IMPLEMENTING THE RECOMMENDATIONS OF THE SHARMAN PANEL

Note of a public meeting held on Thursday 25 April 2013 at the RSA, 8 John Adam Street, London, WC2N 6EZ

PANEL

Stephen Haddrill	Chief Executive Officer, FRC
Lord Sharman of Redlynch	Chair of the Panel of Inquiry
David Pitt-Watson	Member of the Panel of Inquiry
Marek Grabowski	Director of Audit Policy, FRC

ADDITIONAL SPEAKER

Liz Murrall	Director, Corporate Governance and Reporting, Investment Management Association

---

PANEL PRESENTATIONS

Stephen Haddrill welcomed the members of the Panel and outlined the key challenges to corporate reporting and governance in the wake of the financial crisis that had led to the establishment of the Sharman Inquiry. There had been concerns about whether bank boards had been too short-termist, the role of accounting standards in driving volatility, whether investors were properly informed about risk, whether audit had provided enough challenge to boards and above all how so many banks (and subsequently other companies) had gone bust soon after asserting they were going concerns.

The FRC had already improved the Corporate Governance Code and auditing standards, with audit committees now required to report all significant issues to investors and auditors required to provide assurance on that report, as well as a requirement that the annual report and accounts should, as a whole, provide a fair, balanced and understandable view of the business. The Financial Reporting Review Panel had also highlighted a number of issues over the quality of risk reporting. Guidance had been issued to auditors by the FRC and by financial regulators on the need for greater scepticism and this was a strong theme of the FRC’s audit inspections. All of this had strengthened the focus on the management of short-term and long-term risk and on effective reporting to investors.

The Sharman Inquiry had been asked to identify the lessons for companies and auditors addressing going concern and liquidity risks and to make recommendations and the FRC’s proposed revised guidance on going concern and revised auditing standards had followed from those recommendations.

Lord Sharman gave an overview of the Panel’s purpose and conclusions in which he made the following main points:

- There are two purposes that the going concern assessment and reporting process fulfils.

- First, there are the accounting related matters. Should the going concern basis or a liquidation basis of accounting be adopted? The threshold for doing so is very high – the threat of liquidation must be imminent and virtually certain. And, if not, are there nevertheless material uncertainties about the entity's ability to continue as a going concern that should be reported so as to indicate that the accounting information drawn up on the going concern basis of accounting could be wrong if those uncertainties were to fall in? These are important disclosures.
- However, the Panel concluded that the primary purpose is not to inform outsiders of distress through such accounting disclosures. It is not to try and ensure that the first person to read the accounts on a Bloomberg screen gets to sell their shares, while others are left standing. Rather, it should be about the economic and financial viability of the entity. It should be to demonstrate that the directors' stewardship of the going concern status of the entity has been effective.
- The Panel concluded that the stewardship purpose is or should be the overarching purpose of the going concern assessment and reporting process. It should be to ensure that the directors manage the company to avoid economic or financial distress, while still taking well-judged risks. That judgment must rest with the directors, and we concluded that in making our recommendations we should aim to encourage them to discharge their duties in that regard with skill, and in good faith. The proposal that we would do so was set out in our preliminary report and received overwhelming support.
- Our aim was not to stifle risk-taking but to reinforce responsible behaviour in the management of going concern risks for companies.
- Proper management of going concern is fundamental to the operation of limited liability companies. The law sanctions that limitation. But the privilege must not be abused. The Companies Act also establishes responsibilities to shareholders and to other stakeholders that directors must have regard to as they pursue the success of the company. In doing so, directors must manage the risks that the company faces and that they decide to take in executing the company's business model and strategy, being careful to balance their duties to shareholders and other stakeholders, particularly creditors.
- On the other hand, the expectation that they will not fail must not be so high as to inhibit sensible risk taking that is critical to the growth and maintenance of economic activity.
- Our aims were threefold. First, to encourage better risk decision-taking, having regard to their duties. Second, to ensure that investors are well-protected and informed about risks to the company's going concern status. And third, to create an environment in which directors think about the risks to going concern as an integral part of their business planning so that they are better able to respond early to the onset of financial or economic distress.

