CBI
THE VOICE OF BUSINESS

Sharman guidance on going concern and proposals to improve the auditor's report

CBI response, March 2013

This note sets out the CBI's view on two FRC consultations: guidance on the implementation of the Sharman Panel's recommendations on going concern and liquidity risks; and proposals to improve the auditor's report.

1. Consultation on implementation of Sharman Panel recommendations on going concern and liquidity risks

1.1. The direction of travel is positive, but the scale of change proposed is disproportionate

CBI members see the approach taken in the guidance (of aiming to enhance risk disclosure on solvency and liquidity and encourage a more robust assessment of these risks) as positive. However, significant concerns exist about the scale of the change proposed. This is made especially difficult given the short time-frame, which will be even more of a challenge for small and medium sized businesses.

1.2. Creating two different definitions of going concern will create confusion for preparer, users and auditors

Businesses agree that a broader discussion on going concern in the front end would be valuable for shareholders and would encourage more board-level discussions on going concern. However, businesses are concerned that the guidance uses two different definitions of going concern: one relating to the front end and one to the back end. The back end meaning would relate to the existing accounting definition of going concern, while the front end meaning is much broader, longer-term and associated with stewardship rather than accounting.

The related but different meanings of going concern will do nothing to ensure the front and back end are consistent, as the answer to the question "is company x a going concern" may differ between the two parts. A consistent meaning is important for preparers, users and auditors. We do not believe it is practical for the FRC to use a definition that is not used in the international standards.

1.3. Assessing going concern in the longer-term may be difficult, particularly for SMEs and MSBs

Related to the problem of twin definitions of going concern is the difficulty companies will face in assessing going concern in the longer term. This is especially the case for those that operate in an unpredictable, changeable environment. The unavoidable risks and uncertainty that exist across the business cycle may mean that Directors will struggle to be confident that their business is a going concern, according to the revised front-end meaning. This is likely to lead to an increase in the number of companies disclosing material uncertainties regarding going concern.

The requirement to consider going concern over the business cycle is a particular problem for smaller and medium-sized businesses, which tend to look 12-15 months ahead in terms of cash-flow. CBI members question what smaller and medium-sized businesses would have to start doing, in terms of information collection and risk assessment, to be able to clear the new, much higher and longer-term bar of going

Leo Ringer | Head of Financial Services & Corporate Governance
DL: 0207 395 8305 **M:** 07713 505 828 **E:** leo.ringer@cbi.org.uk

concern. Even if it is expected that they will have to do less than larger companies, smaller and medium-sized businesses, and their advisers, will still have to understand the whole package of guidance to be able to discern what does and does not apply to them.

1.4. There is a risk that going concern and principal risks become conflated

Assessed across the longer-term, businesses are concerned that a company's assessment of going concern and of principal risks could begin to merge. It is seen as potentially repetitious and unhelpful for going concern to be so closely associated with assessments of principal risks. A cross-reference from the principal risks and uncertainty disclosures to going concern issues discussed could be a way of addressing this.

1.5. The timing of implementation will be challenging, particularly for September year-ends

The process does not allow a great deal of time for companies to understand the new guidance and terminology within it. In particular, companies with a September year end may struggle. Even for those companies that have been following the Sharman inquiry closely, to try to pre-empt the changes, it will take time to adjust. The sheer size of the guidance and the numerous new concepts within it are a challenge.

1.6. Alignment of domestic and international approaches would be useful

CBI members continue to emphasise the need for consistency between domestic and international approaches. IFRIC has recently reinforced that going concern should be assessed, as a minimum, 12 months from the balance sheet date. While not inconsistent with the FRC's guidance regarding solvency in the longer-term (since the 12 months is a minimum period), alignment in terminology could help ensure consistency.

2. Consultation on improvements to the auditor's report

2.1. CBI members question the value of the information required

CBI members are concerned that the new information required may not be as useful as expected to investors, once they actually see it. While businesses acknowledge that some investors have expressed an interest in understanding more about auditors' decision-making in some respects, they fear that the new information required could quickly become boiler-plate text, thereby adding to the reporting burden at little or no gain. We would also question how useful the required information would be to those without an audit background.

2.2. Agreement on wording and issues of commercial sensitivity could be time-consuming

Businesses expressed concern about the potentially time-consuming negotiations that would have to take place between the auditor and company to agree the wording of the newly required information. This is related to problems which may arise as a result of the need to avoid the disclosure of commercially sensitive information via the new reporting requirements.

2.3. The requirements add to the already growing burden on the audit committee

CBI members note the additional burden on the audit committee that the proposals would entail. As the new information required is very much audit-specific, it is unlikely that this burden can be easily shared by other parts of the board.