MARKS & SPENCER

Waterside House
35 North Wharf Road
London W2 1NW

Tel: 020 7935 4422
marksandspencer.com

The Sharman Secretariat
c/o Financial Reporting Council
Aldwych House
71-91 Aldwych
London
WC2B 4HN

7 July 2011

Dear Mr Grabowski

Sharman Inquiry – Going concern and liquidity risks: Lessons for companies and auditors

Thank you for your letter requesting the views of Ian Dyson on the questions posed in the Call for Evidence issued as part of the Sharman Inquiry. Ian Dyson left Marks & Spencer plc on 14 July 2010 and I was appointed from 28 October 2010.

The evidence submitted in the appendix is in terms of my role as Chief Finance Officer of Marks & Spencer Group plc which operates in the retail industry. I also have experience in the leisure sector and in the aircraft leasing sector.

Yours sincerely

Alan Stewart
Chief Finance Officer

Appendix

Transparency of going concern and liquidity risk

1 What combination of information about:

- ***The robustness of a company's capital;***
- ***The adequacy of that capital to withstand potential losses arising from future risks; and***
- ***The company's ability to finance and develop its business model,***

would best enable investors and other stakeholders to evaluate the going concern and liquidity risks that a company is exposed to? How effectively do current disclosures provide this information?

1.0 The following information will enable investors and other stakeholders to best evaluate the going concern and liquidity risks to which a company is exposed:

1.1 <u>Robustness of capital</u>
Clarity over the sources and diversity of capital the company has i.e. equity, debt capital, bank debt, free cash flow and working capital.

1.2 <u>Adequacy of capital to withstand losses</u>
Details which provide clarity include the tenor of debt capital; the terms of significant covenants and other restrictions; counterparty risks; and the disclosure of significant risks.

1.3 <u>The ability to finance and develop the business model</u>
Relevant information includes access to the market (from experience, documentation and investor knowledge); current credit rating, headroom and sensitivity; and flexibility around capital expenditure, dividend payments and other assets e.g. property; and forecasts and consensus of investors.

1.4 <u>Effectiveness of current disclosures</u>
The current disclosures are effective. Historical information is mostly provided through the published accounts or via the corporate website. The majority of the outlook information can be obtained through credit rating and equity analyst reports.

2 ***What type of disclosures (if any) have been made into the market place outside annual and interim corporate reports about current stresses being experienced by the company and about the management of those stresses? How do these disclosures interact with the requirement to disclose principle risks and uncertainty in the Business Review and the required disclosure on going concern and liquidity risk in the annual and interim financial statements?***

2.0 Disclosures into the market place, outside annual and interim corporate reports, about current stresses and the management of those stresses, include the disclosures in the standard European Medium Term Note programme renewal, which are consistent with those in the annual report. In addition, the corporate website outlines the details of the debt and borrowing facilities including the amounts and the maturity profile and a summary of the treasury risk management policies. These disclosures are sufficient combined with the company's internal process for going concern assessment and its internal process for satisfying its continuing obligations in line with the Listing Rules.

3 ***Are there any barriers within the current corporate reporting environment to companies providing full disclosure of the risks associated with going concern and liquidity both within and outside the company's annual and interim reporting? Are there any changes that might be made to encourage companies to give fuller and more transparent disclosures in this respect?***

3.0 There are no barriers within the current reporting environment (see question 2 above) and fuller disclosures are not necessary.

4 ***Given the current measurement, recognition and disclosure requirements of International Financial Reporting Standards (IFRS), how effective are IFRS financial statements in enabling stakeholders to evaluate the robustness of a company's capital in the context of the going concern assessment? Are there any changes that could be made to these requirements that would better enable them to do so?***

4.0 International Financial Reporting Standards, by their nature, tend to be backwards-looking and the introduction of fair value accounting has potentially removed some of the financial statements focus from cash and cash flow commitments.

Company assessment of going concern and liquidity risk

5 ***What processes are undertaken by directors in making their assessment of whether the company is a going concern when preparing annual and half-yearly financial statements?***

- ***Which records and information are referred to in making this assessment?***
- ***What type of model does the company use to develop scenarios to stress-test the assumptions that have been made when making this assessment?***
- ***What types of risks are included in the going concern assessment: financial, strategic, operational, other? How are these presented in the assessment?***
- ***What is the role of the audit committee and risk management committee (where one exists) in this process and what inputs do they receive in order to carry out this role?***
- ***What impact has undertaking the going concern assessment had on the planning and management of the company?***
- ***How has the assessment of going concern and liquidity risks been incorporated into other aspects of company stewardship and reporting?***
- ***How effective is this assessment in addressing the robustness and adequacy of a company's capital and its ability to continue financing and developing its business model? What, if any, improvements could be made?***

5.0 In making the assessment of whether the company is a going concern when preparing the annual and half-yearly financial statements the following process is undertaken:

5.1 <u>The records and information</u>

These include the operating plan, latest forecasts and three year plans; the debt maturity profile; the liquidity headroom; historical and forecast covenant compliance; the flexibility around the cash flows of the business (e.g. capital expenditure, dividends and working capital); and credit rating metrics.

