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Private & Confidential

Marek Grabowski
Director of Audit Policy
Financial Reporting Council
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LONDON WC2B 4HN

Dear Mr Grabowski

Implementing the Recommendations of the Sharman Panel

We are pleased to respond to your request for comments on “Implementing the Recommendations of the Sharman Panel: Revised Guidance on Going Concern and revised International Standards on Auditing (UK and Ireland)”.

Whilst we acknowledge and welcome the findings of the Sharman Panel we do have some serious concerns about the FRC implementation of the proposals particularly within the non-listed and SME sectors. RSM Tenon is a major provider of services to SMEs and entrepreneurial businesses and we are very aware of the pressures faced by such businesses in the current environment. Whilst we acknowledge the need for developing better disclosures to assist regulators and investors in more sophisticated and larger businesses and broadly support the conclusions of the Sharman Report, we would encourage the FRC to revisit its “think small first” principles and focus on what is an appropriate response for differing layers of entity in the UK economy.

Yours sincerely

Philip Coleman
Head of Compliance, Ethics and Technical - Audit, Accounts and Outsourcing
RSM Tenon

RESPONSES TO THE QUESTIONS

Q1: 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 do not think the Guidance appropriately provides the clarification required by the Sharman Panel.

The application and interpretation of “high level of confidence about the entity’s solvency and liquidity for the foreseeable future” is likely to mean that very few boards of directors will feel able to be unequivocal about the going concern status leading to more explanation of uncertainties and increased use of emphasis of matter paragraphs by auditors. The danger is that the users of financial statements will find this difficult to understand and will have less confidence.

More guidance on disclosures in different going concern situations would be helpful.

The language of the guidance is aimed at very large listed companies and banks and will be difficult for directors in the SME sectors to understand and apply. The 2009 guidance issued by the FRC followed a “think small first” approach and we would recommend this be replicated in this guidance.

Q2: 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?

As noted above, the term “high level of confidence” will be perceived to be too high a bar to reach in most situations and will be confusing when compared to the definition of being a going concern in accounting standards.

We agree that it is important for management to consider all risks and steps to be taken to mitigate the risks or courses of actions available should they crystallise. However, this guidance would appear to suggest that the existence of such risks which might crystallise in the longer term would mean that the entity could not state, without qualification, that it is a going concern, contrary to current practice and understanding.

Q3: 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?

Generally we find the guidance on actions within and outside the normal course of business to be clear.

Q4: 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?

Whilst we agree that the management assessment of the foreseeable future should be consistent with the periods appropriate to reflect the entity’s business cycle, this may create difficulties in practice where a business has a particularly long cycle and therefore it will be difficult to judge where the going concern assessment period should be cut off.

Q5: 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 believe there to be some confusion in the guidance. As noted above the difference between the use of "high level of confidence" to be able to judge a business to be a going concern is seemingly at odds with the generally accepted accounting standard definition of when an entity is or is not a going concern and might depart from the going concern basis of preparation.

This is highlighted in paragraph 27 of section 2 of the guidance.

We would ask the FRC to consider the use of different terminology.

Q6: 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?

No, we do not believe the guidance is sufficiently clear where uncertainties are judged to be material.

On the one hand there is a suggestion that material uncertainties will only need to be disclosed when they are of such magnitude and likelihood that severe economic distress has happened or is imminent (paragraph 2.31). Conversely the second half of paragraph 2.32 states that disclosure of material uncertainty might be made even if management has obtained a high level of confidence about the going concern status of the entity.

Q7: 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 are unclear whether the recommendations are consistent. The FRC seems to be attempting to lead the discussion and is suggesting some major changes in the interpretation and disclosure of material uncertainties. Whether this constitutes being "in line with international consensus" or "engaging with the IASB and IAASB", which are included in the Sharman Panel recommendations, will depend on whether dialogue has already taken place with the wider international bodies.

Q8: 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?

Whilst many of the points are helpful, although perhaps more relevant to risk disclosures rather than consideration of going concern, we have doubts that directors of smaller companies are going to be easily able to digest and utilise the information in this document. There should be a separate "think small first" section, which explains the requirements as they might relate to a smaller company.

Q9: 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?

Firstly we would comment that this question appears to have at least 3 separate questions contained within it.

We agree that many of the disclosures surrounding risks and mitigation thereof should form part of narrative reporting applicable to the listed and banking sectors. However, we do not agree that it is right to impose further reporting requirements beyond the current statutory requirements.

Q10: 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?

As stated in the response to Q7 above, it is not clear if the FRC has sought to reach consensus with international standard setters and risks taking the UK away from existing guidance. We do not agree that the FRC should be making unilateral changes to auditing standards beyond those required to achieve alignment with UK legislation as this was the stated intention at the time the revised and clarity ISAs were introduced in the UK and Ireland.

Q11: 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?

Yes, we agree in broad terms.

Q12: Do you consider the proposed implementation date to be appropriate? If not, why not and what date should the application date be?

No, we consider the implementation date to be too early for businesses of all sizes to understand and apply the requirements. We also believe that changes will be necessary to the guidance which will mean that a deferment will be inevitable.

Q13: 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?

No, we believe the additional work required by the guidance is likely to result in additional cost and bureaucratic burden, especially to smaller businesses. In addition, as highlighted above, the possibility of increased disclosures of uncertainties and risks and use of Emphasis on Matter paragraphs from auditors is likely to lead to more confusion and less confidence from investors, lenders and, most importantly to smaller businesses, suppliers of credit in the UK and beyond. Credit reference agencies do not generally distinguish between variations of non-standard audit opinions, for example, and any disclosures and opinions that require detailed analysis may not translate well into their current systems.

Q14: Do you agree with the approach to SMEs in the Guidance? If not, why not and what changes should be made to the Guidance?

No, the 2009 guidance was developed from a “think small first” perspective with the needs of SMEs considered first and additional requirements of larger and listed companies layered on top. We believe this guidance should be structured in a similar way.

The guidance as drafted is written very much from a very large/listed or banking point of view which is understandable in the light of the need for the Sharman Panel report. However, if the guidance is aimed at all businesses it needs to better take into account the needs and sophistication of the management of smaller entities.

Q15: 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 no further comments.