particularly important in the context of the ongoing Leases and Revenue Recognition projects and believe that materiality should be highlighted in the new drafts of these standards.

Section 3 - Importance of impact assessments and post-implementation reviews

We very much support the Trustees Review and commitment to preparing impact assessments and post-implementation reviews of standards.

However, we would stress that impact assessments and post-implementation reviews for changes to standards and new standards must be carried out across a wide range of users, and in particular the effect of standards on small and mid-cap quoted companies should be considered and pass a cost/benefit test, as these companies make up the vast majority of all quoted companies.

Section 4 - Representation of small and mid-cap quoted companies on the IASB

We believe the requirement that the vast majority of board members be full time has, for example, had the effect that a number of the members of the IASB have not been directly involved in the business and financial communities for many years. We believe it is essential that most of the IASB members have current or, at least, very recent experience of relevant business or financial markets and that this would best be achieved by having far more part-time board members.

We also consider that greater representation is needed from those with experience as preparers or investors in smaller quoted companies. There is a vast difference in the size, nature of businesses of and resources available to small and mid-cap quoted companies compared to their global counterparts and better account needs to be taken of this in the setting of accounting standards. IFRS currently appear to be drafted solely from the perspective of global listed companies. Greater consideration needs to be given to making the requirements for small and mid-cap quoted companies proportionate to the size of the business.

The Quoted Companies Alliance

The QCA Financial Reporting Committee's Corporate Reporting Charter

» 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 smaller 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 smaller 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 smaller 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.