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Secretary to Sharman Inquiry on Going Concern and Liquidity Risks
c/o Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London WC2B 4HN

Dear Secretary,

Thank you for your email and for the kind message from the Panel inviting me to put forward my views on the issues covered by the Inquiry. I retired as Chairman of Cadbury Schweppes in 1989 and therefore my experience as a chairman of a public company is not really relevant to the lessons for companies and auditors today in relation, in particular, to liquidity risks. The financial crisis has brought to the fore problems which were less high on the agenda during my time as chairman of a public company.

I felt however that it might be useful to refer to the discussion which we had on the Committee on the Financial Aspects of Corporate Governance relating to "going concern". The Committee reported in December 1992 and paragraphs 5.18 to 5.22 refer to "going concern". It was clear from the evidence which we received that there was confusion both about the nature of the going concern principles and about how they should be applied by directors and checked by auditors.

Under Company Law at that time, there was no explicit requirement for directors to satisfy themselves that their company was a going concern, for example, by preparing an adequate cash flow forecast. We recommended that the law should require directors explicitly to satisfy themselves that the going concern basis was appropriate and to report accordingly to shareholders. The Committee's Report said that there was a strong case for extending the scope of the audit to test going concern assumptions and to require auditors to give an opinion on the Directors' Report.

The Committee was aware of the fine balance in drawing proper attention to the conditions on which continuation of a business depended, but not thereby bringing the business down prematurely. The Committee doubted that directors were fully aware that under the existing auditing guidelines the going concern test meant that the company would still be operating six months following the date of the Audit Report or one year after the date of the Balance Sheet, whichever was the later. The Report proposed that the directors should be required to satisfy themselves that the business was a going concern on the basis that they had a reasonable

expectation that it would continue in operation for the time period which the auditing guidelines defined.

The outcome was that the Committee made four recommendations, that:

- (a) directors should state in the Report & Accounts that the business is a going concern, with supporting assumptions or qualifications as necessary;
- (b) the auditors should report on this statement;
- (c) the accountancy profession, in conjunction with representatives of preparers of accounts, should take the lead in developing guidance for companies and auditors;
- (d) the question of legislation should be decided in the light of experience.

One of the recommendations of the Code of Best Practice was that directors should explain their responsibility for preparing the accounts and position it next to a statement by the auditors about their reporting responsibilities. At the time that the Committee's Report was written, there was undoubted confusion over the respective responsibilities of directors and auditors in relation to Reports & Accounts. The Committee felt that if their respective responsibilities were set out side by side, this would clarify the position both for preparers and users of company Reports & Accounts.

Although this relates to the position on going concern over twenty years ago, it may be useful to rehearse the arguments of the time. There will always be a tension between ensuring that shareholders are fully informed about where a business stands in relation to its continuity and not bringing about the premature failure of the business through inability to forecast its future with sufficient assurance, particularly in a time of recession.

I hope that the Committee's recommendations in relation to "going concern" in 1992 will provide some background to an issue which will always call for a delicate balance of judgement by directors and auditors.

With best wishes

Yours sincerely,
Adrian Cadbury