

For the attention of Steven Leonard
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By post and by email

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Dear Sir

Exposure Draft “Going concern and liquidity risk: guidance for directors of UK companies”

We write in response to the FRC’s invitation to comment on the above-named Exposure Draft.

We continue to welcome warmly the FRC’s initiatives in this area. These initiatives have been timely and proportionate, responding to a need for new guidance on going concern. We believe the Exposure Draft forms a sound foundation for replacing the 1994 Guidance later this year.

We have two continuing major concerns on the proposed Guidance. These two concerns are the status of the Guidance, particularly for directors of non-listed entities, and the period of the going concern review. We expand on these concerns in responding to the FRC’s Questions 1 and 4 respectively below.

Question 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?

We agree that the FRC should at this time provide guidance on going concern, relevant for directors of all companies. Furthermore, the ED achieves this in a reasonably balanced way. However, we see the FRC Guidance merely as an interim solution for the following two reasons.

1. We believe that accounting standards should contain more guidance and require more disclosures on going concern. Going concern is one of the two underlying assumptions in the IASB's Framework for the preparation and presentation of financial statements. Within the body of the accounting standards, the topic is limited effectively to two paragraphs, paragraphs 25 and 26 of IAS 1 (2009) (a similar position exists in UK GAAP). These paragraphs provide that IFRS financial statements are to be prepared on a going concern basis and must contain certain disclosures only in limited circumstances. These are when management is aware of "material uncertainties relating to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern" or "when an entity does not adopt the going concern basis". Therefore, it is only in relatively extreme situations that there will be disclosures on going concern in financial statements as a result of accounting standards. Even then, there is little guidance on the nature, extent and location of the required disclosures under IAS 1.

We acknowledge that there are likely to be other disclosures that are of interest to the question of going concern, including those required by IFRS 7, other parts of IAS 1 and so on. However, such disclosures may be scattered throughout the financial statements and do not result in users receiving a cogent message on the application of the going concern assumption. The recent and continuing economic conditions have highlighted:

- the need to co-ordinate and streamline the disclosures relevant to the assessment of going concern. The economic conditions have highlighted the problem that IFRS has no requirement to have a discussion of business risks in the financial statements or to include a general description of the business model and the risks and uncertainties therein;
- that in IFRS there is no requirement to disclose the particular factors which the directors or management have considered in reaching a conclusion on going concern. In particular, while directors or management may have based their going concern assessment on reasonable assumptions, we live in a time when the unexpected happens. Accordingly, it may be important that these assumptions are disclosed. IFRS demands disclosure of sensitivities around impairment assumptions on particular assets but does not require such disclosure on going concern, one of the two fundamental lynchpins of financial reporting; and
- that there should be a clear statement from the directors or management on their assessment of the going concern assumption.

We recommend that the FRC invites its Accounting Standards Board to develop the paragraphs which should be added to IAS 1 so that the topic of going concern is

handled more effectively within IFRS and to use its lobbying powers to achieve change in this area.

2. Our second reason is our concern over the non-mandatory status of the Guidance as it applies to non-listed entities. As the FRC is aware, Deloitte has been monitoring disclosures on going concern by listed companies. Our current statistics indicate that some 53% of listed companies are currently taking on board in their annual reports the guidance which the FRC issued in its November 2008 Update. Under the Listing Rules there is of course a requirement for directors to make a statement prepared in accordance with the 1994 Guidance, that the business is a going concern, together with supporting assumptions or qualifications as necessary. For listed entities, it may be reasonably expected that when the ED replaces the 1994 Guidance then compliance with its principles will increase. However, the FRC's Statement will remain merely guidance for non-listed entities. We therefore ask that the FRC considers whether any further steps may be taken to emphasise to directors the importance of making adequate disclosures on the going concern assumption.

We particularly welcome paragraphs 76 to 79 of the ED. We consider these to be a very valuable addition to the authoritative literature.

Question 2: Do you agree with the principles as drafted? If not how would you amend them?

We support the four principles set out in the ED. But we see principle 2 as merely a subset of principle 1. In other words, section 2 sets out the procedures which directors carry out in making a formal and rigorous assessment of whether the company is a going concern. Thus, a case can be made for merging sections 1 and 2.

Furthermore, we note that assessment should lead to a conclusion. Paragraph 57 of the paper discusses the necessity for directors to conclude on the entity's ability to continue as a going concern and sets out the three possible conclusions. We consider that this task would be better placed in section one so that it covered using procedures to make an assessment and concluding thereon.

