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ms/kad

For the attention of Deepa Raval

12 January 2016

Dear Sirs

**Exposure Draft: Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks**

We welcome the opportunity to comment on the FRC's Exposure Draft: *Guidance on the going concern basis of accounting and reporting on solvency and liquidity risks* ('the ED'), which will address the gap left following the withdrawal in 2014 of *Going concern and liquidity risk: guidance for directors of UK companies 2009* ('the 2009 guidance').

As well as restoring that guidance, the draft includes material on disclosures in relation to longer-term viability. This is still a new concept for companies that apply the UK Corporate Governance Code, ie an evolving field of reporting. We anticipate that very few if any unlisted companies would choose to make these disclosures voluntarily at this stage. Whilst longer-term viability may on occasion require disclosure as one of the principal risks in the strategic report, this would be better addressed in the FRC's *Guidance on the strategic report*. The inclusion in this draft guidance results in a complex document for directors of unlisted companies: it needs to distinguish material uncertainties over going concern accounting from longer-term viability and the mandatory vs voluntary nature of the guidance in relation to each, and we have some concerns that those needs are not well met in the draft. On balance, we believe that it would be better at this stage in the evolution of viability reporting for this guidance to deal only with the financial statement disclosure requirements in relation to the going concern basis of accounting.



**KPMG LLP**

*12 January 2016*

We have set out our answers to the specific questions raised in Appendix 1 and note our additional detailed comments in Appendix 2.

Please do not hesitate to contact either Mike Metcalf (020 7694 8081) or Karen Duncan (0121 232 3874) should you wish to discuss any aspect of our response further.

Yours faithfully

A handwritten signature in blue ink that reads 'KPMG LLP'.

KPMG LLP

Enclosures: Appendices 1 and 2

## Appendix 1 - Responses to specific questions raised in the ED

In this response we have not generally repeated points that we made in relation to the development of the 2014 guidance for Code adopters that would apply here too (eg, that material uncertainties are about uncertainty as to the validity of using the going concern basis in the accounts in question rather than in a future set).

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

Subject to our overarching comment as noted in our covering letter in relation to the inclusion of guidance on longer-term viability disclosures, we broadly agree with the scope of the guidance. However, we are concerned over the blanket status of the document being non-mandatory (paragraph 1.2). The document could better distinguish between mandatory requirements and guidance thereon; the status is currently confused. We note that the 2009 guidance, in contrast, was described as being a “framework to assist directors” and to “provide assistance on the application” of mandatory requirements (paragraphs 1 and 4 of that guidance).

Further, the term “should” is used throughout the ED. This is appropriate when there is no explicit requirement on the related matter, but where there is a requirement it would be preferable to use less ambiguous language. For example paragraph 3.13 states (emphasis added) that “Directors *should* disclose....material uncertainties”, when in fact directors are *required* to make this disclosure under accounting standards (both FRS 102 and IAS 1). We note that the table in paragraph 3.14 uses both “should” and “shall” with no apparent reason for different terms being used.

A particularly important and difficult point to address is the status of the look-forward period. FRS 102.3.8 unequivocally sets out the long-standing UK consensus: that it is at least 12 months from the approval of the financial statements. This, which is in more straightforward terms than its predecessor – FRS 18 required disclosure if the period was less than that – is the position that we assume that the FRC wishes to apply as a requirement to all UK reporting under any standards. If so, we agree. Paragraph 3.10 of the draft guidance, however, uses the unclear term, “should”, albeit that this applies the same language to all circumstances (eg, FRS 101, 102 or IFRS).

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

We broadly consider the guidance to be sufficient. It is not clear, however, why the example disclosures in Appendices I and II to the 2009 guidance for small and other companies, and the questions for boards given by Appendix III of that guidance, yet have not been included in the ED. In particular, it is not clear whether the removal of example disclosures for companies that are subject to some, but not material, uncertainty over going concern (Example 2 of Appendix II to the 2009 example disclosures) is intentional – these were particularly helpful in 2008/9.



