Financial Reporting Council

November 2013

Implementing the recommendations of the Sharman Panel

Revised Guidance on Going Concern and revised International Standards on Auditing (UK and Ireland)

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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SECTION 1: Introduction

In January 2013, the Financial Reporting Council (FRC) issued a Consultation Paper, *Implementing the recommendations of the Sharman Panel - Revised Guidance on Going Concern and revised International Standards on Auditing (UK and Ireland)* (the 'January Consultation'), to implement the final recommendations of the Sharman Panel of Inquiry (the 'Panel'). The January Consultation included two elements of proposed guidance: *Guidance on Going Concern [Month] 2013* (the 'Proposed Guidance') and *Guidance on Going Concern: Supplement for Banks [Month] 2013* (the 'Supplement for Banks'). The Proposed Guidance was intended to supersede the extant guidance issued in 2009[1].

The purpose of this Paper is to:

- Summarise the comments received in response to the January Consultation; and
- Explain the key changes that the FRC is making to the Proposed Guidance and Supplement for Banks and to the proposed revised ISAs (UK and Ireland) included in the January Consultation, to address the comments received.

[1] *Going Concern and Liquidity Risks: Guidance for Directors of UK Companies 2009*

SECTION 2: Comments received

The FRC received 33 comment letters from the following groups of stakeholders:

Corporate preparers of financial statements (5), Audit Committee Chair (1) and corporate preparer representative bodies (5)		11
Institutional investors (2) and representative bodies (2)		4
Accounting profession representative bodies (includes one non UK and Ireland)		5
Auditing firms		10
Other Stakeholders	- Industry representative bodies	2
	- Business School	1

A list of the individual respondents is included at Appendix 1 to this Paper. All of the comment letters have been placed on the public record by being posted on the FRC website[2].

In addition, a public meeting was held on 25 April 2013 to discuss the proposals presented in the Consultation Paper, at which Lord Sharman outlined the Panel's recommendations in the context of the FRC's Consultation Paper. Many of the issues raised by individual respondents were also raised and discussed at that event and a record of the meeting is also posted on the FRC website[3].

Of these respondents, 12 provided general comments but did not provide specific responses to the questions raised in the consultation paper, as follows:

Corporate preparers of financial statements (3), Audit Committee Chair (1) and corporate preparer representative body (1)		6
Institutional investors (1) and representative bodies (2)		3
Accounting profession representative bodies (includes one non UK and Ireland)		2
Auditing firms		-
Other Stakeholders	- Industry representative bodies	1
	- Business School	-

In the feedback tables below these respondents have been classified as having provided no response to each question. However, their comments have, as far as possible, been integrated with the discussion of other respondents' answers to related questions so as to provide a holistic overview of the feedback we received.

[2] See http://frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/Sharman-Implementation-Consultation-Paper/Responses-to-Sharman-Implementation.aspx
[3] See http://frc.org.uk/Our-Work/Publications/FRC-Board/Implementing-the-recommendations-of-the-Sharman-Pa.pdf

SECTION 3: Key concerns raised in the responses

The January Consultation asked 15 questions. A detailed summary of respondents' answers to these questions, together with other comments made by them is set out in Section V of the Feedback Statement. The following were the key concerns raised in the responses.

Strong support for the Sharman principles but concern about the detailed proposals

There was strong support for the principles underlying the Sharman recommendations and for the aim to promote good practice by company boards in considering, managing, and reporting on solvency and liquidity risks. Respondents' concerns were generally focused on what they perceived to be unintended consequences of the FRC's proposed approach to the implementation of the Panel's principles. They were concerned that the proposed approach would undermine the Panel's principles and the FRC's objectives. There were also general concerns about the proposed timing of implementation with many thinking it was too rushed, especially for smaller companies and other unlisted entities.

There was also support, in the aftermath of the banking crisis, for guidance which would highlight the importance of shareholders and other stakeholders (especially creditors) showing a greater interest in the risks affecting companies and how those risks are managed and mitigated.

Dual uses of 'going concern', the threshold of confidence and the foreseeable future

The principal concern raised by respondents was the dual use of the term "*going concern*", with different definitions for the separate financial reporting and stewardship purposes. The two definitions were intended to drive different reporting outcomes (going concern material uncertainty disclosures, in the first case, and narrative risk disclosures about solvency and liquidity risks that would threaten the entity's survival, in the other).

Respondents also questioned the use of the term "*high level of confidence*" and the interpretation of the term "*foreseeable future*" in defining a "*going concern*" for the stewardship purpose. Taken together with the dual use issue, respondents considered that very few companies would be considered going concerns, without qualification, for purposes of the UK Corporate Governance Code statement ("the Code"). Unless an unqualified statement could be made for stewardship purposes, many stakeholders thought that boards would feel obliged to declare there were material uncertainties about the company's ability to continue as a going concern for financial reporting purposes. The fear was that this would result in many more companies disclosing going concern material uncertainties than at present.

If this fear were to be realised, this might lead to banks and/or trade suppliers being less willing to extend credit to businesses or only doing so at higher cost. It may also cause companies to hold greater reserves of cash or to be otherwise financially more conservative, which could adversely affect investment and growth. This outcome was not intended but the expectation by so many corporate and auditors that this would be so, demonstrates that either a major change in approach is needed or there would be a need for significant clarification of the Proposed Guidance.

Assertion-linked trigger for narrative disclosures is damaging and unnecessary

Linking enhanced disclosures about solvency and liquidity risks to a positive assertion that the entity is a going concern creates a tension in setting appropriate tests for that assertion – tougher tests would drive more enhanced disclosure but would also more frequently force a 'negative' assertion (ie a qualified Going Concern Statement); and less rigorous tests would make a 'positive' assertion more frequent but may drive less appropriate disclosure.

Since the future is by nature uncertain, any binary statement about the future success of the company would need to be heavily caveated if the expectation was that companies would usually be able to make an unqualified statement. Intrinsically, adopting an assertion-linked approach is more likely to give rise to negative (or qualified) statements than positive (unqualified) ones if it is to be effective in driving appropriate disclosures. However, forcing negative statements to trigger better narrative disclosures may imply a failure of stewardship rather than simply conveying the reality of future uncertainty and how this is being managed effectively as good stewardship by the directors. This could damage confidence in business.

There was strong support for the Panel's recommendation for enhanced stewardship reporting of solvency and liquidity risks but it was not thought necessary to take an assertion-linked approach in order to implement this objective.

Impact on SMEs

Other commonly raised issues included the impact on SMEs about which we had asked a specific consultation question:

- Many thought that it would be difficult for SMEs to know how to apply the guidance proportionately – for example, it was not always readily apparent which elements of the guidance applied to them and which did not; and
- Some thought that SMEs would, in any case, find the Guidance too onerous (for example, the use of stress tests).

Consistency with management of other risks

The guidance seemed to overlap with the Code-related guidance on internal control (commonly referred to as the "Turnbull" guidance) and some questioned whether they should be merged.

Supplement for Banks

There was general agreement on the approach taken for Banks though some thought that the requirement for a high level of confidence in the Proposed Guidance was inconsistent with this. A few thought separate guidance for any particular industry was unnecessary.

Auditing Standards

Many objected to the proposed changes to the auditing standards, primarily because they preferred changes to the auditing standards to be introduced through seeking changes to the IAASB's International Standards on Auditing.

Timing

Most respondents thought that the implementation date was too soon and would not be achievable, especially for smaller companies and 30 September year end reporters.

SECTION 4: Outline of FRC response to the feedback received

As announced on 6 June 2013, the FRC welcomed the considered feedback and support for the Sharman principles and encouraged all companies to consider and abide by them. In terms of developing guidance, the FRC's response to the comments received is set out in more detail, in relation to each of the questions asked in the January Consultation, in Section V of the Feedback Statement. The FRC has readdressed the proposed manner of the implementation of the Sharman recommendations and is taking the following approach.

Separate guidance for Code and other companies

Concurrently with this Feedback Statement, the FRC is publishing merged guidance bringing together the Proposed Guidance, significantly revised, with revised Turnbull guidance (the 'Integrated Code Guidance'). The principal changes made to the Proposed Guidance are further described below.

The Integrated Code Guidance would not apply to companies that do not follow the Code and separate guidance is being developed for them, with the assistance of a separate advisory group of stakeholders. This work is in progress and will seek to respond appropriately to the strong concerns raised that the Proposed Guidance would not be effective for use by SMEs and other companies that do not follow the Code. This covers a wide range of companies and separate proposals for guidance for such companies will be brought forward for public consultation in due course.

Restricting the term 'going concern' to its accounting standards usage

The FRC acknowledges that the difficulties arising from the use of the term 'going concern' with two meanings in the Proposed Guidance were the primary root cause of concerns with the proposed approach to implementing the Sharman recommendations. The term 'going concern' has a very particular meaning in the accounting and auditing literature and is widely used internationally in that context. It would not be realistic to change that use. Although the same term is also well-established in the Code, it is possible for the FRC to amend this.

The term 'going concern' is only used in the Integrated Code Guidance as defined in the accounting standards and the term 'going concern assessment' has been replaced with the term 'assessment of solvency and liquidity risks'. The Integrated Code Guidance does not employ the more ordinary English usage of 'going concern' (an entity with sound survival prospects) when discussing the trigger for narrative reporting about those risks that would threaten the company's survival. This is to avoid suggesting that when such narrative reporting occurs, this is necessarily or usually a signal that the company has no realistic alternatives to insolvency. Such narrative reporting is intended to be triggered well before that point is reached.

De-linking narrative reporting of solvency and liquidity risks from a positive assertion

The FRC acknowledges that an assertion-linked approach is not necessary to achieve the intended enhanced narrative disclosures. The FRC also accepts that the Going Concern Statement cannot be determined on a different definitional basis from that used for the Going Concern Information, given the strength of concerns about confusion expressed by respondents. However, the Going Concern Statement then simply confirms what is already addressed (albeit perhaps not explicitly) in the financial statements. It is proposed that the Going Concern Statement should no longer be required.

Instead, enhanced narrative disclosure will be driven by a new Code provision for the directors to establish and carry out a robust assessment process for identifying the principal solvency and liquidity risks the company faces, including those that would threaten its solvency and liquidity, and to affirm that they have done so. The Integrated Code Guidance describes a robust assessment process for a Code company and what would constitute a principal solvency or liquidity risk:

"*The principal solvency and liquidity risks are those risks or combinations of risks that (in the judgement of the board) could so seriously damage the company's cash flows, performance or future prospects that they would give rise to severe distress if they materialised.*"

Eliminating the term 'foreseeable future' but retaining a longer term solvency outlook

As the term 'foreseeable future' appeared to evoke in respondents an unintended expectation that there should be no limit to the period or extent of the assessment, it has not been retained. The Panel did not want to change the primary quantitative focus of the assessment as it has been traditionally applied in determining the Going Concern Information.

