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Dear Mr Leonard

**Response to the FRC's exposure draft of proposed revised guidance on Going Concern and Financial Reporting**

We are writing in response to the invitation to comment on the FRC's exposure draft of proposed revised guidance on Going Concern and Financial Reporting.

We have set out in Appendix 1 to this letter the responses to the detailed technical questions that commentators have been asked specifically to consider (including in Appendix 2 part of our answer to question 2 as well as some significant drafting comments on the proposed revised guidance).

We agree with the comment in section 1 of the paper that the current economic conditions mean that going concern questions are likely to need to be considered in particular detail this year. Indeed, the more widespread effects of current conditions, including credit supply conditions, may raise some new challenges. In any event, the 1994 guidance does not address itself particularly to conditions such as experienced currently. We understand that the FRC is contemplating the urgent issue – within the next few days – of more specific supplementary guidance to deal with this, and we very much support that idea; the FRC needs to be, and is being, responsive to market needs to help create certainty over the particular application of existing guidance just now. In the months immediately following publication of that supplement (the reporting season in which companies are applying it), we firmly believe that it would be inappropriate also to commence a complete overhaul of the 1994 guidance (eg, by issuing a consultation paper) which, we agree, remains fundamentally sound. We believe that such a fundamental review should be carried out in due course, eg commencing later in 2009, building upon the experience of using the combination of the 1994 guidance and the imminent supplement.

Since the changes in accounting and auditing standards to which the FRC is responding in these amendments have been in place for some time, we even question the need to amend the 1994 guidance at this stage for these matters. Moreover, with the urgent supplement, referred to above, about to be issued, we think it would be inappropriate to issue even a limited update for changes in standards. To do so would only detract from the clear, specific focus of this imminent, urgent guidance. Rather, as noted above, we have concluded and strongly recommend that the right course of action is to defer any change to the 1994 material to an exercise beginning later in 2009, through to 2010, being a review to deal with all three of: i) changes in standards; ii) experience in practice with the imminent guidance; and iii) a fundamental review.

Given that the Consultation Paper's changes proposed in relation to accounting and auditing standard will be taken up at some point, albeit not in early 2009, we have answered the questions with a view to informing that aspect of the later top-to-bottom review.

If you would like to discuss any aspect of our response, please contact me on 020 7311 8934.

Yours sincerely



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## Appendix 1

### 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. However, these changes principally address financial statement disclosures rather than guidance on process.*

***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 believe that there continues to be a need for separate guidance to exist for directors on this subject. The guidance is needed not only for its target audience of listed companies in the UK to allow them to consider the requirements of the Combined Code but also, as noted in paragraph 8, to assist directors of other entities by providing them with material additional to the basic accounting rules set out in IAS 1 / FRS 18.

#### 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. The FRC has not sought to identify substantial additional material that might be included.*

***Question 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?***

Before addressing the proposed amendments themselves, we draw attention to the strong recommendation in our covering letter against making any minimal update to the existing guidance to reflect changes in standards and rules.

We acknowledge that the current guidance was issued back in 1994 and that there have been significant changes since then in both the accounting standards used by listed companies and the rules they must follow, and the auditing standards used by their auditors. However, in general we do not believe that the disconnect between the guidance and the rules/standards now in place has been causing practical difficulties for directors.

However, we do perceive that the guidance will ultimately need a more fundamental review and updating. In our view, the minimal update should be deferred in the light of the supplementary guidance about to be issued, addressing the current economic conditions, and once experience has been gained in using that imminent supplement, the FRC should in the course of 2009/2010 commence a fundamental re-appraisal of the guidance considering fully where it needs to be updated and revised.

Turning to question 2, the major areas where we believe that the proposed amendments would not have been sufficient and appropriate are set out below. In addition to these major areas we have also set out in appendix 2 to this letter more minor points.

#### *a) Introduction of the fourth category in paragraph 47*

We are not convinced by the addition of a fourth category in paragraph 47. In our view the current second and proposed third categories merely represent different points on the spectrum of uncertainty/ doubt about the continuation of the company. In our view these two categories should be merged into one category, and that single category should be linked in more directly with the requirements of accounting and auditing standards. It should therefore reflect changes

since 1994 by incorporating: (i) the requirements of paragraph 23 of IAS 1 (2003, revised 2005) / paragraph 25 of IAS 1 (2007) and paragraph 61 of FRS 18; and (ii) the disclosure requirements to be considered by the auditor under paragraph 32 of ISA (UK and Ireland) 570. Furthermore, we believe that disclosure of uncertainties/ doubts are appropriate for both ends of the spectrum within this category. (We comment further on this in our response to question 4.)

