Financial Reporting Council

April 2016

Feedback Statement

Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks

Guidance for directors of companies that do not apply The UK Corporate Governance Code

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries, and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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1 Introduction

1.1 Following the recommendations of the Panel of the Sharman Inquiry,[1] the FRC decided to issue guidance for directors of companies that do not apply *The UK Corporate Governance Code* to replace the FRC's *Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009* ('2009 Guidance') and *An Update for Directors of Companies that Adopt the Financial Reporting Standard for Smaller Entities (FRSSE): Going Concern and Financial Reporting*.

1.2 In October 2015, the Financial Reporting Council (FRC) published an Exposure Draft: *Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks.*

Feedback

1.3 This feedback statement summarises the comments received on the Exposure Draft and explains how they have been taken into account in finalising the guidance. It also documents the key decisions taken during the development of the guidance.

1.4 11 comment letters were received from the following stakeholder groups:

Type of respondent	*Number*
Accountancy firms	6
Accountancy bodies	3
Preparer representative	1
Public body	1

1.5 In addition to the formal consultation, the FRC was keen to obtain input from practitioners at an early stage, particularly those representing small and medium-sized companies. It therefore set up a Working Group to provide input. The Working Group included preparers and auditors as well as representatives from the FRC's Corporate Governance and Audit and Assurance teams. The FRC would like to thank the members of the Working Group for their input during the development of the guidance.

[1] See Final Report and Recommendations of the Panel of Inquiry for further information at: https://www.frc.org.uk/getattachment/591a5e2a-35d7-4470-a46c-30c0d8ca2a14/Sharman-Inquiry-Final-Report.aspx.

2 Main themes

2.1 In general, the Exposure Draft was well received. There was broad consensus amongst respondents that the 2009 Guidance was in need of updating and that the draft guidance was helpful and proportionate. The main themes arising from the consultation are outlined below.

Scope

2.2 The majority of respondents agreed with the scope of the guidance, which excludes small and micro-companies. Others thought it should be best practice for all companies. There were calls for clarity and better signposting in the scoping section of the Exposure Draft, as some believed there could be ambiguity over the application to small and micro-companies.

2.3 There were requests for clearer differentiation between mandatory requirements in law, accounting standards or other regulation and best practice.

Relationship between concepts

2.4 Some respondents stated that the guidance could more clearly distinguish or explain the relationship between the going concern basis of accounting and solvency and liquidity risks.

2.5 Some respondents requested that the guidance state explicitly that when the directors have concluded that there is no material uncertainty regarding the appropriateness of the going concern basis of accounting, the assessment of principal risks and uncertainties may still identify risks that impact solvency and liquidity.

Solvency and liquidity risks

2.6 The majority of respondents agreed with the draft guidance on solvency and liquidity risks. However, respondents noted that the guidance on reporting on solvency and liquidity risk needed to be set in the context of the requirement to prepare a strategic report and disclose principal risks and uncertainties.

2.7 A number of respondents raised concerns regarding the length of the assessment period for solvency and liquidity risks, noting that it may be difficult for a smaller company to look beyond 12 months from the date of approval of the financial statements.

2.8 There was a general concern around the use of the word ‘viability’ as this could be interpreted to imply that there is a requirement for companies within the scope of the guidance to prepare a viability statement.

Practical application

2.9 The majority of respondents agreed that the guidance is sufficiently practical. Respondents particularly welcomed the guidance in section 6 regarding the application of materiality and the placement of disclosures.

2.10 Some respondents were keen for the guidance to include more example disclosures, whilst others felt that this should be avoided as it could result in disclosures insufficiently focussed on the company’s specific facts and circumstances. Examples to illustrate when additional disclosures relating to the going concern basis of accounting are necessary for the financial statements to give a true and fair view were suggested.

