April 2016

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

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

Further copies, £13.00 (post-free) can be obtained from:

FRC Publications
Lexis House
30 Farringdon Street
London
EC4A 4HH

Tel: 0845 370 1234
Email: customerservices@lexisnexis.co.uk
Or order online at: www.frcpublications.com
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.

The FRC does not accept any liability to any party for any loss, damage or costs (including legal costs) arising directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying on or otherwise using this document or arising from any omission from it.

April 2016

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

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

<table>
<thead>
<tr>
<th>Summary</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>1    Scope</td>
<td>4</td>
</tr>
<tr>
<td>2    Overview</td>
<td>6</td>
</tr>
<tr>
<td>3    Going concern basis of accounting and material uncertainties</td>
<td>7</td>
</tr>
<tr>
<td>4    Solvency and liquidity risks</td>
<td>12</td>
</tr>
<tr>
<td>5    The assessment process</td>
<td>16</td>
</tr>
<tr>
<td>6    Materiality and placement of disclosures</td>
<td>20</td>
</tr>
<tr>
<td>7    Auditor reporting</td>
<td>22</td>
</tr>
<tr>
<td>Appendix: Application to other reports</td>
<td>25</td>
</tr>
</tbody>
</table>
Summary

The Financial Reporting Council’s mission is to promote high quality corporate governance and reporting to foster investment. Ensuring that a business is able to continue over the longer term involves an assessment of the solvency and liquidity risks that a company faces. Directors must also assess whether the going concern basis of accounting is appropriate. The process should inform clear and concise financial reporting disclosures that enable investors to understand a company’s exposure to these risks.

Background

In June 2012, the Panel of the Sharman Inquiry published its Final Report and Recommendations on Going Concern and Liquidity Risk.1 The key elements of the recommendations from the Panel included:

- clarification of the accounting and stewardship purposes of the going concern assessment and disclosure process and the related thresholds for such disclosures;
- encouraging companies to move away from a model where disclosures about going concern risks are only highlighted when there are significant doubts about a company’s survival; and
- a review of the FRC’s Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009 to ensure that the going concern assessment is integrated with the directors’ business planning and risk management processes and includes a focus on both solvency and liquidity risks, considering the possible impacts on the business over the longer term.

The FRC published two consultation papers seeking views on the implementation of the Sharman recommendations. For those companies within the scope of The UK Corporate Governance Code (the ‘Code’), the FRC decided to take forward the implementation of the recommendations of the Sharman Panel as part of its September 2014 update to the Code.2 It also published supporting Guidance on Risk Management, Internal Control and Related Financial and Business Reporting.3

In response to the feedback received, the FRC took the decision to issue separate, simplified guidance for directors of companies that do not apply the Code. The FRC consulted on draft guidance during 2015 and now issues the guidance in final form.

---

1 A copy of the report is available at https://www.frc.org.uk/getattachment/591a5e2a-35d7-4470-a46c-30c0d8ca2a14/Sharman-Inquiry-Final-Report.aspx.
Aims of the guidance

The guidance is intended to serve as a proportionate and practical guide for directors of non-Code companies. It brings together the requirements of company law, accounting standards, auditing standards, other regulation and existing FRC guidance relating to reporting on the going concern basis of accounting, and solvency and liquidity risks and reflects developments in the FRC’s thinking as a consequence of the Sharman Inquiry. It incorporates recent developments in the corporate reporting framework, most notably the introduction of new UK and Ireland GAAP and the strategic report. It includes:

- factors to consider when determining whether the going concern basis of accounting is appropriate (section 3) and making an assessment of the solvency and liquidity risks facing a company that might constitute principal risks for disclosure in the strategic report (section 4);
- guidance on the assessment periods for the going concern basis of accounting (section 3) and those risks (section 4);
- guidance on the assessment process (section 5); and
- summaries of related reporting requirements (sections 3 and 4).

The guidance:

- encourages directors to take a broader view, over the longer term, of the risks and uncertainties that go beyond the specific requirements in accounting standards;
- acknowledges that companies will have risk management and control processes in place that will underpin the assessment and that the degree of formality of this process will depend on the size, complexity and the particular circumstances of the company; and
- uses the term ‘going concern’ only in the context of referring to the going concern basis of accounting for the preparation of financial statements.

How to use this guidance

The guidance is structured as follows:

Summary of requirements

This information is intended to summarise important aspects of law, accounting standards\(^4\) or other regulation that underpin the guidance. It is not intended to be a comprehensive analysis of those requirements.

The guidance uses the terms ‘required to’ or ‘must’ to refer to mandatory requirements derived from law, accounting standards or other regulation (considering the scope for the type of company as set out in the table in section 1).

Principles for best practice

The guidance highlights principles for best practice, to assist directors with the practical application of the requirements set out in law, accounting standards or other regulation, applied proportionately depending on the size, complexity or the particular circumstances of the company.

The guidance uses the term ‘should’ to refer to best practice guidance.

Key focus area

For ease of use, the guidance highlights key focus areas for directors to consider when making their assessments of the appropriateness of the going concern basis of accounting and the solvency and liquidity risks facing the company.

Example

Practical examples are included. These examples are intended to be illustrative only and may not be appropriate for all companies and circumstances.

---

\(^4\) The references in this document are to accounting standards that were effective at the date of publication of this guidance.
1 Scope

1.1 This guidance is non-mandatory, best practice guidance to assist the directors of all companies\(^5\) within its scope with the application of the requirements:

- to make disclosures on the going concern basis of accounting and material uncertainties in their financial statements; and
- disclose principal risks and uncertainties, which may include risks that might impact solvency and liquidity, within their strategic report.

1.2 Companies that are required or choose voluntarily to apply *The UK Corporate Governance Code*\(^6\) are excluded from the scope of this guidance.