He also outlined the key recommendations of the Panel which fell into two main groups:

- Those that sought to enhance the behaviours already referred to include:
    - Refocusing the going concern assessment to ensure it appropriately addresses signs of economic and financial distress that would threaten the survival of the entity if they were to fall in.
    - Integrating the going concern process with normal business planning and risk management activities so that it is not seen as an accounting exercise undertaken intermittently when accounts have to be drawn up.
    - An enhanced role for auditors.

- In addition, we proposed some harmonisation and clarification of definitions in the accounting, auditing and governance requirements. We also addressed a critical question that emerged in the crisis in relation to banks: How can disclosure of material uncertainties be reconciled with financial stability?

Enlarging on the above themes, **Lord Sharman** made the following additional points:

- The directors' going concern assessment process should be integrated with their business planning and risk management and the thinking emerging from that process should inform their risk decision taking and better enable them to recognise and respond to financial or economic distress at an early stage - accounting and stewardship disclosures should fall naturally out of this process;
- Outside the financial services industry, the going concern process was largely focussed on liquidity rather than solvency which was at least as important because it underpinned the ability to obtain debt funding as well as equity funding – solvency risks needed to be assessed over the business and economic cycles. The assessment of solvency risks was likely to be more judgemental than an assessment of liquidity risks, which tended to be shorter-term and more quantitatively based;
- Stress testing was a valuable tool which needed to be part of the assessment process, tailored to the circumstances and business environment at the time, taking into account directors' appetite for risk and that of their stakeholders and having regard to their duties as directors;
- IFRS was said to have moved away from prudence towards neutrality and the Panel acknowledged the benefits in terms of comparability from such a shift but took the view that it was important to maintain prudence in making going concern risk assessments;
- Narrative reporting on the going concern status of the company should be integrated with the audit committee reporting and auditing changes introduced by the FRC in September 2012. Such reporting should form part of the picture of principal risks taken and faced by the entity. The report about the work of the Audit Committee should demonstrate the robustness of the assessment – more regular reporting about going concern risks (not only when they are heightened) should reduce the stigma attached to an emphasis of matter paragraph in the auditor's report (the requirement for which the Panel was no longer recommending should be removed). It should also engender a more measured response from stakeholders and greater confidence in the processes undertaken, and decisions taken, by the directors;
- There needs to be an enhanced role for auditors by including an explicit statement in their reports about whether the auditor has anything to add or to emphasise in relation to the narrative disclosures on the going concern status of the entity and related risks and about the robustness of the assessment process;
- Clarity and consistency was needed around what constituted a going concern for the purposes of the board's statement under the Code and what constituted a material uncertainty for the purposes of the accounting and auditing standards. There was evidence these things were not consistently understood, undermining the effectiveness of the going concern assessment process and creating expectation gaps – the definitions of going concern, purposes of disclosures and thresholds for reporting needed to be harmonized in UK standards and efforts made to harmonise them internationally;

In relation to banks, Lord Sharman observed:

- Banks' funding models were inherently unstable and any signalling of material uncertainties about their going concern status may trigger a liquidity shock and potentially a run on the bank leading to a need for government support - disclosure of the need for support would inevitably lead to a run on the bank forcing the hand of the authorities even where the crisis could have been avoided using the liquidity support facilities;

- A question considered by the Panel was whether the public interest objective of financial stability should ever over-ride the public interest objective of transparency in capital markets and the Panel had concluded that a special regime for banks was not necessary.
- The responsible behaviour encouraged by the Panel should reduce the likelihood of banks getting into trouble when faced with significant stresses in the first place. However, where they nonetheless do so, the Panel proposed a balanced approach that maintains appropriate market transparency whilst not taking this so far as to thwart the protection to financial stability which is the whole purpose of the liquidity support facilities the Bank of England provides, with the support of Parliament.
- The balance of the benefit to the public interest lies in non-disclosure of such liquidity support only where a bank is judged: to be solvent and to remain so despite the stresses it faces; to have a credible path to the point where it no longer needs to rely on that liquidity support; and to be eligible to receive that support on the available terms for that period.