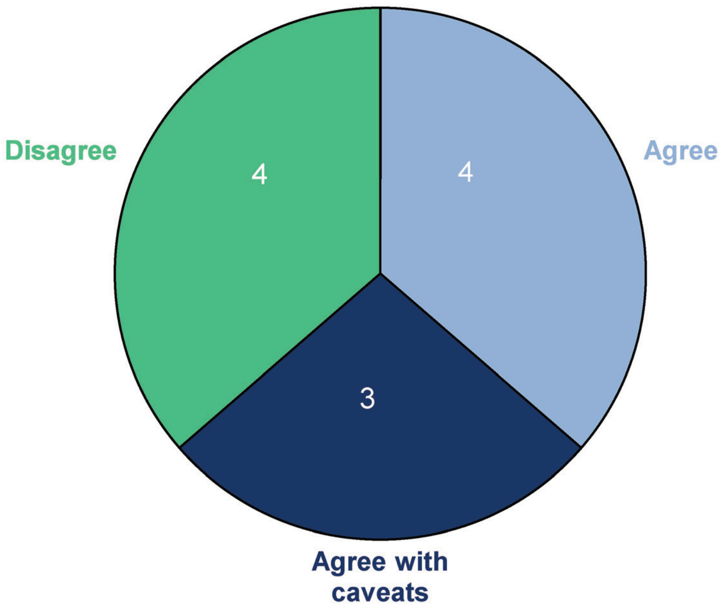
3 Detailed analysis of consultation questions

Scope

3.1 The Exposure Draft excluded small and micro-companies and those companies that are required or choose voluntarily to apply *The UK Corporate Governance Code* from its scope.

> **Question 1**
>
> Do you agree with the scope of the guidance as set out in section 1?

Respondents' views on Question 1



3.2 The majority of respondents agreed with the scope of the guidance and considered that excluding small and micro-companies is appropriate. Other respondents stated that directors of small and micro-companies would welcome proportionate guidance and that these companies should not be excluded from the scope. Two respondents suggested that there should be a separate section in the guidance targeted specifically at small and micro-companies.

3.3 The Exposure Draft acknowledged that some aspects of the draft guidance may be relevant to small and micro-companies. However, some respondents were concerned that the articulation of the scope in the Exposure Draft was confusing and could be seen as introducing new disclosure requirements for small and micro-companies.

3.4 The Exposure Draft highlighted the requirement for small and micro-companies to make an assessment of the appropriateness of the going concern basis of accounting, and for small companies to consider whether there is a need for additional disclosures for the financial statements to give a true and fair view. Some respondents suggested that the FRC redraft the scoping section to more clearly signpost which paragraphs are relevant for small and micro-companies, and include a table clarifying which requirements are applicable for different types of company.

FRC response

3.5 The FRC considered at length the application of the guidance to small and micro-companies in light of the changes that arose from the UK implementation of the EU Accounting Directive (2013/34/EU). Consequently, there is no explicit requirement in UK and Ireland GAAP for small and micro-companies to include disclosures relating to the going concern basis of accounting and material uncertainties. There is also no requirement for small and micro-companies to prepare a strategic report and therefore disclose principal risks and uncertainties.

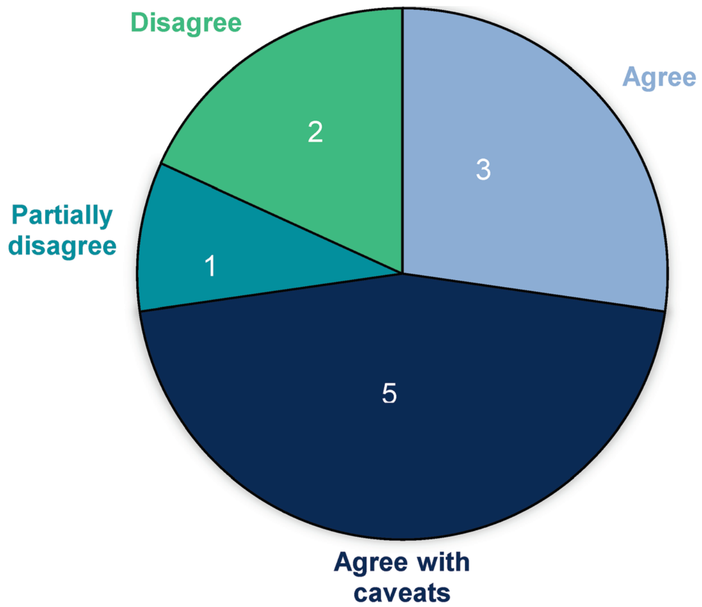
3.6 Given that the explicit disclosure requirements in respect of the going concern basis of accounting and reporting on principal risks and uncertainties are not applicable to small and micro-companies, the FRC concluded that it is appropriate for these companies to be excluded from the scope of the guidance.