1.3 Small and micro-companies must assess whether the going concern basis of accounting is appropriate in preparing their financial statements. However, they are excluded from the scope of this guidance on the basis that:

- micro-companies applying FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* are not required to provide any disclosures on the going concern basis of accounting, as their financial statements are presumed, in law, to give a true and fair view if the (minimal) legal disclosure requirements are met;
- small companies applying Section 1A Small Entities of FRS 102 *The Financial Reporting Standard applicable in the UK and the Republic of Ireland* are not required to provide disclosures on the going concern basis of accounting, although their directors are encouraged to provide such disclosures, where appropriate, in meeting their responsibility to prepare financial statements that give a true and fair view; and
- they are not required to prepare a strategic report.

1.4 The table overleaf sets out the requirements for each type of company, highlighting the sections of the guidance that may assist directors in meeting those requirements. For completeness it includes small and micro-companies, although the guidance has not been written with these companies in mind.

---

\(^5\) For simplicity, this guidance uses the terms ‘director’ and ‘company’. However, the guidance is also likely to be relevant to other entities.

\(^6\) Companies applying *The UK Corporate Governance Code* should refer to the FRC’s *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting*, available on the FRC website. More complex and other publicly traded entities that are not required to apply *The UK Corporate Governance Code* may also wish to refer to this as an alternative source of guidance.
### Main requirements

<table>
<thead>
<tr>
<th>Source of requirements</th>
<th>Micro-entity</th>
<th>Small company</th>
<th>Large or medium-sized company</th>
<th>Guidance paragraph reference</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial statements</strong></td>
<td>FRS 105, 3.3 FRS 102, 3.8 IAS 1, 25</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Assessment of the appropriateness of the going concern basis of accounting</td>
<td>FRS 102, 3.9 IAS 1, 25</td>
<td>×</td>
<td>×</td>
<td>✓</td>
</tr>
<tr>
<td>Disclosure when there are material uncertainties or when the company does not prepare financial statements on a going concern basis of accounting</td>
<td>Companies Act 2006, s393</td>
<td>×</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Additional disclosures that may be required to give a true and fair view</td>
<td>FRS 102 IFRS 7 IAS 1 IAS 37</td>
<td>×</td>
<td>×</td>
<td>✓</td>
</tr>
<tr>
<td>Other relevant financial statement disclosures</td>
<td>Companies Act 2006, s414C(2)(b)</td>
<td>×</td>
<td>×</td>
<td>✓</td>
</tr>
<tr>
<td>The strategic report must contain a description of the principal risks and uncertainties facing the company</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

---

7 Companies Act 2006, section 393(1A). The financial statements of micro-entities comprising only micro-entity minimum accounting items are presumed in law to give a true and fair view.

8 There is no explicit requirement in the Companies Act 2006 or FRS 102 for companies entitled to prepare accounts in accordance with the small companies regime to report on the going concern basis of accounting and material uncertainties. However, directors of small companies are required to make such disclosures that are necessary for the financial statements to provide a true and fair view. Appendix D to Section 1A of FRS 102 encourages the inclusion of disclosures on material uncertainties in order to meet this requirement.

9 Companies Act 2006, section 414B. There is no requirement for companies that are entitled to prepare accounts in accordance with the small companies regime to prepare a strategic report.
2 Overview

2.1 This guidance considers the related requirements in:

- accounting standards which require disclosure in the financial statements on the going concern basis of accounting and material uncertainties; and
- company law which requires disclosure in the strategic report of principal risks and uncertainties, which may include risks that might impact solvency and liquidity.

2.2 Some solvency and liquidity risks may be so significant that they highlight material uncertainties that may cast significant doubt on a company’s ability to adopt the going concern basis of accounting in the future; these material uncertainties must be disclosed in accordance with the requirements of accounting standards. In extreme circumstances, such risks may crystallise thus making liquidation of the company inevitable and the going concern basis of accounting inappropriate.

2.3 A company faces many risks. The principal risks and uncertainties are required to be disclosed in the strategic report. Of these, some may have the potential to threaten the company’s ability to continue in operation because of their impact on solvency and liquidity.

Determining the relevant disclosures

2.4 The process for determining which disclosures are necessary includes:

- identification of risks and uncertainties, including those relating to solvency and liquidity and other potential threats to the company’s ability to continue in operation;
- determining which of the identified risks and uncertainties are ‘principal’ and thereby require disclosure in the strategic report;
- considering whether there are material uncertainties that require disclosure in accordance with accounting standards;
- in extreme circumstances, considering whether it is inappropriate to adopt the going concern basis of accounting; and
- considering whether disclosures additional to those explicitly required by law, regulation or accounting standards are necessary for the financial statements to provide a true and fair view.
3 Going concern basis of accounting and material uncertainties

Assessment

Adoption of the going concern basis of accounting

Summary of requirements

All companies must assess the appropriateness of the going concern basis of accounting when preparing their financial statements.

Companies are required to adopt the going concern basis of accounting, except in circumstances where the directors determine at the date of approval of the financial statements either that they intend to liquidate the entity or to cease trading, or have no realistic alternative to liquidation or cessation of operations.10

3.1 The threshold for departing from the going concern basis of accounting is very high, as there are often realistic alternatives to liquidation or cessation of operations. Such realistic alternatives can exist even if they depend on uncertain future events.

Principles for best practice

The assessment process carried out by the directors (considered further in section 5) should be proportionate to the size, complexity and the particular circumstances of the company.

The assessment should take into account the relevant facts and circumstances at the date of approval of the financial statements.

The assessment should be documented in sufficient detail to explain the basis of the directors’ conclusion with respect to the going concern basis of accounting at the date of approval of the financial statements.

Material uncertainties

### Summary of requirements

Accounting standards\(^{11}\) require directors to make an assessment of a company's ability to continue to adopt the going concern basis of accounting in the future. As part of their assessment, the directors should determine if there are any material uncertainties relating to events or conditions that may cast significant doubt upon the continuing use of the going concern basis of accounting in future periods.

