1 December 2006

Our ref: ICAEW Rep 66/06

Your ref:

AIM Notices
London Stock Exchange
10 Paternoster Square
London EC4M 7LS

By email: aimnotices@londonstockexchange.com

Dear Sirs

LONDON STOCK EXCHANGE AIM NOTICE 24

The Institute of Chartered Accountants in England & Wales is pleased to respond to your request for comments on London Stock Exchange *AIM Notice 24 AIM Rules for Companies, AIM Rules for Nominated Advisers* and *AIM Disciplinary Procedures and Appeals Handbook.*

Please contact me should you wish to discuss any of the points raised in the attached response or alternativly contact Katerina Joannou, Capital Markets Policy Manager in the Corporate Finance Faculty on katerina.joannou@icaew.co.uk.

Yours faithfully

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ICAEW representation

ICAEW REP 66/06

AIM RULES FOR NOMINATED ADVISERS AND OTHER PROPOSED RULE AMENDMENTS

Memorandum of comment submitted in December 2006 by The Institute of Chartered Accountants in England & Wales, in response to London Stock Exchange AIM Notice 24 published in October 2006

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INTRODUCTION

1. The Institute of Chartered Accountants in England & Wales (the 'Institute') welcomes the opportunity to comment on the consultation paper in *AIM Notice 24* published by the London Stock Exchange (the 'Exchange').

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 128,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures these skills are constantly developed, recognised and valued.

MAJOR POINTS

Support for the Initiative

4. We support the lighter touch disclosure and financial reporting requirements, as compared to those required under the full Prospectus Directive Regulations, in particular as set out in Schedule Two of the AIM Rules for Companies. However we believe there remains lack of clarity of the requirements for reporting in the key areas of pro forma financial information and profit forecasts (paras 11 - 14).

5. We are in favour of the increased emphasis on disclosure and transparency of information to be included on an AIM company's website, under Rule 26 of the AIM Rules for Companies. The information, must of course, be accurate, subject to review, and kept up to date at all times so that investors can make their own judgements on a caveat emptor basis.

6. We are however concerned at the proposal to make public the contents of the nominated adviser's declaration to the London Stock Exchange, because of the risk of misleading readers of the admission document and the declaration (paras 15 - 16). We would also encourage more detail in the rules on the persons responsible for an admission document (paras 17 - 18).

7. We agree that, when assessing the appropriateness of an applicant company and its securities for AIM, nominated advisers should also consider the adoption of appropriate corporate governance measures. We firmly believe that the assessment of corporate governance measures should be an ongoing responsibility. While the Combined Code on Corporate Governance ('the Combined Code') does not apply

to AIM companies, we believe that application of its principles and compliance with the general approach taken by its provisions should be an aspiration for the boards of AIM companies, particularly those that aspire to a listing on the Main Market. We believe there is a case for guidance for assessing the continuing application of good corporate governance of AIM companies, including the application of the Combined Code's 'comply or explain' regime, and that such guidance should also be a reference for the AIM company's board (paras 19 - 21).

8. We welcome the codification in the AIM Rules for Nominated Advisers of what, we believe, is best practice in the performance of nominated adviser duties. However we are concerned at the proposal to introduce a general standard of due and careful enquiry for preparation of an admission document (paras 25 - 26). Moreover we feel that the Engagement Responsibilities for new nominated advisers to an existing AIM company may not always be in the interest of the AIM market (paras 27 - 30).

9. The reputation of the London markets is crucial. The Exchange must satisfy itself that these new rules achieve the right balance between:

   - on the one hand, preserving the lighter touch regulation status of AIM, thus continuing to ensure its attractiveness, from a regulatory burden and cost perspective, to possible new entrants as well to existing companies; while

   - on the other hand, being sufficient to protect the reputation, individually of AIM and collectively, of the London markets.

