

Marek Grabowski
Director of Audit Policy
Financial Reporting Council
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3 May 2013

Dear Marek

We welcome the opportunity to comment on the FRC's proposals for implementing the Sharman Report recommendations.

By way of background, Hermes is a leading fund manager in the City of London. As part of our Equity Ownership Service (EOS), we also respond to consultations on behalf of many clients from around Europe and the world, including PNO Media (Netherlands), Canada's Public Sector Pension Investment Board, VicSuper of Australia and the UK's Lothian Pension Fund and The BBC Pension Trust (only those clients which have expressly given their support to this response are listed here). In all, EOS advises clients with regard to assets worth a total of £100 billion (as at 31 December 2012).

As you are aware, we have supported the development of these proposals, both through the Sharman Panel process and more recently. Unsurprisingly therefore, we welcome them and the intent behind them, and believe that disclosures made in respect of these proposals can add real value for shareholders.

We answer the specific questions briefly below.

Yours sincerely



Colin Melvin

Question 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?

Yes, we believe that the proposals deliver on the recommendation. We would note the importance to us and to shareholders more generally of the two-fold purpose of going concern reporting, and would emphasise the central importance of the stewardship purpose in particular. Reporting which seeks to fulfil this purpose should deliver significant value to shareholders and the market as a whole.

Question 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?

We support the proposed definition and approach. We believe that the intent of the guidance is sufficiently clear and that the terms used emphasise the central need for the exercise of professional and intelligent judgement by all parties. The exercise of such judgement is crucial to going concern disclosures that add real value for shareholders. In particular, we believe that the phrase 'high level of confidence' is appropriate in the way that it leaves the right degree of space for the exercise of professional and intelligent judgement.

Question 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?

We support the proposed approach, and the implications of a requirement for actions outside the ordinary course of business. Again, we believe that the intent of the guidance is sufficiently clear and that the terms used emphasise the central need for the exercise of professional and intelligent judgement by all parties. The exercise of such judgement is crucial to going concern disclosures adding real value for shareholders.

Question 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?

We support the proposed definition and approach. Again, we expect boards to exercise professional and intelligent judgement such that they are considering the future to the extent that it is appropriately foreseeable, an extent which will naturally vary from company to company.

Question 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?

We welcome the discussion in the Guidance about the differing and varied uses of the term 'going concern'. There is a danger of confusion being generated by a use of the same set of words in different contexts to mean different things, and the elucidation of the different uses of this terminology is helpful in moving towards greater mutual understanding.

We believe that it is clear that professional and intelligent judgement must be exercised by the directors and that shareholders must also use judgement and not read any assertions as absolute or definitive. Further, we welcome this as we believe that exercises of professional and intelligent judgement are most likely to add value for shareholders and generate confidence in the market as a whole.

Question 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?

Again, we support the approach of requiring professional and intelligent judgement, and believe that the Guidance strikes the right balance of providing a framework for the exercise of such judgement but not in any way controlling its exercise. The exercise of such judgement is crucial to going concern disclosures adding real value for shareholders and for the market as a whole.

Question 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?

We agree that the interpretations are consistent.

Question 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?

Yes we agree that the Guidance appropriately implements this recommendation. We believe that the approach to stress tests, solvency and liquidity issues is appropriate.

Question 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?

Yes we agree that the Guidance appropriately implements this recommendation. We believe that there is sufficient clarity about the intention and meaning of the phrase 'robustness of the going concern assessment process and its outcome' for the

exercise of professional and intelligent judgement that will add real value for shareholders and the market as a whole. We firmly agree that the board should disclose how it has interpreted 'the foreseeable future' for going concern purposes.

Question 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?

Yes we agree that the proposed changes to the auditing standards appropriately implement these recommendations.

Question 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 agree that the proposed approach to banks is the only practicable one in the specific context of that industry, given its systemic nature and its particular challenges with regard to going concern.

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

We agree that the proposed implementation timetable is welcome and appropriate.

Question 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?

We agree that there should be only limited cost implications of these proposals, and that the benefits in terms of better and more intelligent disclosures facilitating deeper understanding, additional engagement where appropriate and greater market confidence overall, are potentially very significant. We thus believe that the cost/benefit balance clearly weighs in favour of the benefits of these proposals and we strongly encourage their implementation.

Question 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 agree with the approach to SMEs.

Question 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 nothing further to add.