*b) UK GAAP*

Not all listed companies prepare their financial statements in accordance with IFRS as adopted by the EU (EU-IFRS) due to the fact that Article 4 of the IAS Regulation mandates the use of EU-IFRS only in consolidated financial statements. Hence listed entities with no subsidiaries are permitted to prepare their financial statements in accordance with UK GAAP and this is commonly done by non-group listed entities such as investment trust companies. Therefore in our view in the following paragraphs the UK GAAP equivalents to EU-IFRS should also be given (this could be by means of footnotes):

- (i) Paragraph 12 – the nearest UK GAAP equivalent is given in paragraphs 21 and 22 of FRS 18.
- (ii) Paragraph 29A – the UK GAAP equivalent is FRS 11.
- (iii) Paragraph 31 – the UK equivalent is FRS 29.
- (iv) Paragraph 37 – the UK equivalent is FRS 29.
- (v) Paragraph 45 – the UK equivalent is paragraph 61 of FRS 18.
- (vi) Paragraph 47 – not a specific reference, but the third bullet should refer to UK GAAP as well as to IFRSs.

Similarly in the Annex to the guidance it is noted that since 1994 developments have occurred and those for IFRSs are noted. The developments in UK GAAP should also be noted, being the issue of FRS 18 (replacement for SSAP 2), FRS 21 (replacement for SSAP 17), issue of FRS 11 and issue of FRS 29.

*c) Annex to the guidance – version of IAS 1*

In this Annex various parts of IAS 1 are quoted with the paragraph number from IAS 1 given in a footnote. All of the quotations and related paragraph numbers are taken from the version of IAS 1 issued by the IASB in September 2007. Strictly speaking it is the existing version of IAS 1 issued in 2003 (and revised in 2005) that continues to be relevant until accounting periods beginning on or after 1 January 2009 (and until endorsed). However, if any update to the 1994 guidance is deferred then this 2007 version will probably by that stage be the appropriate edition to refer to.

**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.*

***Question 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?***

We shall revert to this question when the FRC consults in future about the “bottom up wholesale re-write” referred to in the questions.

### **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).*

***Question 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?***

Our view varies, depending on whether the directors have concluded that there are doubts about the use of the going concern basis of preparation.

Although there are always concerns about the overuse of “boiler plate” wording, we do not perceive that the FRC including standardised text in paragraph 49 has hitherto resulted in a problem in this regard. Where there have been no perceived questions in relation to going concern, the use of the short “boiler plate” wording in paragraph 49 of the guidance has been seen as giving readers comfort on this matter as use of the standard text quickly conveys to the reader that there are no perceived problems.

However, we do not support the continued inclusion of standardised text when there are doubts to report. Instead, we believe that the guidance should set out a framework of matters to be addressed by the directors in their note. This would need to cover the two levels of doubt and uncertainty – a material uncertainty that may cast significant doubt on the company’s ability to continue as a going concern; and a lesser degree of doubt that should nevertheless be disclosed. The examples included in the draft supplementary guidance about to be issued aim at exactly that, and we support that principle.

For the former, we believe that it would be appropriate for the framework to be based on the requirements of IAS 1 / FRS 18 and the matters set out in ISA (UK and Ireland) 570 paragraph 33-2: since that paragraph sets out the minimum that the auditor would normally expect to see included, in order to be able to conclude that the disclosure was adequate, this seems an appropriate starting point for the directors’ construction of their disclosure. The framework should also refer to the need for the two statements set out as necessary in ISA (UK and Ireland) 570 paragraphs 32(b) and 33 – a clear statement that there is a material uncertainty which may cast significant doubt; and that, as a consequence, the company may be unable to continue realising its assets and discharging its liabilities in the normal course of business.

In the latter case, uncertainties warrant disclosure due to the focus on risk factors that is now a part of financial and business reporting. The disclosures should however make explicit that the uncertainties are not material ones that may cast significant doubt on the going concern status (and in that regard the examples in the draft supplementary guidance require revision). This disclosure would also be a good discipline.

### **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.*

***Question 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 believe that it continues to be appropriate for the guidance to require disclosure based on this extended period of twelve months from the date of approval of the financial statements.

The alternative approach of the guidance being silent over this matter would leave only the indirect "requirements" of ISA (UK and Ireland) 570 in relation to the period and extent of disclosures to be given by directors in financial statements prepared under IFRS as adopted by the EU. We do not believe that this would be appropriate.

## Appendix 2

### Other matters

In view of the limited nature of the FRC's current consultation we have not reviewed in detail either the guidance note itself or its appendix of detailed procedures. However, we have set out below both some more detailed comments arising in relation to question 2 (the sufficiency and appropriateness of the proposed amendments) and some other significant drafting comments on the proposed revised guidance.

#### *Company law and similar matters*

1. Paragraphs 8 and 11 refer to the Companies Act 2006. Depending upon the date when the revised guidance is issued by the FRC, the Companies Act 1985 may still be relevant given the implementation date of this part of the Companies Act 2006 is not until accounting periods beginning on or after 6 April 2008.