10. We have no comments to make on the AIM Disciplinary Procedures and Appeals Handbook.

COMMENTS ON AIM RULES FOR COMPANIES

Schedule Two (b)

11. If an issuer chooses to include pro forma financial information in an AIM admission document in accordance with Schedule Two (b) Annex I, subsection 20.2, the AIM Rules for Companies are silent on whether an accountants' report must be prepared on that pro forma financial information. As a result there is inconsistency in market practice on reporting on pro forma financial information. We consider that the AIM Rules for Companies should include some form of guidance, if not a rule, within Schedule Two on this matter.

12. If there were clarity on the reporting requirement on pro forma financial information, this would then enable formal application of the framework of SIR 4000 (reporting on pro forma financial information). At the moment there is inconsistency in the market and no requirement for SIR 4000 to apply when a reporting accountant does report publicly on pro forma financial information although it is usually used as best practice.

Schedule Two (b) and (d)

13. Although profit forecasts are rare in AIM admission documents, the AIM Rules for Companies are unclear as to whether an accountants' report must be prepared on a profit forecast included in an AIM admission document. The guidance note to Schedule Two (d)(iii), however, states that the Exchange would "expect" the nominated adviser confirmation in connection with this rule to be "… founded upon an appropriate basis such as an accountants' report". We consider that this factor is too important to be left as a guidance note and should be incorporated into the rules themselves with clarity on what is expected by way of an accountants' report.

14. This would also make it clearer for the application of SIR 3000 (reporting on a profit forecast) when a reporting accountant does agree to report publicly on a profit forecast.

Schedule Two (e)

15. The proposal to make public the contents of the nominated adviser's declaration to the London Stock Exchange would appear to alter significantly the nature of the role. While there may be a clear understanding between the nominated adviser and the London Stock Exchange of the meaning of the term "appropriate to be admitted to AIM", it is much less clear that the meaning of the term would be apparent to readers of the admission document. The term is not defined in the AIM Rules but is understood, in the context of a nominated adviser's declaration, to be a confirmation that the conditions for admission have been met.

16. There is a distinct danger that a reader of an admission document would read more into the term, for example that the securities were a suitable investment, which would not be the intention of either the nominated adviser or AIM. The proposal might therefore run the risk of misleading investors and we are of the view that the declaration should remain what it has always been - a private communication between the nominated adviser and the London Stock Exchange.

Guidance notes to Schedule Two

17. The AIM Rules for Companies do not set out the persons responsible for an admission document. This important issue is often raised when negotiating terms of engagement between reporting accountants and nominated advisers.

18. The second paragraph of the guidance notes to Schedule Two states "The persons responsible for the information provided in the admission document are the same persons that would be responsible for the information contained in a Prospectus pursuant to the Prospectus Rules". We would propose that the wording used in the Prospectus Rules to define those persons and to detail their responsibilities, be embodied in the AIM Rules for Companies, for the avoidance of doubt.

COMMENTS ON AIM RULES FOR NOMINATED ADVISERS

Schedule Three - Admission Responsibility AR2 Directors and Board

19. Shareholders expect companies in which they invest to be properly governed. A good culture of corporate governance within a company is also important to help ensure that the company is run for the benefit of its shareholders. In the case of companies listed on the Main Market, the corporate governance oversight role is partly undertaken by institutional investors. Investors in companies on AIM will not be so involved in this oversight role and this places additional onus on nominated advisers and their ongoing responsibilities.

20. We note that the only reference to corporate governance in the Rules for Nominated Advisers is in Admission Responsibility AR2 Directors and Board, where it states that, when assessing the appropriateness of an applicant and its securities for AIM, the nominated adviser should usually consider "with the directors of an applicant, the adoption of appropriate corporate governance measures". We firmly believe that nominated advisers have an ongoing responsibility for assessing the application of good corporate governance within the individual AIM companies that they advise, using relevant guidance for making such assessments.

21. We believe that there should be some guidance incorporating the application of the 'comply or explain' regime and key aspects of the Combined Code. For example, while noting that a strong emphasis is placed in the rules on consideration of the board as a whole, the guidance should make reference to at least two independent non-executive directors.

