

Marek Grabowski
Director of Audit Policy
Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London, WC2B 4HN

m.grabowski@frc.org.uk

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Dear Mr Grabowski,

Implementing the Recommendations of the Sharman Panel: Revised Guidance on Going Concern and revised International Standards on Auditing (UK and Ireland)

Introduction

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European **Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Financial Reporting and Corporate Governance Expert Groups have examined your proposals and advised on this response. A list of members of the expert groups is at Appendix A.

Response

We were broadly supportive of the Sharman Inquiry and welcomes attempts to achieve better transparency and reporting. Whilst, however, we think it is appropriate for the FRC to engage in a debate around the issues on going concern that the Sharman Report raised, we believe that engaging with the IASB and other international standard setters, rather than acting unilaterally, would have been more in keeping with the Sharman recommendations.

We also believe that the FRC should be clearer about the problem the Guidance is seeking to address. Aside from issues at certain UK banks, we have not noted a raft of unexpected corporate failures and certainly no evidence to suggest that the current guidance on going concern, issued in 2009 after the problems at HBOS and RBS, is inadequate. The FRC should reflect further on the problem they are seeking to address before issuing new guidance applicable to all companies.

We are consistently concerned with 'regulatory creep' whereby more stringent rules are applied to small and mid-size quoted companies as a result of failures at some of the UKs largest financial institutions. Consequently we have serious concerns about the appropriateness of the Guidance in its current form. We are especially concerned that the Guidance has not taken into account the 'think small first' principle which

has guided recent UK and European legislation and the burden of compliance will therefore fall disproportionately on SMEs, including small and mid-size quoted companies not subject to the UK Corporate Governance Code.

In terms of the specific aspects of the guidance, we do not consider that the concept of the 'foreseeable future' for assessing going concern is either helpful or well defined. We are concerned that, contrary to the Sharman recommendations, the FRC is seeking to redefine the terms of the going concern assessment without having achieved an international consensus. As no business will be able to assess going concern over the 'foreseeable future' with a 'high level of confidence', the consequences of the Guidance will be to increase disclosures regarding material uncertainties and emphasis of matter paragraphs in audit reports. We believe that such an outcome would negatively impact the UK economy with little real benefit and are surprised that the FRC have failed to produce a comprehensive impact assessment to accompany such a fundamental change.

In conclusion we do not consider the Guidance to be an improvement on "*Going concern and liquidity risk: Guidance for directors of UK companies 2009*" and would recommend that the FRC withdraw it completely and focus instead on amending the 2009 guidance to ensure better disclosure of long term solvency risks within the Companies Act risk disclosures.

1. Do you agree that the Guidance appropriately provides the clarification recommended by the Panel as to the purposes of the going concern assessment and reporting and is appropriate? If not, why not, and what changes should be made to the Guidance?

The Guidance discusses two purposes for going concern reporting but then goes on to introduce two different thresholds to be applied to those two purposes. This is contrary to current standard UK practice and, contrary to the Sharman recommendation, has been done without the establishment of an international consensus. These two different standards will be confusing for directors and users of financial statements alike.

2. Do you agree with the description in the Guidance of when a Company should be judged to be a going concern? Do you agree in particular that this should take full account of all actions (whether within or outside the normal course of business) that the board would consider taking and that would be available to it; and that, if the underlying risks were to crystallise, there should be a high level of confidence that these actions would be effective in addressing them? Is the term 'a high level of confidence' sufficiently understandable? If not, why not, and how should the description or term be modified?

The Guidance states that "a company is judged to be a going concern if, for the foreseeable future, there is a high level of confidence that it will have the necessary liquid resources to meet its liabilities as they fall due". This is a high threshold and we are not sure that any Board would be able to develop such a high level of confidence over a foreseeable future that could be years in length. How, for example, can a company have a high level of confidence that banking facilities will be renewed in two years time when the funding environment, value of security, business performance or key personnel may well have changed? Consequently we do not agree with the description given in the Guidance.

Requiring such a high level of confidence will increase the use of emphasis of matter paragraphs in audit reports. We do not believe that this is the intention of the FRC as such an increase would only serve to reduce their value to users as warning signs of potential issues.

3. Do you agree with the approach the Guidance takes to the implications and nature of actions within or outside the normal course of business? Do you consider that the Guidance explains their nature sufficiently clearly? If not, why not and what changes should be made to the Guidance?

The Guidance takes a very 'black and white' approach in the examples given; real life examples will be harder to categorise so clearly into being within or outside the normal course of business. Consequently we are unclear as to whether the distinction has any real value.

4. Do you agree with the approach taken to interpreting the foreseeable future and is this sufficiently clear in the Guidance? If not, why not and how should the Guidance be changed?

No, we do not agree with the approach taken to interpreting the foreseeable future.

Defining the foreseeable future will be difficult in practice especially for small and mid-size quoted companies. How long, for example, is the current economic cycle? Should the foreseeable future be linked to the longest term finance or lease that a company has entered into? Defining the term will be as difficult an exercise as seeking to forecast and assess risk over that period.

