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Dear Ms Raval

Exposure Draft: Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks ("the draft guidance")

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to comment on the above exposure draft.

We fully support the FRC's aim of providing proportionate non-mandatory guidance on the going concern basis of accounting. We are still faced with economic uncertainty and therefore the guidance remains relevant and will help directors of unlisted companies understand in greater detail the reporting requirements and enable them to have better informed conversations with both investors and advisers.

We note that the draft guidance also encourages directors to think more broadly about risks and uncertainties that could threaten the company's development, performance, position and future prospects, including solvency and liquidity risk, in particular where those particular risks may present a potential threat to a company's viability. We support the discussion of such issues in the guidance but believe that the related reporting and disclosures should very much be in the context of the existing strategic report/principal risks and uncertainties requirements. As drafted the guidance might be read so as to require the very focused and separate reporting that is now required by Code companies on these matters.

Our main observations

Structure

We agree with many concepts contained within the draft guidance but think that the structure and ordering of the guidance should be changed to make it more effective and easier to follow.

For example Section 3 which covers going concern is not actually referenced to Section 5 which deals with the fundamental aspect of assessment of the going concern basis. This key aspect of the draft guidance is rather subsumed into the discussion of wider solvency and liquidity risks and therefore it loses its prominence and importance in the context of the going concern basis of accounting.

Therefore in terms of structure we recommend that:

- the draft guidance is restructured such that the going concern section incorporates the assessment stage;
- the draft guidance sets out clearly the minimum requirements for companies within the scope of this guidance and those areas of the guidance that are considered to be best practice.

Going concern scenarios

One of the recommendations of the Panel of the Sharman Enquiry was to encourage 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. Accordingly, we recommend that the FRC should consider whether there should be an additional going concern assessment scenario envisaged in this draft guidance - the additional scenario being where there is no material uncertainty disclosed in respect of going concern but where this was a matter of significant judgement. In this case the draft guidance should recommend that directors disclose the significant judgements made in arriving at their conclusion.

Consistency with audit reporting

Paragraph 7.9 refers to the auditor's responsibility to determine whether the financial statements disclose clearly that there is a material uncertainty related to going concern. In fact ISA 570 goes further than that and requires the auditor to determine "whether the financial statements disclose clearly there is a material uncertainty relating to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business". Companies are often reluctant to include the full version of these words in financial statements where there is material uncertainty regarding going concern. In order to bring clarity to this matter, we believe that Section 7 should more faithfully reflect the specific wordings of ISA (UK and Ireland) 570 *Going Concern*.

Detailed comments

Our detailed comments on the specific questions are set out in an appendix to this letter. We also include some additional comments for your attention where we believe that they could help improve the wording in the final guidance.

Contact details

If you have any questions regarding this response, please contact me, Neil Parsons (t: 0121 232 5385;E: Neil.B.Parsons@uk.gt.com) or Andrew Vials (t: 020 7728 3199; E: Andrew.Vials@uk.gt.com).

Yours sincerely

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Reponses to specific questions

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

See our comments in the covering letter.

Question 2 - Is the guidance sufficient for the different types of company that fall within its scope?

We comment in our covering letter on the need to amend paragraph 3.14 to include the additional scenario where there is no material uncertainly but where significant judgement has nevertheless been exercised in the going concern assessment. This scenario often arises in practice.

We believe that certain important aspects of the previous guidance for directors as contained in Going Concern and Liquidity Risk: *Guidance for Directors of UK Companies 2009* should also be transferred to this draft guidance because they are still very much relevant. These additional paragraphs are stated below.

In the general draft guidance to Section 3 on going concern:

Paragraph 8 – "Where companies are facing difficult economic conditions and/or are in financial difficulty this will necessitate particularly careful consideration by directors when making their assessment. If the directors consider that the company might no longer be a going concern they may need to take legal advice."

Paragraph 12 – "Directors should plan their assessment of going concern as early as practicable including deciding on the processes, procedures, information, analyses and board papers that will be needed. These plans should also address the evidence to be obtained, including identifying any potential remedial actions that may need to be addressed, to support their conclusion prior to their approval of the annual or half-yearly financial statements. Addressing these challenges well before the preparation of such financial statements may mitigate problems arising at the last minute that might unsettle investors and lenders necessarily. directors should plan their assessment of going concern as early as practicable."

Paragraph 13 – "Early discussions with the company's auditor about these plans may help minimise the risk of last minute surprises. It is also likely to be helpful if a draft of the relevant disclosures about going concern and liquidity risk is prepared and discussed with the auditor well before the end of the reporting."

In the guidance on the assessment stage we believe that the sensitivity analysis should still reflect the following guidance:

Paragraph 44 –"Sensitivity analysis should be used to seek to ensure that there are no unexpected:

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

Paragraph 45 – "Where sensitivity analysis indicates that there is a significant risk that the headroom between cash requirements and facilities available will be insufficient, the company should stress test its assumptions. Stress testing enables the directors to assess the effect of a combination of pessimistic but plausible estimates or assumptions."

