



Grant Thornton

An instinct for growth™

Mr Marek Grabowski
Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London
WC2B 4HN

National Office

Grant Thornton UK LLP
Grant Thornton House
Melton Street
London NW1 2EP

T +44 (0)20 7383 5100
F +44 (0)20 7383 4715
DX 2100 EUSTON
www.grant-thornton.co.uk

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Dear Mr Grabowski

Implementing the Recommendations of the Sharman Panel

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to comment on the Financial Reporting Council's (FRC) consultation 'Implementing the Recommendations of the Sharman Panel' (the Guidance).

We fully support the recommendations of the Sharman Panel (Panel) and believe that due to the evolving economic situation, there is a need to revisit the 2009 going concern guidance (2009 Guidance) issued by the FRC. The 2009 Guidance was well received and has been widely used in the profession, to good effect. Consequently, we believe that any new guidance should adhere closely to the structure and content of the 2009 Guidance rather than rewrite it completely. We also believe that the Guidance issued by the FRC has gone further than the recommendations of the Panel and appears to have been developed with large companies in mind first and foremost. The Guidance does not follow the "think small first" approach of the Government. We, therefore, disagree with the approach that has been taken by the FRC and do not consider that the 2009 Guidance needed to be completely replaced. We note that the proposed changes add significantly more complexity for a very small increase in clarity.

Grant Thornton supports the growth agenda and believes that the application of reason combined with instinct will allow dynamic businesses to unlock their potential for growth. We, therefore, fully support the production of guidance that will enable companies to release resources that can be used for growth and the contribution to economic prosperity through the creation of employment opportunities. However, we believe the proposals as currently drafted will hinder growth and do not fully develop the principles established by the Panel.

We have included our detailed comments in Appendix A, but overall we recommend that the Guidance should be subject to detailed field testing in order to assess its feasibility prior to being used in its final form. In this context, this would be an ideal project for the FRC's Financial Reporting Lab to embrace.

Chartered Accountants

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Our key points may be summarised as follows:

Going concern

The main focus of the Guidance is that when considering whether a company is a going concern, reference should be made to the Listing Rules. This is illustrated by Section 1.12 "What is a going concern?" These rules require the directors to make a statement that the company is a going concern.

Discussion of the going concern concept in this sense is markedly different from that required by the 2009 Guidance. It requires a long term consideration of whether the going concern basis of accounting is appropriate, involving the consideration of whether the company is solvent over the business cycle, which for some businesses could be many years. Whether the company should prepare its accounts on a going concern basis is viewed as a by-product of this consideration. We believe that the focus of the Guidance is a fundamental shift from the 2009 Guidance, which stated:

"This Guidance provides a framework to assist directors, audit committees and finance teams in determining whether it is appropriate to adopt the going concern basis for preparing financial statements and in making balanced, proportionate and clear disclosures."

A number of the issues we have identified arise due to this change in focus as well as the requirements not being clearly articulated. We note that Panel Recommendations 2b and 3 suggested a discussion of the long-term purpose of the going concern assessment. However, we do not believe the focus of the Guidance needed to be changed to achieve these recommendations.

Material uncertainties

We believe that it is essential that genuine material uncertainties casting significant doubt over the going concern basis of accounting are reported in the financial statements. We also believe that the going concern discussion in the narrative section of the annual report should not be restricted to situations where there are only significant doubts about a company's ability to survive. We, therefore, support Panel Recommendation 4 and any guidance that would encourage companies to provide more insightful narrative disclosure regarding going concern. We believe that the objective to improve disclosure in this area can be achieved within the bounds of current legislation and accounting standards.

We think that the proposals as drafted will lead to a significant increase in the number of companies reporting material uncertainties over the going concern basis of preparation. As a result, many companies that would not have had material uncertainties under the 2009 Guidance will appear to have material uncertainties under the Guidance. We do not consider that this is because material uncertainties are currently being under-reported and do not believe that this was the intention of the Panel. In our view, the extension of the definition of material uncertainties was not required in order to encourage companies to include better narrative discussion around going concern.

Due to confusion over the definition of going concern in the Guidance, the potential increase in the number of reported material uncertainties may have a negative impact on the public perception of companies and also may hinder growth. As the proposals will only be applicable to UK companies, the proposals may also put them at a disadvantage when compared to those operating in other jurisdictions. In the light of this, we encourage the FRC to continue to influence international discussions but to also ensure that the Guidance issued does not put UK businesses at a competitive disadvantage.

