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The Quoted
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16 May 2006

Dear Mr Lee,

Comments on the Exposure Draft ED8 Operating Segments

Introduction

The Quoted Companies Alliance (QCA) is a not-for-profit membership organisation dedicated to promoting the cause of smaller quoted companies ("SQCs"), which we define as those 2,000 quoted companies outside the FTSE 350 (including those on AIM and Ofex) representing 85% of the UK quoted companies, and 25% of EU quoted companies, by number. Their market capitalisations tend to be below €500m.

We are the only UK organisation dedicated solely to promoting and pursuing the interests and concerns of SQCs.

We welcome the opportunity to comment on the exposure draft ED8.

This response has been produced by the QCA Accounting Standards Committee, a list of Committee members is detailed at Appendix A.

Response

We would like to make the following general points:

- The QCA has always been supportive of changes to the financial reporting regime if those changes could demonstrably achieve a balance between improved shareholder understanding, commercial reality and additional administrative burden for the preparer. We do not believe that ED8 achieves that balance.

- We are anxious to avoid a "one size fits all" approach being taken in IFRS, and to move toward standards that reflect the realities of growing businesses.

  The QCA is opposed to a standard being imposed that, whilst designed to enhance shareholder information, will in fact have the perverse effect of potentially destroying shareholder value in some instances. We recommend that companies may withhold full compliance with ED8 if disclosure risks competitive damage, and the Board explains the reasons on a 'comply or explain' basis as accepted for corporate governance matters.

In this regard, we wish to propose that for companies with a market capitalisation during the reporting year below €500 million (or a figure to be agreed), that the Directors of that company may be excluded from providing segmental analysis of the business if they believe it would be prejudicial to the commercial interests of the company. This would be under a provision similar to that widely accepted for Corporate Governance for the Board to 'comply' with ED8 or 'explain' why they have not.

We suggest this is an acceptable proposal as ED8 is not a matter of accounting principle but of disclosure. Financial markets will censure companies who take undue advantage of such an opt-out.

- Whilst most QCA members recognise the ultimate logic of international accounting standards for Listed companies worldwide, the pace of such change and the consequential cost of compliance concern them. Given the significant burden imposed on UK business in complying with IFRS, QCA believes that regardless of its virtues, ED8 is, at this time, an unnecessary addition to the reporting regime.
- QCA believes that global business and academic interest has overtaken general commercial reality in the standard setting process. For example, for most UK Listed companies and particularly QCA's constituency, convergence with US GAAP is of no practicable interest. The proposed introduction of a disclosure standard that is aimed at convergence with US GAAP is unwelcome.
- In earlier discussions about the proposals for ED8, it was argued that when SFAS 131 was introduced in the US and Canada there was no evidence, or claims, of commercial harm to smaller companies through segment disclosure. We contend that this is not a 'like for like' situation as EU small caps (who number several thousand) tend to be earlier stage, very much smaller and are under €500 million market cap whereas in the US businesses of $5 billion are rated as small cap.
- Financial accounts should continue to be prepared primarily for shareholders with a view to enabling those shareholders and not for investors. Under UK company law, shareholders appoint directors to manage affairs on their behalf. This arrangement has many benefits, not least of which is that commercially sensitive information is, to a certain extent, protected. Furthermore, moves towards increased disclosure for the benefit of professional investors has complicated financial statements to the extent that most private investors/shareholders no longer understand them.

Of the six questions on which responses are sought by the IASB, QCA has addressed only the first on the basis that it believes, for the reasons set out above, ED8 to be an unwelcome and unnecessary addition to the rapidly changing financial reporting regime with which UK Listed companies are expected to comply. Specifically we are concerned that if implemented, it may not achieve its objective, it will almost certainly further complicate published financial statements and may, if implemented, expose our members to competitive risk.

Question 1 – Adoption of the management approach in SFAS 131 issued by the US Financial Accounting Standards Board. Is this approach to segment reporting appropriate? If not, why not? What, if any, alternative approach would you propose?

Response

SFAS 131 is a disclosure standard and therefore does not affect the reconciliation of IFRS amounts to US GAAP, though additional disclosure might be needed to comply with US GAAP. QCA does not believe therefore that ED8 is necessary. Additionally QCA questions the usefulness and relevance of a management approach to segmental reporting. We believe that in adopting a management approach there is significant risk that information reported would not be prepared in accordance with accepted GAAP and that summarised information would be distorted by the aggregation of unlike items.

