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26 April 2013

By e-mail to m.grabowski@frc.org.uk

Dear Mr Grabowski,

REVISED GUIDANCE ON GOING CONCERN

The GC100 welcomes the opportunity to respond to the consultation document "Implementing the Recommendations of the Sharman Panel" published by the Financial Reporting Council ("FRC") in January 2013. The GC100 is the association for the general counsel and company secretaries of companies in the UK FTSE 100. There are currently over 120 members of the group, representing some 80 companies. Please note, as a matter of formality, that the views expressed in this letter do not necessarily reflect those of each and every individual member of the GC100 or their employing companies.

Firstly, we acknowledge the challenge which you are attempting to address. The global financial crisis revealed an expectation gap between the wide interpretation of the term "going concern" on the part of the general public and, to a degree, the users of annual reports and financial statements, and the narrower definition of this term relied upon by the preparers of those reports and financial statements, and their auditors. The degree to which this can be addressed through education of the audience as well as, or instead of, amending the underlying definitions should not be overlooked.

Secondly, we agree with your broad objective that narrative reporting should give shareholders (and, indirectly, other users) a view as to the potential threats facing the company, and which may cause its business model and/or strategy to fail to deliver the expected benefits and returns. The use of the going concern basis of accounting is a useful short-term indication that the directors feel that those risks are not materialising and/or can be mitigated successfully. However, we believe that conflating these two different points by requiring a narrative summary of going concern status over the longer term (indeed, through entire economic cycles) is inherently flawed. Businesses exploit risk to create return for their owners, and the uncertainties of the long-term future mean that few, if any, boards of directors can ever reasonably conclude that their own business is assured of survival in all possible future scenarios. Taking this point further, we would expect that many directors will seek to mitigate the liability risks they face by using boilerplate disclosures within the narrative report, noting the risks and uncertainties faced by the company and stating that going concern status (as per the "stewardship" part of the definition) cannot be asserted with a high level of confidence in all reasonably predictable future scenarios, or may make a positive assertion subject to extensive caveats. We do not believe that this is an outcome which the FRC either intends, or would welcome.

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Thirdly, we are concerned that the FRC is proposing to take the UK down a path which the international accounting community is not intending to follow. We do not believe that this is right, and will be to the detriment of UK-incorporated companies, UK stock markets and "UK plc" in general.

Finally, we have very fundamental concerns over the rushed implementation timetable proposed by the FRC, as we note in our response to question 12. We perceive a real risk that the need to implement in such haste will lead to excessive caution by companies, and in turn to further boilerplate drafting in an attempt to mitigate the risks faced by the directors of those companies.

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?

We have strong reservations over the stated over-arching purpose in paragraph 1.3 of the draft Guidance. It seems to us that users of annual reports and financial statements will have solvency and liquidity risks as their primary concerns when they approach the question of going concern status. The proposed broadening of the concept to include "risks that would threaten the company's survival" without any limitation may create a fundamental problem for many companies. All businesses face risks in the normal course of business, some of which may be of a catastrophic nature that could threaten the existence of that company, and it is both appropriate and valid that these risks should be disclosed and discussed in the narrative part of the annual report, but without any explicit linkage to the use of the going concern basis of accounting. Taking the statement in paragraph 1.3 at face value, making a credible and definitive assertion that the company is a going concern for stewardship purposes will be challenging for the directors. As a result, we anticipate that companies will routinely add "boilerplate" disclosure of risks or cross-references to their statement of principal risks and uncertainties which will obscure the clarity of the going concern statement, to the detriment of users of their annual report and financial statements. There is also a material risk that a wide range of companies may no longer be able to claim that they are a going concern (for narrative reporting purposes) and that the term becomes somewhat irrelevant in consequence.

For the same reasons, we are concerned by the dual purpose definition set out in paragraph 1.4 of the draft Guidance. We feel this distinction is unhelpful and does little or nothing to address the expectation gap we acknowledged above; indeed, there is a risk that it may be significantly exacerbated if the term "going concern" has more than one official meaning. Our principal concern is with the stewardship dimension in the first leg of the definition, which we believe confuses the purpose of going concern assessment and reporting. We feel that there should be complete clarity that the concept of "going concern" refers purely to the well-understood solvency and liquidity risks to a company's survival in the context of the basis of preparation of financial statements.

A second concern on paragraph 1.4 is that companies could find themselves preparing their financial statements on the going concern basis, but be stating in their narrative report that the company may not be a going concern, given the uncertainties inherent in its business model or strategy. Indeed, paragraph 2.27 of the Guidance anticipates this problem:

"The corresponding threshold for departing from the going concern basis of accounting is a very high hurdle and may not be reached even when the company is not judged to be a going concern".