We consider the points above to be niceties not necessities. The ED contains all the relevant points. In that regard, it is very important that some of the points currently in the introduction and overview are retained in the final Guidance. These include paragraphs 11 to 14 and the table at paragraph 20. We note that the text in the final box of the table at paragraph 20 does not deal with all of the possible consequences for the auditor's report. For example, paragraph 36 of the extant ISA (UK and Ireland) 570 and paragraph A26 of Proposed Clarified ISA (UK and Ireland) 570 indicates that, where accounts are prepared on an alternative basis, the auditor "may consider it necessary to include an emphasis of matter paragraph in the auditor's report". It may also be the case that, in such circumstances, uncertainties as to the price at which assets will be sold and liabilities settled will result in multiple uncertainties leading to a disclaimer of opinion (paragraph 34

of extant ISA (UK and Ireland) 700 and paragraph 10 of Proposed Clarified ISA (UK and Ireland) 705).

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

We confirm that we agree with the three conclusions proposed in the ED. These conclusions appear at paragraph 11, 20, 57 and Appendix 1 to the ED. We recommend that the FRC reviews these references above and ensures that the language is consistent and clear. For example, paragraph 57 uses the phrase “there is no realistic alternative to liquidation” as the third conclusion. This should be amended to the correct wording as used in paragraph 10, namely that “the use of the going concern basis is not appropriate”. Another example of inconsistency is the disclosures needed when a company is in a situation where there are no material uncertainties that may cast significant doubt on going concern. Paragraph 78 sets out the key components of the note on going concern. We recommend that the various paragraphs referred to above are made consistent with this paragraph 78 which is consistent with the examples in Appendix 1 to the ED.

Question 4: Do you agree that the directors should disclose when the period that 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?

In our letter of 27 February 2009 to the FRC we commented on the review period and in particular on IAS 1 which states that the foreseeable future is at least 12 months from the end of the reporting period, not from the date of the approval of the financial statements. We continue to believe that international consistency is very important and that the points which we made in our earlier letter remain valid. The length of the period of review should be a matter taken up by the Accounting Standards Board in lobbying for change at the international level, a topic to which we refer under Question 1.

We recommend that the FRC revisits the wording in paragraph 49 and 50 in particular. Principle 3 sets out that the directors should consider all the information about the future of which they are aware at the date of approval of the financial statements. This principle is entirely correct and reflects the wording of accounting standards. The problem is that in paragraph 49 and 50 the use of the word “however” suggests that the preceding points may be ignored and that the focus is solely on the period of 12 months from the date of approval of the financial statements. We believe the discussion needs to be extended to discuss how known matters arising in say 12 to 24 months from the date of approval should be handled. We do not expect that the exposure draft can give definitive guidance but it may indicate how a particular fact pattern may result in additional disclosure in the financial statements under review.

Question 5: Do you believe that it would be appropriate to replace the existing Guidance for directors with this document for periods ending on or after 31 December 2009? If not, what alternative application date would you suggest?

We confirm that it will be appropriate to replace the 1994 Guidance with effect for periods ending or after 31 December 2009, subject to the following:

- the FRC issues its revised Guidance in November;
- the FSA confirms in November that the new Guidance is effective for 31 December 2009 onwards; and
- there are no major changes to the Guidance, which might cause practical problems in achieving the proposed effective date.

If the above conditions are not met, then we suggest that the new Guidance is effective for periods ending on or after 31 December 2010. We do not support bringing the revised Guidance into effect during 2010 because of our view that regulators should be seeking to bring all new and amended regulations into effect from a single date in the year and that having a myriad of effective dates does not assist users of financial statements.

Three further points

In addition to responding to the FRC's questions we also ask that the language in the ED is reviewed by an expert to remove unnecessary wording and to improve the general quality. We make this recommendation, bearing in mind the proposals in the FRC's paper "Louder than words".

We note that the ED does not deal with preliminary announcements. Whilst preliminary announcements are voluntary, many listed companies still choose to issue these. Investors rely heavily on the disclosure therein in assessing the results of the company, particularly when the full report and accounts do not follow for a few weeks. We believe it would be helpful for the ED to re-iterate the messages set out by the FSA in section 2.2 of the January 2009 edition of List!. Disclosure of information about going concern is likely to be significant information necessary for the purpose of assessing the results being announced. We consider this to be valuable guidance to directors.

In a similar vein, we recommend that the Guidance refers to summary financial statements. For many small shareholders in listed companies and for members of building societies, summary financial statements are the only information that they receive about an entity in which they have invested. Without guidance recommending that directors include disclosure of going concern issues in summary financial statements, it will be left to the

auditor to police this issue by threatening qualification on the grounds of lack of consistency by omission of information (paragraph 18(d) of APB Bulletin 2008/3).

If you have any questions regarding our comments above, please contact Isobel Sharp or Richard Gillin.

Yours faithfully

Deloitte LLP