For many enterprises, a “management approach” to segmental reporting will result in more segments being reported and significantly more information being disclosed than is presently required. Whilst QCA accepts that the incremental costs of preparing the information may be negligible, it is concerned that there is potential for competitive harm. Specifically, Listed companies may be at a disadvantage to non-Listed businesses, foreign competitors that do not have to disclose segment information or larger groups that, whilst reporting under IFRS are of such a size and have such a diverse range and mix of products that no meaningful information could be inferred from analysis of margins. By way of example, smaller quoted companies involved in defence, and early stage pharmaceutical industries, rely on a degree of confidentiality over the distribution and profitability of particular product lines until they are sufficiently well established. This is important to help build a commercial lead in the marketplace and is clearly also in the interest of its shareholders. Large private companies competing with our members are not required to disclose and early stage development of similar products in a large Listed Companies are unlikely to be as obvious. We believe therefore that smaller quoted companies will be at a distinct disadvantage.

There is evidence of widespread concern amongst our membership and set out below are some examples raised by companies in the context of IAS14. Those concerns are equally valid in the context of ED8. We believe that if ED8 was to be introduced there would be a temptation to protect commercially sensitive information by running two sets of management reports, one of which would be used for the decision making process and the other for the purposes of segmental reporting. This would, of course, be counter-productive.

Company Response A

- We have a Marine Safety division whose market is extremely competitive on a global basis and information re margins is likely to be utilised by competitors.
- We may feel so aggrieved by the proposals that we may consider accepting a qualification from audit rather than disclosing information.

Company Response B

- We would just like to add this company’s voice to express our grave concern about segmental accounting and the fact that under the new rules there is no exemption on the basis of commercial sensitivity. There are very few quoted finance houses and the majority of our competitors are unquoted subsidiaries of major banks that do not have to make such disclosures. In addition, we operate through a network of brokers and those who account for a larger share of our business might be able to identify the fact as a result of segmental accounting, perhaps on a regional basis, and therefore press for better terms.

Company Response C

- In our particular case, having just made a big show of moving to ‘Product Line’ management rather than ‘Geographical’ management, we would have no choice other than to use product lines as our primary segmental analysis.
- From a competitive point of view there are also issues. We have never given any information by product line, other than sales and an indication of which product lines have gross margins about or below the average. Giving operating profit and return on assets information by product line would give our competitors and our customers far more insight into our business. We may see this information being used against us in a competitive situation to the detriment of our financial results. It would be ironic if information that is supposed to improve investor visibility actually led to reduced investor returns.

- Many of our competitors would be able to avoid showing comparable segmental information due to their status as private companies, their divisional structure or their geographical location. The new visibility would not be reciprocated.

Company Response D

- The key elements in good accounting standards enable the reader to understand the nature of the business, assess the financial trends, give consistency, clarity and transparency and be confident that the statements have been properly prepared.
- For a company such as ours…this would result in disclosure that is prejudicial to our commercial interests, and therefore question the rationale behind the IFRS – especially as the financial statements are primarily for the shareholders, whose wealth we are potentially compromising by preparing those financial statements.

Company Response E

- We are fundamentally against the proposals for segmental reporting. The inter net has made a great deal of information readily available to many people and this includes the information contained in the Annual Report. We believe it is very important to have good communication with all stakeholders but we would never dream (ordinarily) of providing information which allowed a competitor to get a clear unambiguous picture of the margins we earn from our different products and how those margins are changing.

Company Response F

- Our major competitors are two companies owned by large privately owned American entities and one large privately owned UK Company. None of these three businesses segment account or are likely to. Our segment disclosure may provide these three companies with competitive information that they would otherwise not be privy to.

We hope the IASB will consider seriously the arguments and examples included, and provide some flexibility.

If you would like to meet at some stage with myself, and representatives of both producers of accounts, and their users – the investors, then I would be very happy to arrange it.

Yours sincerely,

John Pierce

John Pierce
<u>Chief Executive</u>

cc: UK Accounting Standards Board
Ulf Linder – European Commission
Commissioner McCreevy, European Commission
European Financial Reporting Advisory Group (EFRAG)
Department of Trade & Industry (Accounting Regulatory Committee)
HM Treasury
Institute of Chartered Accountants in England and Wales (ICAEW)

APPENDIX A

Members of the Quoted Companies Alliance Accounting Standards Committee

Tim Gordon (Chairman)	Ernst & Young LLP
Edward Beale	City Group plc
Anthony Carey	RSM Robson Rhodes LLP
Peter Chidgey	BDO Stoy Hayward LLP
Paul Clarke	Fuller Smith & Turner PLC
John Edwards	MGI Wenham Major
David Gray	Dowlis Corporate Solutions plc
Harriet Mossop	Ernst & Young LLP
Chris Ogle	Flomerics plc
Richard Portman	Dignity plc
Paul Rayner	Chemring Group plc
Nick Winters	Vantis Numerica LLP
John Pierce	Quoted Companies Alliance