

Our ref: JH/kmf

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Dear Mr Leonard

Going Concern And Liquidity Risk - Guidance for Directors Of UK Companies. Exposure Draft

Thank you for the opportunity to comment on the Financial Reporting Council's exposure draft on going concern and liquidity risk.

Our responses to the specific questions raised by the FRC are included below together with our more detailed comments on the document and our concern about the FRC providing examples of wording that might be used by directors in different going concern situations.

Response to the questions raised by the FRC

- 1. Do you agree that the FRC should provide guidance on going concern relevant for directors of all companies? If so, do you believe that the Exposure Draft achieves this in a reasonably balanced way?*

YES.

We believe that in the current economic climate, where going concern is an issue that is affecting an increasing number of companies not just listed companies, the separate guidance for directors about going concern issued in 1994 should be updated and reissued as soon as possible applying to all companies. We believe that subject to the comments made in this response in relation to the conclusions drawn and the inclusion of example going concern wording the guidance achieves this in a reasonably balanced way.

- 2. Do you agree with the principles as drafted? If not how would you amend them?*

NO.



We recommend that the first two principles should be combined. Principles 1 and 2 in the exposure draft are essentially addressing the same point, the assessment of whether the company is a going concern, and could be combined as follows:

“When preparing financial statements intended to give a true and fair view directors should make a formal and rigorous assessment of whether the company is a going concern that is proportionate in nature and depth depending upon the degree to which going concern is an issue for the company and the size and complexity of the company and its operations.”

We would also question the format adopted of a principle supported by application guidance which follows directly on from it. Although this is consistent with other guidance issued by the FRC it is now inconsistent with the clarified ISAs issued by the IAASB which have been issued in exposure draft format by the APB. The clarified ISAs separate out the requirements and application guidance and although the guidance for directors contains “principles” rather than “requirements” we consider that the same format could be adopted allowing the directors to concentrate on the principles.

3. *Do you agree with the three conclusions? If not, please explain what alternative you would suggest?*

YES.

Although we agree with the three conclusions made by the directors we do not agree with the consequences for the audit report that are included in the table in paragraph 20 of the exposure draft. We have two main concerns

- *Audit report guidance* - We do not believe that the going concern guidance for directors should contain guidance on whether the auditor’s report will be modified or unmodified. The wording of the auditor’s report is the responsibility of the auditor and inclusion of guidance to directors that in certain circumstances the auditor’s report will be unmodified whilst in others it will be modified only undermines the auditor’s position and could result in disputes.
- *Non-going concern basis and unmodified report* - We do not agree with the guidance that where the directors consider the going concern basis is not appropriate and draw the accounts up on a non-going concern basis this would result in an unmodified opinion. We consider that the use of the non-going concern basis is so fundamental that it should be drawn to the attention of the reader of the accounts and we recommend that the auditor includes an “other matter” paragraph highlighting this to a reader of the accounts.



4. *Do you agree that the directors should disclose when the period they have considered is less than twelve months from the date of approval of half-yearly and interim financial statements that give a true and fair view?*

YES.

We agree with the proposed approach adopted by the FRC that requires directors to disclose when the period they have considered is less than twelve months from the date of approval of half-yearly and interim 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.

Further detailed comments

Para	Comment
38	<p><i>Explanation of impact of covenant breaches on classification of debt</i> Paragraph 38 refers to discussing potential deficits, arrears or breaches with the company's bankers in order to determine what action is needed. Where covenants are breached usually long-term borrowings will become payable on demand, 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 even where successful re-negotiation of the covenants has taken place after the year end but before the financial statements are authorised for issue.</p> <p>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>
Appendix 1, Pages 23 to 25	<p><i>Concern over inclusion of examples of wording for disclosure by directors</i> Appendix 1 includes examples of going concern disclosures that directors might use to explain their use of the going concern basis of accounting.</p> <p>We do not consider that it is appropriate to include such standardised text within the guidance to directors. In our opinion, it is not the role of the FRC to effectively prescribe wording for directors to use to explain their use of the going concern basis of accounting in the financial</p>



Para	Comment
	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.
Appendix 1 examples 2 and 3, Page 23	<p><i>Potential that insufficient difference between examples 2 and 3 could cause confusion</i></p> <p>Examples 2 and 3 in the Appendix deal with situations where there are uncertainties about going concern but in example 2 these are uncomplicated and presumably there would be no emphasis of matter in the auditor's report and in example 3 they are complicated and the directors conclude there is a material uncertainty which would require an emphasis of matter regarding going concern.</p> <p>The decision about whether or not something is a material uncertainty resulting in an emphasis of matter is a difficult area and in many cases requires a lot of judgement involving discussion within the engagement team and with the client. We consider that there is too much overlap between examples 2 and 3 and the distinction between the two examples is not clear enough. This could cause confusion with the risk that directors use the examples to try and justify why they do not consider that it is necessary for the auditor to include an emphasis of matter in the auditor's report and could undermine the auditor's position. For this reason we do not feel that the examples given are appropriate and we would recommend that either:</p> <ul style="list-style-type: none">• the examples are deleted (see comment above);• example 2 is deleted because it is too close to example 3 and will cause confusion; or• example 2 is reworded to make it sufficiently different from example 3 for there not to be any confusion.

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

Yours sincerely

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