Chartered Accountants Ireland

Chartered Accountants House
47–49 Pearse Street
Dublin 2

Tel +353 1 637 7200
Fax +353 1 668 0842
Email ca@charteredaccountants.ie

www.charteredaccountants.ie

Marek Grabowski
Secretary to Sharman Inquiry on Going Concern and Liquidity Risks
Financial Reporting Council
Aldwych House
71 – 91 Aldwych
London
WC2B 4HN

8 July 2011

Dear Marek

Chartered Accountants Ireland response to the call for evidence from the Sharman Inquiry

Going concern and liquidity risks; lessons for companies and auditors

Chartered Accountants Ireland ('the Institute') is pleased to respond to the request for submissions on this important topic. This is a timely initiative given comments and concerns that have been raised in recent months about how entities address issues associated with 'going concern and liquidity risk'. Rather than attempting to comment on each individual question raised, as set out in the call for evidence, we provide comments under each of the principal headings of the document. We would like, however, to draw your attention to the following comments made below, which we consider to be of particular relevance to your deliberations, namely:

- We believe that enhanced disclosure of an entity's financial risks would benefit stakeholders in their assessment of the sustainability of the entity;
- Enhanced disclosures could include comprehensive information in relation to projected liquidity headroom and a sensitivity analysis demonstrating the entity's ability to withstand adverse developments;
- We believe that there is a strong case for the involvement of the audit committee, or other independent board sub-committee, in overseeing the extent to which risk information is provided; and
- We are open to further enhancement and development of the role of the auditor, including on 'going concern' issues, but would stress that any such proposals should be made on a global basis and be linked to a consideration of auditor liability reform.

FRC Guidance: Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009

The FRC Guidance issued in November 2009 was issued subsequently in Ireland by the Institute, with the permission of the FRC, in December 2009. The FRC Guidance was amended solely to reflect Irish specific company law references. A similar approach was adopted with an earlier document issued by the FRC 'An Update for Directors of Listed Companies: Going Concern and Liquidity Risk' issued by the FRC in November 2008.

While there has been no change in respective legal responsibilities of directors and others with regard to 'going concern', the recent documents issued by the FRC represented timely reminders on those responsibilities and obligations by bringing together the various requirements of company law and accounting standards and providing further assistance on the application of the principles of *Assessment, Review Period* and *Disclosures*.

It is perhaps worth considering at the outset whether there has been sufficient time and experience of working with this recently issued FRC material for it to be embedded within company financial reporting processes. In other words, whether there is a problem with the guidance itself, or, perhaps, insufficient time has elapsed to allow for more robust and rigorous application of its content by preparers of financial statements.

1. Transparency of going concern and liquidity risk

The FRC is in a pivotal position to stimulate and influence the debate in Ireland and the United Kingdom on the gap between expectations of stakeholders in relation to this issue and the information being provided in company financial statements. In particular, we believe it would be worthwhile to debate whether the concept of going concern, as currently defined, adequately reflects expectations of stakeholders about assurance in relation to a company's financial health and its continued sustainability.

We agree that additional disclosures in relation to a company's financial risk, including sensitivity analysis demonstrating the company's ability to withstand adverse developments in relation to those risks, could significantly enhance the usefulness of financial statements.

It may be that financial reporting standards, both global and local, require amendment to reflect additional requirements for enhanced disclosure, and we would be supportive of dialogue with the relevant standard setters in this regard.

We recognise that a key barrier to the provision of fuller disclosure in relation to this matter is the understandable concern of company directors wishing to avoid a "selffulfilling prophecy" by indicating uncertainty on their part regarding the company's sustainability. This could be addressed by introducing an explicit requirement for every company to provide comprehensive information in relation to projected liquidity headroom and the impact of adverse developments in relation to key risks through sensitivity analysis. We also consider that a requirement to involve the audit committee, or other board sub-committee comprising independent directors, in determining the extent of the risk disclosures to be included, could further enhance the usefulness of the information provided to stakeholders in making their assessment of the sustainability and viability of the business.

Of course, the issues that are the subject of the 'call for evidence' represent but one element of the continuing examination of issues associated with the financial crisis. The FRC will be aware that, in the case of banks, it has previously been suggested that bank disclosures include a 'detailed going concern statement' which would include reasons why directors are satisfied about an entity's ability to continue as a going concern. There is merit in considering such an idea further.

For listed entities, consideration should be given to making such disclosures mandatory in preliminary announcements and to the inclusion of the 'going concern statements' as an AGM agenda item to be voted on by shareholders, similar to remuneration committee reports.

2. Company assessment of going concern and liquidity risk

Companies should have well established processes which support the directors in making their assessment of whether the company is a going concern when comparing annual and half yearly financial statements. It might be helpful if companies were required to confirm the existence of such processes, perhaps through a report from the audit committee.

3. The auditors approach to going concern and liquidity risk

There is extensive guidance in relation to the approach to be taken by auditors in assessing going concern and liquidity risk. We are not aware of any evidence that this guidance is inadequate or that is not being followed in practice by auditors. It may be considered that the scope of the auditors' responsibility should be extended in light of any enhanced disclosure requirements emerging, or indeed arising from any fundamental review of the forward looking commentary that may be contained in company financial statements. Chartered Accountants Ireland is open to further enhancement and development of the role of the auditor, including with regard to 'going concern'. While the FRC and the Auditing Practices Board are ideally placed to lead developments in these areas, we believe that any proposals on these matters should have international acceptance. We would also consider that any extension of

Chartered Accountants Ireland

the reporting obligations of auditors, regarding 'going concern' or other issues, heightens the need for the consideration of auditor liability reform.

4. Feedback on the guidance for directors of UK companies in respect of going concern and liquidity risk

We believe that existing guidance in relation to this matter is comprehensive, but that a focus on the fundamental issue of whether the concept of going concern meets the expectations of stakeholders needs to be explored. If such consideration results in changes or refinement of the concept, then guidance will need to be developed to support such changes.

Mechanisms to reinforce to preparers the need to provide more specific and granular disclosures around going concern might also be considered.

We have referred above to the fact that there are numerous reviews and initiatives that are on-going into possible improvements and reforms to financial reporting, auditing and its supervision, and governance practices. The Institute is of the view that global solutions to these matters are essential and encourages the FRC's efforts in this regard.

If you would like to discuss our comments in more detail, please do not hesitate to contact me.

Yours sincerely,

pp Mal Kenny

Aidan Lambe

Director, Representation and Technical Policy