3.2 Events or conditions might result in the going concern basis of accounting being inappropriate in future reporting periods. In performing this assessment, the directors should consider all available information about the future, the realistically possible outcomes of events and changes in conditions and the realistically possible responses to such events and conditions that would be available to the directors.

3.3 Uncertainties relating to such events or conditions are considered material if their disclosure could reasonably be expected to affect the economic decisions of shareholders and other users of the financial statements. This is a matter of judgement. In making this judgement, the directors should consider the uncertainties arising from their assessment, both individually and in combination with others.

### Key focus area

In determining whether there are material uncertainties, the directors should consider:

- the magnitude of the potential impacts of the uncertain future events or changes in conditions on the company and the likelihood of their occurrence;
- the realistic availability and likely effectiveness of actions that the directors could take to avoid, or reduce the impact or likelihood of, the uncertain future events or changes in conditions; and
- whether the uncertain future events or changes in conditions are unusual, rather than occurring with sufficient regularity for the directors to make predictions about them with a high degree of confidence.

3.4 Uncertainties should not usually be considered material if the likelihood that the company will not be able to continue to use the going concern basis of accounting is assessed to be remote, however significant the assessed potential impact.

---

\(^{11}\) FRS 102 paragraphs 3.8–3.9, IAS 1 paragraphs 25–26.

8 Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks (April 2016)
The assessment period

3.5 Accounting standards provide for a minimum period that should be reviewed by directors as part of their assessment of the going concern basis of accounting.

Summary of requirements

In making their assessment of the company’s ability to continue to adopt the going concern basis of accounting and material uncertainties, companies applying FRS 102 must consider a period of at least 12 months from the date the financial statements are authorised for issue.12 Companies applying IFRS must consider a period of at least 12 months from the reporting date.13

Principles for best practice

Although IAS 1 specifies a period of at least 12 months from the reporting date, directors should consider a period of at least 12 months from the date the financial statements are authorised for issue.

Paragraph 7.6 of this guidance highlights the auditor’s responsibilities if a shorter period is considered by the directors.

3.6 When assessing the company’s ability to continue to adopt the going concern basis of accounting, directors should consider all available information about the future at the date they approve the financial statements, such as the information from budgets and forecasts.

Reporting requirements

Summary of requirements

FRS 102 and IAS 1 14 require disclosure when a company does not prepare financial statements on a going concern basis or when there are material uncertainties related to events or conditions that cast significant doubt upon the company’s ability to continue to adopt the going concern basis of accounting.

3.7 Directors must disclose information about the going concern basis of accounting and material uncertainties that are necessary for the financial statements to give a true and fair view.

---

12 FRS 102 paragraph 3.8 and FRS 105 paragraph 3.3 require that the minimum period considered be at least, but not limited to, 12 months from the date the financial statements are authorised for issue.
13 IAS 1 paragraph 26 requires that the minimum period considered be at least, but not limited to, 12 months from the reporting date (this will also apply for entities adopting FRS 101 Reduced Disclosure Framework).
14 FRS 102 paragraph 3.9, IAS 1 paragraph 25.
3.8 Following the directors’ assessment, three scenarios can be identified in the explicit requirements of accounting standards:

<table>
<thead>
<tr>
<th>Basis of accounting</th>
<th>Disclosure requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) The going concern basis of accounting is appropriate and there are no material uncertainties.</td>
<td>The directors should use the going concern basis of accounting when preparing the financial statements. No specific disclosure requirements for the financial statements.</td>
</tr>
<tr>
<td>b) The going concern basis of accounting is appropriate but there are material uncertainties related to events or conditions that may cast significant doubt upon the company’s ability to continue to adopt the going concern basis of accounting in the future.</td>
<td>The directors should use the going concern basis of accounting when preparing the financial statements. When the directors are aware, in making their assessment, of material uncertainties related to events or conditions that cast significant doubt upon the company’s ability to continue to adopt the going concern basis of accounting, the entity shall disclose those uncertainties.</td>
</tr>
<tr>
<td>c) The going concern basis of accounting is not appropriate.</td>
<td>The directors should use a basis other than that of the going concern basis of accounting when preparing the financial statements. When a company does not prepare financial statements on a going concern basis of accounting, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the going concern basis of accounting is inappropriate.</td>
</tr>
</tbody>
</table>

**Principles for best practice**

When there are material uncertainties that may cast doubt upon the company’s ability to continue to adopt the going concern basis of accounting in the future, the financial statements should disclose clearly the existence and nature of the material uncertainty, including a description of the principal events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern and the directors’ plans to deal with these events or conditions. Directors may wish to bear in mind the obligation of the auditor to report if an appropriate level of clarity in the disclosure of material uncertainties has not been achieved.
True and fair view

Summary of requirements

The directors are responsible for ensuring that the financial statements give a true and fair view.  

3.9 Directors must consider whether additional disclosures are necessary when compliance with the explicit disclosure requirements of accounting standards relating to the going concern basis of accounting and material uncertainties are insufficient to present a true and fair view.

3.10 In some circumstances there are grounds for disclosure beyond the explicit reporting requirements in accounting standards. For example, disclosures might be appropriate even when there are no material uncertainties over the appropriateness of the going concern basis of accounting.

Example

A subsidiary company may be heavily loss making or have substantial net liabilities. The financial statements of a subsidiary company might therefore give the impression that the company is experiencing significant financial difficulties. However, the existence of ongoing support from its parent may, in some circumstances, mean that no material uncertainty exists. Disclosure of this ongoing support may be necessary to give a true and fair view.

Example

A company may be reliant on the continuation of a material bank overdraft facility that is due for review and reapproval by the bank at a date after the financial statements are approved. If, for example, the company’s directors have an open, current and active dialogue with its bank on its performance, position and future financing needs and have received indications that the overdraft is likely to be reapproved they might conclude that there is no significant doubt over the company’s ability to continue to adopt the going concern basis of accounting in the future. However, if, for example, the financial statements indicate to users that the company’s performance has deteriorated and market conditions are difficult, disclosure of the fact that the company will need to continue to rely on the overdraft facility and the current status of the reapproval process may be necessary to give a true and fair view.

