The Quoted Companies Alliance

The Quoted Companies Alliance
6 Kinghorn Street
London EC1A 7HW
Tel: +44 20 7600 3745
Fax: +44 20 7600 8288

Web: www.quotedcompaniesalliance.co.uk
Email: mail@quotedcompaniesalliance.co.uk

International Accounting Standards Board
30 Cannon Street
London
EC4M 6KH

7 July 2010

Dear Sirs,

**Exposure Draft ED/2009/12 – Financial Instruments: Amortised Cost and Impairment**

***INTRODUCTION***

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

The QCA Financial Reporting Committee has examined your proposals and advised on this response. A list of Committee members is at Appendix A. Our Reporting Corporate Charter is at Appendix C which details our desired principles for accounting standards.

***RESPONSE***

We welcome the opportunity to respond to this consultation.

**General comments**

The Committee has considered the provisions in the exposure draft and we agree with the proposed replacement of the incurred loss model for impairment with an expected cash flows model for financial assets measured at amortised cost. We do have concerns, however, that many smaller entities may have difficulty with the additional administrative burden arising from the detailed approach proposed. The main benefit of an expected loss approach is that we believe that it would better reflect the economic reality associated with the transactions involved.

Additionally, we note that the Expert Advisory Panel working with the IASB on the IAS 39 replacement project does not appear to be entirely representative of all entities across all the industry sectors that this new standard would affect; representation from non-financial institutions does not appear sufficient.

The Exposure Draft appears to have been prepared with financial institutions primarily in mind. We believe the IASB should undertake further consultations on whether the proposed revisions are appropriate for the vast majority of companies that are not financial institutions.

Our detailed responses to the questions posed are set out below.

**Objective of amortised cost measurement (paragraphs 3-5)**

**Question 1**
**Is the description of the objective of amortised cost measurement in the exposure draft clear? If not, how would you describe the objective and why?**

We agree that the description of the objective of amortised cost measurement is clear.

**Question 2**
**Do you believe that the objective of amortised cost set out in the exposure draft is appropriate for that measurement category? If not, why? What objective would you propose and why?**

We believe that the objective of the amortised cost is generally appropriate for that measurement category.

**Measurement Principles (paragraphs 6-10)**

**Question 3**
**Do you agree with the way that the exposure draft is drafted, which emphasises measurement principles accompanied by application guidance but which does not include implementation guidance or illustrative examples? If not, why? How would you prefer the standard to be drafted instead, and why?**

As the new impairment model is a significant change we believe it would be useful to provide implementation guidance and illustrative examples to assist with the transition to the new model.

**Question 4**
**(a) Do you agree with the measurement principles set out in the exposure draft? If not, which of the measurement principles do you disagree with and why?**
**(b) Are there any other measurement principles that should be added? If so, what are they and why should they be added?**

Question 4(a)(b): We have significant concerns regarding the use of the probability-weighted expected values for cash flow inputs.. As outlined in our responses to previous consultations, this method of estimation will result in additional work for our members, who in general have limited accounting resource available. We would suggest that leaving the method of estimation up to the preparer of the financial statements would allow for more reliable measurement that is reflective of the business and management's knowledge of historical cash flows on similar contracts. An example of this is trade receivables, where management would keep their own records of historical bad debts upon which to base their expectations for actual losses.

However, we note it is yet to be determined to what extent the Board is going to further clarify estimation techniques that are allowable / suggested for the reporting entity.

For our members, we would anticipate that there will be operational challenges in relation to estimating the timing and amounts of initial expected credit losses, particularly for those entities that will have to seek out additional external market data to apply to the measurement criteria. In addition, the management of such entities may not have the resources to deal with such data. It is requested therefore to provide more specific guidance in this area.

We do not believe it is necessary to add other measurement principles.

**Objective of presentation and disclosure (paragraphs 11-12)**

**Question 5**
**(a) Is the description of the objective of presentation and disclosure in relation to financial instruments measured at amortised cost in the exposure draft clear? If not, how would you describe the objective and why?**
**(b) Do you believe that the objective of presentation and disclosure in relation to financial instruments measured at amortised cost set out in the exposure draft is appropriate? If not, why? What objective would you propose and why?**

Question 5(a): Yes, the description of the objective of presentation and disclosure in relation to financial instruments measured at amortised cost appears clear

Question 5(b): Yes, it appears appropriate.

**Presentation (paragraph 13)**

**Question 6**
**Do you agree with the proposed presentation requirements? If not, why? What presentation would you prefer instead and why?**

For our members we do not believe it is necessary to present such a level of detail in the statement of comprehensive income; rather it may be sufficient to present net interest revenue and net interest expense on the face of the statement of comprehensive income and a reconciliation of these net figures including the expected credit losses and changes to estimates within the notes to the financial statements. This is particularly true for entities that do not have significant interest income and expense.

We also note that the proposals, which relate to the presentation of what is effectively a reconciliation of gross interest revenue to net interest revenue, taking into account initial expected credit losses and gains and losses resulting from changes in estimates on the face of the statement of comprehensive income, may simply be ‘information overload’ for the users of the financial statements and may also be confusing to the more inexperienced users.