Schedule Three - Admission Responsibility AR3 Due Diligence

22. In the second bullet point reference is made to "… reports and statements …" in respect of working capital and financial reporting systems and controls. Market practice usually means that a reporting accountant prepares a working capital report in respect of the directors' statement on working capital. The reporting accountant may also prepare a comfort letter on the working capital statement. The reporting accountant also usually prepares a comfort letter on accounting and financial reporting procedures. It is unclear what the "statements" referred to in the bullet point are. We recommend that the wording be amended to reflect the wording normally used by the market in respect of the working capital report and the comfort letter on financial reporting procedures (and any other private comfort letters and reports) prepared by reporting accountants.

23. We believe that further clarity is required in the wording of the fourth bullet point, in particular in respect of the word "basis". For example, working capital assumptions are not the basis of the report but the basis of the preparation of the working capital forecasts that are prepared by the issuer for review by the reporting accountant and reported on in the working capital report. We agree that

it is appropriate for the nominated adviser to agree the scope of the due diligence that is required.

24. We would also encourage more clarity in the fifth bullet point. The nominated adviser needs to consider the *comfort letters* as well as the due diligence and due diligence reports. We also recommend that the nominated adviser be required to 'assess' the due diligence etc. The phrase "are dealt with" is not sufficiently explicit – in our view the requirement should be that any material issues arising from the due diligence should be 'adequately resolved'.

Schedule Three - Admission Responsibility AR4 Admission Document

25. AR4 proposes that the nominated adviser should be actively involved in the preparation of the admission document, satisfying itself that it has been prepared in compliance with the AIM Rules and that the "statements and information included in it have been made after due and careful enquiry". While the standard of due and careful enquiry exists in relation to working capital statements and profit forecasts by virtue of Schedule Two (c) and (d) of the AIM Rules, the use of such a concept for *all* statements and information in an admission document introduces a different standard from that customarily envisaged for public documents.

26. It would seem unreasonable to introduce general standards for preparation in the Rules for Nominated Advisers. We would suggest that the phrase "statements and information included in it have been made after due and careful enquiry" should be replaced by 'appropriate verification has taken place'.

Schedule Three – Nominated Adviser Engagement Responsibilities

27. When a nominated adviser is being engaged as a nominated adviser to an existing AIM company, the Engagement Responsibilities in Schedule Three apply. The standards of the Engagement Responsibilities are arguably no less onerous than those applicable in the context of a new admission to AIM. Although this may be unobjectionable in principle, it is questionable whether the effect on the AIM market of incoming nominated advisers performing due diligence in all cases will be entirely beneficial.

28. The cost of such a level of due diligence by an incoming nominated adviser will need to be borne by the AIM company. Companies are therefore likely to be very reluctant to change nominated advisers voluntarily, even if they are dissatisfied with the quality of service received from the nominated adviser.

29. In addition, where a nominated adviser resigns from its role through no fault of the AIM company, a combination of the one month deadline for appointing a new nominated adviser under Rule 1 of the AIM Rules for Companies and the level of due diligence required by the incoming nominated adviser could mean that an AIM company finds that its admission to AIM is cancelled, leaving investors 'high and dry'.

30. We suggest the following amendments to the text in Engagement Responsibilities:

- Change the hierarchy of the suggested actions in ER1 by changing the order of the first and third bullet points and inserting additional wording so that the section reads as follows:

  'In satisfying this, the nominated adviser should usually:
  - consider contacting the outgoing nominated adviser to discuss their experiences with the AIM company. An outgoing nominated adviser should be constructive and open with a new nominated adviser who conatcts them for such opinion
  - gain a knowledge of any recent major develpments relating to the company since admission and consider the effects on the appropriateness of the applicant and, if the results of such procedures indicate that there are issues that need to be investigated further,
  - take appropriate actions by reference to AR1.'

  In this way the first suggested action for an incoming nominated adviser will be to pick up on the experiences of the outgoing adviser, after which the adviser will seek knowledge of developments and following that, where necessary, they may take further appropriate actions by reference to AR1.

- Change ER2 to read "In making this assessment the nominated adviser should undertake the actions considered appropriate by reference to AR2" .

- Change ER3 to read "A nominated adviser should usually take appropriate action by reference to AR5".