---

15 Companies Act 2006, section 393.
16 The FRC paper True and Fair provides further information and is available at https://www.frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/True-and-Fair.aspx.
4 Solvency and liquidity risks

Assessment

Summary of requirements

The Companies Act 2006 requires all companies that are not small or micro to prepare a strategic report. The strategic report must contain a fair review of the company’s business, and a description of the principal risks and uncertainties it faces.17

4.1 The strategic report, by its nature, has a forward-looking orientation and the directors are encouraged to think broadly about all relevant matters that may pose risks to the company. When making their risk assessment, the directors will identify as principal risks and uncertainties those matters that could significantly affect the development, performance, position and future prospects of the company. The principal risks and uncertainties identified will generally be matters that the directors regularly monitor and discuss because of their likelihood, the magnitude of their potential effect on the entity, or a combination of the two.18

4.2 Solvency risk is the risk that a company will be unable to meet its liabilities in full. Over the long term a company must generate sufficient value such that its assets exceed its liabilities. A failure to do so could render it insolvent. Insolvency is likely to be preceded by a lack of liquidity.

4.3 Liquidity risk is the risk that a company will be unable to meet its liabilities as they fall due. A company must generate and retain sufficient cash to allow it to meet its liabilities at the time contractual payments are due. The liquidity of an otherwise profitable company can be threatened if it is incapable of converting assets into cash when it is necessary to make such payments.

Principles for best practice

Directors should consider threats to solvency and liquidity as part of their assessment of the principal risks and uncertainties faced by the company. When the directors have concluded that there is no material uncertainty regarding the appropriateness of the going concern basis of accounting, the assessment of principal risks and uncertainties may still identify risks that impact solvency and liquidity.

When making the assessment of principal risks and uncertainties, directors should consider the full range of business risks including both those that are financial in nature and those that are non-financial. Principal risks and uncertainties that arise from, for example, operational, competitive, market or regulatory factors, may ultimately impact on a company’s solvency and liquidity. Principal risks and uncertainties should be described in a clear, concise and understandable way; it is not necessary to label risks as solvency and liquidity risks when other descriptions can more easily set out their nature and potential impacts.

17 Companies Act 2006, section 414C(2).
18 Further guidance on the disclosure of principal risks and uncertainties is included in the FRC’s Guidance on the Strategic Report, which is available at https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Guidance-on-the-Strategic-Report.pdf.

12 Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks (April 2016)
Example

The directors of a company that is heavily reliant on a single customer may identify this as a principal risk to the business that could have an impact on its solvency or liquidity. If this customer ceases to purchase the company’s products or services, or becomes unable to pay its debts to the company, the company might be unable to meet its liabilities as they fall due. In an extreme case, the loss of the customer might have the potential to render the company insolvent.

4.4 In making an assessment of the risks and uncertainties that may affect solvency and liquidity, directors should consider the likelihood and possible effects of those risks materialising.

4.5 The extent of the process for assessing the risks and uncertainties and considering their implications should be appropriate to the size, complexity and particular circumstances of the company and is a matter of judgement for the directors. The assessment process is considered further in section 5.

The assessment period

4.6 The period of the assessment for solvency and liquidity risks in the context of the requirement to disclose principal risks and uncertainties in the strategic report will ultimately be a matter of judgement for the directors and will depend on the facts and circumstances of the company.

Principles for best practice

The period of assessment for solvency and liquidity risks will usually be longer than 12 months from the authorisation for issue of the financial statements. The length of the period should be determined, taking into account a number of factors, including the nature of the business, its stage of development and its investment and planning time horizons.

4.7 Given the forward-looking nature of this assessment, the level of detail and accuracy of the information available relating to the future will vary.19

Reporting requirements

Disclosure of principal risks and uncertainties

Summary of requirements

The strategic report must include a description of the principal risks and uncertainties facing the company.20

---

19 Section 414C(14) of the Companies Act 2006 states that section 414C does not require the disclosure of information about impending developments or matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company.

4.8 The strategic report should provide shareholders with information about the development, performance, position and future prospects of the company, consistent with the size, complexity and the particular circumstances of the company. It should include a description of how the principal risks and uncertainties are managed or mitigated.

**Principles for best practice**

Where the directors consider that solvency or liquidity risks are material, they should explain the particular economic or operational conditions that give rise to those principal risks and uncertainties, and the potential impact on specific aspects of the business. Issues that may require disclosure will depend upon individual facts and circumstances but may include:

- uncertainties about current financing arrangements (whether committed or uncommitted);
- potential changes in financing arrangements such as critical covenants and any need to increase borrowing levels;
- counterparty risks arising from current credit arrangements (including the availability of insurance where relevant) with either customers or suppliers;
- a dependency on key suppliers and/or customers; and
- uncertainties posed by the potential impact of the economic outlook on business activities.

4.9 Where relevant, the description of the principal risks and uncertainties facing the entity should highlight any linkage with disclosures relating to the going concern basis of accounting, material uncertainties and risks in the financial statements.

