THE
INVESTMENT
ASSOCIATION
INVESTMENT MATTERS

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Dear Anna

**RE: Improving the Quality of Reporting by Smaller Listed and AIM Quoted Companies, Discussion Paper on the FRC's findings and proposals**

The Investment Association represents the asset management industry in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of approximately £5 trillion (€5.6 trillion) of assets, which are invested in companies globally. In particular, our members manage holdings amounting to just over 30% of the domestic equity market.

In managing assets for both retail and institutional investors, our members are major investors in companies that access capital from the markets. Therefore, they have an interest in the standards governing how such companies prepare their accounts and the information disclosed to them as users. The Investment Association welcomes the FRC undertaking this initiative and seeking to improve the quality of reporting by smaller listed and AIM quoted companies.

At the outset, the Discussion Paper notes a perception gap in that many smaller quoted companies believe investors do not read their annual report and, therefore, it is of little value. We disagree with this.

The annual report is a vital tool for investors in demonstrating management's accountability. Management is entrusted with shareholders' funds and the annual report should show how effectively it put those funds to use and the performance derived from those funds. An investor is more likely to provide capital if the annual report clearly conveys a company's business model and financial position, and has clear accounting policies that provide insight into management's judgements. Investors can better understand the quality of management from seeing how directors have exercised their professional judgement in determining what is important information and how it should be reported

In this context, as annual reports tend to be published some time after the events to which they relate and are backward looking, they are essentially a confirmatory document to the market. What is important is that all the other source documents, outside the annual reporting framework, which help investors assess a company's prospects, such as analyst briefings, investor meetings, strategy presentations, stock exchange announcements and non-financial information, can ultimately be referenced to the annual report that has been subject to a quality assurance – the external audit.

As acknowledged in the Discussion Paper, it is precisely because there is often little, if any, coverage by analysts and an absence of other publicly available information that the annual reports of smaller quoted companies are particularly important to investors. We recognise and agree with the issues raised in the Discussion Paper regarding the quality of reporting by smaller companies. Thus whilst in general the annual reports of smaller listed and AIM quoted companies are received on a timely basis and are of a reasonable standard, there are more instances of poor quality reports from such companies, as compared to their larger counterparts, and room for improvement in key areas (question 1).

We also largely agree with the actions proposed by the FRC and consider they are (i) a proportionate; and (ii) an adequate response to the issues identified (question 2). However, we caution against the expectation that there should be more pressure on investors to provide feedback on smaller quoted companies' annual reports. Investors in certain instances provide feedback and particularly engage if they have concerns about an annual report and/or how management has exercised judgement. But as noted above, the annual report is largely a confirmatory document produced months after the events to which it relates. Whilst there may be a perception that investors neither read accounts nor value them, it is more likely that the reverse is true and that the absence of feedback is an indication that the information is trusted and as such, is valued. We set out our more detailed comments on the proposed actions in the attached Annex.

I trust that the above and the attached is self-explanatory but please do contact me if you require any clarification of the points in this letter or if you would like to discuss any issues further.

Yours sincerely

Liz Murrall
Director, Stewardship and Corporate Reporting

THE INVESTMENT ASSOCIATION'S VIEWS ON THE FRC'S PROPOSALS TO ASSIST SMALLER QUOTED COMPANIES

Set out below are The Investment Association's views on the FRC's proposals to assist smaller quoted companies.

**Communications with investors**

The Discussion Paper notes a perception gap as to the value of the annual report in that many smaller quoted companies believe investors do not read their annual report and, therefore, it is of little value. We disagree with this.

In fact the annual report is a vital tool for investors in demonstrating management's accountability. Management is entrusted with shareholders' funds and the annual report should show how effectively it put those funds to use and the performance derived from those funds. An investor is more likely to provide capital if the annual report clearly conveys a company's business model and financial position, and has clear accounting policies that provide insight into management's judgements. Investors can better understand the quality of management from seeing how directors have exercised their professional judgement in determining what is important information and how it should be reported

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As acknowledged in the Discussion Paper, it is precisely because there is often little, if any, coverage by analysts and an absence of other publicly available information that the annual reports of smaller quoted companies are particularly important to investors. In this context we share the FRC's concerns. Thus whilst in general the annual reports of smaller listed and AIM quoted companies are received on a timely basis and are of a reasonable standard, there are more instances of poor quality reports from such companies, as compared to their larger counterparts, and room for improvement in key areas.

