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Dear Steve

Exposure Draft on Going Concern and Liquidity Risk: Guidance for Directors of UK Companies

IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of approximately £3 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, the Annual IMA Asset Management Survey showed that at the end of 2008 IMA members managed holdings amounting to 44% of the domestic equity market.

In managing assets for both retail and institutional investors, IMA members are major investors in companies whose securities are traded on regulated markets. Therefore, we have an interest in the requirements governing how such companies prepare their accounts and the information disclosed to our members as the ultimate owners of companies and users of that information.

The current economic climate has led to significant business failures both within and outside the financial services sector and has shown how quickly financial institutions, in particular, can unwind. Deteriorating economic conditions and the drying up of liquidity have raised the importance of the going concern assumption and it is important that going concern disclosures in the forthcoming year-end are robust. We, therefore, welcome the timing of the updated guidance and the emphasis of the importance of addressing these matters well before the preparation of the accounts¹. It should help focus management's attention on the issue earlier and trigger discussions with banks on the availability of finance going forward.

¹ Paragraph 9

We particularly agree with the guidance being addressed to all UK companies and clarification of the position on interim results in that a company should be able to continue as a going concern for 12 months from the date of approval and where the period is less than 12 months, they should disclose the fact and explain their decision. This position was not clear at the time of the current year interim reports.

We appreciate the fact that the FRC has responded to our concerns and now only proposes three conclusions in the Guidance whereas the previous discussion paper had four in that it added IFRS requirements for disclosure where directors identify "material uncertainties that cast significant doubt". Whilst we considered four conclusions unhelpful in including both "doubt" and "significant doubt" in that the latter is more likely to become a self-fulfilling prophecy than if there were simply three conclusions, we do not consider that adopting the category required by IFRS and material uncertainties would necessarily ensure sufficient disclosures. Investors want any circumstances which give rise to doubts as to an entity's going concern disclosed and would prefer the retention of the conclusion of potential significant uncertainties that raise doubts.

Lastly, whilst the paper is helpful in terms of clarifying going concern disclosures, in the current economic climate, situations can arise which can affect the accounting treatment. For example, where a holding company or a subsidiary breaches its loan covenants, it typically means that the loan becomes repayable on demand and its classification in the balance sheet should change. It would be helpful if the Guidance were to clarify the accounting treatment and disclosures in these situations and, for example, what would happen if:

- the lender agrees at some point between the balance sheet date and issue of the accounts not to demand repayment;
- if an earlier breach was waived at the year end but the waiver was for less than twelve months after the balance sheet date; and
- if the loan is refinanced, a waiver agreed or the breach rectified after the balance sheet date but before the accounts are approved.

Further as discussed at our meeting on 5 August, certain of our members are concerned that the IFRS requirements for the disclosure of contingent liabilities excludes those contingencies that may be regarded as "remote". They consider this could mean that contingencies are not disclosed that are relevant for covenant purposes and hence the entity's going concern status, and as a consequence could be overlooked in the board's review.

Certain members are also concerned about the interdependencies when a parent company's intra group receivables are dependent on the going concern of subsidiaries in that this has been an issue in certain groups. They consider it would be helpful if the guidance were to refer to the importance of avoiding the situation whereby a subsidiary is considered a going concern on the basis of assumed parent company support, when the parent's standing is dependent on the going concern status of subsidiaries.

We set out in the attached our answers to the specific questions raised and trust that the above and the attached are self-explanatory. However, please do contact me if you require any clarification of the points in this letter or if you would like to discuss any issues further.

Yours sincerely



Liz Murrall
Director, Corporate Governance and Reporting

ANNEX

IMA RESPONSE TO EXPOSURE DRAFT ON GOING CONCERN AND LIQUIDITY RISK: GUIDANCE FOR DIRECTORS OF UK COMPANIES

All UK companies

The 1994 Guidance was written to assist directors of listed companies. However, recent events have resulted in requests for the FRC to publish guidance that could be applied by directors across the full spectrum of UK companies. The Exposure Draft seeks to achieve this and addresses the issue of going concern for companies of all sizes including smaller companies that adopt the Financial Reporting Standard for Smaller Entities (FRSSE). The Guidance has been drafted on the basis of “think small first” and consequently comments relevant to smaller companies are addressed at the beginning of each section.

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?

IMA agrees that the FRC should provide guidance on going concern relevant for directors of all companies and considers that the guidance achieves this in a balanced way.

Introduction of principles

The sections have been reorganised and now begin with a principle supported by application guidance.

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

We support the introduction of principles supported by application guidance and understand that this was done to follow the format of the Combined Code. However, we question whether such a fundamental re-ordering was essential in that it is difficult to determine what, if anything, has been removed from the previous guidance and what added. This makes it difficult to identify and comment on the changes made.

Disclosures when there are doubts about the ability to continue as a going concern.

The guidance has three conclusions as to going concern:

- “clean” going concern conclusion, i.e. there are no material uncertainties;
- “qualified” going concern conclusion where the directors believe there are material uncertainties; and
- use of a basis of accounting other than going concern.

Question 3: Do you agree with the three conclusions? If no, please explain what alternative you would suggest?

We appreciate the fact that the FRC has responded to our concerns and now only proposes three conclusions in the Guidance whereas the previous discussion paper had four as a consequence of adding the requirements introduced by IFRS that disclosure should be made where directors identify “material uncertainties that cast significant doubt”.

Whilst we considered four conclusions unhelpful in including both “doubt” and “significant doubt” in that the latter is more likely to become a self-fulfilling prophecy than if there were simply three conclusions, we do not necessarily consider that adopting the category required by IFRS and material uncertainties would ensure sufficient disclosures. Investors want any circumstances which give rise to doubts as to an entity’s going concern disclosed and would prefer the retention of the conclusion of potential significant uncertainties that raise doubts.

Half yearly and interim financial statements – period of the going concern review

The FRC believes that there is merit in adopting a consistent approach to the disclosure of the review period for both annual and interim financial statements that give a true and fair view. Paragraph 55 of the Exposure Draft, therefore, requires directors who apply this Guidance to disclose when their going concern review has not extended to a period of at least twelve months from the date of approval of half-yearly and interim financial statements that give a true and fair view.

Question 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?

We welcome clarification of the position on interim results in that a company should be able to continue as a going concern for 12 months from the date of approval and where the period is less than 12 months they should disclose the fact and explain their decision. This position was not clear at the time of the current year interim reports. However, we do not understand the text in paragraph 56 in relation to all financial statements intended to give a true and fair view. First, that this is the “practical effect of these disclosure requirements”. We believe the FRC should mandate this as is the case elsewhere in this section. Secondly, whilst we understand what is intended, the text “in rare cases” could be taken to mean that the disclosures themselves are rare as opposed to instances when the review period is less than twelve months and we would welcome this being clarified.

Implementation date

The FRC hopes to issue the revised guidance by mid-November 2009.

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 agree with the early adoption of the guidance and consider it appropriate to replace the existing Guidance for directors with this document for periods ending on or after 31 December 2009.