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Dear Deepa,

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

We are pleased to have the opportunity to comment on *Exposure Draft: Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks* (the Exposure Draft or the Draft Guidance).

We support the steps the FRC are taking in seeking to replace *Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009* (the 2009 Guidance) with up-dated guidance aimed at companies that do not apply the UK Corporate Governance Code. In general, we consider the guidance on the concepts included in the individual sections of the Exposure Draft to be proportionate and clear. We do, however, have two principal concerns about the Draft Guidance, namely:

- Scope - We consider the scope, as described in section 1 of the Draft Guidance, could be made more succinct. In our view, both small companies and micro-entities would benefit from clear guidance on many of the matters covered in the Exposure Draft and that any guidance aimed at those companies should be included in this document. We also recommend that the Draft Guidance is restructured in order to facilitate this widened scope.
- Relationship between the concepts - We do not think that the Exposure Draft adequately highlights the relationships between the concepts it covers. In our view, more should be done to explain how the going concern assessment (and associated disclosures) interacts and overlaps with the identification and assessment of solvency and liquidity risks.

Our detailed responses to the questions asked in the Exposure Draft are set out in an appendix to this letter.

If you wish to discuss any of the points further, please do not hesitate in contacting me.

Yours sincerely,

BDO LLP

BDO LLP  
Nicole Kissun  
Partner  
For and on behalf of BDO LLP





*Appendix: Responses to the questions asked in the Exposure Draft*

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

No, we do not agree with the scope of the Draft Guidance as set out in section 1. All companies, including both small companies and micro-entities, are required to decide whether the going concern basis of preparation or an alternative basis is most appropriate to their circumstances. Consequently, in our view, the guidance on the going concern assessment included in the Exposure Draft is directly relevant to all companies, not just medium-sized and large companies.

Similarly, although going concern disclosures are not included in the list under section 1A of FRS 102, a company using the small companies' regime is required to prepare financial statements that give a true and fair view of its assets, liabilities, financial position and profit or loss. It is difficult to envisage how, where a small company is not a going concern, or where there are material uncertainties over a small company's going concern status, the "true and fair" requirement can be satisfied without some disclosures on the matter being provided. Consequently, in our view, guidance on going concern disclosures within the financial statements of a small company is necessary.

Finally, we acknowledge that the financial statements prepared under the micro-entities' regime are deemed in law to give a true and fair view. However, we are concerned that, in circumstances where a micro-entity is not a going concern or where there are material uncertainties over its going concern status, financial statements prepared under the micro-entity regime may be misleading in the absence of any going concern disclosures. Consequently, in our view, some proportionate guidance on going concern disclosures that might be included voluntarily within the financial statements of a company applying the micro-entities' regime would be useful.

In the light of the above, we consider the scope of the Draft Guidance could be made more succinct. In our view, both small companies and micro-entities would benefit from clear guidance on many of the matters covered in the Exposure Draft and any guidance aimed at those companies should be included in this document, rather than potentially in a separate (third) publication addressed only to small companies and micro-entities. We would consider it more appropriate for the Draft Guidance to be described as "non-mandatory, best practice guidance for all companies, except those that are required or choose voluntarily to apply the UK Corporate Governance Code".

In order to facilitate this widened scope, we think the guidance could be structured a little differently. In our view, the Draft Guidance should include individual sections which provide:

- An overview of how the concepts of the going concern and solvency and liquidity risk interact (See our response to question 5);
- A more detailed discussion of the going concern basis of accounting and material uncertainties; and
- A more detailed discussion solvency and liquidity risks (See our response to question 3).

There should then follow separate individual sections that articulate how to apply these concepts in large and medium-sized companies, small companies and micro-entities respectively. Using separate individual sections would allow the Draft Guidance to offer proportionate advice to these different classes of company and could help identify the differing legal requirements and other considerations (eg best practice) that apply to them. Despite the fact that this might result in some repetition in the Draft Guidance, it would make it more accessible for preparers.



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

Yes, subject to our comments in respect of questions 1 and 6 in respect of small companies and micro-entities, we consider the Draft Guidance sufficient for the different types of company that fall within its scope.

In our view, the level of guidance included in the Exposure Draft is consistent with that included in the 2009 Guidance that it is intended to replace and which applied to similar sized companies. We also consider that the Draft Guidance is written in such a way that is it scalable to the needs and circumstances of companies of different sizes and complexities.

**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 have two principal comments on the guidance on the assessment of solvency and liquidity risk included in the Exposure Draft, which stem from the use of language and concepts used in *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting (September 2014)* (the Code-company Guidance).

Firstly, we do not consider that the Exposure Draft differentiates clearly enough between liquidity risk and solvency risk. In particular, it is not clear to us from the descriptions included in the Exposure Draft how “...unable to meet its liabilities as they fall due...” (Liquidity risk) and “...unable to meet its liabilities in full...” (Solvency risk) differ in practice. Consequently, in our view, the Draft Guidance should elaborate on the descriptions of the concepts that have been drawn from Appendix B to the Code-company Guidance.