**Example**

A company that is growing rapidly may need to ensure that it is able to access long-term financing to support its future development. The inability of the company to access this finance could result in liquidity risk and in extreme circumstances lead to insolvency. Directors may have actions planned for mitigating this, for example, obtaining a bank loan or raising funds through the issue of shares. The risk of not raising sufficient finance and the planned actions to mitigate that risk are likely to need to be disclosed as a principal risk and mitigation in the strategic report. Directors should also consider whether the risk represents a material uncertainty relating to the going concern basis of accounting requiring disclosure in the financial statements.
Other disclosures

4.10 Accounting standards require other disclosures that may be relevant to an understanding of solvency risk and liquidity risk. An overview of the main requirements is set out below:

<table>
<thead>
<tr>
<th>Disclosure</th>
<th>FRS 102</th>
<th>IFRS\textsuperscript{21}</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risks arising from financial instruments</td>
<td>11.48A(f), 34.23 to 34.30\textsuperscript{22}</td>
<td>IFRS 7, 31 to 42</td>
</tr>
<tr>
<td>Undrawn borrowing facilities and any restrictions on the use of those</td>
<td>n/a</td>
<td>IAS 7, 50(a)</td>
</tr>
<tr>
<td>facilities such as covenant requirements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Defaults and covenant breaches</td>
<td>11.47</td>
<td>IFRS 7, 18 and 19</td>
</tr>
<tr>
<td>Significant judgements relating to the application of accounting policies</td>
<td>8.6</td>
<td>IAS 1, 122 to 124</td>
</tr>
<tr>
<td>Sources of estimation uncertainty about the carrying amounts of assets</td>
<td>8.7</td>
<td>IAS 1, 125 to 133</td>
</tr>
<tr>
<td>and liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contingent liabilities</td>
<td>21.15</td>
<td>IAS 37, 86 to 88</td>
</tr>
</tbody>
</table>

Financial instruments

4.11 The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 also require similar disclosures for financial instruments in the directors’ report.\textsuperscript{23} These include the financial risk management objectives and policies of the company as well as its exposure to price risk, credit risk, liquidity risk and cash flow risk, when material. A company may be able to meet some of these requirements with a cross-reference to the financial instruments note in the financial statements.

\textsuperscript{21} Some exemptions from IFRS disclosure requirements are available for companies applying FRS 101.

\textsuperscript{22} The disclosure requirements in FRS 102 paragraph 11.48A(f) only apply to certain financial instruments at fair value through profit or loss. The requirements in paragraphs 34.23-34.30 apply to financial institutions only.

\textsuperscript{23} Schedule 7.1(6).
5 The assessment process

5.1 This section sets out factors to consider and techniques that may be applied in identifying principal risks and uncertainties to disclose in the strategic report (which may include risks that might impact solvency and liquidity), and assessing whether the going concern basis of accounting is appropriate or whether there are material uncertainties that cast significant doubt that it will continue to be so.

5.2 Directors should assess which factors are likely to be relevant to their company. These factors will vary according to the size, complexity or the particular circumstances of the company, its industry and the general economic environment. Some of these factors will be more relevant to the strategic report assessment of risk whereas others will be more relevant to the assessment of the going concern basis of accounting and financial statement disclosures.

Principles for best practice

The extent of the directors’ assessment process will depend upon the size, complexity and the particular circumstances of the company. Some companies tend to be dependent upon fewer providers of finance, have fewer business activities and a more limited number of creditors. As a result, the process and procedures for those companies are likely to be simpler and less extensive than those for more complex companies. However, it is still important that the assessment is carried out and addresses, to the extent necessary, the directors’ plans to manage the company’s borrowing requirements, the timing of cash flows and the company’s exposure to contingent liabilities.

Key focus area

The level of detail applied in the analysis of these factors will depend on the scale and nature of the risks a company faces and the time horizon over which the analysis is applied. Longer-term assessments, such as those that will inform the disclosures in the strategic report, are likely to be performed at a higher, more aggregated level, reflecting the difficulties in making detailed long-term predictions.

Forecasts and budgets

5.3 Forecasting and budgeting are long-established techniques in business management. For the purposes of assessing solvency and liquidity risks and whether the going concern basis of accounting is appropriate, directors might prepare a budget, trading estimate, cash flow forecast or other equivalent analysis covering the appropriate assessment periods (as described in paragraphs 4.6 to 4.7 and 3.5 to 3.6, respectively).

Timing of cash flows

5.4 Directors might assess whether their financial plans indicate an adequate matching of projected cash inflows with projected cash outflows, including those for the settlement of liabilities, loan repayments, payment of tax and pension liabilities and other commitments.
Sensitivity analysis

5.5 Directors may wish to undertake sensitivity analysis. Sensitivity analysis involves measuring the impact on forecasts of changing relevant assumptions within severe but plausible scenarios and provides directors with an understanding of the critical assumptions that underlie such forecasts. As an example, directors might consider the impact of varying assumptions of future revenue levels on the company’s compliance with current financing covenants and the need for future additional financing. The extent of the analysis should be proportionate to the size, complexity, particular circumstances of the company and the risks it faces. It may, depending upon the facts and circumstances, be appropriate to test the impact of changes of all or some of the following:

- interest rates;
- exchange rates;
- expected sales volumes and prices;
- raw material costs;
- expected selling costs;
- a customer or supplier failing;
- availability of borrowings;
- margin requirements dependent on varying underlying prices for derivative contracts;
- likely extent of damages arising from unfavourable legal judgements;
- changes in legislation; and
- taxation rates.

5.6 Sensitivity analysis may be used to ensure that there are no unexpected:

- shortfalls in facilities against requirements; or
- breaches of covenants or other triggers within funding arrangements.

Products, services and markets

5.7 Directors might obtain information about the major aspects of the economic environment within which the company operates, considering the size of the market, its strength, and their market share, and assess whether there are any economic, political or other factors which may cause the market to change. It may be necessary to do this for each of the main product or service markets.

5.8 Directors might assess whether their products or services are compatible with their market projections in terms of market position, quality and expected life.

5.9 Market conditions impact companies differently. It cannot be assumed that difficult market conditions, affecting many companies, mean that a material uncertainty exists about a specific company’s ability to continue as a going concern. Equally, material uncertainties may exist about a company’s ability to continue as a going concern in times of relatively benign economic circumstances.
Financial and operational risk management

5.10 There are many types of financial and operational risks facing a company and directors should identify which risks are most significant.

