To: Marek Grabowski, m.grabowski@frc.org.uk., 23 January 2014

Response to the FRC consultation on proposed changes to the UK Corporate Governance Code in relation to Going Concern.

We are delighted to submit evidence in response to the FRC's consultation paper on going concern and other matters.

By way of background, and to put our comments in context, Governance for Owners (GO) is an independent partnership between its executives and long term investors such as Railpen and IPGL. GO offers a number of investment management and shareowner services products, including:-

- The GO European Focus Fund that invests in a small number of European public companies where value can be added through exercising owners' rights to address key structural or strategic governance issues that have historically impaired company performance

- GO Stewardship Services that offer independent voting, corporate engagement and other advisory services on environmental, social, and corporate governance (ESG) matters.

A key observation of the Sharman Committee was that there was some confusion about what Going Concern meant. At one end there was a common sense interpretation, (that the company could meet it liabilities as they fell due), the other that it was appropriate to use standard accounting rules, which are known as the Going Concern Basis of Accounting. The Committee was of the opinion that the common sense interpretation was, de facto, the higher hurdle, and an important one for investors. Its vital purpose was to ensure that companies did not abuse limited liability protection.

The Committee recommended that directors should be able to declare that they had reviewed risks to the ability of the company to meet its liabilities, and that either it was a Going Concern, or that any assumptions and qualifications to this were made clear. They suggested that that assessment should be done prudently, that it should be made for the foreseeable future, not just for one year. If viability was in doubt it should be reported, but the aim of the attestation was to ensure that the company did not intentionally trade in a way, which might allow them to exploit the "option value" of limited liability (unless of course its investors understood this, as they might in an equity financed start up).

However, in the FRC consultation, this position seems to have changed. Going Concern is only to apply to the technical issue of whether it was appropriate to use “going concern accounting standards” not to the common sense meaning of the phrase. It is unclear whether risks which did threaten viability would be separately identified, nor is it clear the directors or the auditor be asked to confirm that, in their best judgment the company was viable or report any caveats they might have to that judgment.
In the Proposed Revisions to the UK Corporate Governance Code the clause requiring Directors to report that the business is a going concern has been dropped.

From a shareholder protection standpoint, it is difficult to understand why the FRC is proposing a measure that reduces shareholder protection. In a personal capacity as an Audit Committee Chairman and as a former Big Four audit partner, Eric Tracey has seen the enormous improvement in the quality of going concern papers going to audit committees and boards since the directors have had to make a positive statement on going concern in the annual report. The positive statement has been of real value and has reflected a full review of assets and liabilities (including contingent liabilities) and projected cash flows for a period usually of 18 months from the date of approval of the financial statements and sometimes beyond that when the circumstances required it. The FRC's proposed change is a seriously retrograde step, which, we fear would lead to the going concern work being done to support the basis of accounting and be seen as a "technical accounting matter" and not putting the directors reputations at risk in the way the going concern statement by them currently does.

Furthermore, the FRC proposals appear to minimise the responsibility of the auditors too. Rather than an auditor having to form an independent opinion on going concern, based on rational business economics, the FRC proposal would have the auditor merely forming a view on the going concern basis of accounting. This provides no basis for the auditor to conclude that the company is not a going concern if:-

- the board supports a reckless strategy (as happened with some banks)
- the board's approach to asset and liability measurement is so arcane as to leave the board unaware of its actual financial position is (as happened with many banks)

Accordingly, we strongly request the FRC to revisit this proposal and reinstate the requirement for Board to make going concern affirmations in their companies; annual reports.

The FRC's recommendation on going concern seem completely inconsistent with its recent very good contribution to improving the quality of annual reports with its pronouncements on “fair, balanced and understandable”, the introduction of audit committee reports and the FRC’s request to the IASB to bring back prudence, stewardship and reliability.

For and on behalf of Governance for Owners LLP

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