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Dear Mr Leonard

**Going Concern And Financial Reporting. Proposals To Revise The Guidance for Directors Of Listed Companies. Consultation Paper**

Thank you for the opportunity to comment on the Financial Reporting Council's consultation paper on going concern and financial reporting.

Our responses specific questions raised by the FRC are included below together with more detailed comments on the document.

**Response to the questions raised by the FRC**

***1. In the light of these developments, do you believe that there is a continuing need for separate Guidance for Directors about Going Concern?***

**YES.**

We believe that in the current economic climate, where going concern is an issue that is affecting an increasing number of companies, the separate guidance for directors about going concern is even more essential than it was in 1994 and should be updated and reissued as soon as possible.

***2. Do you believe that the proposed amendments are sufficient and appropriate? If not, what alternative amendments do you believe need to be made and why?***

**NO.**

Our major concern about the proposed amendments to the guidance is in relation to the additional going concern conclusion added to the bullets in paragraph 47 of the revised guidance.

Paragraph 47 now identifies four basic conclusions that the directors can reach about going concern compared to the three conclusions included in the 1994

guidance. Whilst we acknowledge that the new conclusion in bullet three of paragraph 47 which relates to a situation where the directors have identified “material uncertainties that may cast significant doubt about the going concern basis” is a natural extension of the conclusion in bullet two and is consistent with the requirement in ISA (UK and Ireland) 570 paragraph 33 for the auditor to modify the audit opinion by adding an emphasis of matter paragraph highlighting the existence of a material uncertainty that may cast significant doubt about the entity’s ability to continue as a going concern we are concerned that there is not sufficient explanation of the distinction between the conclusions in bullets two and three and that this lack of explanation could cause confusion when the guidance is adopted.

Bullets two and three of paragraph 47 make the distinction between:

- “factors which cast doubt on the ability of the company to continue in operational existence for the foreseeable future but they consider that it is appropriate to use the going concern basis” and
- “material uncertainties that may cast significant doubt about the ability of the company to continue as a going concern and so additional disclosures are required”.

Having made this distinction we do not feel that the guidance in paragraphs 50 to 51A then provides sufficient explanation of how this should be addressed by the directors and the potentially different impacts on the audit report of the two conclusions.

Whilst we accept that there is a distinction between the two conclusions it may be impracticable to explain it with sufficient clarity and, because it is so judgemental and may lead to real confusion and possible conflict with auditors, in our opinion the new bullet three should be deleted and paragraph 47 should revert back to the three conclusions included in the original 1994 guidance, updated to cover the reference to material uncertainties and significant doubt.

**3. *Do you believe that any significant parts of the proposed guidance can be deleted as unnecessary? If so, which paragraphs can be removed and why?***

**NO.**

Although we have highlighted some amendments in our responses to the FRC’s questions and in our detailed comments below we do not consider there are any significant parts of the guidance that should be deleted.

We do however consider that the guidance in the annex covering developments in IFRSs since 1994 relating would be better incorporated into the main body of the document. The 1994 guidance was written in a UK GAAP context and did not have to deal with the requirements of International Standards particularly the different requirements relating to the period considered by the directors and we

feel that it would be more helpful if the requirements of IAS 1 regarding going concern were included in the main body of the document and that the document dealt upfront with the differences in the requirements of IAS 1 and ISA (UK and Ireland) 570 with respect to the period considered by the directors and the potential impact on the audit report.

**4. *Do you believe that it continues to be appropriate to include standardised text within the proposed Guidance for Directors indicating how directors might explain their use of the going concern basis of accounting?***

**NO.**

We do not consider that it is now appropriate to continue to include such standardised text within the proposed guidance. In our opinion, it is not the role of the FRC to effectively prescribe standardised text for directors to use to explain their use of the going concern basis of accounting in the financial statements. In the current economic climate, with companies facing a myriad of going concern problems and many having difficult discussions with their banks, we consider that the FRC should be encouraging directors to draft their own going concern statements addressing the particular circumstances that their company is facing rather than relying on standardised wording provided by the FRC.

Experience shows that since the original guidance for directors was published many companies have used the example wording provided in the 1994 guidance without necessarily considering whether there are any other factors particular to their own circumstances which should be described. As a result, some of the going concern statements made by directors in the past might be viewed, albeit with the benefit of hindsight, as inadequate particularly in the current economic environment when simply repeating standardised wording is not appropriate.

Apart from the general concern about the inclusion of standardised wording we also have a specific concern about the example wording given in paragraph 51 of the revised guidance to describe a potential going concern issue where there is a breach of covenants and negotiations are continuing. We consider that the example wording does not reflect the current economic climate post the credit-crunch where banks are now taking breaches of loan covenants much more seriously than previously and the renewal of bank facilities cannot be relied upon as a matter of course, particularly where there is a breach of covenants. In the current economic climate we would, as a minimum, interpret a breach of banking covenants at the year end and a failure by the date of approval of the financial statements to agree a new facility as a material uncertainty that may cast significant doubt about the going concern basis and, as a result, would expect the auditor's report to refer to this material uncertainty through the addition of an emphasis of matter.

There also appears to be some inconsistency between paragraphs 51 and 51A of the revised guidance. In our opinion paragraph 51, which describes a breach of

covenants at the year end, refers to a situation where there is a material uncertainty that may cast significant doubt about the going concern basis and the FRC guidance includes example wording for the directors to describe this situation. This is in contrast to paragraph 51A which states that where there is significant doubt about the company's ability to continue as a going concern such disclosures are likely to be more specific and extensive and so suggested text is not included. The distinction between the situations described in paragraph 51 and 51A is a matter of judgement where directors and auditors are likely to hold contrasting views. In the light of the current economic climate and recent experience of the attitude of banks to covenant breaches, we do not consider it appropriate for the FRC to issue the example wording in paragraph 51 and make the distinction between paragraphs 51 and 51A because this might be interpreted by directors as FRC guidance that breaches of covenants and a failure to agree facilities by the date of approval of the financial statements do not result in an emphasis of matter.