We also note that an increase in the number of material uncertainties will potentially increase the number of emphasis of matter paragraphs in audit reports and as a consequence devalue their use. This development will also work against the FRC's cutting clutter agenda. It is also not clear what consideration has been given to the impact that the expected increase in material uncertainties will have on bank covenants and funding arrangements.

New Concepts

The Guidance introduces a number of new concepts and interpretations around "high level of confidence", "material uncertainty", "foreseeable future" and "solvency" etc. Further, the 2009 Guidance cannot be traced to the new guidance. As a result, the Guidance will require a significant investment from users to become familiar with its requirements. We do not believe that the implementation date allows sufficient time for this investment.

Application to all

The guidance appears to be written primarily for companies listed on the Main Market of the London Stock Exchange but will be applicable to companies of all sizes. We believe that this will prove onerous to all companies that are not listed on the Main Market. The development of the guidance also appears have been developed without consideration of the Department for Business, Innovation and Skills (BIS) principle of guidance and legislation starting small and building for larger companies.

If you have any questions on our response, or wish us to amplify our comments, please contact Jonathan Shaw (tel: 020 7728 2576, email: jonathan.shaw@uk.gt.com) or Peter Leadbetter (tel: 020 7728 2977, email: peter.leadbetter@uk.gt.com).

Yours sincerely



Mark Cardiff
Head of Audit
For Grant Thornton UK LLP

T 020 7728 280
E mark.cardiff@uk.gt.com

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 acknowledge that the Guidance considers two different purposes of going concern reporting and agree with the purpose of the going concern assessment. However, the Guidance promotes the Stewardship purpose, ie requirements of the UK Corporate Governance Code (the Code), as its primary focus. As noted, the primary focus of the 2009 Guidance was regarding the application of the going concern basis of preparation of financial statements and the reason for this change in emphasis is not clear. We do not believe that this change of focus was recommended by the Panel.

In particular, we note that the heading of Section 1.12 of the Guidance (Section) "What is a going concern?" will cause confusion. This section may be read as referring to either the going concern statement required by the Code or the going concern basis of preparation. If it is read with reference to the going concern basis of preparation, then it introduces new concepts that are not used by generally accepted accounting standards in determining the going concern basis of accounting.

We, therefore, recommend that the definition of a going concern is consistent with that used in relevant accounting frameworks on which financial statements are prepared.

The guidance could be improved by having two distinct sections – one for the stewardship purpose and going concern statement required by the Code and the other for the financial reporting purpose.

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?

We agree with the description in the Guidance of when a company should be judged to be a going concern, with the exception of the use of "high level of confidence." However, this consideration of going concern must not be confused with the going concern basis of accounting, which the guidance appears to do. We do not believe that this was the intention of the Panel.

We agree that the going concern assessment should consider all actions whether inside or outside the normal course of business and that this would be consistent with current discussions by the International Accounting Standards Board (IASB).

The term "high level of confidence" is not sufficiently understandable because it is a new term and, due to its nature, it is a matter of judgement. The use of the term "high level of confidence" combined with the requirement to base consideration of going concern over the business cycle of the company, in our view, places the bar too high. The threshold should be modified by using a term that is already used in either law or accounting standards.

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?

Section 2.12 makes clear that actions outside the normal course of business are usually symptomatic of severe distress. The implications of actions outside the normal course of business are, therefore, clear. We note the discussions by the IASB in January 2013, that actions outside the normal course of business may indicate material uncertainties when considering the going concern basis of accounting. The term "outside the normal course of business" is, therefore, being used both in determining whether the company is a going concern for the purposes of the Code and for determining whether there are material uncertainties when considering the going concern basis of accounting. The fact the term is used in both circumstances may lead to further confusion.

The examples in table 2.10 are at two extremes and do not cover the large range of scenarios that fall between these points. As acknowledged by the Guidance, consideration of these will be a matter of judgement. By definition therefore, the Guidance cannot provide clarity regarding the concepts.

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?

The going concern assessment period is not clear due to there being two meanings of foreseeable future in the Guidance. Section 2.20 states that the period of assessing detailed budgets will normally be 12 months from the date the financial statements are approved and that there must be a high level of confidence that the solvency and liquidity risks can be managed in this period. However, section 2.21 then states that when considering solvency, boards will address longer periods. Section 2.22 appears to suggest that there are different parts to the going concern process by the use of the term 'periods' rather than period.

