24 November 2008

Our ref: ICAEW Rep 132/08

Your ref:

Mr Steven Leonard
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By email: s.leonard@frc-apb.org.uk

Dear Steve

GOING CONCERN AND FINANCIAL REPORTING

The Institute of Chartered Accountants in England and Wales (the Institute) is pleased to respond to your request for comments on the Consultation Paper *Going Concern and Financial Reporting - Proposals to Revise the Guidance for Directors of Listed Companies*, published by the Financial Reporting Council in September 2008.

Please contact me if you would like to discuss any of the points raised in the attached response.

Yours sincerely

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW REPRESENTATION

ICAEW REP 132/08

GOING CONCERN AND FINANCIAL REPORTING

Memorandum of comment submitted in November 2008 by The Institute of Chartered Accountants in England and Wales, in response to the Consultation Paper *Going Concern and Financial Reporting - Proposals to Revise the Guidance for Directors of Listed Companies*, published by the Financial Reporting Council in September 2008.

Contents	**Paragraph**		

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the Consultation Paper *Going Concern and Financial Reporting - Proposals to Revise the Guidance for Directors of Listed Companies*, published by the Financial Reporting Council in September 2008.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

4. Our members occupy a wide range of roles throughout the economy. This response was developed by the Financial Reporting Committee of the Institute, which includes preparers, analysts, standard-setters and academics as well as senior members of accounting firms.

MAJOR ISSUES

Overall response

5. We agree that the FRC is right to keep its guidance to directors on going concern under review, and that some updating is required to take account of changes in the law and accounting standards since 1994 (which perhaps should have been done before now). However, we have reservations about some of the other proposed revisions, and we are not convinced that overall the proposals will lead to substantive improvement. We suggest that the FRC should make certain limited changes as a result of this review, but commit to carrying out a thorough review in the near future, once the post-mortem on the current credit crisis (and any subsequent recession) has been completed. Our comments in this response should be read in the context of this overall view.

6. We set out some comments on major issues in paragraphs 7 - 10 below; our responses to the specific questions raised by the FRC are in paragraphs 11 - 20; and we raise some other issues in paragraphs 21 - 27 below.

Additional conclusion available to directors

7. The Consultation Paper (see paragraph 47) proposes making an additional conclusion available to directors in relation to going concern; namely that

> ‘they have identified 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 by IFRSs’.

This seems very closely related to the existing conclusion, that

> ‘they have identified 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 in preparing the financial statements’.

IAS 1 requires disclosure where material uncertainties may cast significant doubt upon the entity’s ability to continue as a going concern and the new requirement mirrors that wording. But it is very close to the existing second conclusion and we are not convinced that having two conclusions that are so similar offers any added value. Given that the source of the wording of the existing second conclusion is unclear, we suggest this conclusion to be simply deleted in favour of the new material, which is aligned with the wording in IAS 1 *Presentation of Financial Statements*.

8. It may be that the intention was to attempt to deal with the decision in the Mayflower case, in which the Accountancy Investigation and Discipline Board tribunal held that ‘Although refinancing was an uncertainty, it was not a *significant* uncertainty’ [emphasis added]. If the intention is to deal with circumstances where there is concern but not significant concern about the going concern basis, it is not clear to us how the proposals achieve this. If this is the FRC’s intention, it should give an explicit explanation in the Guidance.

Consistency of conclusions with requirements of IAS 1

9. We note that the final conclusion available to directors is unchanged: ‘they consider that the company is unlikely to continue in operational existence for the foreseeable future and therefore the going concern basis is not an appropriate one on which to draw up the financial statements.’ This is inconsistent with IAS 1 and IAS 10 which require the use of the going concern basis ‘unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so’. It is possible to envisage a situation where a company is ‘unlikely’ to continue in operational existence but would not meet the tougher test in IAS 1 which requires an actual liquidation or cessation of trade or ‘no realistic alternative’. We suggest that the words in the guidance should be made consistent with the accounting standards, even if the cases where this might need to be used are rare.

Business Review

10. We note that the proposed new guidance requires the directors’ statement on going concern to be included (unless it impacts on the truth and fairness of the financial statements) in the Business Review section of the Directors’ Report. This seems to be the result of simply substituting the Business Review for the OFR. As the OFR was a voluntary statement, companies at the moment have a choice of where to locate the statement on going concern, and do not necessarily choose to locate it in the mandatory Business Review. We question whether it is worth imposing a mandatory location when there is apparently nothing to suggest that the present requirement is deficient in practice. If the FRC is making this change deliberately, it should explain why it is doing so.

SPECIFIC QUESTIONS

1. 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.

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?

11. We do believe that there is a continuing need for separate guidance on going concern, but it should be kept up-to-date in the future.

2. 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.

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?

12. Please see paragraphs 7 - 8 above for our comments on the additional conclusion available to directors.

13. Please see our comment in paragraph 9 above in relation to the need to be consistent with IAS 1.

14. We set out some additional points in paragraphs 21 - 27 below.

3. 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).