5. ***Do you believe that it continues to be appropriate for the Guidance for Directors to require directors to consider whether an additional disclosure should be given where they have not considered a period that extends to at least twelve months from the date of approval of the financial statements?***

**YES.**

We agree with the proposed approach adopted by the FRC that continues to require directors to consider whether an additional disclosure should be given where the directors have not considered a period that extends to at least twelve months from the date of approval of the financial statements. This is consistent with ISA (UK and Ireland) 570 which, among other things, requires disclosure to be made by the auditor if the period considered by the directors in making their going concern assessment is less than one year from the date of approval of the financial statements and the directors have not disclosed that fact. In the current economic climate we consider that it would be a backward step for the FRC to issue guidance that recommended consideration of a period of anything less than twelve months from the date of approval of the financial statements or was silent on the need to make disclosure when the period considered by directors was less than twelve months from the date of approval of the financial statements.

In our opinion it is also important to highlight the difference between the periods of consideration required by IAS 1 and the UK requirements ISA (UK and Ireland) 570. Directors often focus on the requirements of International Accounting Standards and question why auditors are concerned about the period being considered extending to twelve months from the date of approval of the financial statements rather than the twelve months from the balance sheet date allowed by IAS 1. It would be helpful if the developments described in the annex highlighted this difference in interpretation and in doing so repeated some of the text from the background material included on page three of the exposure draft which states that the FRC believes that the UK approach of considering one year from the date of approval of the financial statements is superior to that of the

approach under International Accounting Standards and has been widely adopted within Europe.

### Further detailed comments

Para	Comment
Title	The title of the guidance has been changed to “Guidance for directors of listed companies incorporated in the UK” rather “registered in the UK” which was used for the previous guidance. If the guidance is aimed at directors of companies that are required to comply with the Listing Rules of the Financial Services Authority then this could include companies incorporated overseas as well as UK incorporated companies. A solution might be to refer to “UK listed companies” which could be defined in a footnote. This would be consistent with the use of “UK Listing Rules” in other FRC publications.
1	Paragraph 1 refers to the “Combined Code” and because the Combined Code is continually being updated it would be more accurate to refer to a particular version of the Combined Code for example the Combined Code 2006.
2	Paragraph 2 states that the guidance “is not intended to, and indeed cannot, guarantee that a company will remain a going concern until the next annual report and accounts are issued”. This is inconsistent with both the IAS 1 requirement that “management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period” and the FRS 18 requirement for disclosure “where the foreseeable future considered by the directors has been limited to a period of less than one year from the date of approval of the financial statements”. Depending on the circumstances the date of the issue of the next annual report and accounts could be longer or shorter than twelve months from the date of approval of the financial statements and we consider that it is confusing to introduce a third time period.
6	The first sentence of paragraph 6 that refers to the procedures that the directors follow when considering going concern has been deleted. The next sentence which refers to the guidance codifying best practice and not representing a substantial increase in the amount of work necessary and we consider that it would make more sense if the first sentence was retained.
8	Paragraph 8 includes the terms “large private companies” and “public interest entities” and we consider that it would be helpful if these terms were defined.
20	Paragraph 20 states that where the period considered by the directors has been limited, for example, to a period of less than one year from the date of approval of the financial statements, the directors “should determine

Para	Comment
	<p>whether, in their opinion, the financial statements require any additional disclosure". This is less stringent than the requirement of FRS 18 which requires that where the foreseeable future considered by the directors has been limited to a period of less than one year from the date of approval of the financial statements that fact should be disclosed.</p> <p>We consider that the guidance for directors should refer to the requirement in ISA (UK and Ireland) 570 paragraph 31-4 which requires that if the period to which those charged with governance have paid particular attention in assessing going concern is less than one year from the date of approval of the financial statements, and those charged with governance have not disclosed that fact, the auditor should do so with the section of the auditor's report setting out the basis of the audit opinion, unless that fact is clear from any other references in the auditor's report.</p>
31-32	<p>Paragraph 31 refers to discussing arrears or breaches with the company's bankers and paragraph 32 refers to seeking confirmation from bankers regarding the existence and status of any finance arrangements. Often, banking covenants make reference to the position shown in the audited accounts and so breaches of banking covenants only become evident after the year end when draft financial statements are prepared and where covenants are breached usually long-term borrowings will become payable on demand.</p> <p>In the current economic climate we consider that the guidance should make reference to the issue of whether such long term borrowings should be re-classified and presented as current liabilities where successful re-negotiation of the covenants has taken place after the year end but before the financial statements are authorised for issue. This is covered by IAS 1 which makes clear that a post balance sheet waiver of a covenant breach is a non-adjusting event and the liability that has become payable on demand due to the breach should be presented as a current liability. At the balance sheet date there is no unconditional right for the company to defer payment of the liability for at least 12 months from the balance sheet date and the liability is therefore current. [IAS 1 para 65]. The only exception to this rule is where the lender has agreed before the balance sheet date to provide a period of grace ending at least 12 months from the balance sheet date, within which the entity can rectify the breach and that it cannot demand immediate repayment during that 12 months.</p>
Annex Pages 27-31	<p>We also consider that the IFRS 7 guidance in the annex relating to liquidity risk, estimating future cash flows and disclosure of estimation certainty would be better incorporated into the appendix of detailed procedures rather than have guidance in two places.</p>

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

John Hudson  
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