Overall, the term 'foreseeable future' is not clear. The Guidance appears to confuse the period of assessment for concluding:

- When an entity is a going concern for the purposes of the directors' statement required by the Listing Rules; and
- When the going concern basis of accounting is appropriate.

We believe that the Guidance should be changed by clearly distinguishing between the two assessments. In this context, we note the Sharman Panel Final Report (FR) FR117 comments that:

"The Panel was not seeking to change the primary focus of the assessment on the entity's ability to continue as a going concern for the foreseeable future and, in that context, on the entity's ability to meet its liabilities and to continue in operation for at least the next twelve months. However, the Panel recognised that the definition of the foreseeable future already rightly focused on the need to consider all available information about the future."

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, in our view, a key cause of confusion is different uses of the term 'going concern.' The guidance does not clarify or address this point directly. This confusion will only serve to add to the expectation gap between users and preparers of financial statements.

A particular confusion appears in sections 2.26 and 2.27 which consider the appropriateness of the going concern basis of accounting. However, the sections are in the middle of a section that appears to be considering the Code's requirement for a statement that the company is a going concern. Their placement, therefore, causes confusion.

Section 2.33 makes clear that it is a matter of judgement whether the company is a going concern. It appears that this reference relates to the statement required by the Code. The guidance in this section states the company is a going concern in terms of the Code by reference to the going concern basis of accounting. It achieves this via cross reference to Section 4.6. The going concern statement required by the Code is, therefore, defined by reference to the going concern basis of accounting – although the two concepts appear to be distinct in earlier discussions. In our view, this cross reference adds to the confusion regarding the use of the terms.

The Guidance should be improved by including a clear section that states the meaning of whether a Company is a going concern for the purposes of the Code and the meaning for the going concern basis of accounting. The going concern basis of accounting should be defined by reference to the applicable accounting standards.

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?

The assessment of material uncertainties is a matter of judgement and we, therefore, agree with the Guidance in this regard.

Section 2.32 requires the board to have a high level of confidence about the solvency and liquidity of the company for the foreseeable future. This appears to mean a high level of confidence regarding solvency and liquidity is needed over the business cycle. We do not believe that the majority of companies will be able to obtain a high level of confidence in this area and believe it is a test that most companies are almost certain to fail. We, therefore, anticipate a significant increase in the number of material uncertainties. We acknowledge that accounting standards require all information regarding the future to be considered when discussing material uncertainties. However, accounting standards do not require directors to obtain a high level of confidence regarding the effectiveness of their actions over the business

cycle. It is, in our opinion, the requirement to obtain a high level of confidence over the business cycle that will trigger an increase in the number of material uncertainties.

The guidance appears, therefore, to extend the application of material uncertainties to the long term rather than to assessing whether the going concern basis of accounting should be adopted in preparing the financial statements. The interpretation of material uncertainties is, therefore, not consistent with current UK and International Accounting Standards and the discussions that the IASB is currently undertaking. As a result, the Guidance appears to move the UK away from both current accounting standards and international developments, which was not a recommendation of the Panel.

We note that the Panel in FR108 states:

"In developing the final recommendation in this area, the Panel recognised the concerns that a good number of respondents raised that the FRC should seek to take the international community with it rather than making changes to UK accounting and auditing standards and then seeking to influence the international community to adopt similar amendments."

We, therefore, recommend that the Guidance issued should not be inconsistent with the principles applied internationally.

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?

We do not believe the interpretations are consistent with FRS 18 and ISA 570 due to the extension of material uncertainty as discussed in question 6. We also note that the interpretations are not consistent with FRS 102. We believe the guidance should be amended to remain consistent with accounting 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?

The Guidance contains qualitative points in relation to solvency. These points were not included in the 2009 Guidance and so the Guidance implements Recommendation 3. We support the Guidance in encouraging directors to make longer term considerations when performing the going concern assessment. As noted in the Guidance, the going concern assessment should not be an exercise that is undertaken once a year nor an exercise that only looks forward over 12 months. We note that accounting standards require all information to be taken into account when considering whether the going concern basis of accounting is appropriate and therefore the guidance is consistent with accounting standards in this regard. However, contrary to the Guidance and discussion in question 6, we do not believe that Recommendation 3 would lead to changes in the use of material uncertainty.