In the UK and Ireland, the generally accepted minimum period is twelve months from the date of approval of the financial statements, which is driven by the accounting and auditing standards. However, this does not mean a fixed period of twelve months. The accounting standards require all information that is available about the future to be taken into account.

The Integrated Code Guidance continues to require consideration of solvency over longer periods having regard to the evolution of the company's own business cycles and the economic cycle. Any information obtained in considering solvency over longer periods would also have to be taken into account by the directors in making their determination of the Going Concern Information, if relevant. Hence the guidance continues to take the approach that there is a single assessment process that informs each of the different reporting requirements.

Limiting the use of the 'high level of confidence' threshold

The use of this threshold has been restricted to the statement that "the board needs to have *a high level of confidence* that solvency and liquidity risk can be managed effectively *during at least the twelve month period from the date of the financial statements …".* It is no longer linked to a binary assertion about the future success of the entity but rather to the directors' judgment about their ability to manage these risks effectively over a particular timescale. This is intended to convey that the directors should be able to judge that they would have realistic options available to them for doing so if such risks were to materialise.

Guidance on determining going concern material uncertainties

Given the Panel's conclusion that there is not a common understanding in this area and that there is currently diversity in application, the FRC has concluded that there is a need for some clarification through national guidance, pending further developments at the IASB. The previously proposed guidance has been retained but significantly modified to remove some of the more prescriptive thresholds. In responding to the comments received, the overriding requirement for judgement, which received strong support, has also been given greater emphasis.

Having taken the advice of the Accounting Council, the FRC believes that this guidance as modified is appropriate and consistent both with IFRS and UK and Ireland accounting standards. The FRC will also continue to seek to influence the IASB to develop greater clarity in relation to the requirements for the determination of when going concern material uncertainties exist and what should be disclosed about them under IFRS. The Integrated Code Guidance will be kept under review for consistency with any such developments.

Revisions to auditing standards

The FRC understands the desire to make revisions to the auditing standards through influencing changes to the IAASB's international standards on auditing. However, the FRC took the decision to move ahead of the IAASB in relation to audit committee and auditor reporting when finalising the changes resulting from its review of the Corporate Governance Code in 2012. The proposed changes to the auditing standards were to integrate consideration of the principal solvency and liquidity risks and reporting thereon with the changes made in response to the 2012 Corporate Governance Code changes and in line with the Sharman recommendations.

The FRC had been and continues to work closely with the IAASB to ensure that the IAASB proposals will be able to accommodate the approach to governance in the Code and the FRC's desire to address audit committee and auditor reporting issues in a holistic manner. The IAASB's recent proposals for auditor reporting demonstrate this. The FRC meanwhile proposes to implement the proposed changes to the auditing standards, updated to reflect the other changes to the implementation approach and to apply a materiality qualification to the requirement for the auditor to consider whether the auditor has anything to add to the narrative reporting.

Banking Supplement

There was strong support overall for the approach taken to banks and for the Supplement for Banks. The changes made in developing the Integrated Code Guidance to address comments received in response to other questions should also be responsive to the comments made about the Proposed Guidance being inconsistent with the Supplement for Banks.

The FRC therefore proposes to issue the Supplement for Banks as a standalone document, making only such changes as are necessary to keep it consistent with the final wording of the Code and the Integrated Code Guidance. The resulting proposed amendments are shown in the draft now being exposed for comment in mark-up as compared with the draft included in the January Consultation.

During the consultation period, we will be seeking further discussions with the authorities in Ireland with a view to determining whether and, if so, how to adapt the draft revised supplementary guidance for banks for use in Ireland.

Timetable

The FRC is proposing that the revisions to the Code, the Integrated Code Guidance, the revised Supplement for Banks and the proposed revisions to the auditing standards would apply to reporting periods beginning on or after 1 October 2014.

SECTION 5: Feedback to Specific Consultation Questions and FRC Response

Question 1: Do you agree that the Guidance appropriately provides the clarification recommended by the Panel as to the purposes of the going concern assessment and reporting and is appropriate? If not, why not, and what changes should be made to the Guidance?

Consultation responses

The responses to this question may be summarised as follows:

		Agreed	Agreed – some reservations	Disagreed	No specific response
Corporate preparers of financial statements, Audit Committee Chair and corporate preparer representative bodies		-	-	5	6
Institutional investors and representative bodies		1	-	-	3
Accounting profession representative bodies (includes one non UK and Ireland)		-	1	2	2
Auditing firms		-	2	8	-
Other Stakeholders	- Industry representative bodies	-	-	1	1
	- Business School	1	-	-	-

Many of the respondents commented that the two separate purposes were clearly stated. However, 16 of the 21 respondents who answered this question did so negatively either on the grounds that:

- Although the distinction between the purposes was appropriate (however one thought it unnecessary to emphasise this), in practice the approach taken in the Guidance would conflate the disclosure triggers for each purpose. They thought this would cause confusion amongst those preparing and using the resulting reporting and/or excessive reporting of material uncertainties. The root cause of this conflation was the dual use of the term 'going concern' as discussed in the feedback to Question 2 below (15 respondents); or
- There was no international consensus for moving towards a more significant recognition of the stewardship purpose (1 auditing firm respondent).

2 respondents agreed that the purposes were clear (one institutional investor and one academic institution). 3 other respondents broadly agreed with this but had some reservations:

- One thought that using the term 'stewardship' to describe activities of both the shareholders and directors would be confusing;
- One thought that parts of the guidance could be re-ordered to make the distinction clearer and offered specific suggestions for doing so (but also had concerns about confusion that may result from the dual use of the term 'going concern'); and

- One thought further clarity would be required about the meaning of the term a ‘high level of confidence’ and whether this was required over the period of at least twelve months from approving the accounts or over the business/economic cycle.

Of those who did not respond to the specific questions but commented more generally:

- 2 (institutional investor/representative body) broadly welcomed and supported the approach in the guidance;
- 7 (2 accounting profession representative body, 4 corporate reporters and 1 industry representative body) supported the need for enhanced stewardship reporting but questioned the implementation approach taken in the guidance – most of these identified the same concerns about conflation of the disclosure triggers for each purpose and the resulting confusion referred to by many negative respondents – see above;
- 1 (institutional investor representative body) supported the greater incorporation of the stewardship and prudence concepts but thought it would be better to emphasise the interrelationships rather than differences between the appropriate approach to meeting this and to meeting the financial reporting purpose; and
- 2 did not make any relevant comments.

There was little comment on the overarching purpose of the assessment of solvency and liquidity risks in the responses received but one respondent had strong reservations about the reference to ‘risks that would threaten the survival of the company’ in the context of the ‘going concern’ assessment. They thought that this term went further than the solvency and liquidity risks that, it seemed to them, users of annual reports and financial statements would have as their primary concerns when approaching the question of the going concern status.

They accepted that all businesses face risks in the normal course of business, some of which may be of a catastrophic nature that could threaten the existence of the company. They also considered it both appropriate and valid that these risks should be disclosed and discussed in the narrative part of the annual report, but without any explicit linkage to the use of the going concern basis of accounting.

Again, the underlying root cause of the reservations appears to be that the consideration and reporting of the potential longer term impact of risks that would threaten the survival of the entity should not be implied to be coincident with the basis for determining the financial reporting of whether the going concern basis of accounting is appropriately applied and whether there are going concern material uncertainties (the ‘Going Concern Information’).

Another respondent commented that it is not possible for an assessment on these terms to ‘ensure’ that all risks that could threaten survival are identified and managed.

FRC Response

Overall, there was strong support for the Sharman Panel recommendations for greater emphasis on the broader consideration of significant solvency and liquidity risks and on improved narrative reporting about these risks and how they are being managed (to meet the stewardship purpose). However, there was also considerable concern that if implemented in the manner proposed by the FRC this would result in significant collateral damage to the well-established and well-understood basis for going concern financial reporting and the related statement required under Code provision C.1.3 and the Listing

Rules (the ‘Going Concern Statement’) and would result in confusion for preparers and users of the annual report and accounts.

The FRC has made a number of major changes to the proposed implementation approach to respond to these comments. These are aimed at avoiding the dual use of the term ‘going concern’ which many identified as the root cause of the unintended conflation of the disclosure triggers and the resulting confusion that they anticipate.

The term ‘going concern’ is now only used in the context of the financial reporting purpose (and in the overarching purpose the reference to the ‘going concern assessment’ has been replaced with the term ‘solvency and liquidity assessment’). The overarching purpose and the two reporting purposes have been retained but the inter-relationships between the two reporting purposes are further explained in the context that there is only a single assessment that informs both types of reporting (see FRC Response in relation to Question 2 below).

The word ‘ensure’ in the overarching purpose was not intended to indicate that <u>all</u> risks must be identified and managed and the overarching purpose therefore stated that the purpose was to ensure that such risks are <u>properly</u> identified and managed Integrated Code Guidance.

Question 2: Do you agree with the description in the Guidance of when a Company should be judged to be a going concern? Do you agree in particular that this should take full account of all actions (whether within or outside the normal course of business) that the board would consider taking and that would be available to it; and that, if the underlying risks were to crystallise, there should be a high level of confidence that these actions would be effective in addressing them? Is the term ‘a high level of confidence’ sufficiently understandable? If not, why not, and how should the description or term be modified?

Background

The Panel had recognised that the requirement for the directors to assert that the ‘company is a going concern’, in the Going Concern Statement was generally seen as simply mirroring the conclusions drawn by the directors about whether an entity should adopt the going concern basis of accounting and whether there are going concern material uncertainties (the financial reporting ‘Going Concern Information’). This was, for example, reflected in the 2009 Guidance in the language used in the reporting examples for a Code or Listing Rule Going Concern Statement, such as:

> “*The directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future.* ***<u>Thus</u>*** [emphasis added] *they continue to adopt the going concern basis of accounting in preparing the annual financial statements.*” (Example 2, Appendix II)

In other words, the general view was that a Going Concern Statement could only be made without qualifications and assumptions if the going concern basis of accounting was considered appropriate and there were no material uncertainties identified. Conversely, the general view was that if the Going Concern Statement was to be made <u>with</u> qualifications or assumptions, those qualifications or assumptions had to be the same as the going concern material uncertainty disclosures.

The Panel noted that the 2009 Guidance had been developed on the basis that it brought together the requirements of company law, accounting and auditing standards, the Code and the Listing Rules. Whilst recognizing that doing so had been appreciated by commentators, the Panel feared that this had conflated the two purposes of the assessment of solvency and liquidity risks. In effect, it believed that the Going Concern Statement ought to be to meet the stewardship reporting purpose and that this should be different from the Going Concern Information which was intended to meet the financial reporting purpose.

The Panel noted that the moment when a company moves from being a ‘going concern’ to a ‘gone concern’ is dependent on a variety of interrelated factors and it is therefore important to articulate the assumptions, caveats and sensitivities associated with the going concern status of the entity (ie the subject of the Going Concern Statement) well before going concern material uncertainties emerge.

