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Dear Ms Colban and Mr Fitz-Gerald

Improving the Quality of Reporting by Smaller Listed and AIM Quoted Companies

Deloitte LLP is pleased to respond to 'Improving the Quality of Reporting by Smaller Listed and AIM Quoted Companies: Discussion Paper on the FRC's findings and proposals'. We have set out our detailed responses to the questions raised in the Discussion Paper in the Appendix to this letter.

Overall we support the FRC's initiative to explore ways in which the quality of reporting by smaller listed and AIM quoted companies ('smaller quoted companies') could be improved. Our key comments, which we expand on in the appendix to this letter, are as follows:

- we recognise and relate to the issues raised in the Discussion Paper and the challenges faced by smaller quoted companies;
- despite these challenges we are pleased to note that the FRC has concluded that the quality of reporting by smaller quoted companies is generally of good standard, so the focus is on improving;
- we agree a company wanting the benefits of being quoted must comply with the additional regulation and transparency that it brings. However, we agree that this is more challenging for smaller quoted companies which typically have fewer resources to dedicate to this compared to their larger counterparts;
- the success of the proposals relies on buy-in from the smaller quoted companies. They need to understand and recognise the benefit of good corporate reporting, including a reduced cost of capital. In that regard, active investor engagement and feedback on company annual reports is critical to changing behaviour;
- we believe the tone of any communications or guidance to smaller quoted companies should balance the technical reminders with the desire for clear and concise reporting, i.e. that companies are not being asked to do more, but in light of the changes to IAS 1 on materiality, freeing up time to do the things that matter better; and

- in respect of the role of the auditor, we treat larger and smaller quoted companies equally. We have, however, taken the areas of suggested improvement, including consideration of the sophistication of the audited entity's financial and narrative reporting resourcing and expertise, into account when developing our quality and learning plans for the current year.

We would be happy to discuss our letter and the draft proposals with you. If you have any questions, please contact Amanda Swaffield on 020 7303 5330 or aswaffield@deloitte.co.uk.

Yours sincerely

A handwritten signature in black ink, appearing to read 'V Poole', with a stylized flourish at the end.

Veronica Poole
National Head of Accounting and Corporate Reporting
Deloitte LLP

Appendix

Detailed responses to questions

Question 1 To what extent do you recognise and agree with the issues raised in the report regarding the quality of reporting by smaller quoted companies?

We recognise and agree with the issues raised in the Discussion Paper.

The Discussion Paper refers to 'promoting high quality/good quality corporate reporting' but it doesn't make it clear how quality translates into the smaller quoted company environment. It would be helpful for the FRC to provide examples of what high quality reporting looks like in a smaller quoted company so that preparers are clear about how they could be 'better'.

Question 2 Do you consider that the actions proposed are (i) a proportionate response to the issues identified; and (ii) an adequate response to the issues identified?

Yes, we are broadly supportive of the suggested actions. Many of the actions are dependent on companies being engaged in the idea of improving the quality of reporting, so increasing engagement and getting their buy in will drive the success of the proposed actions.

Quite a few of the actions are in the form of reminders from the FRC. Whilst reminders are helpful, it is worth exploring perhaps why new or changed requirements weren't actioned by smaller quoted companies when first communicated. If it is due to the volume of information/updates/newsletters that finance teams receive, the way such reminders are communicated should be given consideration.

We comment on some of the proposed actions suggested in the Discussion Paper below:

Communications with investors

Investors are the primary users of the annual report. We believe that investors should engage with and provide feedback to smaller quoted companies, unprompted or otherwise. We don't believe it is purely the responsibility of the FRC to create pressure on investors – companies should be encouraged to seek feedback directly. The Investor Forum could be a good mechanism to get a direct message around the importance of the annual report across from investors to smaller quoted companies; the FRC might also consider the provision of investor feedback to companies when next updating the Stewardship Code.

We recognise there may be a different perception gap for AIM company investors and smaller listed company investors. Some AIM companies have concentrated shareholder bases with whom they communicate regularly so they put less importance on the annual report for this reason; others have broad shareholder bases with less interaction who rely more on the company's formal reporting.

Encouraging companies to engage with investors and the activities of the Lab is a good idea. The challenge will be getting the CFO engaged when faced with competing priorities due to resource constraints. We note that the FRC is reaching out to existing forums for smaller quoted companies, e.g. the QCA as part of this initiative and we suggest it would be useful for them to get feedback on the level of engagement those forums experience, to consider whether those companies where reporting is considered of lower quality are or are not represented, and the possible barriers to participation by smaller quoted companies.

