Group Reporting

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The Sharman Secretariat
c/o Financial Reporting Council
Aldwych House
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UNITED KINGDOM

Dear Sir

Call for Evidence - Going Concern and Liquidity Risks: Lessons for Companies and Auditors

We refer to your letter to Mr David Crawford of 31 May 2011 requesting the submission of evidence on the topics of Going Concern and Liquidity Risks.

We welcome the opportunity to provide this response, written on behalf of BHP Billiton and prepared from the perspective of a large multi-national corporate entity reporting under International Financial Reporting Standards and UK, US and Australian corporate governance requirements.

Transparency of going concern and liquidity risk

1. What combination of information about:
- **The robustness of a company's capital;**
- **The adequacy of that capital to withstand potential losses arising from future risks; and**
- **The company's ability to finance and develop its business model**

would best enable investors and other stakeholders to evaluate the going concern and liquidity risks that a company is exposed to? How effectively do current disclosures provide this information?

1.1. When considering the information needs of investors and other stakeholders, we believe it is necessary to remain conscious of the diversity in their sophistication and capacity to interpret and use such information effectively. However, for the purpose of external financial reporting by large corporate entities, it is only feasible to accommodate the information needs of sophisticated users.

1.2. We do not believe that it is appropriate to develop comprehensive and prescriptive disclosure requirements targeted at going concern and liquidity risks. Rather, the focus should be on clarification of principles under which each entity can design their own disclosures. This approach discourages boiler plate disclosures and encourages fit for purpose disclosure which is appropriate to the circumstances of an entity.

1.3. In formulating disclosure principles relevant to going concern and liquidity risk, we believe a key feature should be the presentation of information "through the eyes of management". That is, management should present information in the financial statements consistent with the information and processes it uses to manage liquidity risk. Another feature of the disclosure principles should be a focus on risk and risk management techniques, rather than a focus on detailed financial analytics.

1.4. We believe much of the disclosures already prescribed under IFRS provide information relevant for assessing going concern and liquidity issues. This includes information concerning:

- Revenue and expenses (and trends therein)
- Cash flows, categorised into operating, investing and financing flows
- Assets and liabilities, categorised into current and non-current or displayed in order of liquidity
- A description of key judgements and estimates underlying the accounting information
- A description of key accounting policies, including those relating to the assessment of asset impairment
- Commitments and contingency information, including capital expenditure commitments
- Financial risk management information on market, liquidity and credit risk including standby arrangements and unused credit facilities, maturity profile of financial liabilities, fair value and credit risk information
- Statements on the ability of the company to meet its debts as and when they fall due

1.5. In the BHP Billiton Group's annual report, the information in the financial statements is supplemented by a range of additional disclosures, including a description of business risk factors, an overview of the business, a description of material contracts, a discussion of external factors and trends affecting our results and an overview of liquidity and capital resources. We believe that all of these disclosures are relevant to an assessment of an entity's ability to operate as a going concern and its liquidity risks. We strongly encourage the Secretariat to research the range of disclosures already specified in other jurisdictions (such as the United States) in assessing the nature of information considered relevant in the UK environment.

2. What type of disclosures (if any) have been made into the market place outside annual and interim corporate reports about current stresses being experienced by the company and about the management of those stresses? How do these disclosures interact with the requirement to disclose principal risks and uncertainties in the Business Review and the required disclosure on going concern and liquidity risk in the annual and interim financial statements?

2.1. In the wake of the significant economic and financial difficulties affecting most economies in recent years, many companies responded with risk mitigation actions. Such actions included deferral of discretionary capital expenditure, rationalisation of investment and operating portfolios, renegotiation of financing arrangements, discontinuation of transactions, etc. BHP Billiton was not immune to the impacts of the global downturn in economic activity and responded in a manner that remained consistent with its long term strategy but which saw the exercise of discretion consistent with its liquidity risk management strategy. Such actions were reported to the market in accordance with normal market disclosure requirements. Examples of such disclosures can be found on our website via the following links:

Rio Tinto Offers No Longer In The Best Interests Of BHP Billiton
Samarco Joint Venture Production Reduction

3. **Are there any barriers within the current corporate reporting environment to companies providing full disclosure of the risks associated with going concern and liquidity both within and outside the company's annual and interim reporting? Are there any changes that might be made to encourage companies to give fuller and more transparent disclosures in this respect?**

   3.1. The key barrier to disclosing risks associated with going concern and liquidity is no different to the normal challenge of achieving appropriate market disclosure. That is, keeping the market informed, but in a manner which is not detrimental to the interests of the company and its shareholders. Careful judgement must always be exercised in satisfying both market disclosure, commercial confidentiality and entity welfare requirements.

