bvca The voice of long-term investment

1st Floor North, Brettenham House
Lancaster Place, London WC2E 7EN
T: +44 (0)20 7420 1800
F: +44 (0)20 7420 1801
E: bvca@bvca.co.uk
www.bvca.co.uk

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

sharman.secretariat@frc.org.uk

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Dear Sirs

I am writing on behalf of the British Private Equity and Venture Capital Association ('BVCA') in response to the Call for Evidence by the Sharman Enquiry into Going Concern and Liquidity risks.

The BVCA is the industry body for the UK private equity and venture capital industry. With a membership of over 450 firms, the BVCA represents the vast majority of all UK based private equity firms and their advisers. This submission has been prepared by the BVCA's Legal & Technical committee, which represents the interests of BVCA members in legal, accounting and technical matters relevant to the private equity and venture capital industry.

As major investors in private companies, and some public companies, our members have an interest in financial reporting matters, the conduct and information presented by such companies, and the burdens placed on the management of such companies.

Private equity ownership involves the close alignment of interests between investors and the management of a company, and this leads to closer and often more informal relationships than between comparable forms of ownership. As such, the level of communication between these parties tends to be high, and to a level that covers the areas investors require.

We are providing this submission in order to register our interest in this enquiry and its results and we would like to submit some general observations based on our experience.

Public v Private Companies

Public companies and private companies deal with their stakeholders in very different ways. Because public companies' shares are mainly listed, their communication to stakeholders on financial matters is concentrated on financial reports and regulated announcements and press releases. It is therefore important that such material has 'sufficient information for stakeholders to make financial decisions.

Private companies are not so restricted and tend to have a more informal relationship with their stakeholders so the benefit of requiring additional disclosure in financial reports can often be less than the burden of having to provide it.

We consider that, for both private and public companies, each disclosure proposal needs to be considered on a cost benefit basis and that, for private companies, the better answer on matters of going concern and liquidity is to encourage informal dialogue with stakeholders rather than mandating additional financial reporting requirements.

Self Fulfilling Prophesies

It is our perception that sometimes public disclosure of a risk (or risks) in a document governed by law and regulations can be misinterpreted as being more serious than it is, leading to stakeholders making decisions that increase the risk. Therefore, the mention of the risk actually contributes to a problem that might otherwise have been resolved.

In general, we would support additional disclosure for public companies relating to liquidity risk as long as it is useful and clear and does not, in itself, damage the commercial prospects of those companies.

Auditors

The relationship between private equity and venture capital and their investees is different to that of a parent and its subsidiaries. Our members' investments are mainly held as financial investments for a limited period of time often without day to day involvement in management.

However, often when a company is distressed, auditors require some form of letter of support as part of their requirement to be able to agree with the directors that the company is a going concern.

In many situations, even though our member may be supportive, the fiduciary duty owed to their investors would not allow them to make a formal commitment. This means that the investee company in exactly the same financial condition as a subsidiary in a group will sometimes have an 'emphasis of matter' in the audit report simply because there is no letter of support from equity investors.

Accounting Standards

The disclosures required by accounting standards relating to capital and debt are already considerable, and we consider them to be adequate to enable the reader to understand the capital structure of a company, and assess the liquidity risk in the light of economic circumstances and the position of other companies. We do not consider that any further disclosure in this area is required.

Forecast Information

Many companies have detailed budgets and forecasts which cover their present financial years or, sometimes, over a twelve month period. We would not agree with any proposal that required companies to maintain full visibility, such as over its 'normal business cycle' because predicting anything with a sufficient degree of certainty is almost impossible for periods of over a year.

We consider that too much importance is given to these letters and that guidance to auditors should concentrate on other factors.

The BVCA would of course be willing to discuss further this submission and looks forward to receiving and commenting on any proposals which the Enquiry makes.

Yours faithfully

Simon Witney
Chairman – BVCA Legal and Technical Committee