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The 2009 guidance's paragraphs 15-17 (particularly the first bullet point of paragraph 15) were also especially helpful. Together with Example 2, these innovations were of paramount importance at the time. It is not clear why they are now being set aside.

Please also see our detailed comments in Appendix 2 to this letter.

*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?*

Yes, but please see our detailed comments on section 4 in Appendix 2.

*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)?*

The distinction is not always clear. For example, the first 3 bullets in paragraph 4.15 are typically relevant to whether there is a material uncertainty, whereas as drafted here one could read them as being an issue only for longer-term viability. The confusion caused by including these under the guidance on longer-term viability could potentially enable companies to avoid disclosing a material uncertainty. Paragraph 5.5 compounds this issue as it combines the two periods of assessment.

Please also see our comment in our covering letter and our response to question 5 below and our detailed comments on sections 3 and 4 in Appendix 2.

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

We consider that section 2 of the ED partially highlights the relationships between the concepts. As noted in our response to question 4, we have particular concerns over the distinction between going concern accounting versus the longer-term viability concept, notably in paragraphs 4.15 and 5.5.

Further, the guidance could usefully clarify that the use of the term "foreseeable future" (currently often used in practice) should be avoided and replaced with reference to the specific going concern accounting assessment period considered, particularly if the final guidance retains reference to longer-term viability disclosures. This would help reduce any confusion over the different assessment periods for going concern and longer-term viability.

In addition, section 1 includes various references to "viability" (e.g. paragraphs 1.5 and 1.6). The definition in paragraph 1.6 refers to a company continuing in operation and meeting its liabilities as they fall due over "the period of assessment". There is no explanation of the difference between assessing the going concern basis of accounting and (potentially longer-term) future viability, particularly as regards the respective periods of assessment.

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*Question 6: Do you consider that the guidance is sufficiently practical? In not, how might the guidance be improved?*

ISA (UK and Ireland) 570 paragraph 18 is clearer than accounting standards that certain wording is necessary in the directors' disclosures in relation to going concern when a material uncertainty exists, i.e. specific disclosure that there is a material uncertainty related 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. The auditor's opinion is required to be modified if this disclosure is not given. Whilst this is implicit in accounting standards, it has in the past been a common cause of unnecessary friction, but that was largely taken away in 2009 by paragraph 66 of that earlier guidance. We strongly recommend the restoration of this point in the guidance in order to bring this requirement to the attention of directors.

It would also be useful if the guidance could make clear that mitigating actions, although relevant as disclosures, will not always, or even often, avoid a material uncertainty. For example, it might be a realistic alternative that revenue will increase as a result of a sales drive, or that an asset will be sold for the right price at the right time, but these are out of the directors' control, and so they cannot rely on them to "cure" a material uncertainty. The nature of a material uncertainty is that the directors are dependent on something inherently uncertain to resolve the situation.

As noted in our response to question 2, example going concern disclosures would be useful. It is not clear why these have been omitted from this guidance when they were included as Appendix I and II in the 2009 guidance, nor why the "Key questions for boards" in appendix III to the 2009 guidance has been removed as we consider both to have been useful aides to practical implementation of the guidance. Nor is it clear why other key innovations from 2009 are not being carried forward.