David Pitt-Watson commended the FRC for its consultation document which complemented the Panel's aim of trying to encourage good commerce. 2008 had been bad for commerce and investors, with a loss of trust in the system and a resultant wave of new regulation. In examining going concern the Panel had sought to be true to the traditions of audit and to promote a system that encouraged directors to do the right thing in the first place. Going concern, among other things, was primarily about ensuring directors did what was needed to avoid financial or economic distress while still taking well-judged risks.

Going concern was an internal decision of the company and, while a lot of the information declared would be useful to investors, its primary purpose was in demonstrating that the limited liability privilege was not being abused.

The last thing the Panel would want was to put additional bureaucracy on small businesses but there was evidence of the directors of small businesses looking for help too late when they should have been taking action much sooner. The Panel's recommendations should help to make sure that did not happen. Better management that avoided economic and financial distress would be a big boon to small companies.

It was in the interest of good commerce for directors to behave in a way that avoided economic and financial distress while still taking well-judged risks – judgements that had to be taken by directors, not regulators.

Marek Grabowski outlined the approach taken by the FRC in trying to implement the Panel's recommendations in the context of the changes to the Corporate Governance Code introduced in 2012 and explained how the consultation document had been structured.

The FRC’s proposals addressed the Panel’s primary recommendations on the purposes of the going concern assessment, reinforcing good behaviours, clarifying meanings and central support for banks and aimed at producing guidance that was practical and appropriate. The FRC had also continued its liaison with the IASB and IAASB to influence and monitor developments internationally.

In developing its proposals, the FRC had put forward an overarching purpose of the going concern assessment: *“to ensure that risks that would threaten the company’s survival are properly identified and managed, respecting the interests of shareholders, creditors and other stakeholders”* under which the stewardship and financial reporting purposes had been addressed, a key aspect of which was additional guidance on when an entity was judged a going concern for the purposes of the Code and in relation to the existence of material uncertainties.

The proposed definition of when an entity would be judged a going concern under the Code was: *“If there is a high level of confidence that, for the foreseeable future, it will have the necessary liquid resources to meet its liabilities as they fall due and will be able to sustain its business model, strategy and operations and remain solvent, including in the face of reasonably predictable internally or externally generated shocks”* was intended to be met even if there was no realistic alternative to taking actions outside normal course of business so long as there was also high confidence those actions would be available and effective. Even where such a high level of confidence was obtained, there may be material uncertainties to disclose, for example, where knowledge of the impact of necessary mitigating actions would affect economic decisions of users.

In relation to this definition:

- *“High level of confidence”* was not an absolute level of confidence but a judgement arrived at through the assessment process with the board applying its skills and experience; and
- *“The foreseeable future”* was not a fixed period but was the period over which the board had or would be reasonably expected to have available information about the future, based on a robust assessment process, including its qualitative assessment of solvency risks over the investment cycle.

The proposals set out an interpretation of what was meant by material uncertainties, whose purpose was to forewarn of significant solvency and liquidity risks (of such magnitude and meaningful possibility of occurrence that they would raise serious questions about the company’s ability to continue as a going concern). Boards would be expected to consider the possible implications for economic decisions of users including the magnitude of the impact on the company, the likelihood of occurrence, the impact of mitigating actions available (and their likelihood of effectiveness), including any that would be outside the normal course, and the implications of their crystallisation or of necessary mitigating actions for users.

Materiality was a matter of judgement, but something would usually be material if severe distress had occurred (or was likely to result) and there was no realistic alternative to actions outside normal course of business unless the board was highly confident that those actions would be effective. Something would not be material if its likelihood was remote.

The proposals also covered narrative and financial reporting by boards and reporting by auditors.

In relation to banks the consultation document set out supplementary guidance as there was a lot of contextual material not relevant to other sectors) which proposed that central bank support should be regarded as a normal source of funding and emphasised the importance of liaison between all interested parties.

Liz Murrall gave an investor perspective on the FRC's proposals in which she emphasised the importance to investors of the information on which they had to base their investment decisions and exercise their responsibilities as owners. Trust in this information was vital. With accounts being presented on a going concern basis investors in failed companies had often received little indication that there was anything amiss. In the run up to the financial crisis the customary boilerplate disclosures conveyed very little about how companies were being managed. In the case of RBS its 2007 accounts had been signed off in 2008 with no indication of future financing problems. There had been rumours in the market in April. In June, RBS had gone to the market with one of the largest rights issues ever. Investors could not possibly have contemplated this in the absence of any signals from the bank itself or its auditors. Some people argue that the accounts are largely confirmatory of past events and that such a significant post balance sheet event could not have been predicted at the time. However, the uncertainties must have been such that questions should have been asked and the matter made more transparent to investors.

