



Our Ref NJJ/PC/FRC GOING CONCERN 0908  
Your Ref FRC GOING CONCERN 0908

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Dear Mr Leonard

Consultation paper: going concern and financial reporting - proposals to revise the guidance for directors of listed companies

We welcome the opportunity to comment on the consultation paper.

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### **The current economic environment**

The FRC decided to refresh and update the guidance as, since its issue in 1994, financial reporting has been influenced by changes in legislation, regulations, accounting standards and investors' expectations of the amount and quality of disclosures. Unfortunately, the revision has occurred at a time when there is uncertainty over the ability of a number of companies to continue as going concerns due to the current economic environment. We do not believe the revision adequately addresses this current environment.

However, the FRC has issued a further document, 'An update for directors of listed companies: going concern and liquidity risk' (further document) as one of several responses to the current environment. This document addresses a number of the inadequacies in the revised paper, particularly the importance of disclosures of uncertainties and judgements which are now required by IFRS.

Given the existence of these two papers we will make some generic points that are relevant to this paper, but the need to issue a further document, which addresses the current economic situation, highlights the deficiency of the guidance and its lack of robustness in testing times. If it is decided to reissue the paper as stand alone guidance, as it has already been issued as an appendix to the further document, we consider that it should incorporate much of the contents of the further document and its issue be accompanied by a publicity campaign by the FRC concerning the difficulties facing companies and auditors reporting in the current situation.

### **Addressees of the guidance**

Guidance should not be confined to the directors of listed companies as it is equally relevant to the directors of all companies. While the Listing Rules require a statement to be made by the directors, the directors of other companies still have to consider the going concern presumption as it is fundamental to the preparation of financial statements. The requirements for establishing that the company is a going concern are the basically the same under both UK GAAP and IFRS. We believe that the guidance should be issued as guidance for directors of all companies and any parts that are specific to the Listing Rules can be labelled as such.

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### **Guidance on uncertainties**

The guidance should address the wider issue of uncertainties, and not be restricted just to the going concern presumption. Judgements and estimates are an integral part of addressing uncertainties during the financial reporting process, and the going concern presumption is the result of this process. Without diluting the clarity of the main message in the paper the FRC could take this opportunity to raise awareness of references to estimates and judgments in accounting standards and expectations of disclosures in the financial statements.

### **Division of disclosure into three / four conclusions**

Uncertainties and the associated going concern issues arise on a sliding scale. The paper seeks to define points which force disclosures into defined conclusions, tied to particular words and definitions, which we consider unhelpful. Forcing disclosures into three / four defined conclusions risks distracting directors from the real issue which is the appropriate disclosure of uncertainties facing the business. The paper should avoid the appearance of bright lines and indicate that there is a scale of disclosures, which would be applied to the level and severity of uncertainties which the company faces.

We consider that the focus of the paper on compliance with the requirement to make a statement in accordance with the Listing Rules, and its location in the Business Review section of the Directors' report, unfortunate. This is a missed opportunity to emphasise reporting of uncertainties and judgements in the financial statements and the need, if necessary, to make a statement in the financial statements that the going concern concept has been carefully considered because of the uncertainties disclosed.

Regarding the four conclusions directors can reach (paragraph 47), we consider that there are a lesser number.

The first is the same as that in the first bullet and as far as the financial statements are concerned, there is no mention of the going concern presumption needing to be considered as a result of various uncertainties. Using the sliding scale, this would be near the beginning. There may be a few disclosed uncertainties but they will not impact on the entity's ability to continue as a going concern.

The second is where there are uncertainties that cast doubt on the ability of the company to continue as a going concern, but the directors still consider the presumption is appropriate. This is everywhere else on the scale, other than the end. The severity of the disclosure is indicated by the quantum and content of the uncertainties disclosed. The discussion on the difference between doubt and significant doubt, which arises from IAS 1.23, is not helpful and not applicable to companies that do not report under IFRS.

The third conclusion, is only likely to arise in exceptional circumstances, that being the situation where the going concern basis is not appropriate. If this is the situation, by the time the annual report is issued, the company is likely to be in the hands of administrators or liquidators and the directors will no longer have control of it and would probably be trading illegally if they did.

As a result of the above observations we have not commented on the five questions but have limited our response to the first.

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

We do not.

The issue of the further document illustrates that the paper is deficient when tested under the current environment. While we are repeating some of the points above, briefly our reasons for considering there is no need for separate guidance are as follows:

- The going concern presumption applies to all companies as the requirement is in the Companies Act 2006, IFRS and UK GAAP. The guidance would be of more use if it was issued by the ASB and referred to by the FRC as the location of the guidance for directors of listed companies.
- Directors have to state in their responsibilities statement that they are required to prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business. It could be argued that stating that it is the directors' responsibility to prepare financial statements on a going concern basis is not the same as stating that the company is a going concern in the foreseeable future, but the argument is tenuous as the directors take responsibility for the financial statements. In fact for listed companies, this statement is often removed from the directors' responsibilities statement because of the statement in the corporate governance report / business review.
- We believe there is a need for guidance, for the directors of SMEs who may not prepare robust budgets, cash-flow forecasts, etc and may not be subject to audit.
- The original document has served its time. The corporate world is now more sophisticated. 1994 was a different era without visible corporate governance, a lack of acknowledgement of directors' responsibilities and less comprehensive accounting standards.

The other questions, if the answer the question 1 is not the consensus, are answered through the main body of the letter.

If you have any questions on this response, please contact me.

Yours sincerely

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