**Appendix 2: Additional detailed comments on the ED (including drafting comments)**

<i>Paragraph</i>	<i>Comment</i>
Section 3	
3.2	The wording of this paragraph could helpfully reflect the fact that this is (as per IAS 10 <i>Events after the Reporting Period</i> ) seen as at the date of approval of the financial statements, not the balance sheet date (IAS 10.14).
3.3	This could usefully go on to explain at the end, "... , for example whether the realistic alternative will be successful."
3.4	This does not explain why the guidance is now seeking to go beyond assessment and reporting, also to cover internal documentation.
3.5 and throughout	General references to "accounting standards", e.g. paragraph 3.5, could usefully be accompanied by footnote cross-references to the relevant standards/ paragraphs. In other places (eg, footnote 13 to paragraph 5.16) the footnote refers only to FRS 102 and not to the equivalent IFRS/ IAS.
3.13	It is not clear why this principle (and supporting guidance) is not applicable to small companies (via the boxed text at the start of section 3). After all, small companies' accounts are required to give a true and fair view and their directors should, therefore, consider what disclosures are necessary to meet that requirement.
3.17	<p>Paragraph 3.17 clarifies that liquidity risk disclosures are required under FRS 102 only for financial institutions. It would be clearer if this were made more prominent in, for example, the table in paragraph 3.15. There is also no discussion of the disclosure exemptions available under FRS 101.</p> <p>The legal requirements in paragraph 3.17 refer to Schedule 7 paragraph 6 of SI 2008/410 – this could helpfully include the following from the</p>



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	wording of the SI: “unless such information is not material for the assessment of the assets, liabilities, financial position and profit or loss of the company.”
3.16 and 3.17	Paragraphs 3.16 and 3.17 are in the section on going concern but deal with liquidity risk (the same applies to parts of the table in paragraph 3.15). These might be better located in section 4.
Section 4	
4.4	The purpose of the assessment of risks and uncertainties could usefully be referenced to the legal requirement for the directors to consider these matters. Without this the text appears to require an assessment for its own sake.
4.16	Given that there are no disclosure requirements in accounting standards for solvency risk, the meaning of “however, this will also be a consideration in the context of the financial statements” in footnote 12 to paragraph 4.16 is not clear. Is the proposition that such disclosures may nevertheless be required in order for the financial statements to give a true and fair view? If so, this needs to be more fully explained – eg, what sort of circumstances, what sort of disclosure and how is that necessary for a true and fair view of the results and position?
Section 5	
5.2	We understand what is behind the opening sentence, ie that this guidance cannot pre-specify what directors should consider in their companies’ particular circumstances. However, it may be mis-read as giving directors the sole authority to decide what is relevant, which would make the roles of auditor and regulator more difficult.
5.7	Paragraph 5.7 includes a reference to revenue sensitivity. It would be clearer for the reader if this was included in the bullet point list in that paragraph.

5.17	With regard to parental support we suggest the term “such support” in the second bullet is replaced with “adequate support”. Further the third bullet might also refer to cross-guarantees as an example of exposure to other group members.
Section 6	
6.2 to 6.4	Paragraphs 6.2-6.4 include generic statements about materiality. It is not clear how these provide <i>application</i> guidance on the principle given in 6.1 “disclosures relating to solvency risk and liquidity risk should only be provided when material.”
6.5 to 6.10	The proposed distinction between signposting and cross-referencing could result in misinterpretation and confusion and would benefit from being phrased more clearly and concisely. We consider that it would be more appropriate to confine it to a simple statement to the effect that required disclosures may be given by cross-reference, albeit care is needed as cross-references need to be sufficiently precise (specifying the information and position in the accompanying document and noting that it forms part of the accounts); anything else, e.g. “see page x” is merely a sign post.
Section 7	
7.2	Auditors do not (under current ISAs (UK and Ireland)) express a conclusion on the use of the going concern basis of preparation. It may be more appropriate to state that the auditor is required to “assess whether...”.
7.8	This paragraph would be better worded as “...the auditor considers disclosures relating to solvency and liquidity risk ( <u>where required by accounting standards</u> ) and the going concern basis...” since not all companies are required to give solvency and liquidity disclosures (see our comment on paragraph 3.17 above).
7.7	This paragraph seems to separate the concepts of “may cast significant doubt” and “material uncertainty”. It is not clear if this is intentional. If so, that fact and its consequences are not explained. Please also see our