3.7 In response to the comments received, section 1 now includes a table setting out the requirements for each type of company and highlighting specific paragraphs of the guidance that may assist the directors of such companies in meeting the regulatory requirements applicable to their companies. The text has also been redrafted to improve clarity.

Question 2

Is the guidance sufficient for the different types of company that fall within its scope?

Respondents' views on Question 2



3.8 The majority of respondents agreed that the guidance is sufficient for the types of companies that fall within its scope and is scalable to the needs and circumstances of companies of different size and complexity.

3.9 Many respondents requested that the guidance differentiate more clearly between mandatory requirements derived from law, accounting standards or other regulation and best practice guidance. Some respondents stated that the inclusion of more examples would assist companies with application to particular scenarios.

3.10 Several respondents noted that determining whether there are material uncertainties regarding the appropriateness of the going concern basis of accounting can be challenging and requested that the guidance in this area be expanded.

FRC response

Mandatory requirements and best practice

3.11 The revised guidance uses icons and colour-coded boxes to distinguish between mandatory requirements derived from law, accounting standards or other regulation and best practice guidance. It also highlights key focus areas for directors to consider. The language in the guidance has also been revised so that the term 'must' is used to refer to mandatory requirements and the term 'should' is used to describe best practice.

Examples

3.12 Additional examples have been included in the guidance to illustrate key concepts. Although there were some calls for us to reinstate the disclosure templates in the 2009 Guidance, the FRC believes that there is a need to strike an appropriate balance between including some illustrative examples and avoiding the promulgation of 'boilerplate' disclosures.

Material uncertainties

3.13 The extent of guidance on reporting on material uncertainties regarding the appropriateness of the going concern basis of accounting is consistent with the FRC's *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting* for companies that apply *The UK Corporate Governance Code*.

3.14 The FRC acknowledges that determining if there are material uncertainties regarding the appropriateness of the going concern basis of accounting may be challenging. This assessment is highly context-specific and the guidance emphasises that directors will need to apply their judgement, taking into account the particular circumstances of the company and all available information. The guidance highlights the importance of the overarching concepts of materiality and providing a true and fair view.

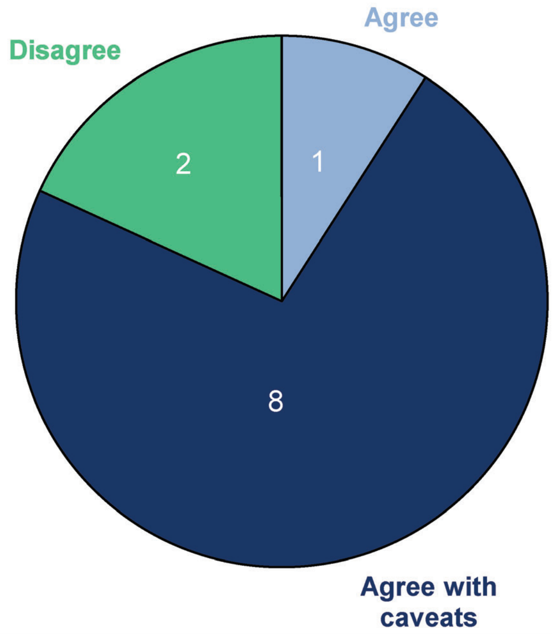
Solvency and liquidity risks

3.15 One of the aims of the draft guidance was to encourage directors to think broadly about risks and uncertainties that could threaten the company's development, performance, position and future prospects, including solvency and liquidity risk.

Question 3

Do you agree with the draft guidance on the assessment of solvency and liquidity risk as set out in paragraphs 4.1 to 4.6?