Additionally there will be a considerable variation in how this is interpreted between different companies and industries which will not aid comparability.

We recommend that the Guidance does not seek to change the current practice of 12 months from the date of signature without first achieving an international consensus.

5. Do you agree that the use of the term 'going concern' in the phrase 'going concern basis of accounting' is sufficiently clearly distinguished in the Guidance from its use in the Code requirement for a statement that the company 'is a going concern' and from its use in the accounting and auditing standards in the context of material uncertainties about the company's 'ability to continue as a going concern'? Is it clear from the Guidance that the statement the directors are required to make under the Code (that the Company is a going concern) should reflect the board's judgement and is not intended to be absolute? If not, why not and what changes should be made to the Guidance or the Code requirement?

See our answer to question 1 above.

6. Do you agree that the judgemental approach in the Guidance to determining when there are material uncertainties to be disclosed is the appropriate interpretation of the relevant accounting standards? Do you agree that the factors and circumstances highlighted respectively in paragraphs 2.30 and 2.31 are appropriate? If not, why not and what changes should be made to the Guidance?

Determining whether it is appropriate to use the going concern assumption will always be a matter of judgement, made at a particular point in time, and the Guidance could not do anything other than adopt a judgemental approach. The Guidance itself, however, is contradictory in first of all wishing to 'forewarn of significant solvency or liquidity risks' (2.29), but then demanding a 'high level of confidence' over the 'foreseeable future' (2.32) as to mean that almost all companies will need to disclose uncertainties. This

will result in relevant disclosure being masked by boilerplate wording. We do not see this as an improvement on current reporting.

7. Do you agree that the interpretations adopted in the Guidance in implementing Recommendation 2(b) are consistent with FRS 18 and ISA (UK and Ireland) 570? If not, why not and what changes should be made to the Guidance or those standards?

Amendments to accounting and audit standards should only be made after due consideration and recommendation by the IASB and the IAASB.

8. Do you agree that Section 2 of the Guidance appropriately implements Recommendation 3? Do you agree with the approach to stress tests and the application of prudence in conducting them? Do you agree with the approach to identifying significant solvency and liquidity risks? Do you agree with the description of solvency and liquidity risks? If not, why not and what changes should be made to the Guidance?

Judgements on going concern need to be made based on a company's best and most realistic assessment. Stress testing is most appropriate in informing the board of the risks that it faces (some of which may well be principal risks and uncertainties which should be disclosed under the Companies Act).

9. Do you agree that the approach taken in Section 4 of the Guidance in implementing the disclosures in Recommendation 4 is appropriate? Is the term 'robustness of the going concern assessment process and its outcome' sufficiently clear? Do you agree that the approach the board should adopt in obtaining assurance about these matters is appropriately reflected in Section 3 of the Guidance? Do you agree that the board should set out how it has interpreted the foreseeable future for the purposes of its assessment? If not, why not and what changes should be made to the Guidance?

We are unclear how a boilerplate disclosure concerning process adds value especially given that Company Law is currently clear on directors' duties in this area. Further guidance should also be given on how this section applies to small and mid-size quoted companies/SMEs, which may well not possess the governance structures described in Section 3.

10. Do you agree that the proposed amendments to the auditing standards appropriately implement the enhanced role of the auditor envisaged in Recommendations 4 and 5? If not, why not and what changes should be made to the auditing standards?

Aside from not believing that it is appropriate to amend auditing standards without an international consensus, we are concerned that the amendment will extend the scope of the audit into the narrative sections of the annual report. We are concerned that this will have cost implications and will damage the competitiveness of UK capital markets. We do not believe that there is sufficient evidence of a demand from users to justify such a change.

11. Do you agree that it is appropriate for the Supplement to confirm that central bank support for a solvent and viable bank does not necessarily constitute a material uncertainty? In particular, do you agree that central bank support (including under ELA) may be regarded as in the normal course of business where the bank is judged to be solvent and viable? Do you agree that the approach set out in the Supplement to assessing whether there is a material uncertainty is appropriate and consistent with the general approach in the Guidance? If not, why not and what changes should be made to the Supplement to the Guidance?

We have no comments on this question.

12. Do you consider the proposed implementation date to be appropriate? If not, why not and what date should the application date be?

For the reasons set out above, we believe that the Guidance will require considerable revision and amendment prior to issue and further time should be taken to ensure that this is properly done, the impact assessed and the outcome fully consulted upon. Consequently the implementation date should be revised.

Notwithstanding the above point, we note that the implementation date would impact 31 December 2013 year ends and 30 June 2013 interims. Given that the FRC does not intend to publish the final Guidance until the end of June 2013, we do not think that there is enough time for directors to assess the impact of the Guidance and plan for its implementation prior to the release of interim results. For significant changes in accounting standards, the IASB seeks to provide companies with 18 months' notice; as currently drafted we consider this Guidance to be a significant change and consequently it should have an application date of no earlier than accounting periods commencing on or after 1 January 2015.