The description of a going concern in the Proposed Guidance was not intended to be used to determine the Going Concern Information. It was only intended to be used as the basis for determining whether the directors could make a Going Concern Statement, <u>without supporting qualifications and assumptions</u>. In other words, failure to meet the test in the description was intended to be the trigger for identifying matters that should be disclosed as qualifications or assumptions in making the Going Concern Statement.

The Sharman Panel recommended that “the discussion of strategy and principal risks always includes, in the context of that discussion, the directors’ Going Concern Statement and how they arrived at it” (see Recommendation 4 (a)). The use of a strong description of a ‘going concern’ in the Proposed Guidance as the trigger for disclosure of qualifications or assumptions to the Going Concern Statement was therefore intended to be the mechanism which would drive the enhanced disclosures about solvency and liquidity risks envisaged in Panel recommendation 4(a). This would create a dichotomy that had not previously existed (at least in practice) between the concept of a ‘going concern’ for purposes of the Going Concern Statement and that normally applied in determining the Going Concern Information. The description in paragraph 1.12 of the Proposed Guidance was intended to be a clearly and significantly higher hurdle than that used for determining the Going Concern Information.

The FRC recognised that this proposal would not be effective if this dichotomy was not embraced by stakeholders or if the term ‘going concern’ in the Going Concern Statement and the related description in paragraph 1.12 of the Proposed Guidance would be confused or conflated with the concept of a ‘going concern’ for determining the Going Concern Information – a company whose directors have no plans for, and have realistic alternatives to, its insolvency or the cessation of its trade. This was why Question 5 (see below) was included in the January Consultation.

Consultation responses

The responses to Question 2 may be summarised as follows:

		Agreed	Agreed – some reservation	Disagreed	No specific response
Corporate preparers of financial statements, Audit Committee Chair and corporate preparer representative bodies		-	3	2	6
Institutional investors and representative bodies		1	-	-	3
Accounting profession representative bodies (includes one non UK and Ireland)		-	-	3	2
Auditing firms		-	1	9	-
Other Stakeholders	- Industry representative bodies	-	-	1	1
	- Business School	-	1	-	-

Of the 21 respondents who answered this question, 15 disagreed with the description of a going concern for purposes of making the Going Concern Statement. 14 of these respondents set out a version of the following rationale in their responses:

- The description in paragraph 1.12 establishes a very high hurdle for an unqualified Going Concern Statement as a result of a number of 'new terms' being introduced – the need for a high level of confidence over the foreseeable future (a period many thought was considerably extended under the Proposed Guidance relative to the 'period of at least twelve months' referred to in the accounting standards). This 'extension' reflects the Panel's view that directors need to consider the likely evolution of solvency risks over the company's own business cycles and the likely evolution of risks as the general economic cycle is played out in the future.

- Given that the future uncertainties would be considerable over such an extended period, very few directors would be able to establish the high level of confidence over the foreseeable future that they would need in order to conclude that the Going Concern Statement could be made without qualifications and assumptions. Most companies would therefore have to give enhanced disclosures about solvency and liquidity risks.

- Although this outcome might be consistent with Recommendation 4(a) of the Panel, it would be achieved at the expense of companies usually (or at least much more commonly than at present) no longer being able to make an unqualified Going Concern Statement.

- Given that the Going Concern Statement (and related qualifications and assumptions) and the Going Concern Information would both be given in the Annual Report and Accounts, having different descriptions of a going concern as the basis for their respective determinations would be very confusing both for preparers and users.

- Faced with such confusion, in practice preparers would run for their safest haven and use the most demanding description (ie that in paragraph 1.12 of the Proposed

Guidance) for both purposes. As a result, the Going Concern Information would be determined on a much more conservative basis than at present. The Panel did not intend this and such a shift in the basis for determining the Going Concern Information would put UK practice out of line with international practice.

- Various outcomes would follow from this, including that:
  - companies would become more risk averse, which was not the Panel's intent;
  - companies would ask lenders for longer and/or more certain commitments of facilities;
  - if granted, this would increase costs for businesses (especially smaller businesses that already find it difficult to obtain such commitments);
  - if not granted, and in any case, companies would be driven to hold more cash reserves;
  - which would drive down business investment at a time when more investment is needed to support economic growth;
  - material uncertainty disclosures would increase very significantly;
  - there would be few if any unqualified Going Concern Statements; and
  - these last two factors would give rise to tighter trade and financial credit and risk further threatening growth and could trigger self-fulfilling prophecies.

Only one respondent (Institutional investor) agreed outright with the description of a going concern for purposes of the Going Concern Statement. Their view was that the term a 'high level of confidence' was appropriate because it allowed for the exercise of the right degree of professional and intelligent judgement.

Five further respondents agreed in principle but had some reservations. In each case the principal reservation was with respect to the requirement for a high level of confidence. One thought this was appropriate but needed some further definition (but without imposing a bright line). The remaining four thought it essentially created too high a bar and one of these suggested an alternative test of a "reasonable" level of confidence.

Of those who did not respond to the specific questions but commented more generally:

- 2 (institutional investors/representative groups) generally welcomed the guidance;
- 5 (2 accounting profession representative bodies, 2 corporate preparers and 1 industry representative body) made comments which indicated that they did not consider the description appropriate, generally for similar reasons to those who answered 'No' to this question (see above); and
- 5 did not make any specific comments relevant to this question.

Only 12 of the respondents addressed the question whether all actions (whether within or outside the normal course of business) should be considered by the directors. All of these agreed that all actions should be taken into account.

FRC Response

The FRC has concluded that the primary root cause of the concerns underlying these responses is the dual use of the term 'going concern', with different definitions, for the purposes of triggering narrative disclosures as qualifications or assumptions to the Going Concern Statement (stewardship reporting) and for purposes of determining the Going

Concern Information (financial reporting). Many believed that this would create a contradiction in terms when the company 'fails' the stewardship definition but 'passes' the financial reporting definition. This problem would be exacerbated if the expectation was that companies would 'fail' the stewardship test more often than not. This was considered inevitable if the intent was that there should always be disclosure about solvency and liquidity risks not just when they are heightened to the point where there are going concern material uncertainties.

Another fundamental root cause of the widespread concern about the proposed approach is also evident in the responses received. Linking enhanced disclosures about solvency and liquidity risks to a positive assertion that the entity is a going concern creates a tension in setting appropriate tests for that assertion – tougher tests would drive more enhanced disclosure but would also more frequently force a 'negative' assertion (ie a qualified Going Concern Statement); and less rigorous tests would make a 'positive' assertion more frequent but may drive less appropriate disclosure.

Since the future is by nature uncertain, any binary statement about the future success of the company would need to be heavily caveated if the expectation was that companies would usually be able to make an unqualified statement. Therefore, intrinsically, adopting this assertion-linked approach is more likely to give rise to negative (or qualified) statements than positive (unqualified) ones if it is to be effective in driving appropriate disclosures. However, the majority of respondents were concerned that negative statements may have the unintended psychological effect of driving financial conservatism, self-fulfilling prophecies and tighter credit markets. This was because they may imply a failure of stewardship rather than simply conveying the reality of future uncertainty and how this is being managed effectively as good stewardship by the directors.

Virtually all respondents supported the Panel's recommendation for enhanced stewardship reporting of solvency and liquidity risks. A number of respondents pointed out that it was not necessary to take an assertion-linked approach in order to implement this objective. It was suggested that a more appropriate alternative approach would be to establish relevant criteria for such disclosures that are not linked to an absolute assertion about the company's future.

The FRC acknowledges that an assertion-linked approach is not necessary to achieve the intended enhanced disclosures. The FRC also accepts that it would be untenable for the Going Concern Statement to be determined on a definitional basis that is different from that used for the Going Concern Information, given the strength of concerns expressed by respondents. However, once this is accepted, the Going Concern Statement is readily seen to be a tautology. It simply confirms what is already addressed (albeit perhaps not explicitly) in the financial statements. In light of this, the FRC considered the following options for addressing the requirement for this Statement in the Code and Listing Rules:

- To retain it and accept the implied position – that it merely asserts compliance with the requirements of the accounting standards;
- To replace it with a required 'viability' or 'business sustainability' statement together with an explanation of any necessary qualifications or assumptions; or
- To eliminate it and develop 'positive' criteria for disclosure which are therefore not linked to the failure to meet a particular assertion about the company's future success.

Adoption of the first of these approaches would fail to meet the recommendation of the Panel for enhanced stewardship reporting of solvency and liquidity risks.

The second of these approaches would require a trigger description of ‘viability’ or ‘business sustainability’ corresponding to that for a ‘going concern’ in paragraph 1.12 of the Proposed Guidance. If this new description were to include similar tests for viability or business sustainability as those in paragraph 1.12 of the Proposed Guidance, it would probably give rise to a number of the same concerns that have been raised in relation to the proposal to trigger enhanced disclosures by reference to the Going Concern Statement. For example, if the tests were the same, just as many boards would be unable to assert that their companies were viable or their businesses sustainable under the new statements as would have been unable to assert they were a going concern in their Going Concern Statement under the Proposed Guidance.

Although this approach may address the apparent *contradiction in terms* between a negative Going Concern Statement and a positive conclusion in the Going Concern Information, it would not address the other root cause of respondents’ concerns. It would carry the same intrinsic risk of inappropriately implying a widespread failure of stewardship, as the proposal to link disclosures to the Going Concern Statement appeared to do for many respondents.

One issue that was considered in relation to the third option was that even if it is merely a statement of compliance with the accounting standards, it may serve to focus attention on an important aspect of the preparation of the financial statements. The FRC concluded that this matter would be better addressed in the financial statements and that if a more explicit statement was desirable, consideration should be given to requiring that as part of the IASB’s deliberations about a limited amendment to IAS 1. The FRC also considered whether half-yearly financial statements would adequately deal with this issue if the requirement for the Going Concern Statement were to be eliminated. The conclusion was that it would be both because of the existing requirements in accounting standards and because the FCA’s Disclosure and Transparency Rules require listed companies to disclose in their half-yearly financial reports any changes in accounting policies and/or in their principal risks since the previous annual report and accounts

On balance, the FRC therefore concluded that it should adopt the third of the possible approaches described above. The revised proposal is that enhanced disclosure of solvency and liquidity risks should be driven by the directors establishing and executing a robust assessment process for identifying and making appropriate disclosures about the principal solvency and liquidity risks the company faces. The assessment should be an integral part of business planning and risk management. This should be proportionate to the size and circumstances of the company. For a Code company, the disclosures about the principal solvency and liquidity risks should be integrated with other information about the company’s business model, strategy and principal risks in the narrative report. For other companies, such disclosures should be proportionate having regard to the company’s narrative reporting obligations under the Companies Act.

The revised approach is built around a description of what constitutes principal solvency and liquidity risks:

"*The principal solvency and liquidity risks are those risks or combinations of risks that (in the judgement of the board) could so seriously damage the company's cash flows, performance or future prospects that they would give rise to severe distress if they materialised.*"

as well as a description of what constitutes a robust assessment process.