Respondents' views on Question 3



3.16 The majority of the respondents agreed with the guidance on the assessment of solvency and liquidity risks. However, a number raised concerns about the length of the assessment period for solvency and liquidity risks. Paragraph 4.8 of the Exposure Draft states that 'except in rare circumstances it should be significantly longer than 12 months from the approval of the financial statements.' Some respondents noted that this would be onerous for many of the smaller companies within the scope of the guidance.

3.17 Some respondents highlighted the importance of setting the guidance on solvency and liquidity risk in the context of the requirements for companies to prepare a strategic report and provide disclosures on the principal risks and uncertainties facing the company. In addition, there were some calls for more guidance on the factors that may give rise to solvency and liquidity risks and to explain more clearly how such risks might impact a company.

FRC response

Assessment period

3.18 Where appropriate, the information in the strategic report should have a forward-looking orientation. With that in mind and taking into consideration the comments received, we have modified the wording in the guidance so that it reads that the period of assessment for solvency and liquidity risk 'will usually be longer' than 12 months, rather than 'it should be significantly longer' as was set out in the Exposure Draft. The wording 'except in rare circumstances' was also removed.

3.19 The FRC recognises that the assessment period will vary for different types of company. The guidance highlights that the period of assessment will ultimately be a matter of judgement for the directors and will depend on the facts and circumstances of the company.

Strategic report requirements

3.20 Section 4 on solvency and liquidity risk has been redrafted so that it is set in the context of the strategic report requirements. Additional guidance has been included to highlight the types of factors that may give rise to solvency and liquidity risks, along with an additional example to illustrate the potential impact of such a risk. This recognises that there may be business risks that could have an impact on the solvency or liquidity of a company.

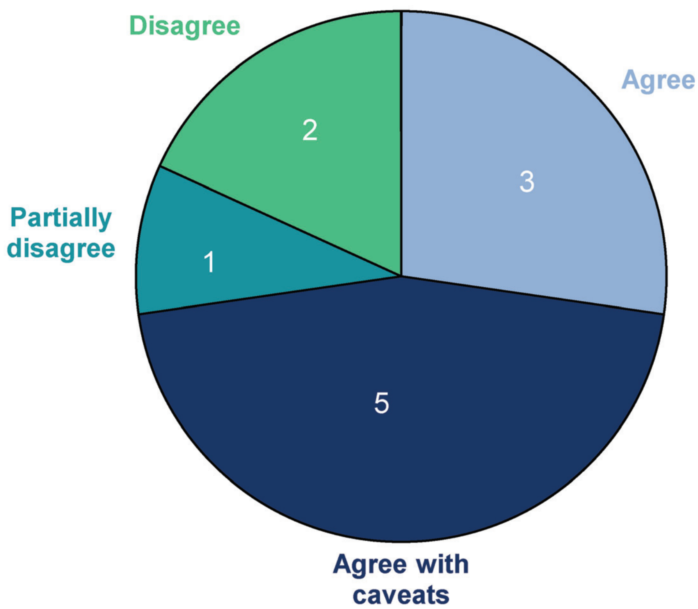
Linkage

3.21 The going concern basis of accounting, material uncertainties and principal risks and uncertainties are distinct but linked concepts.

Question 4

Does the draft guidance sufficiently distinguish between the assessment of and reporting on the 'narrow' going concern basis of accounting (section 3) and the broader concept of solvency risk and liquidity risk (section 4)?

Respondents' views on Question 4



3.22 The majority of respondents agreed that the draft guidance sufficiently distinguished between the going concern basis of accounting and the broader concept of solvency and liquidity risk. However, there were various views on how the guidance could be structured to differentiate more clearly between the two concepts.

3.23 Some respondents suggested that the assessment process described in section 5 should either be incorporated into the section on the going concern basis of accounting (section 3), or divided between that section and the section on solvency and liquidity risks (section 4). Some respondents noted that paragraphs 3.15 to 3.17 of the Exposure Draft relating to other disclosure requirements in accounting standards (in the section on the going concern basis of accounting) relate primarily to solvency and liquidity risks and suggested that this information be moved to section 4.

