

Matthew Lester
Chairman: The 100 Group Investor Relations and Markets Committee

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Investor Relations and Markets Committee

Marek Grabowski
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Dear Sir

Implementing the recommendations of the Sharman Panel

I am writing in my capacity as Chairman of The 100 Group Investor Relations and Markets Committee to share with you our views on the FRC's Consultation document on the above stated topic.

As Directors of large international companies, we clearly understand the importance of the going concern assertion, and are supportive of the FRC's desire to improve the transparency of reporting on corporate governance. However, we are concerned with some matters.

First, this review has taken such a long period of time, audit committees and their advisers have already adapted to the new expectations of investors in terms of giving greater clarity as to how the going concern determination has been made.

The guidance is not clear in particular the splitting of the definition of going concern for stewardship and accounting purposes could lead to confusion and misinterpretation.

There could be unintended consequences if this guidance is interpreted as requiring directors to be more conservative in their going concern assessment than they had previously been.

Generally, we feel this is a difficult area and that audit committees are best placed to consider what is the most appropriate basis on which to approach the going concern determination and to disclose this with appropriate detail, based on the circumstances of their business.

Who we are

The 100 Group represents the views of the finance directors of FTSE 100 and several large UK private companies. Our member companies represent almost 90% of the market capitalisation of the FTSE 100, collectively employing over 7% of the UK workforce and in 2012, paid, or generated, taxes equivalent to 14% of total UK Government receipts. Our overall aim is to promote the competitiveness of the UK for UK businesses, particularly in the areas of tax, reporting, pensions, regulation, capital markets and corporate governance.

Our views

Our primary view is that audit committees have already adapted to the new expectations regarding the rigour of the going concern determination and enhanced disclosures of how that determination was arrived at. Adding more requirements, in an area where it is very difficult to be generic, is fraught with difficulties and we question whether there is more to be gained from this, so long after the first impacts of the financial crisis were felt.

We set out below some specific concerns.

Clarity: two meanings of going concern

Although we welcome better business model reporting we believe that the two proposed purposes for the going concern assessment have different objectives and should be addressed separately. In order to provide clarity, there is a need to distinguish any disclosures detailing forward-looking information about the financial and economic viability of the business model (the stewardship purpose), from the question of the basis of accounting and accounts disclosures (the financial reporting purpose).

The requirements for the assessment of going concern for financial reporting purposes are generally understood. This accounting decision is (in effect) explicitly stated, under existing FRC guidance, as the LR 9.8.6R(3) statement that the company is a going concern, with any material uncertainties being given or referred to as supporting assumptions or qualifications. In our view, this assessment should be retained, with liquidity continuing to be the primary focus of the assessment.

The proposals in respect of the stewardship purpose go significantly beyond this and we believe that using the same terminology for a different objective would create confusion to users of annual reports.

Clarity: level of confidence

We believe that using terms such as the "foreseeable future" will lead to a wide range of interpretations. It would be more helpful to be specific as to a minimum period but to emphasise to directors that they should look beyond this if there are known trends or issues that fall outside this period, which may materially affect the going concern determination.

Growth

An unintended consequence of the Guidance as currently stands may cause businesses to respond by becoming more risk averse, reduce investment and hold more cash, thereby further limiting growth.

International application

We believe the Guidance will cause very real difficulties for companies with other, regulatory listings or in countries where seeking to raise finance. As we have described previously, we believe there will be significant confusion caused to any users, including international users. We see no evidence in the consultation paper that the FRC has sought to engage with the IASB and the IAASB to agree a common international understanding. We would urge the FRC to revise its Guidance in order to be truly representative at an international level.

Overall, we feel that implementation of the Guidance as currently drafted risks companies conserving liquidity and capital beyond appropriate levels and confusing investors and stakeholders:

- The current drafting indicates a loss of the presumption that there is risk in investing in companies, which is precisely why the return on equity is higher. This could drive a more conservative approach, reducing investment.
- There could be a loss of clarity as to which companies actually do have issues meeting the going concern principles: all companies will be disclosing risks and concerns and the users of the accounts will be required to work out for themselves how important these factors really are. Under current guidance, the majority of companies report clean statements indicating the types of issues that they have considered in arriving at this assessment, with those that have poignant going concern issues being obvious.

Introducing a different going concern consideration for stewardship and using similar terminology is confusing. The FRC has already issued helpful Guidance in this area in 2009 and we find the additional Guidance confuses rather than clarifies the overall approach.

We have addressed some specific questions in relation to the consultation document in the Appendix to this letter.

Please feel free to contact me if you wish to discuss the views contained within this letter.