The revised approach retains many of the tests that were implicit in that definition for disclosure about solvency and liquidity risks but de-links these from a binary assertion about the future success of the company:

Under the Proposed Guidance	**Under the Integrated Code Guidance**
Disclosure about solvency and liquidity risks would have been triggered if the directors were unable to conclude that the Going Concern Statement required by the Code and Listing Rules could be made without qualifications or assumptions when tested against the description of a going concern in paragraph 1.12 of that guidance. The tests that would have triggered such disclosure were:	A Code Company describes the principal risks in its Strategic Report. A new provision of the Code requires the board to confirm, when disclosing these risks, that the board has carried out a robust assessment of the principal risks facing the company, including those that would threaten the solvency and liquidity of the company. The tests for principal solvency and liquidity risks in a robust assessment include:
– for the ***foreseeable future***, there is a … This was not a fixed period – the directors considered cash flow and liquidity over a period of at least a year and used their judgement to also consider what they knew or should reasonably be expected to know about the future over longer periods based on their normal business planning and risk management processes, considering how solvency risks were likely to evolve over the company's own business cycles and the general economic cycle.	– the board considers ***all available information about the future*** The term 'foreseeable future' has not been retained because it seemed to evoke in respondents an unintended expectation that there was no limit to the period or extent of the assessment. It is also not included in the description of principal solvency and liquidity risks because it is an aspect of the assessment process not of the risks themselves. However the guidance on 'Considering what information is available about the future' is broadly consistent with the concepts in the Proposed Guidance, subject to a number of improvements intended to respond to concerns raised on consultation (see Question 4 below).

Under the Proposed Guidance	Under the Integrated Code Guidance
– ***high level of confidence*** that [the company] will …	– the board needs to have ***a high level of confidence*** that solvency and liquidity risk can be managed effectively ***during at least the twelve month period from the date of the financial statements*** *…*
A high level of confidence was intended to be a high but not absolute level, leaving room for an appropriate degree of evidence-based judgement by the directors.	Again, this element is not addressed within the description of principal solvency and liquidity risks because it is an aspect of the assessment process not of the risks themselves. It is no longer linked to a binary assertion about the future success of the entity but rather to the directors' judgement about their ability to manage these risks effectively over a particular timescale. This is intended to convey that the directors should be able to judge that they would have realistic options available to them for doing so if such risks were to materialise.
– have the necessary liquid resources to ***meet its liabilities as they fall due*** and – will be ***able to sustain its business model, strategy and operations and remain solvent***,	– *[about risks] that could* ***so seriously damage the company's performance or future prospects … that they would give rise to severe distress*** *if they materialised* What constitutes severe distress is a matter of judgement but the board needs to be aware of those [risks …] that can ***seriously affect the future performance, solvency or liquidity of the company*** – irrespective of how they are classified or ***whether they stem from failures of strategy, operations***, organisation or behaviour An understanding of the nature of economic and financial distress is important in applying this and was discussed in the Panel's reports but has not been included in the Integrated Code Guidance to avoid excessive length.

Under the Proposed Guidance	Under the Integrated Code Guidance
– including in the face of ***reasonably predictable internally or externally-generated shocks***.	– A robust assessment process should identify and assess risks considering what the board **knows or should reasonably be expected to know** about the future – this includes their knowledge (inherently uncertain) about how the future will unfold and its implications for the business.

In order to avoid the confusion that the dual use of the term going concern might generate, the Integrated Code Guidance uses the term 'going concern' specifically to refer to a company that meets the criteria for using the going concern basis of accounting, as defined in accounting standards. Meeting those criteria is a low threshold and would be met whenever the company has 'realistic' alternatives to insolvency. The Integrated Code Guidance does not employ the more ordinary English usage of 'going concern' (an entity with sound survival prospects) when discussing the trigger for narrative reporting about those risks that would threaten the company's survival. This is to avoid suggesting that when such narrative reporting occurs, this is necessarily or usually a signal that the company has no realistic alternatives to insolvency. Such narrative reporting is intended to be triggered well before that point is reached.

Question 3: Do you agree with the approach the Guidance takes to the implications and nature of actions within or outside the normal course of business? Do you consider that the Guidance explains their nature sufficiently clearly? If not, why not and what changes should be made to the Guidance?

Consultation responses

The responses to Question 3 may be summarised as follows:

		Agreed	Agreed – some reservation	Disagreed	No specific response
Corporate preparers of financial statements, Audit Committee Chair and corporate preparer representative bodies		2	1	2	6
Institutional investors and representative bodies		1	-	-	3
Accounting profession representative bodies (includes one non UK and Ireland)		-	3	-	2
Auditing firms		1	3	6	-
Other Stakeholders	- Industry representative bodies	-	-	1	1
	- Business School	1	-	-	-

The terms “within” or “outside” the normal course of business were considered clear by most respondents who answered this question, irrespective of whether they agreed, had reservations about or disagreed with the approach taken to such actions. They generally recognised that ultimately whether an action was within or outside the normal course of business should be a matter of judgment and found the table helpful.

Of the 16 respondents who disagreed with the proposed approach (9) or had some reservations (7), most (13) thought that, although the distinction was satisfactorily explained, it was either less clear how the distinction was intended to be applied (6) or that the distinction was not useful (7). The remaining 3 (who each agreed with the proposed approach but with some reservations) and a few others questioned whether the concept was yet adequately explained or wanted further guidance on how to apply it in other circumstances.

For example, one respondent thought the examples were pitched at the ends of a spectrum and therefore did not deal with the more nuanced middle ground. One questioned whether covenant renegotiation would always be outside the normal course of business and another suggested this was becoming a normal event. Another respondent raised questions about whether a change in the business model or a downsizing of the business would be within or outside the normal course of business.

Of the 12 respondents who did not answer the specific questions but only commented more generally, none made specific comments relevant to this question.

FRC Response

We have sought to make clearer in the guidance the relevance of the distinction between actions within and outside the normal course of business. The purpose of drawing the distinction is to assist in making assessments about whether identified risks would give rise to severe distress. Severe distress could either already be evident at the time of the assessment because the underlying risks and their impact have already materialised or they could merely be the possible outcome of identified solvency or liquidity risks that could materialise in the future. In between these two ends of a spectrum, identified solvency and liquidity risks may threaten more or less imminent distress of greater or lesser severity and with higher or lower likelihood.

In the guidance, it is the threat of severe distress (the key characteristic of which is that its impact may threaten the survival of the entity), irrespective of its imminence or likelihood, that is the starting point for the assessment process. The directors are asked to design a robust assessment process that will enable them first to identify, and then further assess, risks of that type. This assessment will inform both the determination of the Going Concern Information and any narrative reporting of principal risks.

The guidance indicates that the first consideration of whether a risk (or combination of risks) would threaten severe distress is made net of, and takes account only of, actions within the normal course of business. Risks that are not considered to threaten severe distress net of such actions are not taken forward for further assessment. As a result, those risks that are taken forward will either be residual risks that the directors accept and monitor in pursuing the company’s strategy and business model or will only be susceptible to mitigation (to the extent the directors wish to do so) through taking actions outside the normal course of business.

Whilst remaining a judgement, such risks are considered likely to be principal risks, which the Integrated Code Guidance describes as:

"*Those risks or combinations of risks that can seriously affect the future performance, solvency or liquidity of the company – irrespective of how they are classified or whether they stem from failures of strategy, operations, organisation or behaviour, or from external factors over which the board may have little or no direct control.*"

Having determined which of the solvency and liquidity risks are principal risks, the directors assess them further, in terms of the severity and consequences of their impact, their imminence and their likelihood. They also assess the availability and likely effectiveness of actions that they would consider undertaking, either in advance or when a trigger event occurs, to avoid or reduce the impact of the underlying risks. In doing so, consideration is given to all such actions that would realistically be available to them (whether within or outside the normal course of business).

A principal risk may or may not have materialised at the time of the assessment. If it has, the directors will need to consider the actions being taken (and any contingency plans) to address the distress that has or may result. If it has not materialised at the time of the assessment, estimates of the likelihood and imminence of its materialisation may fall within a wide range of outcomes and there may be a wide range of potential actions (which may be within or outside the normal course of business or both) that could be taken to address it. The ability of the directors to control actions outside the normal course of business generally may be expected to be lower than actions within the normal course of business.

The assessment process informs a number of distinct but related disclosures in the annual report and accounts. They include the disclosure of principal risks and how they are being managed. They also include the Going Concern Information in the financial statements. In determining whether there are going concern material uncertainties, the guidance addresses factors that the directors may take into account in making their judgement.

The Integrated Code Guidance indicates that when the directors believe that they would have no realistic alternative but to take actions outside the normal course to address uncertainties that either have at the date of assessment given rise to or, in the directors' judgement, will in the next twelve months give rise to severe distress these would usually be considered going concern material uncertainties unless the likelihood of their occurrence was remote.

As a number of respondents commented, whether an action is within or outside the normal course of business is a matter of judgement for the directors taking into account all the facts and circumstances. It is not therefore possible to provide a precise definition of this concept. The responses to this question suggest that the examples given had provided adequate help in understanding the concept.

The exercise of this judgement by the directors could influence their conclusions, amongst other matters, about: the determination of the principal solvency and liquidity risks; the likelihood that actions may be available to the directors to address them if they were to materialise; the related narrative reporting in the Strategic Report; and the determination and reporting of going concern material uncertainties in the financial statements. The exercise of good judgement in these areas, and related reporting through the 'eyes' of the directors, has potential to provide real value for shareholders and other stakeholders. Whilst more examples could always be given, the FRC does not wish to stifle that judgement by providing greater prescription through a proliferation of such examples.

Question 4: Do you agree with the approach taken to interpreting the foreseeable future and is this sufficiently clear in the Guidance? If not, why not and how should the Guidance be changed?

Consultation responses

The responses to Question 4 may be summarised as follows:

		Agreed	Agreed – some reservation	Disagreed	No specific response
Corporate preparers of financial statements, Audit Committee Chair and corporate preparer representative bodies		-	-	5	6
Institutional investors and representative bodies		1	-	-	3
Accounting profession representative bodies (includes one non UK and Ireland)		-	2	1	2
Auditing firms		-	1	9	-
Other Stakeholders	- Industry representative bodies	-	-	1	1
	- Business School	-	1	-	-

16 of the 21 respondents who answered this question did not agree with the approach taken to the interpretation of the foreseeable future. Many linked their responses to this question to their response to Q2 (11: 4 corporate preparers/representative bodies; 6 Audit firms and accounting profession representative bodies; 1 industry representative body), indicating that their concerns were linked to the requirement for a high level of confidence to be obtained over the foreseeable future. 4 (1 corporate preparer representative body and 3 audit firms) identified a number of difficulties in interpreting the approach, including that it may be difficult especially for SMEs and 1 (audit firm) thought it confused and should address separately the appropriate periods for narrative and financial reporting.