The Panel recommended the implementation of stress tests which the Guidance has incorporated and we support the Panel's recommendation. However, this will be a new concept for many entities that do not have the current sophistication to complete such an exercise and so this area could usefully be field tested before implementation. When performing this field testing it is important that the pilot companies include smaller and medium sized entities, with a view to ensuring that the provisions regarding stress testing are not unduly burdensome for smaller entities.

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?

The term 'robustness of the going concern assessment and its outcome' is not clear and represents an additional new concept for users to become familiar with. However, the risk that the requirement will lead to boiler plate disclosure is mitigated by the Guidance requiring specific issues to be addressed in discussing the going concern assessment.

We agree with the approach that the board should adopt as discussed in Section 3.

As the Guidance is currently drafted, we agree that the board should set out how it has interpreted the term "the foreseeable future". This is necessary because the period used is likely to influence whether material uncertainties are identified – if a company interprets the foreseeable future to be 20 years then it is more likely to have material uncertainties than a company which interprets the foreseeable future to be a period of say 5 years. An explanation of the term foreseeable future will be essential for a user to be able to put any material uncertainties that are disclosed into context.

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 understanding is that this recommendation is in relation to the auditors assessment of the wider narrative reporting that would be made in the annual report and not to the financial statements. With that in mind, we do not oppose the Sharman recommendation for auditors to include an explicit statement in their report as to whether they have anything to add or emphasise in relation to the disclosures made by the directors about the robustness of the going concern assessment process and its outcome.

However, the proposed ISA 570 and ISA 700 need to be clear that the requirements are in relation to the auditors consideration of the commentary in the annual report. In our view the requirements currently imply that the auditor should supplement financial statement disclosures made by the directors about the going concern assessment and its outcome, where there is information missing. This would breach the requirements of ISA 705 to express a qualified opinion when the auditor concludes that the financial statements are misstated.

In particular, ISA 570.18(a) requires the auditor to determine whether the financial statements "adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern."

The guidance should clarify that auditors will need to think carefully as to whether supplementary information in relation to the disclosures made by the directors constitutes inadequate disclosure under the financial reporting framework, and therefore whether a qualified opinion is required on the financial statements in accordance with ISA 570.20 and ISA 705.7(a).

In addition, the guidance in ISA 260.A20-7 notes that the directors may also be assisted in their assessment of the going concern basis of preparation by understanding the auditors views on the robustness of their assessment. This, in our view, appears to be circular and it is not clear how it would be applied in practice. Further, it is important that the auditor remains independent from this process yet the Guidance as written appears to preclude this.

In addition, the guidance in Section 1. Paragraph 17(e) of the Draft Guidance on Going Concern notes that the directors will be assisted in their assessment of the going concern basis of preparation by understanding the auditors views on the robustness of the directors assessment. This activity is circular and impracticable, as the auditor will be unable to fully consider the robustness of the directors' going concern assessment, and report thereon, until the directors have completed their review. Further, it is important that the auditor's judgement on the matter remains independent from the directors' judgement, yet the Guidance as written appears to preclude this. We strongly suggest that the requirement for directors is deleted.

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?

As detailed in our response to the Sharman inquiry – Preliminary Report and Recommendations of the Panel of Inquiry, we do not believe that there should be separate guidance for banks. We believe that it is for the prudential regulators to set such additional requirements for banks, should that be necessary. We also believe that if support is irrevocable or if on agreed terms then this does not constitute a material uncertainty. Finally, we believe that the banking system is not established to run on regular central bank support for 'normal' operations.

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

No. The Guidance is very different to the 2009 Guidance and therefore will represent fundamental changes for all companies. As such, we would recommend field testing the Guidance ahead of implementation. The Financial Reporting Lab may be able to provide an environment for such field testing.

Question13: 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 do not believe that the Guidance will deliver the intended benefits as the positive messages will be lost amongst the unnecessary increase in the number of companies reporting material uncertainties and having an Emphasis of Matter in the audit report. It is impossible to quantify the cost or impact of this and we would recommend field testing in order to assist in establishing this.

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?

We recommend that the FRC provides greater clarity to SMEs on the practical application of the principles in the Guidance. In this context, we encourage the FRC to use the format adopted in the 2009 Guidance.

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?

We do not have any further points to make.