Smaller companies' reporting practices
Consultation response from the UK Shareholders' Association

General

1. Paragraphs 6 and 7 on page 6 are unsatisfactory. The first and last sentences of paragraph 6 read like a standard 'could do better' school report. How is one to relate "not fundamentally flawed" with "higher incidence of poorer quality annual reports"? The fundamental issue for *private* investors – many of whom focus on smaller companies for long term savings growth – is that it is in a company's annual report that they should find reliable information on which they can base their assessment of value; there should therefore be no shades of grey. The discussion paper acknowledges the significance of allowing AIM companies in ISAs, but does not appear to draw the surely obvious conclusion that as only individuals can invest in this way their needs should have special care – as indeed is strongly suggested by the statistics quoted on page 10 (87% and 27%).

2. UKSA's participation in the project after it was already quite far advanced, the orientation of the published discussion paper and the tenor of comments from the panel at the Barbican event on July 9 have all given the UK Shareholders' Association the impression that the needs of private investors have been inadequately understood. For example, little attention has been paid in the discussion paper to what should be the fundamental importance of a clearly written and to-the-point strategy report: this may be the fault of the respondents, but it is surely evident to the FRC that some smaller company directors have no concept of strategy at all and yet, for such companies, where the track record may say little about the intended direction, a forward looking statement is essential. Describing a company's business model is not the same thing as describing the directors' objectives and how they plan to achieve them.

3. If the FRC is serious about improving smaller company reporting – which we sincerely hope it is – it should also be active in extending the requirement for a strategic report to AIM companies (which we understand are not regarded as 'quoted' companies and therefore not subject to the relevant regulation). We also strongly suggest that the FRC's position on strategy reports should be revisited, as it has turned 3 clear pages of regulation into 30 pages of guidance plus four appendices – a daunting prospect to read, let alone study.

4. We also observe at this point that no regard has been paid to the readability of smaller company reports, whether on paper or on screen. We have begun to draw attention to our serious concerns about this in a general sense, but the problems are more evident in the smaller company sector. Too many smaller companies treat their annual reports as sales documents rather than as reports to their investors, whose needs should be paramount. Easily readable figures and narrative are far more important than pictures (except of the directors) and 'clever' design.

5. The UK Shareholders' Association welcomes the FRC's intentions concerning "communications with investors" set out on page 21, but wonders how it envisages applying "pressure" to private investors to provide feedback to company directors. We draw the FRC's attention to the increasing difficulties faced by private investors, whether in ISAs, SIPPs, other nominee accounts or even with their names on company share registers, in obtaining company reports. Although the FRC withdrew its 2011 proposal to abolish the publication of printed reports, it has done nothing to stem the tendency of companies to make maximum use of the 2006 Companies Act to discourage the desire for paper reports, nor has it used its influence to encourage companies to ensure that individual investors in nominee accounts are easily able to obtain them and we wonder whether it is among those pressing for Part 9 of the Companies Act to be extended to AIM companies.

6. These are matters on which the UK Shareholders' Association would welcome the FRC's assistance and, as much as we are able with our limited resources (being an organisation supported only by members' subscriptions) we would be glad to help the FRC find ways in which investors with their own money in smaller companies could be enabled to provide the feedback the FRC intends to seek.

Accounting matters

7. We welcome the FRC's commitment, on page 8, to consider improving the ability of auditors to be more supportive of directors' efforts to provide better quality annual reports. We do not want to see the principle of auditor independence compromised, but that should not inhibit reports to management pointing out areas for improvement and how these might be tackled. This requires careful judgement, but investors' needs should be the primary concern. We endorse the FRC's findings at the top of page 13, providing this does not result in pointless duplication of work. It is of course fundamental to good financial reporting to have a sound and appropriate management information and accounting system in place.

8. When considering what to disclose in annual reports, companies should not be influenced by any potential effect on the share price. Concern about share price is deeply corrupting: companies should want the share price to be fair as between buyers and sellers.

9. Although the discussion document notes the relatively low quality of directors that can be found in smaller companies – eg the second paragraphs of 3.3.2 and 3.3.3 – the steps which the FRC is proposing to take because of this seem unduly limited. The UK Shareholders' Association has no specific proposals to make, but good governance cannot be achieved if directors are not up to the job so the matter at least merits study.

10. The FRC has encountered criticism of the effect of the longer reporting period allowed to AIM companies, but has not declared its intention to take up the matter with a view to reducing the period. It is not obvious to us why such an extended period should be allowed and repeating the FRC's own finding that smaller company reports matter more to investors – especially private investors – than those of fully listed companies, this is surely an aggravating factor which should receive attention.

Eric Chalker, Policy Director, July 31 2015