1 respondent agreed with the approach adopted and a further 4 agreed with some reservations. Those reservations included that it might be difficult for long business cycle businesses to know when to cut off their assessment, that a clearer statement that it should cover at least one year should be made, that the guidance should recognise that not all things can be predicted, that the foreseeable future should be linked to the period of the strategic planning process and that greater clarity could be helpful around any application differences for accounting and narrative reporting and around defining business and economic cycles.

Of those who did not respond to the specific questions but commented more generally:

- 3 (2 institutional investors/representative groups; 1 accounting profession representative body) welcomed the approach to the foreseeable future;
- 1 did not agree with the approach and cited the link to the high level of confidence;
- 1 agreed with the approach to the period of assessment but didn't think it would be helpful to report externally consistent with this;
- 1 said that this seemed to diverge from the approach internationally and this could harm UK interests; and
- 6 did not make any specific comments relevant to this question.

FRC response

As indicated in relation to the responses received to Question 2, a number of changes have been made to de-link the narrative disclosure trigger from the Going Concern Statement and to link them instead to the description of what constitutes a principal risk and what constitutes a robust process. The future period over which particular matters are considered in the assessment is a matter of judgement and is an important element of establishing a robust assessment process. As the term 'foreseeable future' appeared to evoke in respondents an unintended expectation that there should be no limit to the period or extent of the assessment, it has not been retained.

As one respondent pointed out, the Panel did not want to change the primary quantitative focus of the assessment as it has been traditionally applied in determining the Going Concern Information. This focus is derived from the requirement of the accounting standards that directors should consider all information available about the future, which should be a period of at least twelve months.

In the UK and Ireland, the generally accepted minimum period is twelve months from the date of approval of the financial statements. In relation to those following the FRSSE and FRS 102, that is what the accounting standard requires. In relation to those following EU-adopted IFRS or FRS 101, although the basis in IAS 1 is twelve months from the end of the accounting period, the UK and Ireland auditing standard (ISA (UK and Ireland) 570) requires the auditor to state in the audit report if the period of assessment was less than twelve months from the date of approval of the financial statements.

However, this does not mean that in the UK and Ireland there is a fixed period of twelve months from approval of the financial statements. The accounting standards require all information that is available about the future to be taken into account. Many companies in practice have regard to financial projections of cash flows and facilities over periods that exceed twelve months from approval of the financial statements.

The requirement to take all available information into account means that considering matters over a longer period to support the narrative reporting than for the financial reporting would not be appropriate. If, for example, some consideration was made looking into the longer term ostensibly only for determining the appropriate narrative reporting, any information obtained in doing so would also have to be taken into account by the directors in making their determination of the Going Concern Information. Hence the guidance continues to take the approach that there is a single assessment process that informs each of the different reporting requirements.

However, in explaining how directors are to judge how far into the future to make their assessment, the following clarifications have now been made in the Integrated Code Guidance:

- Quantitative analysis of liquidity risks (cash flows and available facilities), including sensitivity analysis, is undertaken for a period of at least twelve months from approval of the financial statements and is the primary underpinning for the determination of the Going Concern Information;

- A high level of confidence needs to be developed by the directors, at least over this period, that they can manage the solvency and liquidity risks effectively (ie that they would have realistic options available to them for doing so if such risks were to materialise);

- Longer term consideration is given to solvency risks, over the specific business cycles of the company and having regard to the likely evolution of risks over the economic cycle. The company also undertakes stress tests on a prudent basis over appropriately judged periods. These elements of the assessment process provide a longer term perspective and are an important incremental step in assessing and reporting on principal solvency and liquidity risks; and

- Any information obtained by the directors from their longer term considerations or from other relevant analyses should be taken into account in making their determination of the Going Concern Information if it suggests that the company is likely to experience liquidity or solvency issues.

Question 5: Do you agree that the use of the term 'going concern' in the phrase 'going concern basis of accounting' is sufficiently clearly distinguished in the Guidance from its use in the Code requirement for a statement that the company 'is a going concern' and from its use in the accounting and auditing standards in the context of material uncertainties about the company's 'ability to continue as a going concern'? Is it clear from the Guidance that the statement the directors are required to make under the Code (that the Company is a going concern) should reflect the board's judgement and is not intended to be absolute? If not, why not and what changes should be made to the Guidance or the Code requirement?

Consultation responses

The responses to this question may be summarised as follows:

		Agreed	Agreed – some reservations	Disagreed	No specific response
Corporate preparers of financial statements, Audit Committee Chair and corporate preparer representative bodies		-	-	5	6
Institutional investors and representative bodies		1	-	-	3
Accounting profession representative bodies (includes one non UK and Ireland)		-	-	3	2
Auditing firms		-	2	8	-
Other Stakeholders	- Industry representative bodies	-	-	1	1
	- Business School	-	1	-	-

Consistent with the responses to Question 2, the vast majority (17) of respondents who answered this question (21) disagreed, and considered that the dual definitions of a 'going concern' for stewardship and financial reporting purposes would cause widespread confusion for preparers and users, inconsistent application and increased expectation gaps. Only 1 respondent agreed outright that the distinction was clear. 3 other respondents thought the distinction was clear but 2 of these believed that it could well be misunderstood in practice and 1 suggested that it would improve clarity if there was a clear indication in relation to each responsibility set out in Appendix 2 of the Proposed Guidance as to which definition of going concern was intended to be used.

Of those who did not respond to the specific questions but commented more generally, one commented to the effect that the approach taken would lead to inconsistency between the front and back of the annual report.

FRC Response

The term 'going concern' has a very particular meaning in the accounting and auditing literature and is widely used internationally in that context. It would not be realistic to seek to have the terminology used to define the concept in that literature changed. Although the same term is also well-established in the Code (having been included in the original Cadbury Code in 1992 and the related guidance for directors on going concern published in [1994]), it is within the ambit of the FRC to amend this.

As described in the response to Question 2, the FRC has concluded that the term "going concern" should therefore now only be used in the sense it is required to be used in determining the Going Concern Information (an entity that has realistic alternatives to liquidation or cessation of trading) and not in a more normal English usage (an entity with sound survival prospects). See also the FRC response to Question 2.

Question 6: Do you agree that the judgemental approach in the Guidance to determining when there are material uncertainties to be disclosed is the appropriate interpretation of the relevant accounting standards? Do you agree that the factors and circumstances highlighted respectively in paragraphs 2.30 and 2.31 are appropriate? If not, why not and what changes should be made to the Guidance?

Background

Paragraphs 28 to 33 of Section 2 of the Proposed Guidance set out the proposed judgemental approach to determining when there are going concern material uncertainties to be disclosed.

Purpose of going concern material uncertainty disclosures

Paragraph 28 explained that there was no consensus on the purpose of these disclosures internationally and paragraph 29 set out the proposed purpose to be adopted:

".. to forewarn of significant solvency or liquidity risks of such a magnitude and such a meaningful possibility of occurrence that, if disclosed, they would provoke serious questions about their implications for the entity's ability to continue as a going concern and this would affect the economic decisions of shareholders and other users of the financial statements."

This link to the economic decisions of users was intended to be responsive to the conclusion of the Panel that:

"…… the material uncertainty disclosure should be an early warning signal that one or more risks that the entity will not remain a going concern for the foreseeable future has been heightened to the point where knowledge of that fact would be material to users of the financial statements." (See paragraph 104 of the Panel's Final Report)

It was also intended to be consistent with the IFRS concept of what is 'material' ie:

"Information is material if omitting or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity." (See the IFRS Conceptual Framework)

Judging whether disclosure of an uncertainty would meet the proposed purpose

Paragraph 30 set out examples of possible implications of solvency and liquidity risks that could affect the decisions of users of the financial statements and factors that the directors should consider. This was intended to assist in judging whether the proposed purpose of disclosure would be met in the particular circumstances. The examples included the effects of those risks, if they materialised, on realisable values of assets, on the entity's credit rating and on the entity's ability to pursue its strategy and business model.

Paragraph 31 set out some indicators of circumstances in which the judgment would usually be that there are or are not material uncertainties, in the context that this is always a judgment. These included some criteria to be applied by reference to a 'more likely than not' threshold, a 'high level of confidence' or a 'highly likely' threshold. Those indicators were not intended to cover the middle ground but rather to indicate the usual boundaries of the judgement.

Relationship between material uncertainties and narrative risk disclosures

Paragraphs 32 and 33 set out some comments that were intended to be helpful to users of the Proposed Guidance in understanding the relationships between material uncertainty disclosures in the financial statements and disclosures about solvency and liquidity risks in the narrative report.

Paragraph 32 was intended to indicate simply that there could be going concern material uncertainty disclosures to make even if the directors were able to judge the entity to be a going concern for purposes of making the Going Concern Statement on the new basis proposed – for example, if there were material consequences of actions outside the normal course of business that would need to be taken to address the risks identified. But there was an error in the preamble:

"When the board is unable to obtain a high level of confidence about the entity's solvency and liquidity for the foreseeable future, but the going concern basis of accounting is appropriate, there ***will*** *[emphasis added] be material uncertainties to disclose. However, there may also be material uncertainties to disclose even if …"*

The word 'will' was inadvertently used in the second sentence of this paragraph rather than the word 'may' and this understandably but unintentionally indicated to many respondents that the FRC was proposing that there should always be material uncertainty disclosures when the directors were unable to make the Going Concern Statement without assumptions or qualifications. This was never intended and if it had been, as many respondents noted, this would have been expected to increase the number of companies with material uncertainty disclosures very substantially from current levels.

Consultation responses

The responses to this question may be summarised as follows:

		Agreed	Agreed – some reservations	Disagreed	No specific response
Corporate preparers of financial statements, Audit Committee Chair and corporate preparer representative bodies		-	-	5	6
Institutional investors and representative bodies		1	-	-	3
Accounting profession representative bodies (includes one non UK and Ireland)		-	-	3	2
Auditing firms		-	2	8	-
Other Stakeholders	- Industry representative bodies	-	-	1	1
	- Business School	1	-	-	-

2 respondents agreed outright with the judgmental approach set out in the Proposed Guidance. 2 further respondents agreed but had some reservations in relation to either the detail of the guidance (the 'more likely than not' criteria in paragraph 31) or that the intended

meaning of the terms ‘high level of confidence’ and ‘foreseeable future’ needed some clarification in the context of the guidance.

However, the remaining 17 respondents who answered this question disagreed that the proposed approach was appropriate (though many of them specifically confirmed that they believed a judgemental approach is appropriate). Those who objected often cited more than one reason for this, as follows:

- They did not, in principle, support any interpretation of the application of IFRS in the guidance outside an IFRIC or IASB due process document – divergence from the international standards was undesirable even in this respect (3 respondents);
- They did not believe the guidance in paragraphs 29 (purpose), 30 (examples of effects that might meet the purpose) and/or 31 (indicators that material uncertainty does or does not usually exists) were consistent with IFRS or otherwise did not agree with it – some said that these were individually inconsistent with IFRS and/or with each other (7 respondents);
- They disagreed with the absolute ‘requirement’ (inadvertently intimated by the error in paragraph 32, as described above) – for material uncertainties to always be disclosed if the Going Concern Statement could not be made without qualifications or assumptions. Even without this ‘requirement’, their expectation was that many preparers would in practice default to taking this approach in response to the confusion that they thought would arise from the dual use of the term ‘going concern’ (see also responses to Question 2). In either case, the number of companies with going concern material uncertainties disclosed would increase significantly and UK businesses would be at a disadvantage to other international companies (11 respondents);.
- They thought it was unclear whether this guidance was intended to be applied in determining the reporting to meet the stewardship or financial reporting purposes (1 respondent);
- They believed the guidance was unclear (2 respondents); or
- No specific reasons were given (1 respondent).