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?

15. We have not identified any significant parts of the proposed guidance that could be deleted.

4. 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?

16. We are content for the proposed guidance to continue to include standardised text. However, we some comments on specific wording.

17. We note that the wording in paragraph 49 of the proposed guidance is unchanged. We believe that it would be preferable if the wording were to stress that the directors have formed a judgement at a particular point in time. For example:

> 'After making enquiries, the directors have formed a judgement, at the time of approving the financial statements, that there is a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. For this reason, the directors continue to adopt the going concern basis in preparing the financial statements.'
> *(Deloitte iGAAP 2008 Financial Statements for UK Listed Groups)*

18. We have suggested that the proposed additional conclusion available to directors should in fact be a replacement for the existing second conclusion (see paragraph 7 above).

- If our suggestion is adopted, then the given circumstances would be an example of a material uncertainty that may cast significant doubt on the use of the going concern basis of preparation, and the existing example in paragraph 51 would need to be deleted. We suggest that paragraph 51A should be revised to include the wording required by paragraphs 32(b) and 33 of International Standard on Auditing (UK and Ireland) 570 *Going Concern*:

  > '... there is a material uncertainty ... which may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.' ISA 570.32(b)

  While we accept that the guidance is for directors, they should understand that auditors are required by auditing standards to ensure certain disclosures are made.

- If our suggestion not adopted, we question whether the circumstances of the example in paragraph 51 do in fact point merely to a simple 'doubt'. In these circumstances, we would expect the auditors to give an emphasis of matter paragraph, since as described there appears to be a material uncertainty that may cast significant doubt. We suggest that the facts of the example need to be changed if the intention is to retain an example of disclosure when there is less doubt.

Our comments above regarding ISA 570 and paragraph 51A will also be relevant.

19. If paragraph 51A retains the reference to additional disclosures required by IFRSs, it would be helpful if it contained a cross reference to show where in the IFRSs these disclosure requirements appear.

5. 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?

20. We agree that the guidance should retain the requirement to disclose when the period considered is less than 12 months from that date of approval of the accounts. However, it may be worth stating explicitly in the guidance the requirement in IAS 1, that the directors must consider a period of at least 12 months from the balance sheet date, with the guidance continuing to require an explicit statement if that period ends within 12 months of the date of approval. This is consistent with International Standard on Auditing (UK and Ireland) 570 *Going Concern*.

ADDITIONAL POINTS FOR CONSIDERATION

Effective date

21. As the Consultation closes on 24 November, is the FRC's intention to publish final guidance in December or early in the New Year, effective immediately? Clearly, there is a potential issue for 31 December accounts not yet finalised.

Entities not complying with IFRS

22. The guidance has been redrafted to refer only to IFRSs, even though certain listed companies (particularly investment trusts) continue to report under UK GAAP. Also, paragraph 8 says some unlisted companies might want to refer to the guidance. This could be fixed quite easily by a paragraph explaining that although the guidance refers to IFRSs, the equivalent UK GAAP requirements are in FRS 18 and FRS 21 which are converged with the equivalent IFRS requirements.

Other issues

23. In paragraph 2 of the Preface, the word 'annual' has been inserted before 'report and accounts'. Given that the credit crisis seems to have arisen (or the main effects are being felt) in the second half of the year, this amendment could be seen as over-restrictive, even if it is what was originally intended. Paragraph 57 states explicitly that 'Directors cannot be expected to consider going concern as fully at the interim, but they should undertake a review of their previous work.' We question whether it is helpful to make this statement in the present environment. Paragraph 57 should be revised to provide a stronger imperative for directors to consider going concern and

make appropriate disclosure at the interim stage. Directors, surely, have a duty to be constantly alert to any going concern issues. We suggest that the issue of which communications by management should involve a proper consideration of going concern needs much fuller examination in a thorough review of the guidance at a later date (in line with our comment in paragraph 5 above.)

24. Paragraph 55 could be expanded (or another paragraph added under it) to consider the position of subsidiaries (or other reporting entities, such as a branch of an overseas company) in the group context: for example, the dependence on the parent.

25. We note that paragraphs 30 - 33 dealing with borrowing facilities and liability management are unamended. This seems a relaxed response to the current crisis, and is another area that might benefit from a fuller review in due course.

26. We note that the FRC believes that that no improvements could be made to the 14-year old Appendix, even in the light of current events. We suggest that the appendix should be revisited as part of the thorough review of the guidance we recommend for a later date.

27. Procedure 3.5 includes a consideration of whether taxes might be overdue. With certain taxes, there is a procedure to ask for ‘time to pay' or other requests to defer payment of tax. Strictly, if a plc has requested such time to pay or a deferral, it isn't ‘overdue'. However, we suggest that it would suggest considerable doubt as to the entity's ability to pay (as that is what the request actually says). So, this might be amended to say ‘or where the entity has requested that the tax authorities allow extra time to pay tax liabilities (PAYE, VAT or CT) beyond the statutory period'.

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