

**FINANCIAL REPORTING COUNCIL**

**GOING CONCERN AND FINANCIAL REPORTING**

**CONSULTATION ON REVIEW OF 1994 GUIDANCE  
FOR DIRECTORS OF LISTED COMPANIES**

**CBI RESPONSE**

**24 November 2008**

**I INTRODUCTION AND SUMMARY OF CBI POSITION**

1. We are pleased to respond to the Board's consultation.
2. We supported a review of this Guidance in our response to the FRC's Draft Plan and Budget for 2008 / 09. Ever since, the global credit crisis has hit with increasing intensity significantly adversely affecting the financial position of many UK listed companies and companies generally. In particular, it is very concerning how apparently successful companies can suddenly fail without warning.
3. We understand that some 5% of FTSE-listed companies are already receiving modifications to their auditors' reports, relating to their ability to continue as a going concern, and that on a single day in mid-October, 13 AIM companies received such modifications. It would cause significant damage to the UK economic outlook if this trend were to continue, bearing in mind that the consequences of such a modification can include an immediate 80% plunge in share price – with suppliers adjusting their behaviour in a way that can lead to going concern uncertainty becoming a self-fulfilling prophecy.
4. A key issue highlighted by the credit crisis is the ability or difficulties companies have faced in securing, renewing or extending bank credit facilities, which could affect their going concern status and ability to continue in business. Also many companies can also find themselves in breach of banking covenants, which could lead to similar results. The expression of going concern uncertainty in a company's accounts will also in any circumstances result in a greater reluctance on the part of suppliers of finance to extend facilities. But in the present circumstances it can be extremely difficult, if not impossible, for a company in this position to access finance at any reasonable cost. Indeed, it would appear that existing credit facilities are being withdrawn, or the cost of finance pushed up, far more readily than usual.



5. We would welcome any actions or influence the FRC has to try to minimise the consequences for companies, and develop understandings with banks on such matters. It would be very helpful if banks were able to give companies some form of assurance that they are not aware of any reason why credit or banking facilities should not continue to be available in cases where there are no discussions between the banks and a company relating to specific concerns.

**6. The FRC needs urgently to develop further guidance for directors which creates more opportunity to convey the general economic uncertainties in such a way as to avoid triggering heavy going concern modifications to auditors' reports.**

7. Steps must be taken to prevent the question of going concern uncertainty getting out of control. The FRC must, therefore, develop further guidance for directors as soon as possible, creating more opportunity to convey general economic uncertainties in such a way as to avoid triggering heavy 'going concern' modifications to auditors' reports. We therefore strongly welcome the news that the FRC plans to publish a Bulletin on Going Concern and Liquidity to assist directors and audit firms, and we look forward to its publication as soon as possible.

8. Beyond the urgent need to address forthcoming year-end issues, in developing updated Guidance for Directors of listed companies for use over the medium term, the revised Guidance might usefully draw together and remind directors of a listed company's legal and regulatory disclosure obligations about matters which directors need to take into account, or should have regard to, in making their going concern assessment. Specifically there are requirements to disclose risks and uncertainties in the Business Review, and obligations in the FSA Disclosure and Transparency Rules to update shareholders on those risks and uncertainties and other matters affecting the business in the half yearly statement and in interim management reports. There may be other relevant examples to make reference to.

9. We set out below our responses to the specific consultation questions.

## **II RESPONSES TO CONSULTATION QUESTIONS**

### **Need for Guidance for Directors**

**The FRC has observed that very significant changes have been made to the accounting standards that must be applied by directors of listed companies when preparing their consolidated accounts in compliance with IFRSs as adopted for use in the EU (see Appendix 1). However, these changes principally address financial statement disclosures rather than guidance on process.**

**Q.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.

### **Adequacy of proposed amendments to the existing guidance**

**The FRC has set out some proposed amendments to the existing Guidance for Directors with the objective of a minimal update to respond to changes in the supporting standards and rules (see Section 2). The FRC has not sought to identify substantial additional material that might be included.**

**Q. 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?**

The possible choice of Statements directors might make is set out at Para 47 on Page 18 of the consultation paper.

The proposed additional choice at the third Indent would mean that there would be two options, the Second and Third Indents, referring to “doubt” about the going concern. We believe only one version is necessary, and the wording of the Second Indent is preferable to the possible new Statement at the Third Indent. Having both these choices referring to “doubt” are likely to lead to the same response from auditors i.e. a going concern emphasis of matter statement based on ISA 570.

If there was to be a fourth option, this could perhaps more usefully address ‘concern but not significant concern’, which would not require an emphasis of matter paragraph.

The wording of all these Statements needs to be clear and unambiguous, with further disclosures by the directors and cross references to other sections the annual report and accounts, as appropriate.

Consistency wherever possible with IFRS requirements should also be the aim, or changes sought to IFRS if necessary to seek to achieve consistency in the future.

### **Redundant content in the proposed guidance**

The FRC has not set out to adopt a more radical approach to the proposed Guidance for Directors, such as a bottom up wholesale re-write. As a result, the FRC has not considered whether substantial parts of the text could be dropped (see Section 2).

**Q.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?**

Whilst we are broadly content with the general approach, an updated revised draft should be exposed for public comment, which takes into account the comments made in this response and the consensus of views from respondents generally.

### **Approach to the inclusion of example text for directors to include in financial statements**

The FRC notes that since 1994 there has been a trend away from giving detailed guidance that prescribes standardised text towards encouraging directors to draft the text of disclosures in a way that is specific to their own facts and circumstances. However, the proposed guidance continues to contain example disclosures, (see Section 2 paragraphs 49 and 51).

**Q. 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?**

Yes precedent wording is helpful, but we oppose the inclusion of both of options (b) and (c). See our comments in response to Q.2. above.

### **Approach to the disclosure of a minimum period of review**

The FRC notes that the proposed text continues to be consistent with International Standards on Auditing (UK and Ireland) which, among other things, require 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. However, whilst IFRSs require management to take into account all available information about the future, this period need only be twelve months from the end of the reporting period.

**Q. 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 ?**

IAS 1 refers to a period of not less than 12 months from the balance sheet date, whereas the existing Guidance specifies 12 months from the date of approval of the accounts by the directors. It would be helpful if there was some international agreement and harmonisation on the appropriate period, and that the Guidance was generally consistent with IFRS requirements for listed companies.

This might also be an issue that the FRC Complexity Project should take up.