



The Quoted
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FRC guidance on 'going concern' focuses on directors' roles

Directors will come under greater scrutiny as the FRC updates its guidance on the 'going concern' concept

Given the current economic climate, the [Financial Reporting Council](#) wants to ensure its guidance on how directors report on the 'going concern' principle is still robust enough to satisfy regulators and investors. As a result, it has published a consultation paper setting out proposals for its revision.

Currently, the Listing Rules of the [Financial Services Authority](#) require the annual reports of listed companies to include a statement by the directors on the going concern status of the company. But the regulator believes the guidance published in 1994 needs updating to keep in line with corporate reporting requirements and best practice.

Directors at present can reach three conclusions on a going concern:

- Directors have a reasonable expectation that the company will continue in operational existence for the foreseeable future and have, therefore, used the going concern basis in preparing the financial statements;
- Directors have a reasonable expectation that the company will continue in operational existence for the foreseeable future and have, therefore, used the going concern basis in preparing the financial statements;
- Directors have identified factors which cast doubt on the ability of the company to continue in operational existence for the foreseeable future, but they consider that it is appropriate to use the going concern basis in preparing the financial statements; and
- Directors consider that the company is unlikely to continue in operational existence for the foreseeable future and, therefore, the going concern basis is not an appropriate one on which to draw up the financial statements.

But the FRC has proposed adding a fourth, which states that "directors have identified material uncertainties that may cast significant doubt about the ability of the company to continue as a going concern and so need to make additional disclosures."

However, there are fears that more extensive disclosures could unsettle investors. **John Pierce, chief executive of business lobby group the [Quoted Companies Alliance](#), says, "We're wary about rushing on such a key area. We are studying it to determine whether it means a change in substance or in form. If substance, then it could have all sorts of unintended consequences and perhaps precipitate the demise of a business that, without veiled warnings, could pull through."**

Updating the rules

The FRC has said it does not consider the changes to be a new departure and says they largely represent updates to [accounting](#) rules made since the guidance was first drawn up almost 15 years ago.

But some experts have questioned the need for a fourth category in the updated guidance. Steve Priddy, director of technical policy and research at the Association of Chartered Certified Accountants, says it is not clear why the FRC has developed a fourth option when "it could just use the new tougher language and replace the middle one."

The FRC intends to publish a summary of key comments received and its plan for revision during December 2008 to help boards understand how the Guidance for Directors may be amended. The consultation period ends on 24 November.

More changes

But the additional conclusion on going concern is not the only substantial change in the consultation paper. Other changes relate to greater disclosure, prompted by the apparent failure of many organisations particularly those in the financial services sector to alert investors or regulators about the state of their organisations' finances.

The FRC's consultation paper says that:

- Directors should make an explicit written statement in their [annual report](#) that they are satisfied that the going concern assumption remains appropriate;
- Directors should say if the period they have reviewed in making their going concern assessment isn't at least 12 months beyond the date they approved the financial statements;
- Auditors should assign a qualified report if they are unable to obtain all the information and explanations which they consider necessary for the purpose of their audit, especially if the period is less than 12 months;
- Any potential deficits, arrears or breaches should be discussed with the company's bankers to determine whether any action is needed. The onus is on the directors to be satisfied that there are likely to be appropriate and committed financing arrangements in place. The FRC points out that IFRS 7 Financial Instruments: Disclosures requires disclosure to be made of defaults on borrowings and

certain breaches of covenants. It also requires directors to disclose what financial risks they face and their objectives, policies and processes for managing these risks; and

- The going concern statements should be included in the Business Review section of the directors' report, which lets members of the company assess how the directors have performed their duty to promote the company's success.

While the guidance is primarily intended for directors of listed companies, the directors of AIM companies, PLUS-quoted companies, large private companies and public interest entities may wish to adopt appropriate procedures to comply with best practice.

Gerard Cranley, a partner at law firm [Howard Kennedy](#), says the FRC is not trying to impose any further duties on directors. "The regulator just wants more disclosure on the actions that directors are already taking. The credit crunch has highlighted investor concerns over the level and timeliness of directors' disclosures about the financial risks and exposure that their companies are facing, particularly as banks are now less likely to lend funds," Cranley says. "The FRC is trying to tackle these issues, but businesses do have some concerns about whether these changes are being made too quickly or unnecessarily."