5.2 <u>Models used to develop scenarios and stress-tests</u>

To stress test the assumptions downside scenarios are applied to internal operating plans, forecasts and three year plan models. In addition some statistical analysis and credit rating forecast modelling is performed.

5.3 <u>Types of risk included in assessment</u>

The risks included in the assessment are primarily financial and concern the ability of the company to maintain and support capital. Strategic risks are included within the financial forecasts (e.g. capital expenditure plan) and operational risks are limited and are mainly considered through the risk register.

5.4 <u>Role of Audit Committee and Risk Management Committee</u>

The role of the Audit Committee is to review and challenge the analysis and the assumptions used in order to test the stress basis before the assessment goes to the Board for their consideration. A going concern paper is presented to the Audit Committee in order to facilitate this review. The Risk Management Committee does not get involved in the process directly, but its annual assessment of risks is indirectly captured within the going concern review.

5.5 Impact of assessment on planning and management of the company

The guidance has introduced more clarity which is now specifically followed by the Audit Committee, the Board and the auditors.

5.6 Incorporation of going concern assessment into company stewardship and reporting

The assessment of going concern is incorporated into the company's corporate risk profile and register which is reported quarterly to the Executive Board, regularly to the Audit Committee, and annually to the Board. It is also an integral part of the operating plan, three year plan and quarterly forecasting process. It is also incorporated into the Board's annual capital structure review.

5.7 Assessment effectiveness

The directors' assessment is effective.

6 What is different about the review of going concern when raising capital compared to the annual going concern assessment undertaken for accounting purposes? Could some of the different procedures be used in the annual accounting or audit assessments?

6.0 No specific comment.

7 Does the company assess future cash flows and liquidity on a regular basis throughout the year? If so, how regularly is this done and is the information used any different to that used in the annual and half-yearly assessment of the purpose of preparing financial statements?

7.0 Liquidity is monitored on a weekly basis using the actual and forecast information, and cash flow variances to forecast are monitored monthly. The company assesses future cash flows for the current year on a quarterly basis as part of the forecast process. The operating plan and three year plan are updated annually.

8 To what extent and how do directors assess the viability of a company over the course of its natural business cycle?

8.0 An annual review of capital structure is undertaken by the Board. This takes in to account the business model, its reliance on external factors and its natural business cycle.

9 The current model of disclosure identifies three categories of company. What sort of behaviours does this model drive? Is there a different model that might be useful? Would more guidance on the application of the current model be helpful?

9.0 The current model places the onus on the auditors and the directors to identify the appropriate categorisation. This process is sufficient.

10 In your experience, what issues have resulted in a heightened focus on the assessment of going concern? What was the nature of the risks that gave rise to these circumstances? Had these risks been identified in advance, and if so, how?

10.0 The issues that have heightened the focus on the assessment of going concern are primarily caused by systemic near-failure of the banking and financing system with significant unrecognised counterparty exposures.

The auditor's approach to going concern and liquidity risk

11 How does the auditor approach the assessment of going concern and liquidity risk? To what extent does this involve the testing of the company's processes and what other work is carried out? Is there any specific reporting on the work done by the auditor on going concern and liquidity risk to Audit Committees? Does the assessment of going concern involve different processes in certain industry sectors? Are there different processes used where there is overseas reporting in addition to UK reporting?

11.0 The auditors approach to the assessment of going concern and liquidity risk involves the following:

11.1 The assessment is performed in line with the relevant auditing standards (ISA (UK&I)) and relevant regulation.

11.2 A key part of any review of going concern is that the auditors have a good understanding of the business and the people within the business. Their review is independent, robust and challenging and involves a thorough review of the models, approach and the stress testing.

11.3 The auditors review the going concern assessment with the Group Treasurer, the Chief Finance Officer and attend the Audit Committee during the company's presentation of the going concern review to the Committee. The Auditors' report to the Audit Committee contains a section on the review of the assessment of going concern and their conclusion as to the appropriateness of the company process. The Auditors also confirm their conclusions of this assessment to the Group Board. There are no significant overseas reporting requirements for the Group.

Feedback on Guidance for Directors of UK Companies in respect of going concern and liquidity risk

12 Do you believe that amendments to the Guidance for Directors of UK Companies in respect of going concern and liquidity risk would be helpful? For example:

- ***Guidance for directors on disclosures does not specify the language to be used, whereas auditors use more standardised wording. Is this helpful?***
- ***Is there a need for a clear boundary between the three types of company?***

12.0 Amendments to the Guidance for Directors of UK companies in respect of going concern and liquidity risk is not necessary as a comprehensive going concern assessment is already in place and incorporated into the forecast and planning process. Responsible businesses already take this approach.