Yours faithfully



Matthew Lester
Chairman

The 100 Group: Investor Relations and Markets Committee

Appendix 1: The 100 Group views on the consultation draft questions

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?

No. We believe that the term 'going concern' is widely and internationally understood so far as it relates to the basis of accounting. In attempting to implement new concepts for stewardship reporting purposes, this adds a layer of complexity to what is a simple and fundamental concept of preparation of financial statements. If material uncertainties are to be disclosed whenever the board 'is unable to obtain a high level of confidence about the entity's solvency and liquidity for the foreseeable future', we believe that almost all listed companies will be unable to say that it is a going concern. The additional disclosure will be confusing to investors and other users of accounts.

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?

Although we broadly agree with the description, we are concerned with the subjective nature of a - "high level of confidence" - the meaning of which is unclear.

Whilst we appreciate that any risks that may crystallise in the long-term that affect the potential future status of a company should be disclosed, this should not lead to company's being unable to say, without qualification, that it is a going concern. There could be an interpretation that a higher degree of financial conservatism is associated with this guidance with potential knock on consequences for investment

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?

Yes, the distinction between within and outside the normal course of business appear clear. However, we find the Guidance confusing in how it intends these concepts to be applied and, absent any illustrative examples, believe this has not been developed sufficiently for practical usage.

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?

No, we do not agree with the approach taken to interpreting the foreseeable future, particularly when considered in conjunction with the level of confidence required.

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, we do not find the distinctions to be clear. However much of the going concern basis of accounting is explained in the Guidance as being different from the definition of a going concern for narrative reporting purposes, we do not believe that the distinction will be understood and will not lead to the common understanding that is sought.

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?

No, we do not agree with the Guidance's definition of when to disclose material uncertainties. The definitions of material uncertainty given in paragraphs 2.29 and 2.30 are different, and neither appears to agree with current practice and international consensus.

We disagree with the factors and circumstances in paragraphs 2.30 and 2.31. Paragraph 2.31 attempts to provide a threshold for recognising a material uncertainty but has minimal practical consideration. These criteria are then overwritten by the statement, in 2.32, that there will always be material uncertainties to be disclosed whenever the board "is unable to obtain a high level of confidence about the entity's solvency and liquidity for the foreseeable future". As stated previously, it will be unclear what level of confidence a board has adopted and the existence of this Guidance would imply that it was possible to set an objective standard.

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?

No. Recommendation 2(b) states: "(b) The FRC should seek to clarify the accounting and stewardship purposes of the going concern assessment and disclosure process and the related thresholds for such disclosures and the descriptions of a going concern in the Code (and related guidance for directors and auditors) and in FRS 18 and ISA (UK & Ireland) 570, **if possible in line with such international consensus**; ... "(emphasis added).

We cannot see any evidence in the Guidance that the FRC has attempted to address the international implications. The IASB is currently considering amendments to IAS 1 for the disclosure requirements of 'material uncertainties'. The proposed Guidance redefines the meaning of 'material uncertainty' well beyond either what is currently best practice under IFRS or what the IASB Board is due to consider. In this context, we consider that a different definition and disclosure requirement in the Guidance would be confusing to users.

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?

Broadly, yes for stewardship purposes where these considerations would be useful in the context of risk disclosures, although as noted elsewhere, we believe that these are not

appropriate for the assessment of going concern and should be addressed separately from the requirement to assess going concern for financial reporting purposes.

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?

Broadly, yes, although we reiterate that clarity is not enhanced by the combination of the two separate and different going concern purposes. We note that the term 'robustness' adds a further layer of subjectivity within the Guidance and is not particularly helpful.

We suggest that Section 3 of the Guidance should reflect that, however much assurance they receive on going concern, the directors remain ultimately responsible for their assessment.

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?

No comment.

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?

We do not seek to provide industry specific commentary.

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, we consider the implementation date to be completely unrealistic. The proposal to finalise the guidance in June 2013 and be applicable to companies with a financial year commencing on or after 1 October 2012 should be deferred. The significantly broadened requirements for the assessment of going concern for stewardship purposes will require significant planning and it is essential that companies are given enough time to understand and plan for implementation of the Guidance. We suggest that the implementation date is set sufficiently far in the future to provide directors with an appropriate period to review the final version of the Guidance.

Delaying the implementation date would also allow international coordination and alignment on this matter, taking account of all other, recently proposed developments such as that made by the IAASB in the area of audit reports.

Question 13: 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 believe this is an area which has already developed to reflect a better practise and as you can see from the above responses we are concerned that this Guidance could actually create a bigger expectation gap and, at worse, lead to a shift of an inappropriately more conservative approach at a time when the UK least needs 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?

No comment.

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?

No further comment.