**Example**

Exposure to fixed-price contracts and to movements in foreign currency exchange rates may be amongst the most significant risks for a construction company engaged in overseas markets.

5.11 Directors may also wish to consider counterparty risks that arise from reliance on key suppliers or customers who may themselves be facing financial difficulty. The directors may consider how such risks could affect the company and how they are managed in practice.

**Borrowing facilities**

5.12 The availability of borrowing facilities may be dependent upon the company’s compliance with specific terms and conditions (covenants). An analysis of borrowing documentation might be undertaken to ensure that all critical terms and conditions are identified so that the risks to continued compliance can be assessed.

5.13 The availability of borrowing facilities is also likely to depend on the lender’s assessment of the risks to the solvency and liquidity of the company, amongst other factors. The directors may need to consider the likely outcome of their assessment and how it might impact the continuation or renewal of existing facilities beyond contractual periods.

5.14 If there is uncertainty or variation in the contractual arrangements with lenders and other providers of finance, directors may consider seeking confirmation from the lenders of the principal terms and conditions. However, the absence of confirmations does not necessarily give rise to significant uncertainty.

5.15 The onus is on the directors to be satisfied that there are likely to be adequate financing arrangements in place. The directors might compare the facilities available to the entity with the entity’s expected cash requirements from such facilities, as indicated by cash flow forecasts, budgets or trading estimates.

**Contingent liabilities**

5.16 Directors should consider the company’s exposure to contingent liabilities. These may include sources of potential cash outflows during the review period relating to legal proceedings, guarantees, margin or other credit support provisions under derivative contracts, environmental costs and product liability.

---

24 Defined in Appendix 1 to FRS 102 and IAS 37 paragraph 10 as: (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the control of the entity; or (b) a present obligation that arises from past events but is not recognised because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) the amount of the obligation cannot be measured with sufficient reliability.

18 Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks (April 2016)
Subsidiary companies

5.17 Directors of subsidiary companies must make their own assessment to support disclosure of the principal risks and uncertainties facing the company in the strategic report and of the subsidiary’s ability to continue to adopt the going concern basis of accounting, taking into account the specific facts and circumstances of the subsidiary company, in particular:

- the need for support from the parent company or fellow subsidiaries;
- the ability and willingness of the parent company or fellow subsidiaries to provide adequate support; and
- the risks to the company arising from support that it has undertaken to provide to other members of the group, for example through cross-guarantees.

5.18 The directors might consider the degree of autonomy exercised by the subsidiary company, how the subsidiary’s business fits into the group’s activities and future plans, and the particular business risks the group faces. The adequacy of the evidence of any parent company support is a matter of judgement for the directors of the subsidiary company. Their judgement usually incorporates their experience of dealing with the parent company over time, in the context of recent events and current circumstances. This includes considering the development, performance, position and future prospects of the group and the group’s ability to support the subsidiary, taking into account other guarantees made by the group and the availability of group borrowing facilities.

Companies owned by, or dependent on, the government

5.19 In addition to the assessment process set out in paragraphs 5.1 to 5.18, directors of companies either owned by, or dependent on, the government should also consider the impact of:

- risks arising from the need for support from government bodies; and
- developments in policy or public finance which may affect the solvency or liquidity of the company.

Directors should make their own assessment and disclosures relevant to the company’s particular circumstances and the nature of its business model.

25 ‘Support’ for this purpose encompasses both financial and non-financial support.
Materiality

6.1 The assessment of materiality is dependent on the context of its application. Information is material if its omission or misrepresentation could be reasonably expected to influence the economic decisions of users.

Summary of requirements

In the context of the financial statements, FRS 102 paragraph 2.6 states that ‘information is material, and therefore has relevance, if its omission or misstatement, individually or collectively, could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances.’

Principles for best practice

For the strategic report, principal risks identified should be those that are considered material to a user’s understanding of the development, performance, position or future prospects of the business.

6.2 The inclusion of immaterial information can obscure key messages and impair the understandability of information provided in the annual report. For example, the inclusion of risks that are not material to an understanding of the business will detract from the usefulness of the principal risks and uncertainties disclosures; disclosures relating to solvency and liquidity risk should only be provided when material.

Placement of disclosures

Principles for best practice

Directors should consider the placement of disclosures with a view to facilitating the effective communication of that information.

Key focus area

In some instances, it may be helpful to group together similar or related disclosure requirements arising from different legal or regulatory requirements that apply to different components of the annual report. This will reduce duplication and enable linkages to be highlighted and explained clearly in one place.

---

26 Similar descriptions are included in IAS 1 paragraph 7 and the IFRS Conceptual Framework for Financial Reporting (September 2010), paragraph QC11.

6.3 Company law and accounting standards set the requirements for disclosures relating to principal risks and uncertainties and the going concern basis of accounting. This may result in the inclusion of these disclosures in different components of the annual report (for example, the strategic report and financial statements).

6.4 Where law or regulation specifies the location for a disclosure (for example, the financial statements) and the information is presented outside of that specified component of the annual report, cross-referencing must be used in order for the disclosure requirement to be met.

6.5 Cross-referencing is a means by which an item of information, which has been disclosed in one component of an annual report, can be included as an integral part of another component of the annual report. A cross-reference should specifically identify the nature and location of the information to which it relates in order for the disclosure requirements of a component to be met through the relocated information. A component is not complete without the information to which it is cross-referenced. Cross-referenced information must be included within the annual report.

6.6 In other cases, it may be helpful to direct users to related information included in different parts of the annual report or outside the annual report. Signposting can be used for this purpose.

6.7 Signposting is a means by which a user’s attention can be drawn to complementary information that is related to a matter disclosed in a component of the annual report. A component must meet its legal and regulatory requirements without reference to signposted information.
7 Auditor reporting

7.1 The purpose of this section is to help directors understand the responsibilities that the auditor has in connection with the directors’ assessment of the company’s ability to continue to adopt the going concern basis of accounting and related disclosures in the financial statements or annual report.