   3.2. Some entities may also be concerned with the potential bias of a significant focus on the disclosure of going concern and liquidity risk information. We believe that all such information needs to be presented in a balanced manner, such that a description of risks should be balanced with a description of actions and controls available to management to mitigate those risks.

   3.3. In addition, for UK companies that are also SEC registered, there is a tension between the UK "Business Review" requirements around risk reporting and the SEC rules. The UK Financial Reporting Council issued a press release in February outlining concerns expressed by its Financial Reporting Review Panel with the way some companies are reporting their principal risks in their Annual Reports. The Panel's concerns include use of boilerplate language; lack of specificity; inconsistency between the principal risks section and other parts of the Annual Report; and lack of information about how the risks are managed. However, the comment relating to lack of information about how risks are managed raises a potential conflict with the regulatory requirements for companies with a US listing. This is because under SEC rules, the risk factors section is not generally allowed to articulate how the risk is mitigated / controlled.

4. **Given the current measurement, recognition and disclosure requirements of International Financial Reporting Standards (IFRS), how effective are IFRS financial statements in enabling stakeholders to evaluate the robustness of a company's capital in the context of the going concern assessment? Are there any changes that could be made to these requirements that would better enable them to do so?**

   4.1. Refer to our response to Question 1. We believe there is sufficient opportunity under existing IFRS requirements to convey information relevant to the assessment of going concern and liquidity risk.

Company assessment of going concern and liquidity risk

5. **What processes are undertaken by directors in making their assessment of whether the company is a going concern when preparing annual and half-yearly financial statements?**
   - **Which records and information are referred to in making this assessment?**
   - **What type of model does the company use to develop scenarios to stress-test the assumptions that have been made when making this assessment?**
   - **What types of risks are included in the going concern assessment: financial, strategic, operational, other? How are these presented in the assessment?**
   - **What is the role of the audit committee and risk management committee (where one exists) in this process and what inputs do they receive in order to carry out this role?**
   - **What impact has undertaking the going concern assessment had on the planning and management of the company?**
   - **How has the assessment of going concern and liquidity risks been incorporated into other aspects of company stewardship and reporting?**
   - **How effective is this assessment in addressing the robustness and adequacy of a company's capital and its ability to continue financing and developing its business model? What, if any, improvements could be made?**

5.1. The Directors have access to a range of information that is relevant to their assessment of the company's status as a going concern and the effective management of its liquidity risk. Such information includes:

- Long term financial plans
- Short term financial budgets
- Rolling profit and cash flow forecasts
- Periodic reporting of actual results compared against budget and forecasts
- Investment assessments and the associated decision making process
- Capital management plans
- Debt portfolio analysis and refinancing plans
- Business risk reports

5.2. Scenario analysis is performed in the evaluation of investment opportunities and in the update of short term cash flow forecasts. Sensitivity to changes in economic assumptions is built into cash flow forecasts using a cash flow at risk methodology (similar in concept to value at risk methodologies), as described in the financial risk management disclosures in our annual financial statements. This methodology incorporates the impact, and correlation, of all material financial risks to the Group's cash flows.

5.3. The assessment of going concern has had limited impact on the Group's governance processes as the majority of information and activity relevant to this assessment was already a part of the Group's normal governance and risk management procedures. The effectiveness of the assessment of going concern is dependent on the integrity of the process design and the sincerity of an organisation in executing that process. If designed and executed with proper intent, the assessment should be effective in demonstrating to the Board the validity of its conclusions on the going concern assumption.

6. **What is different about the review of going concern when raising capital compared to the annual going concern assessment undertaken for accounting purposes? Could some of the different procedures be used in the annual accounting or audit assessments?**

6.1. The procedures required to be undertaken in a capital raising (such as to prepare a working capital statement) are often onerous and excessive relative to the objective, and unduly influenced by externally imposed assumptions or requirements which are unrealistic. We have found that the normal procedures followed for the annual assessment of going concern are fit for purpose and we would not seek to expand those procedures along the lines of a working capital statement review.

7. Does the company assess future cash flows and liquidity on a regular basis throughout the year? If so, how regularly is this done and is the information used any different to that used in the annual and half-yearly assessment for the purpose of preparing financial statements?

7.1. The Group has a regular process of updating earnings and cash flow forecasts on a monthly basis, and establishment of budgets and long terms plans on an annual basis. These processes are consistent from month to month, and consistent with the process and information applied for annual and half-yearly assessments.

