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24 November 2008

Dear Sir

**Going concern and financial reporting: proposals to revise the guidance for directors of listed companies**

We are responding to your invitation to comment on the above consultation, which was issued in August 2008. We set out below our concerns about the timing of the proposed revisions to the guidance. In addition, we comment on the proposals we consider to be contentious, and respond to the specific questions asked in the invitation to comment. Detailed drafting comments are included in the Appendix to this letter.

**Timing of revised guidance**

We support the FRC's initiative in updating this guidance: it has been in place for a number of years and is misaligned with current accounting standards, corporate governance guidance and the UKLA's Listing Rules.

The FRC suggests that one of its purposes in updating the guidance is to assist directors in making the going concern statement required by the Listing Rules, given the deteriorating economic conditions. In our view, the proposed changes do not sufficiently enhance the existing guidance such that this aim is achieved and therefore we believe that, in the short-term, the FRC should focus its resources on a number of other current initiatives aimed at achieving that goal.

This approach would have the benefit of enabling the FRC to reflect during 2009 on whether any literature issued in 2008, resulting from those initiatives is relevant only in times of profoundly adverse economic conditions, or whether elements of it should be incorporated into the revised enduring guidance for directors on going concern, which is designed to be applicable in the more stable economic environment in which companies normally operate.

Whether the FRC decides to revise the guidance as planned, or after a period of reflection as we have suggested, we have a number of comments on the proposals, which are outlined below.

**Content of disclosure by directors**

**We disagree with the proposal in paragraph 47 of the guidance to increase the number of conclusions that directors can reach. We do, however, support the principle of aligning these conclusions with current accounting and auditing standards; the current inconsistency introduces unnecessary complexity, which is likely to lead to confusion.**

**To achieve alignment, we believe that the existing second conclusion should be redrafted as follows:**

> **"they have identified material uncertainties that may cast significant 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;"**

Both the existing and proposed guidance identify 'end of spectrum' conclusions that directors can reach: that they have a *reasonable* expectation that the company will continue in operational existence for the foreseeable future, so the going concern basis of accounting is appropriate; and that the company is unlikely to continue in operational existence for the foreseeable future, so the going concern basis of accounting is inappropriate. We agree with the retention of these conclusions.

The existing guidance contains one 'middle-ground' option: factors exist which cast doubt on the company's ability to continue in operational existence for the foreseeable future, but the directors conclude, nonetheless, that the going concern basis of accounting is appropriate. Arguably, this scenario can be seen as one where the directors' conclusion is that there is a *reasonable* expectation that the going concern basis is appropriate, and therefore the same, in essence, as the first conclusion. Where this 'middle-ground' option applies, the existing guidance recommends (in paragraphs 43 and 50) that the directors disclose in the Operating and Financial Review factors giving rise to doubts over the appropriateness of the going concern basis, and how those problems are to be resolved by the directors. An important message, which should be retained, is that this may need to be cross-referenced to the notes to the financial statements, where the basis of preparation of the accounts is discussed, in order for the financial statements to give a true and fair view.

From the perspective of the international accounting standards framework, IAS 1 "Presentation of financial statements" requires disclosure of uncertainties in situations where management is aware of material uncertainties that may cast significant doubt about using the going concern basis. A similar requirement is contained in FRS 18 within the UK GAAP framework. Since the directors' responsibility statement states that the accounts are prepared in accordance with IFRS/UK GAAP as appropriate, these disclosures would be expected to appear within the financial statements.

Auditing Standards (ISA (UK & Ireland) 570) place a related obligation on auditors: where material uncertainties exist that cast significant doubt on a company's ability to continue in operation, the auditor is required to consider whether the financial statements contain adequate disclosure about the uncertainties and factors giving rise to doubts; thus, implicitly requiring the directors to make disclosure within the financial statements, rather than in the unaudited narrative section of the annual report.

We believe that the mismatch between the guidance for directors and both the accounting and auditing standards is unhelpful and confusing and should be eliminated.

The FRC's proposals in paragraph 47 of the guidance purport to contain two 'middle-ground' conclusions, but actually do not: the existing conclusion (arguably regarding a reasonable expectation as noted above) remains, but the newly introduced 'conclusion' refers directors to existing disclosure requirements in IFRS, without stating whether the going concern basis of accounting remains appropriate and therefore is not a conclusion.