Only one of those who did not respond to the specific questions but commented more generally addressed this in particular. They thought the approach would result in many more going concern emphasis of matter paragraphs in auditor’s reports than currently and that this would be unhelpful.

FRC response

There was generally strong support for the notion that determining what is a going concern material uncertainty is primarily a matter of judgement. In responding to the comments received, the overriding requirement for judgement has been given greater emphasis in the Integrated Code Guidance.

However, given the Panel’s conclusion that there is not a common understanding in this area and that there is currently diversity in application, the FRC has concluded that there is a need for some clarification through national guidance, pending further developments at the IASB and guidance in this area has therefore been retained (but significantly modified as indicated):

- the preamble at paragraph 28 of Section 2 has been removed;

- the proposed purpose included at paragraph 29 has been retained;
- the factors to consider (but not the examples) at paragraph 30 have been retained;
- the indicators in paragraph 31 have been retained, but modified to remove the ‘more likely than not’, ‘high level of confidence’ and ‘highly likely’ thresholds and replace them with judgement; and
- the proposed guidance at paragraphs 32 and 33 has been removed.

Having taken the advice of the Accounting Council, the FRC believes that this guidance as modified is appropriate and consistent both with IFRS and with FRS101, FRS 102 and the FRSSE. The FRC will also continue to seek to influence the IASB to develop greater clarity in relation to the requirements for the determination of when going concern material uncertainties exist and what should be disclosed about them under IFRS. The Integrated Code Guidance will be kept under review for consistency with any such developments.

Question 7: Do you agree that the interpretations adopted in the Guidance in implementing Recommendation 2(b) are consistent with FRS 18 and ISA (UK and Ireland) 570? If not, why not and what changes should be made to the Guidance or those standards?

Consultation responses

The responses to this question may be summarised as follows:

		Agreed	Agreed – some reservations	Disagreed	No specific response
Corporate preparers of financial statements, Audit Committee Chair and corporate preparer representative bodies		-	-	5	6
Institutional investors and representative bodies		1	-	-	3
Accounting profession representative bodies (includes one non UK and Ireland)		-	-	3	2
Auditing firms		-	3	7	-
Other Stakeholders	- Industry representative bodies	-	-	1	1
	- Business School	1	-	-	-

Of those who answered this question, 2 respondents agreed outright that the proposed guidance was consistent with UK and Ireland accounting and auditing standards. 3 more agreed but had some reservations, primarily about the guidance creating inconsistency with the international standards and a preference for not doing so but seeking to influence the international outcome. The remaining 16 respondents who answered this question disagreed. The vast majority of these (14) cited inconsistency with the international standards and two cited inconsistency with UK and Ireland accounting and auditing standards.

Of those who did not respond to the specific questions but commented more generally, two made comments relevant to this question. One suggested that there was an inconsistency between the requirement for a high level of confidence as to the availability of funding facilities and the requirement in the auditing standard which suggests that doubt may be cast on the going concern assumption if borrowings approach maturity "without realistic prospects of renewal or repayment". The other urged the FRC to continue its dialogue with the IASB rather than risking inconsistency with the international approach.

FRC Response

Whilst the FRC has been actively working with the international standard setters and remains committed to doing so, for the reasons given in response to Question 6, and subject to the changes proposed to be made described therein, the FRC believes that there is a need for some clarification of the application of IFRS in relation to these matters through national guidance, pending further developments at the IASB. The same guidance is also considered appropriate in relation to the application of the equivalent provisions of the UK and Ireland accounting and auditing standards and will encourage greater consistency between the application of international and UK and Ireland standards. Having taken the advice of its Accounting and Audit and Assurance Councils, the FRC believes that the proposed revised guidance is consistent with the UK and Ireland accounting and auditing standards.

Question 8: Do you agree that Section 2 of the Guidance appropriately implements Recommendation 3? Do you agree with the approach to stress tests and the application of prudence in conducting them? Do you agree with the approach to identifying significant solvency and liquidity risks? Do you agree with the description of solvency and liquidity risks? If not, why not and what changes should be made to the Guidance?

Consultation responses

The responses to this question may be summarised as follows:

		Agreed	Agreed – some reservations	Disagreed	No specific response
Corporate preparers of financial statements, Audit Committee Chair and corporate preparer representative bodies		-	5	-	6
Institutional investors and representative bodies		1	-	-	3
Accounting profession representative bodies (includes one non UK and Ireland)		-	1	2	2
Auditing firms		-	6	4	-
Other Stakeholders	- Industry representative bodies	-	-	1	1
	- Business School	1	-	-	-

2 respondents agreed outright that Recommendation 3 had been appropriately implemented in Section 2 of the guidance. 12 further respondents also agreed in principle but had some reservations and 7 disagreed. The issues raised by those with reservations and those who disagreed were broadly similar and included the following:

- The guidance was unrealistic or disproportionate for SMEs (8 respondents) – for example, stress tests may not be understood or be proportionate for such companies (see also response to Question 14)
- The process was, at least in places, overly prescriptive and needed to be more capable of being applied proportionately to the circumstances of the company – some thought more examples would assist in this respect (4 respondents)
- The assessment process may be appropriate for determining the risk disclosures but not for determining the Going Concern Information (3 respondents) or there were implications for the guidance in this section in relation to concerns about its impact on the determination of the Going Concern Information referred to in responses to Question 6 (4 respondents)
- The guidance would cross over with the Turnbull guidance and perhaps they should be merged or better co-ordinated (2 respondents)
- Care was needed in addressing solvency not to be inconsistent with insolvency law (2 respondents) but no specific inconsistencies were identified.

Of those who did not respond to the specific questions but commented more generally, two made comments relevant to this question. One (Institutional Investor representative body) welcomed the greater emphasis on the consideration of longer term solvency but suggested that disclosures in this respect could be addressed in guidance on narrative reporting. The other (Corporate Preparer) questioned whether solvency and liquidity can be considered and documented to the same degree on an ongoing basis and suggested this would need to be greater when risks were heightened.

FRC Response

See the response to Question 14 below in relation to the comments on proportional application for SMEs. In relation to the need for proportionality for other companies there is greater emphasis on the need for directors to consider what is appropriate in the circumstances of the company including considering using stress tests but not requiring them.

Concerns that the guidance was less appropriate for determining the Going Concern Information than for narrative reporting are addressed in the response to Question 6.

In relation to the overlap with Turnbull, the Integrated Code Guidance now brings together the revised Proposed Guidance with revised Turnbull guidance.

In relation to the cautions raised by a few respondents about potential inconsistency with insolvency law, the description of solvency and liquidity risks is considered consistent with the insolvency law position and the vast majority of respondents did not raise any issues. The differences between liquidity and solvency were explained in relation to insolvency law in the Panel's reports. In describing solvency and liquidity risks in the Integrated Code Guidance there is intended to be a close alignment between these two concepts and the two tests of insolvency in law (respectively failing to meet liabilities as they fall due and what some referred to as the ‘balance sheet test’ which is to some extent a misnomer as explained more fully in the Panel’s Preliminary report[4]).

Question 9: Do you agree that the approach taken in Section 4 of the Guidance in implementing the disclosures in Recommendation 4 is appropriate? Is the term ‘robustness of the going concern assessment process and its outcome’ sufficiently clear? Do you agree that the approach the board should adopt in obtaining assurance about these matters is appropriately reflected in Section 3 of the Guidance? Do you agree that the board should set out how it has interpreted the foreseeable future for the purposes of its assessment? If not, why not and what changes should be made to the Guidance?

Consultation responses

The responses to this question may be summarised as follows:

		Agreed	Agreed – some reservations	Disagreed	No specific response
Corporate preparers of financial statements, Audit Committee Chair and corporate preparer representative bodies		-	4	1	6
Institutional investors and representative bodies		1	-	-	3
Accounting profession representative bodies (includes one non UK and Ireland)		-	2	1	2
Auditing firms		1	3	5	1
Other Stakeholders	- Industry representative bodies	-	-	1	1
	- Business School	-	1	-	-

2 respondents agreed that the approach in Section 4 of the Guidance to narrative and financial reporting was appropriate. 10 further respondents agreed with some reservations and 8 disagreed. There was considerable overlap between the reasons given by those who disagreed and the reservations expressed by those who nonetheless broadly agreed.

The issues they raised were as follows:

- There was a need to be clearer in Section 4 about which companies each of the requirements related to. It had been written for Code companies but certain elements would not apply to other companies as these would go beyond their Companies Act responsibilities and that should be made clear (5 respondents).
- 15 respondents had reservations or concerns about the term “*robustness of the going concern assessment process and its outcome*”. They generally thought it was subjective or undefined and could benefit from further clarification. One thought it was clear but that it would be helpful to state that performing the guidance as a minimum would constitute a robust assessment. Another suggested qualifying the

[4] See [cross reference]

term with the word 'sufficiently'. Another linked their concern to the use of the term 'a high level of confidence'. 3 preferred not to use the term – of these, one would prefer to have a separate standard or guidance on what an 'appropriate' assessment process would be, one thought it unnecessary to make any such statement, as the directors' narrative descriptions of the assessment process should enable users to make their own determination as to whether the assessment was adequate, and the other wanted the focus to be on the standard of care of directors as set out in the Companies Act. 3 other respondents also made a similar point about not going beyond the directors' duty of care under the Companies Act.

- 1 respondent (academic) questioned why the board rather than the audit committee was being asked to make certain statements that the Panel had recommended should be made by the Audit Committee.
- 1 respondent (corporate preparer representative body) suggested that the guidance in Section 4 should be restricted to public companies.
- 1 respondent (audit firm) suggested that the guidance was weaker than the 2009 Guidance in that they believed that the 2009 guidance called on all companies to give some disclosure relating to going concern, even in situations where there was no material uncertainty.

Only 6 of the respondents separately commented in relation to the approach to the directors obtaining assurance in Section 3. With one exception they agreed with the approach. However one of these cautioned that the guidance here should not be taken to suggest that auditors should provide reasonable assurance to the directors about the robustness of the assessment. One commented that they thought this only worked for listed companies and two suggested that a note should be added to the effect that however much assurance the board obtained from others, the assessment process remained the directors' responsibility.

Only 4 respondents separately commented in relation to the suggestion that the directors should make the narrative disclosures in the context of what the board has regarded as the foreseeable future and all of them agreed, at least given the approach to the foreseeable future in the Proposed Guidance.