Various regular reminders are currently provided by the FRC, e.g. the Corporate Reporting Review team's annual report. The key here, as noted above, is to carry out some causal factor analysis to determine why the messages aren't always taken on board. Perhaps the communications could balance the key areas of focus with explaining how the FRC can reduce burdens on companies, for example by

encouraging companies to leave out immaterial disclosure freeing up time to spend focusing on material disclosures.

Resourcing

We agree that resourcing and quality of resource is a challenge faced by smaller quoted companies. Many smaller quoted companies are likely to treat corporate reporting as a compliance exercise as the limited resource is focused on building the business.

We note that the firms and professional bodies already provide a significant amount of guidance focused on smaller quoted companies. However, it would be helpful if the FRC could provide guidance on what smaller quoted companies should prioritise in terms of 'improving quality' so that companies could focus on the areas of greatest benefit.

AIM companies

We believe that the London Stock Exchange should be working with Nomads to ensure that Nomads emphasise the importance of good quality corporate reporting both in preparation for admission to trading and on an ongoing basis. Whilst reporting accountants are normally engaged to provide a "comfort letter" on financial position and prospects procedures to the Nomad prior to admission to trading, there is rarely any ongoing challenge of AIM companies by their Nomads as to whether such processes continue to be applied or need updating. We suggest that Nomads be encouraged to check each year with their client that procedures are fit for purpose, the finance team has the knowledge they need etc. This process need not be overly burdensome or involve formal auditor comfort, but could act as a useful reminder to CFOs and audit committees. Often it is left to the auditors to challenge the firm's procedures.

Corporate Governance

From a corporate governance perspective a key focus has to be on getting suitably qualified and experienced people onto the audit committee. The audit committee should be using their knowledge and experience from other organisations to drive improvements in the quality of reporting. Where this knowledge and experience is lacking then the audit committee members should look to the FRC and/or their auditors for tools and resources on "what good looks like". Audit committees also have a role to play in challenging whether the CFO has been given appropriate resource to prepare good quality reporting.

As part of their communication around the importance of annual reports, the investors could also stress that they see the audit committee as their key agent in driving this improvement.

Application of materiality and disclosures

With regards to a differentiated disclosure framework for smaller quoted companies, the section in the Discussion Paper on 'Consistent Financial Reporting Framework', states that there is a strong consensus that IFRS should remain the reporting framework for all listed companies, including AIM. This seems inconsistent with the suggestion that yet another disclosure framework for a subset of companies should be developed, particularly given that AIM moved to IFRS in response to investor demand.

In our response to the EC Green Paper: Building a Capital Markets Union we stated our strong belief that a full listing on a regulated market means greater transparency and we in fact encouraged the EC to extend IFRSs to the individual financial statements of a fully listed entity, for example the many investment trusts that do not prepare consolidated financial statements. Accordingly, we would strongly disagree with any suggestion that the scope of the IAS Regulation should be narrowed to only larger companies admitted to trading on a regulated market.

Our response to the EC Green Paper also supported the idea of a common set of accounting standards for small and medium-sized companies (SMEs) admitted to trading on an MTF (as opposed to a

regulated market), to enable comparability and a level playing field among such companies. However, we acknowledged there are limitations that need to be considered carefully in determining if a new framework might be appropriate and therefore at this stage full IFRSs should not be imposed on such companies.

Role of the auditor

Our methodology, quality control procedures and learning treat larger and smaller quoted companies equally. However, we recognise the issues that are set out in the Discussion Paper with regard to the role of the auditor. Our own causal factor analysis as a result of external inspection and internal monitoring findings has highlighted the challenges to audit quality acknowledged in the FRC's own Audit Quality Framework around the preparer's resource, experience and knowledge. This includes the impact on the quality of the financial statements when the first draft is only provided to the auditor late in the timetable.

We have, accordingly, taken the FRC's areas of suggested improvement, including the auditor's assessment of the sophistication of the audited entity's financial and narrative reporting resourcing and expertise, into account when developing our quality and learning plans for the current year.

It would be helpful if the FRC could encourage companies to take on board suggestions for improvements from auditors given the expertise they have in corporate reporting.

The Discussion Paper acknowledges that there may be a need for clarification around the role the auditor is permitted to play in supporting smaller quoted companies, while still remaining in compliance with the ethical standards. We would welcome such guidance.

We do not believe a separate 'badge' for Responsible Individuals auditing listed companies is necessary and doing so would be inappropriate. For example, it is likely that a large private company audit with many complex issues would present more challenges to the auditor than a simple smaller listed company. It should be left to audit firms to determine the appropriate audit engagement partner, EQCR reviewer and engagement team to allocate to each client, with perhaps a reminder to firms that to reconsider each year the competence of teams to carry out the audit of an entity (for example, a newly listed company that has moved from UK GAAP to IFRS and has to apply additional auditing requirements relating to corporate governance status) and that once RI status is given it should be revisited on a regular basis.