The auditor’s responsibilities

Summary of requirements

Auditors are required by auditing standards\(^{28}\) to conclude whether it is appropriate for the directors to use the going concern basis of accounting to prepare the financial statements and also whether a material uncertainty exists about the company’s ability to continue to do so.

7.2 There are implications for the auditor’s report where the auditor concludes that a material uncertainty exists and also where the auditor disagrees with the directors’ use of the going concern basis of accounting or the adequacy of the disclosures made by the directors in the financial statements.

7.3 In addition, the auditor has responsibilities for considering, on the basis of the audit work performed, whether the other information included in the annual report is materially misstated, and for reporting in relation to such matters. This other information would include a description of the principal risks and uncertainties, including those related to solvency and liquidity risks, disclosed in the strategic report, where required to be prepared.\(^{29}\)

Evaluating the directors’ assessment

7.4 The auditor is required to evaluate the directors’ assessment. As described in section 3, in performing their assessment the directors should take into account all available information about the future, the realistically possible outcomes of events and changes in conditions and the realistically possible responses to such events and conditions that would be available to the directors.

7.5 In evaluating the directors’ assessment, the auditor considers all relevant information of which the auditor is aware, including all available information the directors used to make their assessment, and any knowledge obtained by the auditor during the audit.

7.6 The auditor covers the same period as the directors used to make their assessment. As set out in paragraphs 3.5 to 3.6 of this guidance, in making their assessment of going concern and material uncertainties, the directors should consider a period of at least 12 months from the date of approval of the financial statements. If the period of the directors’ assessment is less than 12 months from the date of approval of the financial statements, the auditor is required to consider whether it is necessary to provide a modified audit opinion or disclose this fact in the auditor’s report.

---

\(^{28}\) International Standard on Auditing (UK and Ireland) 570 (Revised September 2014) Going Concern.

\(^{29}\) ISA (UK and Ireland) 720 (Revised June 2016), The Auditor’s Responsibilities Relating to Other Information, will apply for audits of financial statements for periods commencing on or after 17 June 2016.

---

22 Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks (April 2016)
7.7 As part of the auditor’s risk assessment procedures, the auditor also considers whether there are any events or conditions – either identified by the directors as part of their assessment or in addition to those – that may cast significant doubt on the company’s ability to continue to adopt the going concern basis of accounting. If any such events or conditions are identified, the auditor concludes whether a material uncertainty related to those events or conditions exists.

7.8 In addition, where such events or conditions are identified, the auditor is also required to evaluate whether, in view of the requirements of the financial reporting framework, the financial statements provide adequate disclosures about those events and conditions, even where the auditor concludes no material uncertainty exists.30

Disclosures

7.9 As part of the audit, the auditor considers any disclosures relating to solvency and liquidity risk, and the going concern basis of accounting made in the annual report. Where the directors have concluded that there is a material uncertainty, the auditor considers the relevant disclosures, including the principal events or conditions that may cast significant doubt on the company’s ability to continue to adopt the going concern basis of accounting and the directors’ plans to deal with those events or conditions.

7.10 Where the auditor has concluded that a material uncertainty related to the going concern basis of accounting exists, the auditor also has a specific requirement to determine whether the financial statements disclose clearly that there is a material uncertainty relating to going concern. A material uncertainty is one relating to events or conditions that may cast significant doubt on the company’s ability to continue as a going concern and that may, therefore, indicate that it may be unable to realise its assets and discharge its liabilities in the normal course of business.31

Reporting

Going concern

7.11 Where the auditor concludes that the use of the going concern basis of accounting is appropriate and no material uncertainty has been identified, the auditor is required to report that they have no matters to report in this regard i.e. reporting by exception.32

7.12 Where a material uncertainty exists, the auditor highlights it in a separate section of the auditor’s report, provided that the circumstances are fully explained in the financial statements.

7.13 If the auditor concludes that the disclosures are not adequate to meet the requirements of accounting standards and the Companies Act 2006, or that the financial statements do not include adequate disclosures to give a true and fair view, the auditor modifies the audit opinion and provides the reasons for doing so.

30 ISA (UK and Ireland) 570 (Revised June 2016), Going Concern, paragraph 20 will apply for audits of financial statements for periods commencing on or after 17 June 2016.
31 ISA (UK and Ireland) 570 (Revised September 2014), Going Concern, paragraph 18(b).
32 ISA (UK and Ireland) 570 (Revised June 2016), Going Concern, paragraph 21-2 will apply for audits of financial statements for periods commencing on or after 17 June 2016.
7.14 In some circumstances, the auditor may be required to describe in the auditor’s report matters which they have assessed as being of particular significance to the audit. These matters may include going concern where it has, for example, involved significant director or auditor judgement or has had significant impact on the audit in terms of resource and effort.33

Other information

7.15 The auditor is also required to read the directors’ report and, where it is prepared, a strategic report and to state in the audit report whether, based on the work undertaken in the course of the audit:
- the information is consistent with the financial statements;
- the information has been prepared in accordance with applicable legal requirements; and
- the auditor has identified any material misstatements in the information34.

7.16 The auditor is also required to report on all other information contained in the annual report as described in paragraph 7.3.35

---

33 ISA (UK and Ireland) 570 (Revised June 2016), Going Concern, paragraph 21-1 will apply for audits of financial statements for periods commencing on or after 17 June 2016.

34 The Companies Act 2006 as amended by The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015 requires these statements for periods commencing on or after 1 January 2016.

35 ISA (UK and Ireland) 720 (Revised June 2016), The Auditor’s Responsibilities Relating to Other Information, paragraphs 22 and 22D-1 will apply for audits of financial statements for periods commencing on or after 17 June 2016.

