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25 April 2013

Our ref: 000/DI/NG

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Dear Marek

Consultation Draft: Implementing the recommendations of the Sharman Panel: Revised Guidance on Going Concern and revised International Standards on Auditing (UK & Ireland)

We welcome the opportunity to comment on the above consultation. BDO is the UK member firm of BDO International, the global accountancy network, with nearly 55,000 people in more than 1,200 offices in 138 countries.

GENERAL COMMENTS

We continue to consider that the recommendations of the Sharman report are welcome, but we have severe reservations about the content of the consultation draft. In particular:

- We believe the proposals put a disproportionate administrative burden on SMEs
- Modifications of audit opinions to make reference to going concern may become commonplace, and even a default position for many companies and even for entire sectors of the economy, devaluing the value and impact of audit reporting and resulting in loss of comparability on the international markets, so disadvantaging UK-based companies.
- The vagueness, deliberate or otherwise, within the guidance makes it practically unhelpful.

We do however welcome the introduction of more granular narrative reporting on going concern, insofar as it affects listed companies, and believe these proposals could be more firmly rooted in more general improvements being made in such reporting.

SPECIFIC COMMENTS

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?

As indicated above, we do not believe the guidance appropriately provides clarification as to the purposes of the going concern assessment, nor its reporting, and is therefore inappropriate.

In particular we believe the use of the phrases “high degree of confidence” and “foreseeable future” and their use in the form and context in which they are given would lead to many companies having to have an emphasis of matter paragraph within their audit reports as a matter of routine. The introductions of these phrases in the text actually provides the opposite of guidance – it merely raises questions about what they mean and how they should be interpreted in practice.

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?

It follows from our answer to question one that we do not agree with the description and the guidance to which you refer. We do agree that any judgement about going concern should take full account of all actions which management could take to mitigate adverse circumstances (such as, for example, the postponement of capital investment). Such actions are normal in a business environment that is inherently 'uncertain' and where the only real certainty is that one's budgets and plans will not be a reflection of outcomes.

Whilst it may be a truism that outcomes do not reflect plans, it is one that becomes more evident the longer the timescale being considered. The longer, if undefined, period of the going concern review must impact on the 'high level of confidence' expected. This effect is exacerbated by the plain fact that businesses operate in an environment that is not entirely of their own making. The providers of finance, whether they be debt or equity, do not tend to make long term commitments about the availability of future funds (possibly because they find it difficult to have a high level of confidence about the future themselves) and, as most businesses will have financing requirements over more than a short term period, it is increasingly difficult for anything that looks like a high degree of confidence to be stated by the directors, when a considerable part of the equation is going to be out of their hands.

Again this could lead to modification of audit reports on a large scale.

We concur that consideration of solvency and liquidity risk should be an integral part of business planning. We find the guidance unhelpful in referring to the foreseeable future and then talking about a generally accepted minimum of 12 months.

Paragraphs 19 to 22 do not constitute 'guidance'.

We find the material on SMEs to be almost risible. Quite apart from the 'red tape' burden that the guidance implies for smaller companies, the likely use of 'stress testing' or sensitivity analysis of business planning for SMEs will, as a practical matter, be observed in the breach. It would be disingenuous to engineer into the SME reporting process (and audit) a level of science which it in reality, very often absent.

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?

We believe the distinction is relatively clear, but unimportant. There will always be a spectrum of actions which will have clarity at their extremes. Most practical considerations will be in the centre of the spectrum where these interesting, but slightly theoretical, concepts merge. We are not entirely sure that the exposition of these concepts has any impact on outcomes anticipated by the guidance.

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?

We do not believe the guidance gives any clarity to interpreting the foreseeable future. We consider that the guidance should be modified to require longer term going business viability concerns to be dealt with in narrative reporting and that the test of going concern in relation to the existence of material uncertainty should remain over a short time period that may be consistent with the possibility of the existence of a high degree of confidence being possible.

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?

There is the potential for confusion here. There is a clear distinction between when a company is not a going concern and when there are material uncertainties which might impact upon the going concern basis of accounting. It does not help to potentially confuse these with long term viability issues by labelling the latter as a question of being a 'going concern'.

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?

As in our response to question five, we believe that the going concern and longer term viability issues are being confused and that these are two separate matters for discussion. The first of these is the going concern assessment, which is necessarily short term in nature, and the longer term features of the business which may have an impact on solvency or liquidity. Clearly there is a relationship between the two but they appear to us to be matters that require separate, albeit linked, discussion. For the reasons given above we do not believe that this guidance clarifies the accounting and stewardship purposes of the going concern assessment. It certainly does not do so in terms of international application, and we are concerned that UK business could be at a competitive disadvantage if the guidelines result in a large proportion of UK companies having modified audit reports in respect of going concern.

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?

The Sharman report recommended the FRC engage with international standards setters on the topics covered by the guidance. The guidance itself notes it is intended to "seek to influence the outcome" of an international position. Whilst we applaud the FRC taking a position of international leadership, we do not believe this guidance is a desirable starting point.

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?

The material relating to SMEs is unrealistic in its expectations of most SME's business planning activities.

Q9 Do you agree that the approach taken in Section 4 of the Guidance in implementing the disclosures in Recommendation 4 are 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?

We agree that the guidance on reporting on going concern in section four is appropriate, within the terms of the guidance overall. We do consider it sensible for disclosures regarding solvency and liquidity, whether they be about going concern or longer term viability to be in the same place within the annual report, unless reference is required in the audit report to the adoption of the going concern basis.

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?

We consider the requirement that the auditor report on whether he has 'anything to add' to be unfortunately open ended.

More fundamentally, we would not support unilateral changes to international standards in one territory unless there was an overriding reason for it. We do not see one here.

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?

Whilst we understand the desire for stability we do find it a little bizarre that the issue that has caused a crisis of confidence is effectively scoped out of the guidance. From what we understand of the facts, if the events of 2008 were to take place again with this guidance in place, the outcomes would remain the same as they were then. This will be difficult to explain to a broad public audience.

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

We do not believe the guidance should be implemented. If it is implemented in a substantially unchanged form then we believe a long period is needed for clarification of what it means (effectively for guidance to become available on the guidance) and we believe the proposed implementation date is wholly impractical.

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?

We do not believe it will deliver benefits, for the reasons set out above.

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?

SMEs appear to feature in the guidance as an afterthought, which is unfortunate in view of their importance to the UK economy and the likely impact this guidance will have. SMEs will struggle with this guidance, to the extent that they could well place an inappropriate level of reliance on their auditors.

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 consider the 2009 Guidance issued by the FRC to be amongst their most effective and powerful communications, both for companies and for auditors. As other commentators have noted it would have made a useful starting point for this guidance.

If you have any queries in relation to our above response, please contact James Roberts on 01293 591087

Yours sincerely

BDO LLP