Therefore, taking into account all the considerations above in relation to content of the disclosure, we propose that the FRC should retain just one ‘middle-ground’ option, that is drafted so as to be consistent with both accounting and auditing standards, as illustrated in bold type above. The reference to the disclosure requirements contained in accounting standards should not be contained in this paragraph.

The change we propose would align the guidance for directors with both accounting and auditing standards but it would not, in practical terms, reduce the options for the conclusions that can be reached by directors, nor impact any of the disclosures currently recommended.

Finally, we note that the basis for concluding that the use of the going concern presumption is inappropriate, i.e., that the company is unlikely to continue in operational existence for the foreseeable future, is inconsistent with the basis for reaching the same conclusion contained in accounting standards (specifically IAS 1 and IAS 10, as illustrated in the extracts provided by FRC on pages 28 and 29 of the consultation document) which focuses on the more stringent test of intention to liquidate, or having no realistic alternative to doing so; such inconsistency is unhelpful.

**References to accounting standards**

The guidance has been updated and refers to the existing requirements of IFRS throughout. A significant minority of listed companies do not prepare financial statements in accordance with IFRS and, hence, references to UK GAAP should also be included. We acknowledge that, in certain cases, the UK accounting standard is identical to the equivalent IFRS, but this is not always true. If this changes in the future, the guidance should be revisited.

We consider that the main focus of the guidance is (and should remain) the considerations and judgements that the directors are required to undertake in order to be able to make the going concern statement required by the Listing Rules and accounting standards. Hence, references to other disclosure requirements in accounting standards are of secondary importance.

**Responses to questions raised by the FRC**

***Question 1: In the light of these developments, do you believe that there is a continuing need for separate Guidance for Directors about Going Concern?***

Yes.

***Question 2: Do you believe that the proposed amendments are sufficient and appropriate? If not, what alternative amendments do you believe need to be made and why?***

We disagree with the FRC’s proposal to amend paragraph 47 of the guidance, but instead believe an alternative amendment will be appropriate; see detailed comments above.

Also as noted above, we believe that references to the disclosure requirements of accounting standards should be to both UK GAAP and IFRS.

The detailed procedures contained in the Appendix to the guidance, will clearly assist many directors when assessing the appropriateness of the going concern basis of accounting. However, the introduction to the appendix should make clear that the suggested procedures may not be appropriate to companies in all sectors: for example in our view not all of the procedures would be applicable for banks.

As noted above, we believe that the FRC should consider the content of any short-term guidance issued in 2008, as well as the practical experience of directors making going concern statements in early 2009, with a view to making potential improvements to the revised guidance.

***Question 3: Do you believe that any significant parts of the proposed guidance can be deleted as unnecessary? If so, which paragraphs can be removed and why?***

Yes, see response to question 4.

***Question 4: Do you believe that it continues to be appropriate to include standardised text within the proposed Guidance for Directors indicating how directors might explain their use of the going concern basis of accounting?***

No. The circumstances surrounding uncertainties differ from company to company. The inclusion of proposed wording for one possible uncertainty risks encouraging the use of boilerplate wording in such circumstances. We believe that directors should be encouraged to make disclosure that is specific to the company's circumstances and the evidence that they have considered in concluding that the going concern assumption is appropriate.

**Question 5: Do you believe that it continues to be appropriate for the Guidance for Directors to require directors to consider whether an additional disclosure should be given where they have not considered a period that extends to at least twelve months from the date of approval of the financial statements?**

"Guidance" is not equivalent to "requirements", so we don't consider that there is currently any such requirement imposed on directors, other than somewhat conflicting requirements about the period to which they should have regard contained in accounting standards. However, we do believe that it is appropriate to recommend in this guidance additional disclosure in the circumstance referred to in this question.

If you have any questions or comments about this response, please contact Margaret Cassidy (020 7213 1285) or Angela Green (020 7213 5401).

Yours faithfully

PricewaterhouseCoopers LLP

**Appendix - detailed drafting comments**

1. Paragraph 30 - the inserted text should be moved to after the word 'comparison', so that the second sentence in the paragraph reads "Sensitivity analyses on the critical assumptions should also be used in the comparison, in particular to assess whether the headroom between cash requirements and available facilities is sufficient."

2. Paragraph 51A - the word 'very' should be deleted from the last sentence.

3. Paragraph 57 - the first sentence should be amended to refer to the interim reporting obligations of 'a listed company', rather than 'listed companies' in plural.