In addition, we do not believe that the proposed presentation for expected credit losses and gains and losses arising from changes in estimates would be appropriate for non-financial services entities.

**Disclosure (paragraphs 14-22)**

**Question 7**
**(a) Do you agree with the proposed disclosure requirements? If not, what disclosure requirement do you disagree with and why?**
**(b) What other disclosures would you prefer (whether in addition to or instead of the proposed disclosures) and why?**

Question 7(a-b): If entities are already applying IFRS 7, then they would already be required to provide quantitative and qualitative risk disclosures for financial instruments. However, because the exposure draft requires an expansion of disclosure requirements in addition to existing IFRS 7 provisions, we believe that it would be too burdensome on small and medium sized listed entities operating outside the financial services industry. These entities will be required to disclose a significant amount of information (such as origination/maturity, development of allowance accounts for credit losses, qualitative information associated with credit loss estimates and so on) relating to financial assets and liabilities as a result of these proposed amendments, even if they are not considered significant to the entity's capital structure or integral to their business model. As such, for many entities, complying with the disclosures would provide little relevance and therefore little benefit to the user of the financial statements, but with significant added operational costs.

**Effective date and transition (paragraphs 23-29)**

**Question 8**
**Would a mandatory effective date of about three years after the date of issue of the IFRS allow sufficient lead-time for implementing the proposed requirements? If not, what would be an appropriate lead-time and why?**

Yes, we believe this would allow sufficient lead time to implement the proposed requirements.

**Question 9**
**(a) Do you agree with the proposed transition requirements? If not, why? What transition approach would you propose instead and why?**
**(b) Would you prefer the alternative transition approach (described above in the summary of the transition requirements)? If so, why?**
**(c) Do you agree that comparative information should be restated to reflect the proposed requirements? If not, what would you prefer instead and why? If you believe that the requirement to restate comparative information would affect the lead-time (see Question 8) please describe why and to what extent.**

Question 9(a): Yes, we agree with the proposed transition requirements.

Question 9(b): We would not prefer the customised transition approach which would provide an exception to prospective application and a modified retrospective application. In our opinion this would not represent the objective of the measurement and presentation requirements of the expected cash flow model proposed, but instead a mixture of IAS 39 and IFRS 9 using an effective interest rate under IAS 39 requirements but cash flow estimates inclusive of credit losses. This adds additional complexity and will not present users of financial statements with information that represents the economic reality as cash flows will not be representative of the corresponding effective interest rates used.

Question 9(c): We agree that instead of the alternative transition approach and regardless of the transition approach decided comparative information should be restated to reflect the proposed requirements, and, assuming a three year effective date from publication of the standard, this should not affect the lead time proposed.

**Question 10**
**Do you agree with the proposed disclosure requirements in relation to transition? If not, what would you propose instead and why?**

Yes, the transitional disclosure requirements appear broadly appropriate.

**Practical expedients (paragraph B15-B17)**

**Question 11**
**Do you agree that the proposed guidance on practical expedients is appropriate? If not, why? What would you propose instead and why?**

We believe that it should be clear that it is possible to use practical expedients where there are reasonable grounds for expecting that the impact is not material. It is important to avoid any risk of having to make the alternative calculations in order to demonstrate that the impact of using practical expedients is immaterial. There may be a case for raising the threshold above immaterial to allow that practical expedients could be used where the expected difference is not significant.

**Question 12**
**Do you believe additional guidance on practical expedients should be provided? If so, what guidance would you propose and why? How closely do you think any additional practical expedients would approximate the outcome that would result from the proposed requirements, and what is the basis for your assessment?**

We would not, for instance, support any further principles being added.

If you wish to discuss these issues with us, we will be pleased to attend a meeting.

Yours sincerely,

Tim Ward
Chief Executive

**APPENDIX A**

## THE QUOTED COMPANIES ALLIANCE FINANCIAL REPORTING COMMITTEE

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|---|---|---|
| Anthony Carey (Chairman) | - | Mazars LLP |
| Peter Chidgey | - | BDO Stoy Hayward LLP |
| Sarah Cox | - | Ernst & Young LLP |
| Ian Davies | - | Victoria plc |
| David Gray | - | DHG Management |
| Chris Ogle | - | SQC Consultant |
| Paul Watts/Bill Farren | - | Baker Tilly LLP |
| Nick Winters/James Lole | - | RSM Tenon |
| Tim Ward | - | The Quoted Companies Alliance |
| Kate Jalbert | - | The Quoted Companies Alliance |

**APPENDIX B**

## THE QUOTED COMPANIES ALLIANCE (QCA)

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

The QCA 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; Financial Services Authority (FSA) consultations
- political liaison – briefing and influencing Westminster and Whitehall, the City and Brussels
- accounting standards proposals from various standard-setters

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

### QCA's Aims and Objectives

The QCA 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 exclude business rates, VAT and other indirect taxes.

For more information contact:

Tim Ward
The Quoted Companies Alliance
6 Kinghorn Street
London EC1A 7HW
020 7600 3745
www.quotedcompaniesalliance.co.uk

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**APPENDIX C**

## 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.