---

24 Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks (April 2016)
Appendix: Application to other reports

A1–A2 apply to companies preparing half-yearly reports either to comply with regulatory requirements, such as the AIM rules, or voluntarily, and those preparing preliminary announcements. Companies applying The UK Corporate Governance Code should refer to the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting.36

A1 Half-yearly financial reports

Assessment

Summary of requirements

In preparing financial statements for inclusion in a half-yearly report directors must consider whether the going concern basis of accounting is appropriate. Accounting standards that may be applied in the preparation of such financial statements are IAS 34 Interim Financial Reporting for companies that apply IFRS, and FRS 104 Interim Financial Reporting for companies applying FRS 102 in their annual financial statements.

Principles for best practice

Where a half-yearly report includes principal risks and uncertainties, directors will need to update the assessment made in the previous annual report.

Directors will need to exercise judgement about the nature and extent of the procedures that they apply to assess the appropriateness of the going concern basis of accounting and, if disclosed, principal risks and uncertainties at the half-yearly reporting date. They should consider if new activities, events and circumstances indicate previous assessments should be changed. Issues which might trigger a change in the assessment of the appropriateness of the going concern basis of accounting or additional disclosures around solvency and liquidity risk include:

- a significant adverse variation in operating cash flows between prior budgets and forecasts and the outturn in the first half of the year;
- a significant reduction in revenues or margins forecast for the second half of the year;
- a failure to obtain renewal or extension of bank facilities that had been anticipated; and
- a failure to sell capital assets for their expected amounts or within previously forecast time-frames.

A1.1 If the appropriateness of the going concern basis of accounting has become a significant issue since the last annual financial statements, directors should undertake procedures similar to those that they would have carried out for annual financial statements to ensure that all relevant issues and risks have been identified and considered.

A1.2 Where no new issues have been identified that raise questions about the assessment made at the last year end, the directors will need to undertake procedures to roll forward the previous budgets and forecasts by a half-yearly period.

The assessment period

Summary of requirements

IAS 34 requires that the same accounting principles be applied to interim financial statements as are applied to annual financial statements. Consequently, the minimum review period requirement in IAS 1 paragraph 26 applies to financial statements for an interim period as described in IAS 34. The minimum period considered must be at least, but not limited to, 12 months from the end of the reporting period.

Where FRS 104 is applied in the preparation of interim financial statements, the minimum period considered must be at least, but not limited to, 12 months from the date the financial statements are authorised for issue.

Principles for best practice

Although IAS 34 only specifies a period of at least 12 months from the reporting date, directors should consider a period of at least 12 months from the date the financial statements are authorised. Directors of all companies should consider all available information about the future at the date of approval of half-yearly financial statements including the information obtained from budgets and forecasts.

A management report has a forward-looking orientation. Whilst the period of assessment for any disclosure of principal risks and uncertainties will ultimately be a matter of judgement for the directors dependent on the facts and circumstances of the company, this should cover at least the remaining 6 months of the annual reporting period but will usually be longer than 12 months.

Reporting requirements

Summary of requirements

IAS 34 and FRS 104 provide that entities may elect to provide less information at interim dates, as compared with their annual financial statements, in the interests of timeliness and cost considerations and to avoid repetition of information previously reported. Instead, the focus of half-yearly financial statements is on providing information about new activities, events and circumstances which have not previously been reported. However, even if there have been no significant changes, material uncertainties reported at the year-end date that still exist at the interim date should be disclosed in the half-yearly financial statements.
Principles for best practice

Directors will need to exercise judgement in determining the disclosures about the appropriateness of the going concern basis of accounting, and solvency and liquidity risks that they should include in a set of half-yearly financial statements and interim management reports. Practical experience suggests that new events and circumstances are likely to arise quite often in businesses facing financial difficulties, for example as borrowings are renegotiated, assets sold and businesses closed. In these circumstances, it is likely that half-yearly financial statements and interim management reports will include additional disclosures about the going concern basis of accounting and solvency and liquidity risk, to reflect the changes in the interim period.

Auditor’s half-yearly review report

Summary of requirements

The directors may engage the auditor to review the half-yearly financial statements. The FRC’s International Standard on Review Engagements (UK and Ireland) 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity requires the auditor, among other matters, to inquire whether the directors have changed their assessment of the company’s ability to continue to adopt the going concern basis of accounting.

When the auditor becomes aware of events or conditions that may cast significant doubt on the company’s ability to continue as a going concern, the auditor is required to inquire of the directors as to their plans for future actions, the feasibility of those plans and whether the directors believe that the outcome of those plans will improve the situation.

Where there is a material uncertainty relating to an event or condition that may cast significant doubt on the company’s ability to continue as a going concern, the auditor is required to consider the adequacy of the disclosures about such matters in the half-yearly financial statements and, where the disclosures made are adequate, to add an emphasis of matter to the review report. If such a material uncertainty exists which is not adequately disclosed, the auditor is required to express a qualified or adverse conclusion.

A2 Preliminary announcements

Disclosure

A2.1 When a company prepares a preliminary announcement of annual results, it will form one of the focal points for investor interest. Such announcements are voluntary, although when made by companies within the scope of the Listing Rules their content is subject to minimum requirements.

A2.2 Preliminary announcements should include any significant additional information necessary for the purpose of assessing the results being announced. Therefore, a preliminary announcement should contain appropriate disclosures when the directors have determined that the going concern basis of accounting is inappropriate or material uncertainties regarding its appropriateness have been identified.

A2.3 A preliminary statement of annual results should also include disclosure of the nature of any likely modification or emphasis of matter contained in the auditor’s report that is to be included in the annual financial report. This includes any expected reference to the going concern basis of accounting, or material uncertainties or their disclosure.
April 2016

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

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

Further copies, £13.00 (post-free) can be obtained from:

FRC Publications
Lexis House
30 Farringdon Street
London
EC4A 4HH

Tel: 0845 370 1234
Email: customer.services@lexisnexis.co.uk
Or order online at: www.frcpublications.com