8. To what extent and how do directors assess the viability of a company over the course of its natural business cycle?

8.1. We believe it is overly simplistic to think of an entity as having a single business cycle. Typically, a business will have different cycles that define or govern investment activity, operating activity and financing activity. For each of these cycles, company viability has a different relevance, and consideration of company viability will be more or less explicit. For example, within the investment cycle which typically has much longer time frames, company viability may never be an explicit consideration. However, the long term strategic objectives of the entity (which ultimately point to long term viability of the company) underpin investment decision making.

9. The current model of disclosure identifies three categories of company[1]. What sort of behaviours does this model drive? Is there a different model that might be useful? Would more guidance on the application of the current model be helpful?

9.1. We have no direct experience on which to base a response to this question, but can only speculate that some entities may be less inclined to be categorised into the lower two groupings, in which case such groupings could unduly influence behaviour. Rather than providing more guidance, we suspect it might be more helpful to remove these arbitrary groupings. As an alternative, the disclosure required would be whether or not the directors believe the entity is a going concern, and where they believe it is, to provide further disclosure of any significant uncertainties which might cause that conclusion to change in the future.

[1] The disclosures in the financial statements which follow from the directors' conclusion on whether the company is a going concern identify three categories of company:
1. Those where the use of the going concern basis of accounting is appropriate and there are no material uncertainties related to events or conditions that may cast significant doubt about the ability of the company to continue as a going concern;
2. Those where the use of the going concern basis of accounting is appropriate but there are material uncertainties related to events or conditions that may cast significant doubt about the ability of the company to continue as a going concern; and
3. Those where the going concern basis is not appropriate.

10. In your experience, what issues have resulted in a heightened focus on the assessment of going concern? What was the nature of the risks that gave rise to these circumstances? Had these risks been identified in advance, and if so, how?

10.1. The Group's own financial position and experiences are not particularly relevant to this question. However, across the resources industry, the key risks which have caused a heightened focus on going concern include:

- Significant fluctuations in commodity prices and exchange rates
- Increases in labour and equipment costs, which have put pressure on capital expenditure budgets and the potential viability of individual projects
- Actions by foreign governments which have increased sovereignty risk in certain countries
- Changes in the health of the financial markets which have impacted the cost and availability of capital

On balance, most of these risks were acknowledged by the industry, however the degree to which they were realistically contemplated and the ability of entities to effectively mitigate or respond to the occurrence of the risks has been highly variable. Such variability would be expected given the diversity in the financial and risk management capabilities of entities operating across our industry.

The auditor's approach to going concern and liquidity risk

11. How does the auditor approach the assessment of going concern and liquidity risk? To what extent does this involve the testing of the company's processes and what other work is carried out? Is there any specific reporting on the work done by the auditor on going concern and liquidity risk to Audit Committees? Does the assessment of going concern involve different processes in certain industry sectors? Are there different processes used where there is overseas reporting in addition to UK reporting?

11.1. The auditor's approach to the assessment of going concern and liquidity risk is a function of the severity of that risk to each entity under consideration. Thus, for those entities that are financially strong, pose no immediate going concern issues and have the capacity to absorb liquidity shocks, the nature and extent of the auditor's procedures should be limited. As the risk profile of the entity (with respect to going concern and liquidity) increases, the audit focus and procedures should respond. The extent to which the auditor relies on testing of management's own assessment procedures should reflect their assessment of the quality and auditability of those procedures. It is normal practice for the auditor to include in their report to the audit committee, a comment on the approach they have taken to the assessment of going concern and liquidity, and to convey their conclusion on this specific issue.

Feedback on the Guidance for Directors of UK Companies in respect of going concern and liquidity risk

12. Do you believe that amendments to the Guidance for Directors of UK Companies in respect of going concern and liquidity risk would be helpful? For example:

- **Guidance for directors on disclosures does not specify the language to be used, whereas auditors use more standardised wording. Is this helpful?**
- **Is there a need for a clear boundary between the three types of company?**

12.1. We do not believe there is a need for any further significant guidance on this topic. Directors should be permitted to choose their own words to describe their assessments and conclusions on the subject of going concern and liquidity, rather than be constrained with standardised wording which too often can result in meaningless boiler plate disclosures. As noted earlier, we are concerned that the three types of companies identified in the guidance could have the potential to unduly influence behaviours. As such, we would prefer to see a simpler and less structured approach to communicating the assessment and conclusions on going concern, rather than move towards a more structured approach as implied by the question.

We would be pleased to discuss the above submission further with the Secretariat if required, by contacting Mr Brett Rix on 61 3 9609 3220 or by email (Brett.Rix@BHPBilliton.com). We thank you for the opportunity to present our views on this topic

Yours sincerely,

G.P.S

pp. **Brett Rix**
Vice President External Reporting and Governance