3.24 There were some concerns that use of the word 'viability' in the section on reporting on solvency and liquidity could be misconstrued as being associated with the requirement to prepare a viability statement for companies applying *The UK Corporate Governance Code*.

3.25 Some respondents noted that directors are often reluctant to make disclosures about solvency and liquidity risks and may believe this to be unnecessary if they have concluded that there are no material uncertainties regarding the appropriateness of the going concern basis of accounting. These respondents stated that the guidance would need to be more explicit and direct to encourage behavioural change in this area.

FRC response

Structuring

3.26 The procedures set out in section 5 are intended to provide practical guidance to directors on how they might assess the appropriateness of the going concern basis of accounting and solvency and liquidity risks. The guidance highlights that it is a matter of judgement for directors to determine the extent to which these, or other procedures, are carried out in each assessment. This will depend on the size and complexity of the business and its specific facts and circumstances. The FRC decided to retain a single separate section on the assessment processes in the final guidance. However, sections 3 and 4 of the final guidance include signposts to section 5 to emphasise that the assessment process is relevant to both.

3.27 In response to comments received, paragraphs 3.15 to 3.17 of the Exposure Draft have been moved to the section on solvency and liquidity risk.

Triggers for reporting on solvency and liquidity risks

3.28 The guidance states explicitly that when the directors have concluded that there is no material uncertainty regarding the appropriateness of the going concern basis of accounting, the broader assessment of principal risks and uncertainties may still identify risks that impact solvency and liquidity. It also describes factors that may give rise to solvency and liquidity risks to encourage directors to think broadly when making their risk assessment.

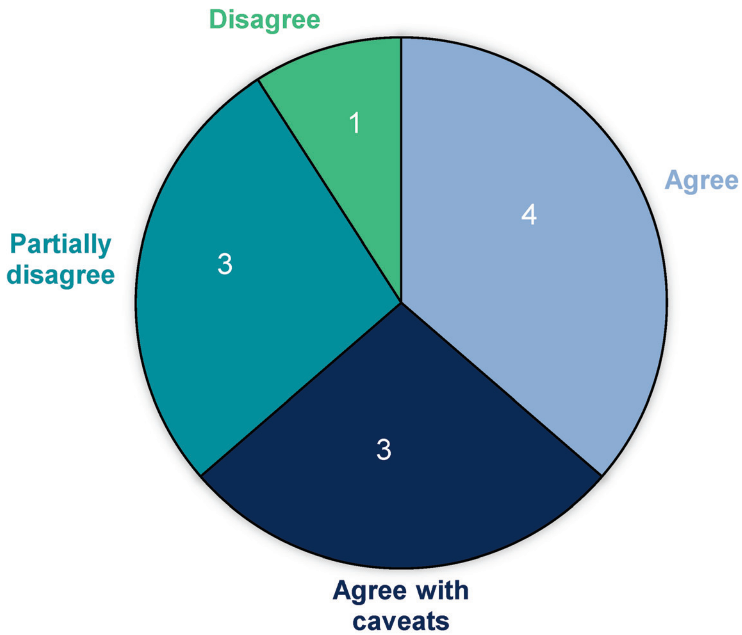
Viability

3.29 To avoid confusion with the requirement of *The UK Corporate Governance Code*, some of the language in the draft guidance has been revised and references to 'viability' removed.

Question 5

Does the draft guidance adequately highlight the relationships between the concepts (section 2)?

Respondents' views on Question 5



3.30 The majority of respondents agreed that the guidance adequately highlights the relationships between the concept of the appropriateness of the going concern basis of accounting and solvency and liquidity risks. That said, a number of respondents made suggestions on how this could be improved.

3.31 In particular, many respondents found the diagram in section 2, showing the relationship between the concepts, confusing. Some thought that there was duplication in the narrative in paragraphs 2.4 and 2.5 of the Exposure Draft explaining the concepts. A number of respondents suggested restructuring this section of the guidance.