None of those who did not respond to the specific questions but commented more generally made comments relevant to this question.

FRC Response

The FRC now proposes to address separate guidance separately to Code and other companies (see response to Question 14 below). In taking forward the development of separate guidance for companies that do not follow the Code, care will be taken to address the concerns raised about the need to clarify what does and does not apply to different types of companies and that the guidance does not require or imply that directors have narrative reporting responsibilities that go beyond those set out in the Companies Act, given the size and nature of the company.

The term 'a robust risk assessment' was coined by the Panel in Recommendation 4, which received strong support in response to the Panel's preliminary report. The term is meant to be used in a plain language manner. The guidance is not intended to be mandatory but to assist directors in fulfilling their responsibilities including carrying out a robust assessment, as set out in proposed new Code provision C.2.1:

"The board should carry out a robust assessment of the principal risks facing the company, including those that would threaten its solvency or liquidity. In the annual report the directors should confirm that they have carried out such an assessment and ..."

Nothing in the Code or guidance is intended to override or extend the directors' duty of care set out in Section 174 of the Companies Act 2006 "Duty to exercise reasonable care, skill and diligence**".**

Panel Recommendation 4 (b) included that *'the audit committee report illustrates the effectiveness of the process undertaken by the directors to evaluate going concern by …'*. The recommendation was made with the intent that it would be done in a way that is integrated and consistent with the changes to the Code and related guidance and the auditing standards to implement proposals that were originally discussed in the FRC's paper "*Effective Company Stewardship" (ECS).*

Although the original proposals in the ECS paper envisaged mandating that the audit committee should carry out the initial assessment of the whether the annual report meets the 'fair, balanced and understandable' test, there was little support in the responses to the ECS consultation for mandating this. The ECS proposals were therefore implemented by adding a new supporting principle in the September 2012 edition of the Code requiring boards to put in place the processes they considered necessary to meet this test. It was then left to the board to decide what, if any, role the audit committee should play.

Consistent with the approach adopted in the September 2012 edition of the Code, the Proposed Guidance made it clear that responsibility for identifying, evaluating and reporting about significant solvency and liquidity risks remains with the board and that it is for the board to determine the extent to which it wishes to obtain the advice of the risk committee or the audit committee. However, under the Code, the audit committee has a direct role in relation to those aspects of the going concern assessment and reporting process that are relevant to its responsibilities for financial reporting and internal financial control. That approach has been retained in the Integrated Code Guidance. The vast majority of respondents to the January Consultation were supportive of that approach.

Question 10: Do you agree that the proposed amendments to the auditing standards appropriately implement the enhanced role of the auditor envisaged in Recommendations 4 and 5? If not, why not and what changes should be made to the auditing standards?

Consultation responses

The responses to this question may be summarised as follows:

		Agreed	Agreed – some reservations	Disagreed	No specific response
Corporate preparers of financial statements, Audit Committee Chair and corporate preparer representative bodies		-	-	3	8
Institutional investors and representative bodies		1	-	-	3
Accounting profession representative bodies (includes one non UK and Ireland)		1	1	1	2
Auditing firms		-	3	7	-
Other Stakeholders	- Industry representative bodies	-	-	1	1
	- Business School	1	-	-	-

3 respondents agreed outright that the proposed amendments to the auditing standards were appropriate. 4 others also agreed but expressed some reservations. One of these had a strong preference for seeking to make any changes to the auditing standards first through the International Standards on Auditing. Another suggested that there would be a need for further practical guidance for auditors, to support the amendments and, of the other two, one said their agreement was conditional on not labelling the narrative disclosures of solvency and liquidity risks as 'going concern' related and the other sought clarification that the requirement to comment if the auditor had 'anything to add' in the auditor's report was not intended to be extended to the Going Concern Information in the financial statements.

Amongst the 12 who disagreed, 9 cited their preference for changes to the auditing standards to be sought, at least at first, through changes to the International Standards on Auditing. 3 suggested that the term 'anything to add' in relation to the narrative disclosures was too open ended and should be qualified to say something like 'anything material to add'. 1 also thought that the audit report should not be extended to the narrative reporting at all as this would, in their view, increase costs for companies.

2 of those respondents who did not respond to the specific questions but commented more generally made comments relevant to this question. 1 (institutional investor representative body) welcomed the implementation of Recommendation 4 of the Panel and the other (accounting profession representative body) urged the FRC to work with the IAASB to address auditor reporting in the International Standards on Auditing in relation to these matters.

FRC Response

The FRC acknowledges the comments to the effect that changes to the auditing standards should be made, or at least that at first the attempt should be made to do so, through influencing changes to the IAASB's international standards on auditing. However, all of the proposed changes to the auditing standards were to integrate consideration of the principal solvency and liquidity risks and reporting thereon with the changes made in response to the

ECS consultation and in line with the Sharman recommendations. This includes the proposal for the auditor to report by exception in relation to narrative reporting about these risks.

The FRC took the decision to move ahead of the IAASB in relation to audit committee and auditor reporting when finalising the changes resulting from the ECS proposals in 2012. At the time, the FRC recognised that the IAASB was (understandably in view of its remit) taking a different but congruent path on auditor reporting. The FRC had been and continues to work closely with the IAASB to ensure that the IAASB proposals will be able to accommodate the approach to governance in the Code and the FRC's desire to address the issues in a holistic manner. The IAASB's proposals for auditor reporting demonstrate this.

The proposed changes to the auditing standards have been revised:

- To qualify the requirement for the auditor to comment if 'the auditor has anything to add' so that this now read: 'the auditor has anything <u>material</u> to add'
- To reflect such other changes that were necessary to reflect changes made to the Code and the different approach adopted in the Integrated Code Guidance as described elsewhere in this Feedback Statement.

In the draft auditing standards now being exposed for consultation, changes now being proposed are shown in mark-up as compared with the draft included in the January Consultation.

Question 11: Do you agree that it is appropriate for the Supplement to confirm that central bank support for a solvent and viable bank does not necessarily constitute a material uncertainty? In particular, do you agree that central bank support (including under ELA) may be regarded as in the normal course of business where the bank is judged to be solvent and viable? Do you agree that the approach set out in the Supplement to assessing whether there is a material uncertainty is appropriate and consistent with the general approach in the Guidance? If not, why not and what changes should be made to the Supplement to the Guidance?

Consultation responses

The responses to this question may be summarised as follows:

	Agreed	Agreed – some reservations	Disagreed	No specific response
Corporate preparers of financial statements, Audit Committee Chair and corporate preparer representative bodies	-	1	-	10
Institutional investors and representative bodies	1	-	-	3
Accounting profession representative bodies (includes one non UK and Ireland)	1	2	-	2
Auditing firms	3	3	3	1
Other Stakeholders - Industry representative bodies	1	-	-	1
Other Stakeholders - Business School	1	-	-	-

7 of the respondents who answered this question agreed outright with the approach taken in the Supplement for Banks. A further 6 respondents agreed but had some reservations. 4 of these agreed with the approach taken in the Supplement for Banks but thought the Proposed Guidance was inconsistent with it (by requiring a high level of confidence, over the foreseeable future). One agreed but urged the FRC to consult further to adapt it to use in the legal and regulatory environment in Ireland. The other respondent made a number of comments including the following:

- More thought should be given to the implications for banks of wider reporting requirements in corporate reports and the linkages between them. For example, material borrowings from the Bank of England may need to be disclosed to comply with the liquidity disclosure requirements of IFRS 7 and to give a true and fair view.
- Difficult judgements will remain for all concerned where a bank is subject to uncertainties that have not yet reached a level where discussion with the authorities on support are necessary.

Of those respondents who did not respond to the specific questions but commented more generally, 5 made comments relevant to this question, as follows:

- 1 (corporate preparer – bank) agreed with the approach in the Supplement for Banks but considered that the Bank of England should have power to override the financial reporting requirements when that was in the interests of financial stability.
- 1 (corporate preparer – bank) echoed the comments made by some who answered this question that the Proposed Guidance did not appear to be consistent with this and thought the Proposed Guidance should be clarified to be consistent with it.
- 3 (2 institutional investor representative bodies and 1accounting profession representative body) suggested that separate guidance was not necessary for banks.

FRC Response

There was strong support overall for the approach taken to banks and for the Supplement for Banks. The changes made in developing the Integrated Code Guidance to address comments received in response to other questions should also be responsive to the comments made about the Proposed Guidance being inconsistent with the Supplement for Banks.

The FRC therefore proposes to issue the Supplement for Banks as a standalone document, making only such changes as are necessary to keep it consistent with the final wording of the Code and the Integrated Code Guidance. The resulting proposed amendments are shown in the draft now being exposed for comment in mark-up as compared with the draft included in the January Consultation.

During the consultation period, we will be seeking further discussions with the authorities in Ireland with a view to determining whether and, if so, how to adapt it for use in Ireland.

Question 12: Do you consider the proposed implementation date to be appropriate? If not, why not and what date should the application date be?

Consultation responses

The responses to this question may be summarised as follows:

		Agreed	Agreed – some reservations	Disagreed	No specific response
Corporate preparers of financial statements, Audit Committee Chair and corporate preparer representative bodies		-	-	5	6
Institutional investors and representative bodies		1	-	-	3
Accounting profession representative bodies (includes one non UK and Ireland)		-	-	3	2
Auditing firms		-	-	10	-
Other Stakeholders	- Industry representative bodies	-	-	1	1
	- Business School	-	-	1	-

With one exception, respondents who answered this question, and a further 5 of those who did not respond to the specific questions but commented more generally, thought that the timetable was too ambitious or unachievable, especially for smaller businesses and for 30 September reporters.

FRC Response

The FRC has acknowledged the timing concerns and deferred the proposed implementation timetable. The FRC is proposing that the revisions to the Code, the Integrated Code Guidance, the revised Supplement for Banks and the proposed revisions to the auditing standards would apply to reporting periods beginning on or after 1 October 2014.

Question 13: Do you believe that the Guidance will deliver the intended benefits? If not, why not? Do you believe that the Guidance will give rise to additional costs or any inappropriate consequences? For example, as compared with the 2009 Guidance, do you believe that the Guidance will give rise to fewer companies being judged to be a going concern and/or more companies disclosing material uncertainties? If so, what are the key drivers and can you give an estimate or indication of the likely cost or impact? Do you believe that such additional costs or impact would be justified by the benefits?