We, therefore, welcome the FRC's proposals to:
- provide focused annual reminders setting out the key areas of focus for investors, common errors and suggestions for improvements;
- look for opportunities to facilitate greater dialogue between smaller quoted companies and investors, for example through roundtables and similar initiatives; and
- encourage more participation by smaller listed and AIM companies and their investors in the practical work of the FRC's Financial Reporting Lab.

However, we would caution against the expectation that there should be more pressure on investors to provide feedback on smaller quoted companies' annual reports. Investors in certain instances provide feedback and particularly engage if they have concerns about an annual report and/or how management has exercised judgement. But as noted above, the annual report is largely a confirmatory document produced months after the events to which it relates. Whilst there may be a perception that investors neither read accounts nor value them, it is more likely that the reverse is true and that the absence of feedback is an indication that the information is trusted and as such, is valued.

**Resourcing**

We recognise that resource constraints are one of the key challenges for smaller quoted companies and welcome the FRC's proposals to:

- discuss with the accountancy and audit Professional Bodies and others, ways of providing more focussed training to finance staff to fulfil CPD requirements;
- discuss with the accountancy and audit Professional Bodies whether the CPD regime could do more to support finance staff in keeping up to date with reporting requirements; and
- against the backdrop of the implementation of the EU Audit Regulation and Directive, review whether the process of granting Responsible Individual status could be improved to ensure that audit partners are suitably qualified and experienced to carry out audits of listed or AIM quoted companies.

**AIM companies**

The Investment Association considers it important that small quoted companies that raise capital through listing provide high quality information to enable investors to assess their performance and prospects. We believe the same or equivalent standards should apply to all quoted companies and that this is one of the costs of accessing capital from the markets.

A recent development that investors have particularly valued is the extended audit report required of auditors of companies that apply, on a comply or explain basis, the UK Corporate Governance Code. If non-Code companies, such as those quoted on AIM or with a Standard Listing, adopted similar requirements we believe it would have a positive impact on the quality of engagement and reporting. We would welcome this being encouraged.

**Corporate Governance**

The Investment Association recognises that smaller quoted companies can have resource constraints and welcomes the FRC's proposals to provide guidance for audit committees on evaluating a company's financial reporting function and other focused guidance. In this context, we agree a non-executive with recent and relevant financial expertise could add significant value to the reporting process. Whilst the FCA's Disclosure and Transparency Rules (DTRs) require that for listed companies at least one member of the audit committee has competence in accounting and/or auditing, AIM companies are not required to apply the DTRs or, on a comply or explain basis, the UK Corporate Governance Code. We would welcome them being encouraged to consider the principles of accountability in Section C of the Code.

**Consistent Financial Reporting Framework**

Small quoted companies that raise capital through the markets need to provide high quality financial information to enable investors to assess their performance and prospects. The Investment Association prioritises market integrity, meaning that the same accounting standards should apply to each and every company that access the capital markets. Our preference is for international consistency, which is achieved by adherence to IFRS. IFRS reporting is widely understood by investors and it is generally accepted that, while not perfect, IFRS provides quality, comparable information. In this context, we welcome the FRC's proposals to address a lack of comparability in respect of the capitalisation of assets and revenue recognition or in the use of alternative performance measures and to:

- highlight the Financial Reporting Lab's Accounting Policy report to smaller quoted companies emphasising the need for companies to clearly identify and explain their significant accounting policies to investors;
- highlight our press notice on alternative performance measures to ensure that any such measures are clearly explained with a proper reconciliation to statutory profit; and
- seek to influence European and international developments relating to alternative performance measures such as ESMA's Guidelines to ensure that it addresses investors' concerns in this area.

**Materiality and disclosures**

The report and accounts has two parts, financial and narrative sections. Whilst it is not a matter of numbers vs. narrative, the accounts as whole could be more cohesive and better integrated. The increasing number of reporting requirements and the length of annual reports and accounts – reporting has become more complex – is a concern. More information is not necessarily better, just as less information is not necessarily better; instead better quality information is needed.

Many smaller quoted companies would benefit by removing immaterial information that clouds more relevant information. From a recent meeting, we understand that companies can be reluctant to remove immaterial information as this can result in a letter from the CRRP. We would encourage a system of pre clearance with the CRRP on removing immaterial disclosures.