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We feel that users will find this duality as unhelpful and unacceptable. From a director's perspective, being required to conclude simultaneously that the company both is, and is not, a going concern should be of material concern, particularly where the director owes statutory duties to employees and creditors of the company alongside the equivalent obligation to prepare financial statements which give a true and fair view.

Finally, there are fundamental difficulties for UK companies with US listings in reconciling the duality of the definitions (and therefore possible conclusions that could be reached) with SEC requirements.

We would recommend that the FRC re-write paragraph 1.3 to refer solely to solvency and liquidity risks, and delete paragraph 1.4 entirely. We note that paragraph 1.5 refers specifically to solvency and liquidity risks, and we support the drafting of this. Consequential amendments would also be needed to paragraphs 1.8 and 1.9.

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?

For the reasons given in our answer to question 1 above, we do not agree with the definition contained in paragraph 1.12 of the Guidance. The second part of the sentence, "*and will be able to sustain its business model, strategy and operations and remain solvent, including in the face of reasonably predictable internally or externally-generated shocks*" creates the problems we have identified and should be deleted.

We would contend that the fundamental rationale for the going concern assessment is so that (1) the directors can satisfy themselves that the financial statements they are responsible for preparing do indeed give a true and fair view so that (2) users of annual reports containing those financial statements, including investors, potential investors and current or future business counterparties (including creditors and employees) can form a view of the financial stability of the company. On this basis, it would be reasonable for the directors to review the actions open to them should a solvency or liquidity risk crystallise, and to the extent that this is judged to be an adequate mitigation, rely on this in reaching their conclusion that the business is a going concern. Indeed, if there is a robust and viable mitigation plan known to offset a particular risk, it would be ludicrous for the directors to be compelled to pronounce that the company was not a going concern when they had a valid alternative course of action available to them.

The use of the term 'high level of confidence' is, we believe, well understood and would give users an appropriate level of comfort.

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 believe that the approach to mitigating going concern risks in paragraphs 1.11 to 1.14 of the

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draft Guidance is clearly expressed and have no concerns with this.

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?

As noted above, we feel that the introduction of the stewardship limb of the going concern definition is unhelpful. This has in turn led to a definition of the 'foreseeable future' in paragraph 1.21-1.22 and A1.1-1.13 which we feel is unworkable. Companies operating in long lead time businesses such as mining and pharmaceuticals will find this definition particularly challenging to implement in practice. We note that the mining sector recently experienced a major bull market, which many commentators interpreted as superseding historic business cycles and the start of a so-called super-cycle. Many businesses also exploit new and emerging technologies either as their business, or as a means of accessing their markets. Given the rapid technological changes which show no sign of abating, and the risk that a new innovation could sweep aside much that has gone before, even retail businesses which do not have a generally long business cycle may find the definition challenging. In both of these examples, asking directors to assess solvency "*through the general economic and specific business cycles*" (1.21) does not strike us as a realistically achievable goal.

We are also concerned that the disconnect between the clear definition of going concern for accounting purposes and the rather more vague definition for stewardship reporting purposes is unhelpful for users of annual reports and financial statements. This definitional problem serves to heighten the issues for both directors and users raised in our answer to question 1, and more probable that a company will produce financial statements on a going concern basis while simultaneously stating in its narrative reporting that it cannot gain sufficient comfort to state categorically that it is a going concern.

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?

No, we have fundamental objections to the duality in the proposed definition of "going concern". Please see our earlier answers which address this point.

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?

Our working group had great difficulty in interpreting paragraphs 2.28-2.31 of the draft Guidance and in seeing how these coalesced to create a workable framework. The economic decisions of users of financial statements may be influenced by the disclosure of material uncertainties as to whether the company is a going concern, but some of the matters raised in paragraph 2.30 do not relate directly to those concerns.

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We are concerned that to avoid misleading readers of the annual report it may be necessary to expand upon the reasons why uncertainties have been deemed not to be material because of the availability of actions outside the normal course of business, which could result in relatively lengthy disclosures and the introduction of caveats, to protect the directors' position should their judgement prove to be inappropriate.

We welcome the statement in the final two sentences of paragraph 2.28 and wonder whether this could better be used in the user education materials we encouraged the FRC to consider in our first general point at the start of this letter.

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?

UK accounting and auditing standards are currently not dissimilar to their international counterparts. We believe that the interpretations proposed would move the UK away from the international equivalents and do not feel that this is appropriate. The description of "material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern" is well understood. We note that Sharman also recommended that the FRC seek to develop a common international understanding of the use of the term going concern. The guidance seems at odds to this recommendation and so cannot be supported.

