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
First Floor
30 Cannon Street
London, EC4M 6XH

21 May 2010

Dear Sirs,

Exposure Draft ED/2010/1 – Measurements in Liabilities IAS 37 – Proposed Amendments to IAS 37

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

You will see from our response below that we consider that the measurement proposals suggested in the Exposure Draft will result in numerous practical challenges for preparers and will make it more difficult for our members' stakeholders to understand and interpret the liability balances included in the balance sheet.

Moreover, we are not persuaded that the proposed guidance is necessary as we are not aware of preparers, auditors or users facing significant challenges in applying or interpreting the current guidance which is based on long-standing practice in this area. We also consider the existing guidance to be aligned with the stewardship approach which we support whereby the board measures a liability at its best estimate of the amount at which it will in practice be settled and is accountable for explaining if the amount at which it is finally settled is significantly different from an earlier estimate. In our view focusing on the most likely

amount at which a liability will be settled rather than a notional amalgam of possible amounts weighted by their respective probabilities also better captures economic reality.

We note that the IASB have not requested further consultation on all the revisions to the original 2005 Exposure Draft following the updates which have been made. We did not provide comments on the original document and given the period of time that has elapsed would have welcomed the opportunity to provide comments on the measurement guidance in the context of the standard as a whole.

Question 1 – Overall requirements

Do you support the requirements proposed in paragraphs 36A–36F? If not, with which paragraphs do you disagree, and why?

We do not support the principle that additional guidance is required in relation to the measurement of liabilities and we do not support a number of the requirements proposed in paragraphs 36A-36F due to concerns about the practical implications and the subjectivity that the proposals will introduce into the financial statements. These concerns are further outlined below.

The Exposure Draft requires that the present value of the resources required to fulfil an obligation should be calculated based on a probability weighted average of the possible outcomes, adjusted by a risk adjustment. More often than not this will differ from the amount ultimately paid to settle that liability. As with our comments on the IAS 12 exposure draft in relation to uncertain tax positions we do not believe that this basis will provide information which is decision-useful and also it will not aid the evaluation of our members' financial statements by analysts and other third parties.

The requirements of the proposed standard are likely to cause additional volatility in financial performance. Outcomes with a low likelihood of occurrence, but large associated cash outflows could have a considerable impact on results, despite management not expecting to settle the liabilities for such significant amounts. To the extent that this has a detrimental impact on our members' financial position it could also impact banking covenants or require additional explanatory disclosure to manage investor relations.

The probability-weighted average approach is only practical if there are sufficient precedents to be able to estimate probability and may also require the introduction of new processes and models to calculate the value for each liability at the end of each reporting period. This will result in additional work for our members, who in general have limited accounting resource available. We agree with the approach suggested in paragraph B4 that when using a probability model an entity should not have to identify all possible outcomes to assess, however we would welcome further guidance on how entities should determine which outcomes are selected for assessment. In our opinion assessing "each possible outcome" as suggested in paragraph B3 is not a practical solution.

We believe that it may be difficult for some of our members to assess the probabilities for each outcome and obtain sufficient evidence to support those assumptions for audit purposes. The proposals will therefore result in challenges for our members in collating and documenting sufficiently robust supporting information to provide to their auditors.

The current proposals will introduce a high degree of subjectivity into the results. This will result in financial information that is not decision-useful and is difficult for analysts and other stakeholders to understand and forecast.

In addition, we note that there will be difficulty in determining the risk-adjustment to reflect the fact that the actual outflows of resources might differ from those expected. Where there is no straightforward way to ascertain how much an entity would pay to relieve itself of a particular liability, management would need to exercise significant judgement to determine how the required adjustment should be calculated or selected. .

Question 2 – Obligations fulfilled by undertaking a service

Do you support the proposal in paragraph B8? If not, why not?

We do not support the proposals in paragraph B8 for two main reasons:-

- Where there is no market for the service, the proposals require that the measurement of the liability is based on the amount an entity would charge another party including a margin. Where the liability is ultimately fulfilled by the company performing the work, this will result in the recognition of an increased liability initially and the release of an 'internal' profit at a later stage.

- Where there is a market for the service, the proposals require that the obligation should be valued based on the price a contractor would charge. Many of our members may intend to undertake services to fulfil the obligations themselves. The consequence of the current proposals is a higher liability would be recognised initially and then released when the obligation is fulfilled.

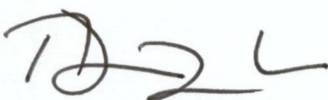
Both points above will result in a potential release of profit when the obligation is fulfilled which will be difficult to explain to analysts and other users of the accounts. We would recommend that the obligations should be measured based on management's expectation of whether they will be fulfilled by a contractor or by the company and where the company expects to fulfil the liability, measurement should be based on the expected costs of doing so.

Question 3 – Exception for onerous sales and insurance contracts

Do you support the exception? If not, what would you propose instead and why?

Yes, we would support this exception.

Yours sincerely,



Tim Ward
<u>Chief Executive</u>

APPENDIX A

THE QUOTED COMPANIES ALLIANCE FINANCIAL REPORTING COMMITTEE

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	-	Vantis plc
Tim Ward	-	The Quoted Companies Alliance
Kate Jalbert	-	The Quoted Companies Alliance

*Main Author(s)

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

-o0o-

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.