Secondly, we consider that the Exposure Draft would benefit from more guidance on the period over which the assessment of solvency and liquidity risks should be made. It will often be the case that companies using the guidance will have more informal, less well documented and, potentially, shorter-term strategic planning and risk management processes compared to companies that apply the UK Corporate Governance Code. Consequently, a suggestion such as “...except in rare circumstances it should be significantly longer than 12 months...”, which has been taken from the Code-company Guidance, may be difficult to achieve in practice. In our view, the Draft Guidance should elaborate on the considerations set out in paragraph 4.9 of the Exposure Draft in order to explain how these factors might influence the assessment period adopted.

**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)?**

Yes, in our view the Draft Guidance does sufficiently distinguish between the assessment of and reporting on the ‘narrow’ going concern basis of accounting and the broader concept of solvency and liquidity risks. However, as described in our response to question 5 below, we think the Draft Guidance could make clearer how the two concepts interact.

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

It is important that the Draft Guidance includes a section that highlights the relationships between the concepts used in it and we consider paragraph 2.4 and Figure 1 to provide a good basis for an explanation of these relationships. However, we have some concerns over the internal consistency of section 2 and its interaction with the rest of the Draft Guidance. The result of the matters we highlight in our concerns below is that, in our view, the Draft Guidance does not adequately highlight the relationships between the concepts.

Firstly, section 2 does not make clear why the going concern basis of accounting is described in isolation in paragraphs 2.2 and 2.3 but is also included as a final step in paragraphs 2.4 and 2.5. This lack of clarity results in a loss of logical flow to the section. Paragraphs 2.4 and 2.5 imply that it is only the risks faced by a company that have an effect on its status as a going concern. However, other factors which may not be considered risks, such as management's and shareholders' voluntary actions or circumstances that involve no uncertainty, may also lead to a conclusion that a company is not a going concern. In our view, paragraphs 2.2 and 2.3 (and section 3 of the Draft Guidance) should make this clear. Doing this would not only create a bridge between paragraphs 2.2 and 2.3 and the rest of section 2, which deals only with the effects of risks and uncertainties on the going concern assessment, it would also make clear why, when it is the last step in Figure 1 and paragraph 2.5, the guidance on the assessment of the going concern basis of accounting is addressed first in the main body of the Draft Guidance.

Secondly, it is unclear what paragraphs 2.4 and 2.5 are intended to illustrate and how they are intended to differ. Both appear to describe a logical process which is principally concerned with the identification of disclosures but both also conclude with a reference to the basis of accounting (recognition and measurement) that is adopted in the financial statements. Both paragraphs, and Figure 1, describe a similar but not identical set of steps. In our view, these paragraphs should first describe how the risk assessment process interacts with the going concern assessment (principally as described in paragraph 2.4) and then go on to highlight where annual report disclosures might arise.

Finally, it is unclear how the guidance in the sections that follow section 2 relates to the processes identified in paragraphs 2.4 and 2.5 of the guidance. In our view, ensuring that the structure used in the body of the Draft Guidance reflects that of the processes identified in section 2 (or vice versa) would significantly improve the clarity and flow of the document as a whole.

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

In addition to the points raised in our responses to questions 1-5 above, we have the following comments on the Exposure Draft:

*Section 1 - Introduction and scope*

- The definitions of solvency and liquidity risk are included both in section 1 and section 4. We recommend that a glossary of definitions is used instead of repeating the text in several places.



*Section 3 - Going concern basis of accounting and material uncertainties*

- Paragraph 3.18 should note that there could be circumstances in which disclosures might be appropriate, even when no material uncertainties over the going concern status of the company exist. For example, the financial statements of a subsidiary company might give the impression that the company is experiencing significant financial difficulties (eg it is heavily loss making or has substantial net liabilities). However, the existence of on-going support from its parent may, in some circumstances, mean that no material uncertainty exists. An acknowledgement of this on-going support would usually be important to a user of the financial statements.

*Section 5 - The assessment process*

- Section 5 does not describe a process (as suggested by its title), it sets out factors to consider and techniques that may be applied in identifying risks and uncertainties that may have an effect on the going concern assessment and disclosure of risks and uncertainties.
- Following on from the recommendation in our response to question 1 (to include small companies and micro-entities within the scope of the Draft Guidance), we suggest that paragraph 5.4 is given increased emphasis in order to ensure that the Draft Guidance is clearly seen to be scalable to the needs and circumstances of a wide range of companies.

*Section 6 - Materiality and placement of disclosures*

- Paragraph 6.4 should refer to IFRSs as well as FRS 102; other sections within the guidance refer to both frameworks. Paragraph 6.4 also duplicates the content of paragraph 6.2.

*Section 7 - Auditor reporting*

- Section 7 covers only the auditors' responsibilities in respect of material uncertainties, it does not deal with, for example, the auditors' responsibilities when a basis of preparation other than that of a going concern has appropriately been adopted. This should be clarified.
- Section 7 also does not clearly differentiate between the auditor's responsibility in respect of the going concern assessment and that in respect of the directors' consideration of the wider risks that might affect solvency and/or liquidity and which may fall to be disclosed in the strategic report. This should also be clarified.

*References to legal and other requirements*

- We recommend that the Draft Guidance more clearly differentiates between disclosures required by law or accounting standards and those that are considered to be best practice. For the former disclosures, we would also recommend that technical references are included in the Draft Guidance to enable drill-down into source documents. This could be achieved either through the inclusion of footnotes or a table in an appendix; both of these approaches were adopted in *Guidance on the Strategic Report*. This may also be another way of differentiating between the requirements that apply to companies of different sizes.