Investors very much welcomed the Sharman Inquiry and subsequent Report. It had asked important questions and had raised good issues, in particular the recommendation that the FRC should move away from a model where disclosures were made only where there were significant doubts to one in which there was more regular reporting on going concern.

Investors also supported the FRC's proposed enhancements to the going concern assessment, its integration into the business planning, risk assessment and strategy and the move from a 12 month 'foreseeable' future to the board's own assessment of the future. The going concern assessment should be integral to business, particularly when times were tough. Past improvements to the guidance had driven directors to consider and deal with issues earlier. Disclosure of material uncertainties and their management, the need for a robust going concern assessment and discussion of how it had been obtained and the requirement for auditor consideration of the disclosures and the process were all likely to improve transparency on the part of companies and auditors. Initial apprehension about some of the disclosures should be overcome once they were better understood and practice was seen to improve.

UK asset managers held only 34% of the UK equity market which was increasingly held by overseas investors so there was a concern that the increased reporting of going concern uncertainties that would result from the proposals might not be understood by overseas investors with a resultant impact on the ability of UK companies to attract overseas finance and ultimately on the cost of capital. Also, over 63% of all assets managed were listed overseas so it was important that concepts and terminology should be standardised internationally (and not just changed unilaterally in the UK) in the interests of global comparability.

Overall, investors supported the proposals for improving the behaviour of companies and their auditors and the information the market will receive.

Stephen Haddrill rounded off the presentations by acknowledging that the issues around going concern had to be considered in the contest of the accounting and auditing standards and that there was a technical dimension but he looked forward to a discussion around the primary objectives and the quality of the judgements made by boards and their ability to do so which needed to be rooted not just in technicality and standards but in the quality of corporate governance within the company.

QUESTION AND ANSWER SESSION

(*Contributions and questions from participants appear in italics below alongside the responses and observations from Panel Members)*

Julia Penny (Wolters Kluwer) *While it was desirable for all businesses to review going concern on an on-going basis as part of their business model would small businesses realistically be able to cope with the proposals in their present form and in particular to translate the requirements for stress testing into their individual situations? The principle was good but the practice might leave small businesses floundering.*

Lord Sharman Most of the evidence put to the Panel had been from larger companies. It had been striking that the evidence of how companies went about making their going concern assessments ran from those for whom it was a last minute exercise shortly before the auditors were due to sign of the accounts through to those (such as the better run financial institutions) where it was a regular board item. The key to getting it right was to somehow get the concept into the mind set of directors and this was as important in a small company as in a large company. Although he had no firm views on how to avoid it being bureaucratic he believed it must be possible to do it simply.

Marek Grabowski The FRC acknowledged that it had set a challenging timetable for implementation because it wanted the going concern material to complete the set of changes published in September 2012 for implementation in 2012 year ends. One possibility in relation to small businesses could be to give them more time. Another possibility was that some of what was in the proposals should not be applicable to smaller businesses.

Stephen Haddrill The FRC would be interested in views on whether there should be thresholds below which some of the requirements would not apply and, if so, what sort of thresholds.

Lord Sharman It was important to remember that the Companies Act 2006 fundamentally changed the responsibilities of boards in relation to the wider community but, in his view, many companies had still not dealt with this change. There might be a natural threshold of whether it was a limited company or not but determining a threshold at some other level was always going to be difficult in the light of the Companies Act requirements which were very wide ranging. It was no longer possible for boards to take key decisions without considering the impact on a whole range of things that would not have been considered previously including customers, suppliers, employees, society at large, the environment and so on.

David Pitt-Watson While small companies were under the same obligations under the Companies Act it was never the intention that it should be a bureaucratic imposition but rather the application of common sense. A small company board needed to be conscious of risks going forward in the interest of the company itself and of the totality of small companies.