Our fundamental belief is that the UK should, wherever possible, be consistent with international accounting and reporting standards.

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?

While larger companies may feel that the draft Guidance is an appropriate response, we do have concerns that small and medium sized companies may not have the resources to perform the stress testing the FRC envisages. Essentially, the challenge is in identifying what constitutes sufficient testing, and we fear that many SMEs will be forced to conclude that, on the stewardship definition, they cannot claim to be going concerns with sufficient confidence. This risks undermining the credibility of a sizeable number of such companies which form the backbone of the UK economy.

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?

Our concerns with section 4 centre on the stewardship limb of the definition of going concern, which we believe is inappropriate and unworkable for the reasons explained earlier.

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Given that the board of every company will need to conduct a going concern assessment appropriate to their own situation, we question the use of the term 'robust'. This is a subjective term which it will be very challenging to define, and as such is relatively meaningless. In addition, as the bases of the assessments undertaken by different companies are unlikely to be comparable, assertions that these meet such an arbitrarily-and ill-defined standard is inappropriate. Our preference would be for further guidance or a standard to be published on what would, and would not, constitute an appropriate basis of assessment, which boards can then report against.

We feel that the recommendations in relation to assurance in section 3 are appropriate, and raise no major concerns.

As we have commented throughout this note, we feel that the "stewardship" definition of going concern is fundamentally mistaken. The uncertainty of defining what is the "foreseeable future" serves well to emphasise the difficulties that the proposed duality creates.

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?

Our fundamental belief is that the UK should, wherever possible, be consistent with international accounting, auditing and reporting standards.

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 Supplement is responsive to the recommendations in the Sharman report, but feel that it is unclear how the Supplement relates to the rest of the Guidance. It would be helpful to clarify this relationship and ensure its consistency so the Supplement does not distract from the Guidance or result in unintended extrapolations. For example, in what situations should other entities assume that funding being available means that the entity is considered to be solvent?

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

Although the consultation paper suggests implementation for financial periods commencing on or after 1 October 2013, we understand that the FRC has subsequently published a correction notice stating that this should read 1 October 2012.

We do not believe that the 1 October 2012 date is realistic, since this would imply that interim financial statements for half-years ending on 31 March 2013 would be prepared on a going concern basis (i.e. under the 2009 Guidance) that could differ materially from that of the equivalent full-year accounts. In addition, we feel that additional materials may be needed in support of the Guidance (see our answer to question 9) which cannot be produced in time for either a 1 October 2012 or 2013 commencement. We would also highlight that BIS is

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implementing significant changes to narrative reporting and executive remuneration which take effect for accounting periods commencing on or after 1 October 2013, and that imposing a further raft of changes from the same date, the burden of compliance with which falls on essentially the same individuals, is inadvisable.

As noted earlier, this rushed implementation will create uncertainty of interpretation, which may lead many boards to adopt a safety-first approach and add boilerplate disclosures and caveats to the narrative description of their going concern status in the first year of implementation. We doubt this is the response the FRC wishes to achieve.

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 have very significant concerns that the Guidance, as currently drafted, will give rise to an unintended consequence. Essentially, every board will be posed the question "On an on-going assessment of your going concern status, can you state with a high level of confidence that all risks can be managed effectively through the general economic and normal business-specific cycles, such that solvency and liquidity can be maintained". We anticipate that few, if any, will be able to give an unqualified positive answer to this question, which amounts to an unrealistic guarantee of solvency in all circumstances. As a result, we believe that the vast majority of companies will continue to prepare their financial statements on a going concern basis (on the more tightly defined 12 month test), but will state in the narrative that they cannot state, with sufficient confidence, that the business is in fact a going concern. The confusion this will create for users can readily be imagined, and would be a seriously retrograde step.

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?

Please see our answer to question 8. Our concern is that many SMEs may struggle to demonstrate, with a high level of confidence in the light of reasonably foreseeable risks that might be faced through the business cycle, that they are a going concern under the stewardship definition of that term. We do not believe that this is the FRC's desired intention.

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?

The working group producing this response found the consultation document and draft Guidance hard to interpret, and poorly drafted in places.

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Our fundamental concern is that the duality of the going concern definition is conceptually mistaken. We would urge the FRC to reconsider this initiative, keeping the going concern basis of preparation of financial statements separate from the valuable and appropriate, but potentially unrelated, topic of risk disclosure.

We would welcome the opportunity to discuss these points with you in greater detail.

Yours sincerely,

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