Consultation responses

The responses to this question may be summarised as follows:

		Agreed	Agreed – some reservations	Disagreed	No specific response
Corporate preparers of financial statements, Audit Committee Chair and corporate preparer representative bodies		-	-	5	6
Institutional investors and representative bodies		1	-	-	3
Accounting profession representative bodies (includes one non UK and Ireland)		-	-	3	2
Auditing firms		-	-	10	-
Other Stakeholders	- Industry representative bodies	-	-	1	1
	- Business School	1	-	-	-

Consistent with the responses to other questions, although 2 of the 21 respondents who answered this question believed that the Proposed Guidance would deliver the intended benefits, the remaining 19 did not agree. The majority of respondents thought that the Proposed Guidance would not deliver the intended benefits because they believed that:

- Very few companies would be able to 'pass' the going concern test for stewardship purposes and either:
  - Due to the dual use of the term 'going concern' companies would align their conclusions for purposes of the Going Concern Information with that for the stewardship purpose to avoid apparent contradictions in their reporting. The overall (unintended) effect would be to significantly increase the number of companies reporting going concern material uncertainties. This would give rise to various undesirable impacts (tighter credit and/or higher finance costs, financial conservatism by companies and potential implications for confidence in business and economic growth) (12 respondents); or
  - If companies used the stewardship definition of 'going concern' only to trigger narrative disclosures but retained the harder to breach definition in the accounting standards (as was intended), there would be an apparent contradiction between the

negative (qualified) Going Concern Statements and the continued adoption of the going concern basis of accounting and non-disclosure of going concern material uncertainties. This would cause confusion and may increase expectation gaps or imply false assurance.

- There would be little or no benefit from implementing the Panel's recommendations as currently proposed (4 respondents);
- The proposals lacked clarity or were overly complex and could be difficult to implement (2 respondents);
- There would be high costs to implement (especially for SMEs) (2 respondents) or that it was not possible to assess the costs (1 respondent);

4 respondents also indicated that it would have been more helpful if the FRC had conducted a more thorough impact assessment rather than relying on responses to the January Consultation to do so.

FRC Response

As noted in the FRC response to earlier questions, the guidance is being fundamentally revised and reorganised to address the widespread concerns raised by preparer and auditor respondents in their answers to those questions, which are also echoed in their responses to this question.

The FRC also understands the comments about the need for impact assessment but, as some respondents acknowledged, there were challenges in doing so in this case. Considerable consultation with market participants was in fact undertaken through an advisory group ahead of publishing the proposals. This did identify concerns that there could be difficulties with the dual use of the term 'going concern' and about the possible implications of requiring a 'high level of confidence' to meet the stewardship test of a going concern to drive narrative reporting.

Fundamentally, whether the proposed approach could be successfully implemented depended significantly on how preparers and auditors would behave in implementing the proposed conceptual approach and how users would behave in interpreting the resulting disclosures. It was not considered possible to judge those behaviours without exposing the detail of the proposed approach for wider consideration. The responses to the consultation clearly indicate that preparers and auditors would not in practice feel able to implement the proposals as they were intended and, therefore, that the intended outcome would not be achieved.

Question 14: Do you agree with the approach to SMEs in the Guidance? If not, why not and what changes should be made to the Guidance?

Background

The Proposed Guidance was designed to describe what would be expected of the boards of companies that follow the Code. The approach taken in that draft for companies that do not follow the Code was to recommend that they should apply the guidance proportionately, recognising that the Proposed Guidance addressed matters that either fell outside the scope of their responsibilities or that, given their size and lack of complexity, would not be a proportionate approach.

Consultation responses

The responses to this question may be summarised as follows:

		Agreed	Agreed – some reservations	Disagreed	No specific response
Corporate preparers of financial statements, Audit Committee Chair and corporate preparer representative bodies		-	-	3	8
Institutional investors and representative bodies		1	-	-	3
Accounting profession representative bodies (includes one non UK and Ireland)		-	-	3	2
Auditing firms		-	1	9	-
Other Stakeholders	- Industry representative bodies	-	-	1	1
	- Business School	1	-	-	-

Only 2 of the 19 respondents who answered this question agreed with the proposed approach and 1 more agreed but expressed reservations, given that the costs of imposing the process on unlisted or unquoted companies had not been assessed.

The remaining 16 respondents who answered this question did not agree with the proposed approach, although many (but not all) acknowledged that the principles underlying the Sharman recommendation were appropriate and were as relevant to SMEs as to listed and other companies that fall between these two ends of the spectrum. They cited a number of reasons for their disagreement, the most common of which were as follows:

- The guidance was too complex, inaccessible and lacked relevance for SMEs and should be simplified and made more relevant to SMEs, for example:
    - The Proposed Guidance uses Code and other terminology that would be unfamiliar to many SMEs
    - It contains little or no guidance specifically for SMEs (just four paragraphs)
    - It conflates Code and Company Law requirements (eg on narrative reporting) which SMEs would need to untangle
    - It doesn't distinguish what would apply at each different level of company size or nature
    - It is not clear what is a requirement and what is just good practice for SMEs

- SMEs are clearly expected to do less than Code companies but it is not clear what 'less' looks like
- It is unclear what would be proportionate for an SME – for example in relation to stress testing or sensitivity analysis

- SMEs would therefore not know how to apply the guidance and the result would be:
  - They would feel obliged to default in favour of doing too much (which would create a disproportionate cost burden) because they will infer that they are 'really' expected to do all that is required of Code companies; or
  - They will place undue reliance on their auditors, which will increase costs.
- There are specific areas where general problems identified would more likely arise for SMEs:
  - More so even than other companies, SMEs would struggle to be able to show that they could survive through the business cycle with a high level of confidence
  - 1 respondent raised particular issues for fixed life companies with the focus on survival over the longer term with a high level of confidence – companies that either have a constitutionally fixed life or that constitutionally are required to take a vote from time to time on whether to cease operations and liquidate the assets for return to shareholders
  - The guidance would be overly demanding (again with reference to the high level of confidence) in relation to the directors' ability to obtain satisfaction that their sources of finance would remain available and/or would be renewed on expiry
- The consequences of the preceding concerns are:
  - Potentially reduced access to financing; or
  - They may incur excessive cost to secure longer term or more secure commitments of financing.
- There are a number of other practical issues:
  - SMEs may struggle to do stress tests or may find them more challenging than larger companies or they may be disproportionate for them
  - SMEs may be unable to identify when it would be appropriate for them to undertake sensitivity analysis
  - These may give rise to excessive costs or a need for costly advice.

Respondents generally thought that the above issues needed to be resolved, particularly given the economic importance of these entities. They would result in the Proposed Guidance being over-burdensome for such entities and suggested that more work is needed to assess costs and benefits for such companies.

Respondents mentioned a number of possible solutions, the most common being as follows:

- There may be less need to apply the Sharman principles, or at least to apply them as vigorously as for other companies, to SMEs. Some suggested not applying them to SMEs or at least deferring their application or having a phased introduction for SMEs (applying the less complex requirements first and the more complex ones later). Reasons for drawing this conclusion that were cited included:
    - The potential benefits may simply be less as stakeholders often already have easier access to the information they want
    - The risks to the economy (for example, risk of not improving good decision taking on risks) were lower than for larger companies – respondents did not elaborate upon this.
- There may be ways to make the guidance more proportionate:
    - Adopt a ‘think small first’ approach – it was thought that the 2009 guidance was successful in doing this – starting with the minimum requirements and building on these, perhaps using tables to clarify what applies to which companies
    - Provide more guidance and examples of proportionate application of the general principles in different circumstances (for example in relation to stress tests, sensitivity analysis, reliance on funding; and address the level of confidence issues).
    - Provide examples of what a good process looks like for each of a typical multinational, medium sized company and small company
- The guidance could be made more accessible by providing separate guidance or an Appendix for SMEs and by avoiding references in the main body to matters that are only applicable to Code companies.

FRC Response

The FRC has decided to develop separate guidance for companies that do not follow the Code and the Integrated Code Guidance would not apply to them. The development of this guidance is in progress and will seek to respond appropriately to the above feedback. A separate advisory group of stakeholders has been established to assist the FRC in this respect. This category of companies covers a wide range including quoted companies, public companies, other large and medium-sized companies (that may be subsidiaries within a group or standalone businesses), companies that fall within the small companies regime under the Companies Act as well as those companies that fall within the recently introduced Micro entities regime.

Separate proposals for providing guidance for such companies will be brought forward for public consultation in due course, having regard to the companies narrative reporting and accounting standard requirements..

Question 15: Are there any other matters which the FRC should consider in relation to the Guidance and the Supplement? If so, what are they and what changes, if any, should be made to address them?

Consultation responses

The responses to this question may be summarised as follows:

		Provided additional comments	Did not provide additional comments	No specific response to the question
Corporate preparers of financial statements, Audit Committee Chair and corporate preparer representative bodies		1	4	6
Institutional investors and representative bodies		-	1	3
Accounting profession representative bodies (includes one non UK and Ireland)		1	2	2
Auditing firms		6	4	-
Other Stakeholders	- Industry representative bodies	-	1	1
	- Business School	-	1	-

Only 8 of those respondents who answered the individual questions provided further comments in response to this question. Of these, 4 in essence repeated comments made in response to other questions, which they wished to emphasise. Amongst the remaining 4, three additional points were raised as follows;

- The guidance did not indicate that it applied to limited liability partnerships – there was no reason it should not and since they are most closely aligned with SMEs if they were to be included within the scope of the guidance in future the requirements should be as for SMEs (1 respondent)

- The APB Bulletin 2008/10 providing guidance for auditors would either need to be updated to align with the proposed guidance or be withdrawn (2 respondents)

- The Proposed Guidance could potentially have an impact on directors' duties and duties of care and this issue should receive attention before finalising the guidance (1 respondent).

FRC Response

The Integrated Code Guidance does not apply to limited liability partnerships. In considering the nature of guidance for companies that do not follow the Code, further consideration will be given to how best to address entities other than companies. Further consideration will be given to the need to withdraw or revise Bulletin 2008/10, in light of stakeholder feedback on the Integrated Code Guidance.

The FRC does not believe there would be any unintended impact on directors' duties through the introduction of the Integrated Code Guidance as it seeks only to provide guidance on meeting the directors' responsibilities under the Companies Act and the Code. Similar considerations will be applied in developing the guidance for companies that do not follow the Code.

APPENDIX 1 - Respondents to January Consultation

	Auditing Firms
1	Baker Tilly
2	BDO
3	Crowe Clark Whitehill
4	Deloitte
5	Ernst & Young
6	Grant Thornton
7	Kingston Smith
8	KPMG
9	PricewaterhouseCoopers
10	RSM Tenon
	Accounting profession representative bodies
11	ACCA
12	CPA Australia
13	ICAEW
14	ICAI
15	ICAS
	Institutional investors and representative bodies
16	Association of British Insurers (ABI)
17	Hermes
18	Investment Management Association (IMA)
19	Local Authority Pension Funds Forum
	Corporate preparers of financial statements and representative bodies
20	Association of Investment Companies (AIC)
21	Association of General Counsel and Company Secretaries of the FTSE 100 (GC100)
22	Barclays
23	BP
24	British Private Equity and Venture Capital Association (BVCA)
25	BT
26	Mr J Hewitt (Audit Committee Chair)
27	HSBC
28	Hundred Group of Finance Directors
29	Quoted Companies Alliance
30	Rolls Royce
	Other Stakeholders
31	British Bankers' Association (BBA)
32	Confederation of British Industry (CBI)
33	University of Birmingham Business School

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