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Need to know
FRC issue draft guidance on going concern for non-Code companies

In a nutshell
- The FRC has issued an exposure draft of best practice guidance on the going concern basis of accounting and reporting on solvency and liquidity risks for companies that do not apply the UK Corporate Governance Code ('non-Code companies').
- The guidance is a simplified version of the going concern elements of the FRC's September 2014 update to the Corporate Governance Code and related guidance, and incorporates recent developments in corporate reporting.
- The guidance is not intended for use by small and micro companies although it may function as a useful aid.
- The final guidance will replace the *Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009*.

Background
The FRC has implemented the recommendations of the 2012 Sharman Inquiry on going concern and liquidity risk, as part of their 2014 update to the UK Corporate Governance Code. It also published supporting *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting*.

This exposure draft has been issued for those companies that do not apply the UK Corporate Governance Code. Some companies apply the Code because they are required to do so (e.g. premium listed companies) and others do so voluntarily (e.g. some companies with a standard listing and some AIM companies). The exposure draft therefore addresses all other companies excluding small and micro companies. This spans a range including large and medium-sized privately-owned businesses and most AIM companies.

The guidance draws on the requirements of company law, accounting standards, auditing standards, and other regulation and is a simplified version of the going concern and risk reporting elements of the FRC's guidance for Code companies. It also incorporates many of the key points and principles from the 2009 Guidance. The guidance is non-mandatory and is intended as best practice advice for non-Code companies.

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What is included in the draft guidance?

Going concern basis of accounting

Directors of all companies are required to assess whether the adoption of the going concern basis of accounting when preparing the financial statements is appropriate. In carrying out this assessment consideration should be given to the size, complexity and circumstances of the business. Under FRS 102 directors should consider a period of at least 12 months **from the date the financial statements are authorised for issue**. This compares to the requirement under IAS 1 *Presentation of Financial Statements* that the period considered is at least 12 months **from the end of the reporting period**.

Observation

There is no requirement for a longer-term viability statement for non-Code companies. This is a requirement for Code companies for periods commencing on or after 1 October 2014 as part of the 2014 revisions to the Code.

In addition, consideration should be given to whether there are any material uncertainties relating to events or conditions that may cast significant doubt about the continuing use of the going concern basis of accounting in future periods.

An uncertainty should be considered material and therefore disclosed in the financial statements if its disclosure could reasonably be expected to affect the economic decisions of shareholders and other users of the financial statements and is a matter of judgement.

Certain accounting standards require other disclosures that may be relevant to the assessment of the going concern basis of accounting, solvency risk and liquidity risk. This includes disclosure requirements on contingent liabilities, under FRS 102 21.15/IFRS 37.86 to 88, and on defaults and covenant breaches, under FRS 102 11.47/IFRS 7.18 and 19.Companies will also want to consider consistency throughout their financial statements, e.g. whether cash flow forecasts used for their going concern assessment are consistent with those used in their impairment review.

Reporting requirements

The three reporting scenarios that may result from the directors' assessment of going concern, and the related disclosure requirements, are as follows:

		Basis of accounting	Disclosure requirements
1	The going concern basis is appropriate and there are no material uncertainties.	Going concern basis	No specific disclosure requirements.*
2	The going concern basis is appropriate but there are material uncertainties related to events or conditions that may cast significant doubt upon a company's abilitiy to continue to adopt the going concern basis of accounting in the future.	Going concern basis	Disclosure of material uncertainties.
3	The going concern basis is not appropriate	Basis other than going concern	Disclosure of the fact that the financial statements are not prepared on the going concern basis together with the basis on which they were prepared and the reason why the going concern basis of accounting is inappropriate.

*The draft guidance clarifies that there are no specific disclosure requirements for financial statements when the going concern basis is appropriate and when there are no material uncertainties. This differs from the 2009 Guidance which encouraged disclosure of any uncertainties.

Solvency and liquidity risks

Directors should consider threats to solvency and liquidity as part of their assessment of risks and uncertainties faced by the company:

- Liquidity risk is the risk that a company will be unable to meet its liabilities as they fall due.

- Solvency risk is the risk that a company will be unable to meet its liabilities in full.

In making their assessment, directors should consider the likelihood and possible effects of those risks materialising for a period significantly longer than 12 months from the approval of the financial statements, except in rare circumstances.

All companies, apart from small companies, are required to produce a strategic report under the Companies Act 2006. The strategic report should include a description of the principal risks and uncertainties facing the company, together with an explanation of how they are managed and mitigated.

The new draft guidance sets out some factors to consider and techniques that may be applied in identifying the principal risks and uncertainties that are required to be disclosed in the strategic report and in assessing whether the going concern basis is appropriate. These include:

- the complexity of the company;

- use of forecasts and budgets;

- timing of cash flows – indicating an adequate matching of projected cash inflows with projected cash outflows;

- sensitivity analysis;

- products, services and markets, i.e. information about the major aspects of the economic environment within which the company operates;

- financial and operational risk management, including any counterparty risks;

- borrowing facilities, including headroom against overdraft facilities;

- contingent liabilities; and

- subsidiary companies, specifically the fact that directors of subsidiary companies need to make their own assessment to support disclosure of principal risks and uncertainties and of the subsidiary's ability to adopt the going concern basis of accounting.

Observation

Disclosures relating to solvency and liquidity risk should only be provided when material. The inclusion of immaterial information can mask key messages and affect the understandability of information provided in the annual report.

The Deloitte publication **Thinking allowed – Materiality**, issued in September 2015, provides guidance on applying the concept of materiality to those responsible for preparing, or approving for release, a general purpose financial report.

Small and micro companies

Although the scope of the draft guidance excludes small and micro companies, such entities may find some aspects of the guidance relevant. Small and micro companies are not required to prepare a strategic report but must assess whether the going concern basis of accounting is appropriate in preparing their financial statements.

Micro companies applying FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* and small companies applying Section 1A Small Entities of FRS 102 *The Financial Reporting Standard Applicable in the UK and the Republic of Ireland* are not explicitly required by those standards to provide disclosures on the going concern basis of accounting. However the directors of small companies should provide such disclosures if judged necessary in order to meet their responsibility to prepare financial statements that give a true and fair view.

Observation

In assessing whether the going concern basis of accounting is appropriate in preparing their financial statements, small and micro companies may find paragraphs 3.1-3.12 of the draft guidance useful.

Further infomation

If you have any questions about the subjects raised in this publication, please speak to your normal Deloitte contact. More information on the existing UK reporting framework, as well as other UK accounting, reporting and corporate governance news and publications, can be found at www.ukaccountingplus.co.uk

The FRC Exposure Draft: Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks can be found at www.frc.org.uk

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