13. Do you believe that the Guidance will deliver the intended benefits? If not, why not? Do you believe that the Guidance will give rise to additional costs or any inappropriate consequences? For example, as compared with the 2009 Guidance, do you believe that the Guidance will give rise to fewer companies being judged to be a going concern and/or more companies disclosing material uncertainties? If so, what are the key drivers and can you give an estimate or indication of the likely cost or impact? Do you believe that such additional costs or impact would be justified by the benefits?

As noted in our general comments above, we are concerned that the Guidance will result in a greater use of emphasis of matter paragraphs in audit reports and confusion amongst users regarding the going concern thresholds and review period. This trend could well have a negative impact on the ability of companies to obtain credit or raise finance, especially outside the UK.

We would have expected the FRC to have undertaken a proper cost benefit analysis and impact assessment as part of the process of developing the Guidance and we do not think that asking for comments on this question is an adequate substitute for such a study. We recommend that for future consultations and prior to the finalisation of the current Guidance the FRC publishes such an assessment.

14. Do you agree with the approach to SMEs in the Guidance? If not, why not and what changes should be made to the Guidance?

We do not think it is appropriate for going concern rules designed as a result of bank failures to apply to small and mid-size quoted companies, as they are at a very different stage of development and represent a much smaller risk to the UK economy as a whole in the case of failure.

The Guidance states that it is applicable to all companies yet much of the detail is based on the UK Corporate Governance Code requirements. The section on SMEs in the Guidance then fails to adequately distinguish which sections are applicable to SMEs and which are not. The Guidance should be written using the 'think small first' principle and should clearly set out the areas applicable to all companies before separately identifying those only applicable to entities applying the UK Corporate Governance Code.

We note that the 2009 Guidance was written in a much clearer manner, clearly distinguishing those sections which were only applicable to companies applying the UK Corporate Governance Code. We would recommend that the FRC use this as a template for any revision to the current draft Guidance.

15. Are there any other matters which the FRC should consider in relation to the Guidance and the Supplement? If so, what are they and what changes, if any, should be made to address them?

We have no additional comments.

If you would like to discuss any of our response in more detail, we would be happy to attend a meeting.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'T. Ward', with a stylized flourish at the end.

Tim Ward
Chief Executive

Quoted Companies Alliance Financial Reporting Expert Group

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| Matthew Stallabrass (Chairman) | Crowe Clark Whitehill LLP |
| Anthony Appleton (Deputy Chairman) | BDO LLP |
| Edward Beale | Western Selection Plc |
| Anthony Carey | Mazars LLP |
| Peter Chidgey | BDO LLP |
| Jack Easton | UHY Hacker Young |
| Bill Farren/Ian Smith | Deloitte LLP |
| David Gray | DHG Management |
| Usman Hamid | Ernst & Young LLP |
| Matthew Howells | Smith & Williamson Limited |
| Nick Winters/James Lole | RSM Tenon Group PLC |
| Paul Watts/Jonathan Lowe | Baker Tilly |
| Niraj Patel | Saffery Champness |
| Nigel Smethers | One Media IP Group plc |
| Chris Smith | Grant Thornton UK LLP |
| Joseph Archer | Crowe Clark Whitehill LLP |

Quoted Companies Alliance Corporate Governance Expert Group

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|---------------------------|----------------------------------|
| Edward Craft (Chairman) | Wedlake Bell LLP |
| Victoria Barron | Hermes Equity Ownership Services |
| Edward Beale | Western Selection Plc |
| Dan Burns | McguireWoods |
| Anthony Carey | Mazars LLP |
| Louis Cooper | Crowe Clark Whitehill LLP |
| Victoria Dalby | Capita Registrars Ltd |
| Kate Elsdon | PricewaterhouseCoopers LLP |
| David Firth | Penna Consulting PLC |
| Peter Fitzwilliam | Mission Marketing Group PLC |
| David Fuller | CLS Holdings PLC |
| Clive Garston | DAC Beachcroft LLP |
| Nick Graves | Burges Salmon |
| Andrew Hobbs | Ernst & Young LLP |
| Alexandra Hockenhull | Xchanging plc |
| David Isherwood | BDO LLP |
| Nick Janmohamed | Speechly Bircham LLP |
| Colin Jones | UHY Hacker Young |
| Dalia Joseph | Oriel Securities Limited |
| Doris Ko | Aviva Investors |
| Claire Noyce/Deepak Reddy | Hybridan LLP |
| James Parkes | CMS Cameron McKenna LLP |
| Julie Stanbrook | Hogan Lovells International LLP |
| Peter Swabey | Equiniti |
| Eugenia Unanyants-Jackson | F&C Investments |
| Melanie Wadsworth | Faegre Baker Daniels LLP |
| Cliff Weight | MM & K Limited |