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National Accounting & Audit

# Governance in brief

## Your summary of the latest corporate governance developments

### Headlines

- Major development on director liability
- Changes proposed to the ground rules for directors of listed companies on going concern

### Major development on director liability

In Brief: Directors will welcome the news that HM Treasury has decided in favour of extending liability relief for companies but against an extension of the statutory liability regime to directors. However, HMT's proposals are not without a sting in the tail. The changes proposed will allow sellers of securities (as well as buyers) to recover from issuers losses arising from fraudulent misstatements. This is likely to lead to more litigation. In addition, a new liability is created for issuer companies – liability for dishonest delay of a disclosure.

The subject of the UK policy on issuer liability for disclosures arose following calls for a 'safe harbour' during the implementation of the Transparency Directive into UK law. After consultation, the Government sought Parliamentary approval for a statutory liability regime that was established in section 90A of the Financial Services and Markets Act 2000 (FSMA), in the section inserted by the Companies Act 2006. It acknowledged, however, that further adjustment to the regime might well be required to address some complex issues that remained unresolved. Accordingly, Treasury was given power in section 90B of FSMA to make further provision about the liability of issuers, including amendments to section 90A.

HM Treasury undertook to explore these issues more fully. Professor Paul Davies QC was asked to carry out an independent review of liability in respect of damage or loss suffered as a consequence of inaccurate, false or misleading information disclosed by issuers or their management to the market, or of the failure to disclose relevant information to the market promptly or at all. Following extensive discussions with stakeholders – including main market and alternative market listed issuers, lawyers and accountants, financial advisers, industry associations and investor groups – Professor Davies published a final set of proposals for further change to the law in June 2007. The Government has considered these and this consultation sets out the Government's response and draft regulations.

In line with Professor Davies' recommendations, the Government proposes the statutory regime be extended to:

- issuers with securities admitted to trading on UK multilateral trading facilities (MTFs), as well as those admitted to regulated markets. This would bring issuers on markets such as AIM and the PLUS-quoted market into scope;
- issuers with securities admitted to trading on an EEA regulated market or MTF, provided they have a registered office in the UK or the UK is their home state under the Transparency Directive;
- a broad range of ad hoc and periodic disclosures to markets including preliminary announcements (over and above periodic disclosures required under the Transparency Directive), by enlarging the regime to include information disclosed by issuers by means of a recognised information service. A third party claiming damages would not have to show that the relevant information was obtained from the recognised information service. And a recognised information service would be defined as any service used to publish regulated information under the Transparency or Market Abuse Directives, or information required to be published under the rules of an MTF;

- permit sellers, as well as buyers, of securities to recover losses (from issuers) incurred through reliance on fraudulent misstatements; and
- permit recovery for losses resulting from dishonest delay of a disclosure. An issuer would be liable where the delay is a dishonest act and is for the purpose of enabling a gain to be made or to cause loss to another or expose another to a risk of loss.

Directors remain liable to the company for negligence and liable to be sued by the company or by a shareholder on behalf of the company through the new derivative action procedure in the 2006 Companies Act.

**Date**: 17 July 2008

**Source**: HM Treasury

**Deadline for comment:** 9 October 2008

**Further info**:

http://www.hmtreasury.gov.uk/newsroom_and_speeches/press/2008/press_79_08.cfm

### Changes proposed to the ground rules for directors of listed companies on going concern

**In Brief**: Challenges presented by the current economic conditions have raised the importance of consideration of going concern by directors. It is therefore perhaps appropriate that the Financial Reporting Council is proposing some changes to the 1994 Guidance for Directors on going concern and financial reporting. The FRC is seeking to determine whether this guidance remains appropriate, or whether it can be improved.

In addition to the turbulent markets and slowdown, there have been substantial changes to the accounting standards applied by directors of listed companies since 1994, in particular for directors preparing consolidated accounts required to comply with International Financial Reporting Standards. The guidance, developed by a working group comprising members of the Hundred Group of Finance Directors, the Institute of Chartered Accountants in England & Wales and the Institute of Chartered Accountants of Scotland, has not been subject to any revision since it was issued. The Listing Rules refer specifically to the need to consider the guidance when directors make their statement that the business is a going concern.

The FRC has taken the approach to keep amendments to the minimum necessary and to seek views from stakeholders on whether more fundamental changes are necessary.

Broadly the procedural guidance has been little changed and the guidance on relevant financial reporting requirements has been updated. However, rather confusingly, the proposals introduce a fourth possible conclusion to be reached by directors when making their going concern statement:

"[the directors] have identified material uncertainties that may cast significant doubt about the ability of the company to continue as a going concern and so additional disclosures are required by IFRSs."

This results in two possible options being 'doubt' or 'significant doubt'. Interested parties should consider whether this is an effective new option, as either conclusion is likely to result in the same outcome for the audit opinion, i.e. an emphasis of matter. Perhaps what is needed is more recognition of the circumstance of concern but not significant concern about the going concern basis.

The FRC has decided to continue to require directors to disclose if their period of review does not extend to at least twelve months from the date of approval of the financial statements. This continues to be inconsistent with, and is more onerous than, the requirements of IAS 1, which requires consideration of a period of twelve months from the balance sheet date.

Given the deadline for comment, the FRC does not believe it will be practical to issue revised guidance before companies are completing their work on December 2008 year-ends. However, the FRC intends to publish a summary of key comments received, and its plan for revision, during December 2008. Care will be needed to avoid causing confusion for directors during the busy reporting season.

**Date**: 29 August 2008

**Source**: The Financial Reporting Council

**Deadline for comment:** 24 November 2008

**Further info**: http://www.frc.org.uk/press/pub1683.html

### Time to take action

- Consider the implications of the proposals for issuer liability fully and take the opportunity to input to the consultation process.
- Review the proposed changes to the Guidance for Directors on going concern and financial reporting and respond accordingly.

### On the horizon

- Revised Smith Guidance to be issued

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