Question 3 - Do you agree with the draft guidance on the assessment of solvency and liquidity risk as set out in paragraphs 4.1 to 4.6?

We agree with the above draft guidance. The draft guidance could, however, explain more clearly why the assessment period for solvency and liquidity risks is significantly longer than 12 months from the approval of the financial statements. This will aid a director's understanding of the context of such risks in line with the longer term strategy and viability.

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

We believe that the draft guidance in Sections 3, 4 and 5 could be re-organised in order to make the distinction between the concepts more clear.

It appears that section 3 is intended to cover the material uncertainties surrounding going concern rather than wider business uncertainties more generally. To emphasise this we recommend that this section is titled "The going concern basis of accounting and material uncertainties arising in respect of going concern". This avoids any confusion with any other uncertainties that may require disclosure but are not linked to the formal going concern basis of accounting.

In Section 3 the requirement for directors to assess whether the adoption of the going concern basis of accounting is not cross-referenced to section 5 which deals with the mechanics of that assessment. This makes the guidance particularly difficult to follow. Either there should be clear cross-references or Section 5 should be embodied into Section 3.

We would prefer the latter approach as Section 5 is fundamental to the going concern assessment.

Furthermore, Section 3 also deals with liquidity risk disclosures and their positioning could confuse directors. We therefore recommend that paragraphs 3.15 to 3.17 are removed from section 3 and placed in an appendix that covers other disclosure requirements envisaged by the draft guidance.

Question 5 - Does the draft guidance adequately highlight the relationships between the concepts (section 2)?

In order to make the diagram in figure 1 clearer we believe that the outer circle in figure 1 should be described as "Risks and uncertainties". It is then clear that material uncertainties are a subset of risks and uncertainties. We believe that directors would benefit from commentary that supports the meaning of the diagram in figure 1.

Section 2 might helpfully cross-refer to the relevant areas of the draft guidance so as to make the guidance easier to follow.

Finally we recommend that Section 2 distinguishes between the minimum requirements for companies and those requirements that constitute best practice.

Question 6 - Do you consider that the guidance is sufficiently practical? If not, how might the guidance be improved?

We believe that the draft guidance is sufficiently practical and believe that it will promote more bespoke (and less boiler plate) disclosures. The guidance in Section 6 on materiality and placement of disclosures is particularly useful to many aspects of financial reporting.

Our responses to the previous questions have set out where we believe that the guidance could be further improved.

Additional comments

We have the following additional comments on the exposure draft as follows:

I. **Paragraph 3.4 –** this paragraph should make clear how and where directors should "document" their going concern assessment.

II. **Paragraph 3.17 –** the footnote refers to the specific disclosure requirements of FRS 102 for financial institutions. It is not clear whether the draft guidance is actually highlighting whether those requirements should only be limited to financial institutions or whether other types of company should consider those disclosures where liquidity risk is material. The final guidance should clarify this matter.

III. **Paragraph 5.7 –** changes to legislation (for example minimum wage) could also have a significant impact on forecasts and forecasts may be sensitive to such changes. We recommend that the final guidance includes this as a particular factor given the current focus on a living wage.

IV. **Paragraph 5.14 –**the wording of this paragraph is not entirely clear. We believe that directors should seek "clarification" of, rather than "confirmation" of the principal terms and conditions of facilities.

V. **Section 7 – Auditor reporting –7.2 and 7.9 -** as noted in our covering letter , in order to avoid any ambiguity as to responsibilities we believe that this section should more faithfully reflect the specific wording of ISA (UK and Ireland) 570 *Going Concern*.

VI. **Section 7 – Auditor reporting – paragraph 7.13** – this paragraph refers to the preparation of a separate corporate governance statement. However, the scope of this exposure draft does not extend to corporate governance statements as envisaged by section 479A of the Companies Act 2006 (for periods on or after 1.1.2016). References to a separate corporate governance statement should therefore be removed.

VII. **Section 7 – Auditor reporting – paragraph 7.13** – this paragraph should clearly reflect up front the Companies Act 2006 requirements for the audit report both for periods beginning before 1 January 2016; and for periods beginning on or after 1 January 2016.

VIII. **Section 7 – Auditor reporting - paragraph 7.13** – for accounting periods beginning on or after 1 January 2016 the draft guidance should follow the exact wording of the required opinion under s496 of the Companies Act 2006 as set out in SI2015/980 *The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015* as follows:
"In his report on the company's annual accounts, the auditor must—
(a) state whether, in his opinion, based on the work undertaken in the course of the audit—
(i) the information given in the strategic report (if any) and the directors' report for the financial year for which the accounts are prepared is consistent with those accounts, and
(ii) any such strategic report and the directors' report have been prepared in accordance with applicable legal requirements,
(b) state whether, in the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, he has identified material misstatements in the strategic report (if any) and the directors' report, and
(c) if applicable, give an indication of the nature of each of the misstatements referred to in paragraph (b)."