Julia Penny *Her concern was not that small business should not have to apply the principles in the proposals but that there were different implementation issues for smaller companies. The consultation document had not been written from the standpoint of the different levels of understanding of the issues in smaller companies with a consequent risk that the requirements will be dismissed by the directors of small companies as something that could not possibly apply to them. A think small first approach to implementation was needed.*

David Pitt-Watson suggested producing simple guidance for directors and auditors of smaller companies alongside the fuller guidance proposed and **Marek Grabowski** acknowledged that it should be possible to present the key elements of the guidance separately for smaller companies.

.

John Grout (Association of Corporate Treasurers) *Typically for small companies in the high-tech and biotech sectors investors would not want to see them having more than six months cash flow available - lenders would not lend to them and investors would not allow them to borrow because the value of those companies was entirely in the real options associated with the products they were developing. A foreseeable future of more than six months did not therefore exist. The issue was not that the directors of very small companies would not understand the guidance but whether it was all relevant and could be cost justified.*

Marek Grabowski accepted that 'foreseeable future' for these sorts of businesses was much shorter than for other sorts of business and that their directors and investors already recognised all the points in the guidance about reliance on outcomes over the next six months before further value could be committed. The guidance should not be burdensome provided people interpret it proportionately.

Stephen Haddrill added that he understood why people might be concerned given the context in which the recommendations were being put forward – that businesses have tended to think about risk over too short a term.

Lord Sharman made the point that the focus should be on the normal business cycle which in the sort of business Mr Grout was referring to was in stark contrast to that for a copper mining business where it would be important to consider the solvency and liquidity risks over the cycle until production.

David Pitt-Watson made the further point that the issue for the directors should be whether the company had the finance to discharge all the liabilities taken on. There was no sense in which the Panel's recommendations should be seen as harmful to start-up businesses who nevertheless still had to recognise that they had obligations to their creditors. If it was clear that, if all directors had this in mind, new start-ups would be seen as safe to do business with.

James Barbour (ICAS) *What was the likelihood of the international standards setters following the UK example?*

Marek Grabowski The IASB and FASB were currently actively looking at their requirements in relation to going concern:

- FASB, having for a long time decided not to do anything so far as its accounting standards were concerned, was now about to publish an exposure draft that was addressing the same underlying issues but was expected to propose very different disclosure requirements. The FASB approach was understood to say that if, net of actions that could be taken in the normal course of business, there was more than a 50% likelihood of the company not being able to meet its liabilities as they fell due, the details of the risks, mitigation actions and consequences for the company would have to be disclosed in the financial statements and in the notes to the accounts. If the risk, taking into account actions outside the normal course of business, rose to 'probable' (around 80% likelihood) a statement that there was substantial doubt would have to be made;
- This contrasted with the FRC proposals which set a relatively high threshold for materiality but considered not only likelihood but also whether the consequences of the risk and mitigating actions were material to stakeholders;
- The IASB's position was harder to judge. Although it had been working on similar lines to the FRC it was now pausing to take stock; and
- There was no guarantee that the IASB and FASB would end up in the same place but the FRC was continuing to monitor developments with a view to encouraging the other standards setters towards a place where there was a reasonable degree of harmonisation.

Stephen Haddrill There was an interesting question as to whether overseas investors would be anxious about what the UK was proposing to do or encouraged that they could have more confidence in what they were reading about UK companies.

David Pitt-Watson Agreement internationally would be a very good thing but in the absence of such agreement the UK could still have companies that were well managed for risk with nobody sailing too close to the wind; and that would be reflected in the stock price. Moving ahead in the UK would not guarantee getting agreement internationally but 'many a mickle makes a muckle'.

Mike Metcalf (KPMG) *Would the sort of tech start-up company already referred to be regarded as free of material uncertainty and able to make an unqualified going concern statement?*

Marek Grabowski It would be surprising if it was a going concern without a qualified statement and any investor was likely to be surprised if there were no assumptions and qualifications because the company would always need refinancing at the next decision point. It does not follow that the market should regard the qualification as a major problem when it was not currently so regarded. The issue of whether there were material uncertainties would depend on the consequences if the company was unable to resolve key matters over the six month period but this should not necessarily be a shock to the system. With the past experience of reactions to an emphasis of matter paragraph, some people might expect this to be more of a shock but the idea was to move on to a new paradigm where discussion of these issues was regarded as normal.