FRC response

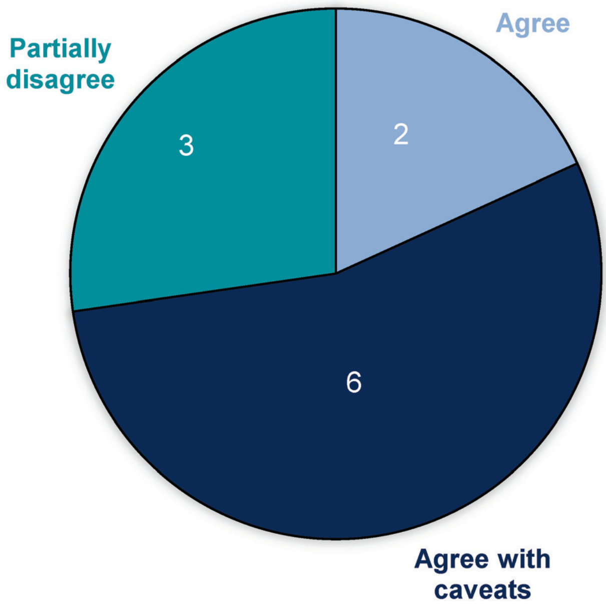
3.32 Section 2 has been redrafted and the diagram removed. This section now begins by summarising the reporting requirements, then explains the relationship between the appropriateness of the going concern basis of accounting and solvency and liquidity risks. This is followed by a summary of the process for determining which disclosures are necessary.

Practical application

Question 6

Do you consider that the guidance is sufficiently practical? If not, how might the guidance be improved?

Respondents’ views on Question 6



3.33 Most respondents agreed that the guidance is sufficiently practical. Respondents particularly welcomed the guidance in section 6 regarding the application of materiality and the placement of disclosures.

3.34 There were a number of suggestions made by respondents:

- Inclusion of example disclosures. However, others noted that this should be avoided because example disclosures might be used as templates, resulting in ‘boilerplate’ disclosures.
- Further guidance should be provided on when additional disclosures relating to the going concern basis of accounting might be necessary for the financial statements to provide a true and fair view.
- Inclusion of Appendix III ‘Key Questions for Boards’ of the 2009 Guidance. Some respondents suggested other specific paragraphs of the 2009 Guidance that they felt it would be helpful to retain in the new guidance.
- Drafting improvements to section 7, which outlines the responsibilities of the auditor. In particular, some respondents stated that the guidance should reflect the proposed changes to ISA (UK and Ireland) 570 *Going Concern*.
- Appendix A on other reports should clarify that the Financial Conduct Authority’s *Disclosure and Transparency Rules* do not apply to most of the companies within the scope of the guidance.

FRC response

Examples

3.35 The FRC has carefully considered the use of examples in the guidance and included some examples to illustrate how the concepts may apply in specific scenarios. However, in line with the views of some respondents, the FRC decided not to include extensive example disclosures in the guidance because this might lead to 'boilerplate' disclosures.

3.36 The guidance on providing a true and fair view has been expanded and now includes example scenarios illustrating circumstances when disclosures in addition to the specific requirements in accounting standards may be necessary.

References to Disclosure and Transparency Rules

3.37 Appendix A has been redrafted. The references to the Financial Conduct Authority's *Disclosure and Transparency Rules* have been removed. The content has been re-positioned so that it is set in the context of the requirements in accounting standards for Interim Financial Reporting. There is clarification on the scope of application of the requirements for half-yearly reports or preliminary announcements, which may result from regulatory requirements or be voluntary.

Sections from 2009 Guidance

3.38 Appendix III from the 2009 Guidance has not been included as it duplicates the content relating to the assessment process in section 5. Larger and more complex companies may wish to refer to the FRC's *Guidance on Risk Management, Internal Controls and Related Financial and Business Reporting,* which contains questions for Boards.

3.39 Key focus areas have been included in the guidance and are intended to meet similar objectives to Appendix III from the 2009 Guidance; i.e. to highlight specific issues for directors to consider when applying the guidance.

3.40 Other additional content from the 2009 Guidance has been included, where relevant, while ensuring that the guidance remains clear and concise.

Auditor reporting

3.41 The section on auditor reporting has been updated to reflect drafting suggestions and proposed changes to ISA (UK and Ireland) 570 *Going Concern.*

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