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Dear Sirs

Call for Evidence to the Sharman Enquiry

1. This evidence is submitted following a request to me from the Enquiry's secretariat to give evidence. I do so in a personal capacity, based on experience as audit committee chairman of a number of quoted companies in recent years. I am currently audit committee chairman and senior independent director of two FTSE100 companies.

2. As background to my views I would first like to comment on the guidance provided by the FRC in November 2009 on how companies could address "the exceptional risks to going concern and liquidity which were facing companies at the height of the credit crisis" – I quote from the Call for Evidence.

3. In my view this guidance was an exemplary instance of a regulator providing clear, considered and timely advice. It was published quickly, once the issue had become apparent. It had the important effect of legitimising qualified comments by companies in an area where qualifications were not normally expected by the readers of company statements. Without the guidance, companies might reasonably have feared being punished unduly by investors for making a qualified statement.

4. As the Call for Evidence recognises, the guidance of November 2009 was issued to deal with exceptional circumstances. The question facing the Enquiry is whether additional continuing guidance is needed during more normal times. My answer is probably not. I shall explain why by starting with a general observation about regulation.

5. A problem with all business regulation is that exceptional cases or exceptional circumstances can be thought to justify the introduction of rules to be applied to all cases and in all times, whether they are exceptional or not. The result is a growing edifice of regulation, compliance with which is time-consuming and expensive and which is in most cases unnecessary. This leads to resentment

amongst those who feel they have to comply and to a devaluing of respect for the regulator. Moreover, resources are used up which would be more productively applied in making the business better. What starts off well ends badly.

6. It might be thought that these strictures are scarcely relevant to the question at hand, which could be portrayed as a benign FRC just trying to help. The reality is that companies and auditors see guidance from the FRC as laying out requirements with which they feel bound to comply, whether the requirements are relevant to them or not. Life is too short for chief financial officers, board members and audit partners to take the risks of non-compliance, be they criticism from the FRRP or a black mark from shareholder representatives eager to demonstrate their stakeholder stewardship. The time and money which the company could be using better are committed to compliance instead.

7. So the stakes are high. In my opinion the Enquiry should consider most carefully whether the risks of some companies failing, in normal times, to focus adequately on liquidity and going concern are sufficient to justify creating a structure of reporting to be imposed on all.

8. My experience is of well-run companies in which the executive team are well able to judge the level of reporting on liquidity and going concern required in the circumstances of the company from time to time. If the Enquiry forms the view that such companies are rare there would be a case for providing a template of behaviour and of internal and external reporting to be recommended to all companies. If, however, the Enquiry concludes that the majority of quoted companies have these issues under appropriate control in normal times it could decide to leave well alone. In the latter case it would, no doubt, be vigilant for the recurrence of some exceptional conditions which would justify ad hoc general guidance of the kind provided in November 2009.

9. I now turn to specific questions set out in the Call for Evidence. First, I group all the questions under “Transparency of going concern and liquidity risk” together. In my view it is for the directors to judge whether, in the circumstances of the time, the issues of liquidity and going concern represent a sufficient risk to be promoted to prominence in their description of key risks to which the company is exposed. In the absence of such circumstances the report on treasury policies and the statement on going concern should suffice.

10. The answers in questions 5,7 and 8 depend on the circumstances of the company and the financial and business conditions in which it is operating. Concentration on liquidity and going concern was intense and continual at the height of the financial crisis. For most companies now there is little doubt that they are going concerns, though the boards on which I sit receive detailed reports giving comprehensive factual support to what is intuitively obvious. Regular treasury reports to the boards give full information on liquidity (as well, of course, as overall debt levels, debt maturities, security of cash

deposits, currency exposures etc.) and this focus will endure given the exceptional challenges to liquidity which recently occurred.

11. The answer to question 6 is that the key difference results from the requirement for an external adviser to report on the adequacy of working capital. Naturally, an adviser requires detailed confirmations of the availability of funds from third parties before taking this responsibility. In the normal course of business, such confirmation would not be routinely necessary for directors who can repose trust in the information provided by the company's finance team.

12. I have nothing to add to what I have already said in relation to questions 9, 10 and 12. I believe it is for auditors to deal with question 11.

13. My comments relate to the generality of quoted companies. In relation to liquidity, in particular, different considerations may apply to some companies in the financial services sector who are, in any case, subject to more comprehensive disclosure and regulatory requirements.

Yours faithfully

David Challen