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	<p>comments on this matter in our response to the FRC's September 2015 consultation on the draft revised ISAs (UK and Ireland).</p>
7.12	<p>Paragraph 7.12 applies only when a company applies the Code (based on current requirements). If this paragraph is retained, it needs to explain when such disclosure is required, for example clarifying that a long-form audit report will be required for Public Interest Entities (whether or not they apply the Code) for periods commencing on/ after 17 June 2016.</p>
7.13	<p>Paragraph 7.13 and its footnote are not entirely accurate. The first statement, ie "...is consistent with the financial statements", is currently required (for the strategic report and directors' report). Only the second statement, ie "has been prepared in accordance with company law or accounting standards", is new for 2016 (or for earlier periods if the company early-adopts the revisions to the Companies Act in SI 2015/980).</p> <p>Further, it is not clear why paragraph 7.13 refers to "accounting standards" since the directors' report, strategic report and any separate corporate governance statement are not prepared in accordance with accounting standards.</p> <p>Furthermore, the new reporting requirement is based solely on the auditor's existing audit knowledge; this is not referred to in the ED. Please also see our comments on this matter in our response to the FRC's September 2015 consultation on the draft revised ISAs (UK and Ireland).</p>
7.14	<p>This paragraph on "other information" does not discuss requirements regarding material misstatements in the other information as required by ISA (UK and Ireland) 720 paragraphs 14 – 16.</p>
General	<p>The FRC's September 2015 consultation on draft revised ISA (UK and Ireland) 570 requires a conclusion on going concern to be included in the audit report even if there is no material uncertainty. Please see our comments on this matter in our response to that consultation.</p> <p>We note that the going concern guidance in the ED will need to be updated to reflect whatever the requirements of the final, revised standard become.</p>

Appendix A	
Introduction	The boxed introduction could helpfully clarify that premium listed companies will apply the Code and hence are subject to separate guidance.
A1	<p>Many companies that are required to prepare half-yearly financial reports will apply the Code and hence will not be in the scope of this guidance. For those that prepare half-yearly financial reports but do not apply the Code, a simpler approach would be to state that going concern considerations and reporting are the same for half-yearly financial reports as at the full year end, and to cross-refer to the relevant guidance for companies applying the Code.</p> <p>As drafted, however, the guidance in A1 implies that the requirements at the half-year are not the same as at the full year end. For example A1.8 (please see our comment below) and A1.10 imply that only changes in the going concern position require disclosure at the half-year, A1.2 refers to “Issues which <i>might</i> trigger a need to re-examine the going concern..” and A.1.3 states “if going concern has become a significant issue ... procedures <i>similar</i>...”.</p> <p>If this approach were taken, many of the other paragraphs in section A1 would no longer be necessary.</p>
A1.6	FRS 101 adopters may also apply FRS 104 if they prepare interim financial reports. Hence, the statement “where such companies use FRS 102, they may apply FRS 104...” is not complete.
A1.8	The comment, “the focus of interim financial statements is on new activities ... which have not previously been reported”, might be read as saying that material uncertainties over going concern that were disclosed in the last annual financial statements do not need to be repeated in the interims. This is not appropriate if the material uncertainties still exist.
A1.9	A1.9 states that “condensed financial statements should provide a true and fair view”. The wording here needs to be carefully reconsidered: notwithstanding the requirements of the DTR, in our view interim financial statements prepared under either IAS 34 or FRS 104 do not give

	a true and fair view, at least not as traditionally understood in the UK (otherwise condensed financial statements would satisfy the requirement for annual financial statements).
A2	It is not clear why a section on preliminary announcements is included as most listed companies will be applying the Code and are therefore not in the scope of this guidance.
A2.3	It is difficult to foresee a case in which LR 9.7A1(5) should not result in disclosure in the preliminary announcement of a material uncertainty in relation to going concern basis of accounting. Yet this paragraph is hedged about: "may need to consider whether ... they need to make appropriate disclosures".