In addition entities other than those incorporated under the Companies Acts may be UK listed, such as Unit Trusts and Building Societies with listed PIBS. Hence it would be preferable to refer to "their relevant legislation" instead of "the Companies Act 2006."

2. Paragraph 8 refers to AIM companies, PLUS-quoted companies etc. In addition to PLUS-quoted there is now PLUS-listed, a new market which is an EU regulated market and hence subject to the Listing Rules. So as to be complete perhaps the first sentence should refer to "This guidance is primarily intended for directors of listed companies (including those on PLUS-listed).
3. Paragraph 11, second sentence refers to the Companies Act 2006 requirement that it is presumed that the company is carrying on business as a going concern under paragraph 11 of Part 2 of Schedule 1 of "The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008". As we comment above, in our view the guidance should refer to financial statements prepared under either EU-IFRS or UK GAAP rather than just EU-IFRS. However, in this paragraph at present only the *UK GAAP* reference has been included, as paragraph 11 of this Schedule applies only to "Companies Act" accounts. The EU-IFRS alternative for the explanation of the first sentence in paragraph 11 is given by paragraph 23 of IAS 1 (2003, revised) / paragraph 25 of IAS 1 (2007).
4. Paragraph 44 refers to the Business Review section in the Directors' Report and states that this relates to past operations. Since 1994 when the previous guidance was issued the focus of the Business Review has become much more forward-looking than previously, with the current amended section 234ZZB of the Companies Act 1985 (that applies for accounting periods beginning on or after 1 October 2007) and section 417 of the Companies Act 2006 (that will apply for accounting periods beginning on or after 6 April 2008) both requiring forward-looking disclosures.

#### *Matters relation to other APB documents*

5. Paragraph 20 now includes a footnote that states that if the period to which the directors have paid attention is less than one year from the date of approval of the financial statements the auditor is required to disclose this fact in the auditor's report. However, this is not the requirement of paragraphs 31-4 to 31-6 of ISA (UK and Ireland) 570 which require this fact to be disclosed in the audit report only if it is not disclosed in the financial statements themselves or in the accompanying information.

6. Paragraph 57 for directors would appear to be inconsistent with the ISRE (UK and Ireland) 2410 requirements for auditors. While both paragraph 57 of the revised guidance and paragraph 57 of ISRE (UK and Ireland) 2410 refer to updating the position that existed at the previous year end, paragraph 58 of ISRE (UK and Ireland) 2410 also requires that the auditor considers new events or conditions that have arisen during the interim period. For consistency, the guidance for directors should note that they need also to consider whether in the interim period and up to the date of the approval of the half-yearly financial report there have been any *new* events or conditions relating to going concern.

Without this latter point it is difficult to understand how the directors will be meeting the DTR requirements, especially where new events or conditions relating to going concern have occurred that give rise to a material uncertainty – including major changes in the economic environment, such as happened over the autumn of 2008. These require: (i) that the condensed set of interim financial statements include “sufficient information and explanations to ensure a user’s proper understanding of any material changes in amounts and of any developments in the half-year period concerned, which are reflected in the balance sheet and the profit and loss account”; and (ii) that the interim management report must include “at least an indication of important events that have occurred during the first six months of the financial year, and their impact on the condensed set of financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year.” Moreover, in our view consideration of going concern issues should cover 12 months from the date of approval of interim information.

#### *Matters relation to IFRS/UK GAAP*

7. Paragraph 2 last sentence refers to when the “next annual report and accounts are issued”. Given that paragraph 3 of IAS 10 and paragraph 3 of FRS 18 use the term “authorised for issue” perhaps this paragraph needs to reflect the current terminology used within the relevant accounting standards.
8. Paragraph 15 refers to the alternative to a going concern basis being to “assume that the company will be broken up.” Rather than “broken up”, paragraph 14 of IAS 10 / paragraph 21 of FRS 18 refers to “being liquidated or ceased trading” or intentions to do either; the guidance should be updated to reflect the current terminology.

#### *Other matters*

9. Paragraph 21 refers to factors which cast doubt on the presumption that the company will continue in operational existence. Given the introduction of the fourth alternative in paragraph 47 of the guidance paragraph 21 should refer to “doubts or material uncertainties that may cast significant doubt”.
10. Paragraph 22, second sentence covers the position where disclosure in the financial statements is not needed in order for those statements to give a true and fair view, in which case disclosure in the Business Review section of the Directors’ Report would be sufficient. In our view the directors have a choice whether in these circumstances the disclosure is made either in the financial statements or in the Directors’ Report and that choice should be acknowledged here.
11. Paragraph 56 refers to the date of approval of the financial statements. Given that both the Directors’ Report and the financial statements need to be approved and, in cases where there are no material uncertainties that may cast significant doubt to which the directors need to refer, the disclosure in relation to going concern will be in the Business Review section in the Directors’ Report, this paragraph should refer to the date on which they approve the Directors’ Report and the financial statements.