Paul Moxey (ACCA) *Directors of SMEs were likely to struggle with some of the terminology being used and might benefit from have some principles based* *guidance. At the other end of the scale there was a question whether following the proposed guidance would have helped a company such as HBOS to avoid the difficulties it got into in 2007/8 and how matters would then have been reported (in particular whether there would have been a qualification of the going concern status).*

Lord Sharman So far as banks in general were concerned he was reminded of what he called ‘the Lawson question’ which had been raised during the House of Lords enquiry when the response from the former Chancellor of the Exchequer to the question why the big four auditors had signed off the banks’ accounts was “we knew you would bail them out”. In his view the key issue in banks had been inadequacies in the flow of information to the board and limitations in boards’ understanding of the risks. It was also remarkable that when Sir David Walker reported on the banks in 2009 he had found it necessary to recommend that their boards should establish a risk committee. Further, when trying to establish risk committees he had encountered difficulties identifying enough people with hands-on experience of managing risk in the banking (or even a related) industry. There were problems where audit committees left the risk issues to the end of their agendas. There were also potential problems where risk committees were established of things falling through the cracks between the risk and audit committees which could be reduced by ensuring the chairs also served on each others’ committees.

Paul Moxey *In the case of HBOS the proposed guidance would seem inevitably to have resulted in a qualification with regards to future solvency even though it was certain that the government would step in.*

Lord Sharman That was absolutely right. What the Inquiry Panel had recommended was that a qualification was not needed where the existence of government support meant that the bank would remain solvent for the foreseeable future.

Marek Grabowski It was important to recognise that the consequence of following the proposed guidance should <u>not</u> have been that there was a material uncertainty requiring an emphasis of matter paragraph.

Stephen Haddrill At the heart of the proposals was the aim of stimulating good judgements by boards and appropriate reporting of those judgements. This was not going to be achieved through a set of rules which would inevitably lead to a box ticking approach. Equally, in order to be able to depend on good judgement there needed to be a good culture in business which was very difficult to write down in a way that would survive when all the lemmings were pointing in the same direction and rushing towards the cliff edge. The test of the new guidance was going to be whether it would hold up if the banks ever faced a situation like that in 2017/8 at some time in the future.

Lord Sharman Judgement was a key issue. At one time people joining the audit profession had to learn to exercise judgement without having any standards or guidance written down at all. While guidance would always be needed, at the core was the ability to make good judgements.

Pauline Wallace (PwC) *While she wholly supported the idea of integrating the going concern assessment with risk and the business model as a whole, there was a potential problem that the FRC was trying to achieve two fundamentally different purposes; there was a social engineering purpose related to ensuring boards properly assessed going concern and a financial reporting consideration where the international dimension came into play. It was a worry that there were two different concepts of going concern (the stewardship concept and the financial reporting concept) and that using the same term to describe both was more likely to confuse people than help them. Some of this potential for confusion may be behind the concerns of SMEs and of the banking sector about how they would balance the objectives of raising funds and satisfying investors with proper disclosures of the* *assumptions made. Was there a simpler approach to disclosing the risks in a balanced manner that would avoid confusion with the judgement made from an accounting perspective until such time as the international debate catches up?*

Stephen Haddrill One of the main drivers behind the recent reform of the FRC had been a desire to integrate the thinking about corporate governance and financial reporting. While the point about potential confusion of terminology was well made the reporting piece and the governance piece in annual reports needed to be well fitted together.

Pauline Wallace *It was absolutely right that there should be full and transparent disclosure of the discussions at board level but there was an archaic concept of going concern built into the accounting literature and there was a risk of confusion in trying to force those two models together. Encouraging the international debate was right but the terminology was going to confuse the issue. What was needed was something that would achieve the aims of the proposals without making things appear more complex and imposing disclosure burdens that would not work because people read the wrong interpretation of 'going concern' in the wrong context.*

Marek Grabowski The FRC recognised that the terminology was being used in two different ways. As things stood, the FRC was stuck with the terminology in the IFRS literature for accounting although it was freer to change the language of the Code. The FRC would welcome practical suggestions about how such changes might be made to address the concern raised.

Richard Gillin (Deloitte) *It was possible to see a situation where a company was not a going concern (on the stewardship definition) but had adopted a going concern basis for the preparation of its accounts. Major investors might understand what that meant and be capable of squaring the circle but there was a risk that smaller investors (and some bank managers) would not. Also there was a potential problem in terms of what the man on the Clapham omnibus might make of a statement that the company had a high degree of confidence that it was a going concern but nevertheless there were material uncertainties. The layman would assume that 'high confidence' meant that the doubts were not material. The answer to this might lie in the way FRC 2009 guidance was being used, as evidenced by a recent survey across a range of listed entities. This showed that 14% of the companies surveyed said they had an uncertainty over going concern but it was not a material uncertainty (so giving good early warning) and 3% had said they had a material uncertainty. There might be a way forward in encouraging disclosure of uncertainties with the reasons why they were not considered to be material.*

Marek Grabowski The FRC recognised that there were potential language issues. The proposals in relation to whether the going concern basis was appropriate while there were material uncertainties came straight out of IAS 1. It would be more common sense language to be able to say that there were material uncertainties but the company had not yet reached the stage where a liquidation basis of accounts was required but that was not what the standard said. The problem might be with the term 'uncertainties'; it was not just the likelihood that should trigger disclosure but the need to give appropriate disclosure about the consequences of risk and of mitigating actions that were relevant to users' decisions. Whilst the FRC was again stuck with the IAS wording it would seem more natural and comprehensible to be able to talk in terms of disclosures about serious risks to solvency and liquidity and the reasons why these did not preclude preparation of the accounts on a going concern basis.

Lord Sharman It would be useful to be able to talk in terms of evaluating the impact of crystallisation of risks rather than uncertainties.

Martin Perrie (BP) *The proposed guidance was not completely clear about the linkage between these risks and the principal risks and uncertainties that had to be described in the business review or the risks and uncertainties in relation to the business model.*

Marek Grabowski The aim was to encourage directors not to think in terms of these risks being entirely different things. One of the Panel reports said that a significant risk to a company's survival was highly likely to already feature among the principal risks and uncertainties in the business review. He would see these risks as a sub-set and wanted to look at whether this had been made sufficiently clear in the proposed guidance.

Martin Perrie *Was the consequence of that interpretation that disclosure of those risks among the principal risks and uncertainties was the same as saying that there were material uncertainties?*

Marek Grabowski That would depend on what had been said about the principal risks and uncertainties. The circumstances in which those risks might crystallise and the consequences of mitigating action would drive whether there were material uncertainties that needed to be disclosed. It would certainly be possible to make disclosure about those risks without having to conclude that there were material uncertainties.

Lord Sharman rounded off by saying that the Panel had wondered what sort of reaction there would be to its recommendations. The House of Lords Committee of Enquiry had been critical both of the big four firms and the influence of IFRS and were genuinely perplexed about how the problems had arisen. The evidence the Panel collected was that there was an expectation gap. Investor used to believe that if there was something wrong the auditor would not sign the audit report so there was a sense in which the audit report and the fact that the accounts were being prepared on a going concern basis was seen as some sort of guarantee. There was therefore a need to make things clearer. Governance had improved significantly since 2007 driven by the FRC and by industry regulators. The pressure of investor bodies had also been an important influence. He believed the Panel's recommendation would help that improvement to continue – it was astonishing that there were still financial institutions and major global corporates who did not have risk committees.

Stephen Haddrill closed the proceedings by saying that he was heartened by the responses and contributions from participants. There did appear to be strong support for the principles the FRC was putting forward in follow up the Panel's recommendations. Important issues had been raised, including how to ensure the guidance was appropriate to SMEs and how to ensure the drive towards better governance does not result in more boilerplate reporting. The FRC would be engaging with major respondents over the coming weeks to ensure their submissions had been properly understood with a view to asking the FRC board to review the outcome of the consultation at its July meeting, which would allow time for any necessary reshaping in the light of the responses received.

He ended by expressing thanks to all the participants, the Panel members, the FRC staff and others involved in putting on the event.