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Going concern disclosures: Guidance by IASB

This article aims to:

Discuss the guidance provided by IASB vis-a-vis going concern assessment and related disclosures under IFRS in its educational material.

Introduction

Going concern is one of the fundamental assumptions underlying the preparation of the financial statements. Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future, unless management intends to liquidate the entity or cease operations or has no realistic alternative but to do so.

When the going concern basis of accounting is used, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and liabilities in the normal course of business.

Given the significant business disruptions caused by the novel coronavirus (COVID-19) for entities across almost all sectors, there is likely to be an increase in events and circumstances which may cast significant doubt on a company's ability to continue as a going concern for instance, significant decline in company's revenue, profitability and liquidity. In such a situation, it becomes important for the management to assess whether going concern assumption is still appropriate as a basis for the preparation of the company's financial statements. This area would require significant judgement.

Recently, the International Accounting Standards Board (IASB) has issued an educational material which aim to provide guidance on application of going concern requirements under the International Financial Reporting Standards (IFRS) by companies. As per IASB, management would need to consider wider range of factors before it can conclude whether preparing financial statements on a going concern basis is appropriate. For instance, in the current environment, it should consider relevant factors such as the effects of any temporary shut-down or curtailment of the entity's activities, possible restrictions on activities that might be imposed by governments in the future, the continuing availability of any government support and the effects of longer-term structural changes in the market (such as changes in customer behaviour).

Additionally, it also emphasised on the need of providing adequate disclosures relating to going concern by companies.

In this article, we aim to summarise key guidance provided by IASB on going concern related matters including disclosures in its educational material.

Dynamic assessment of going concern

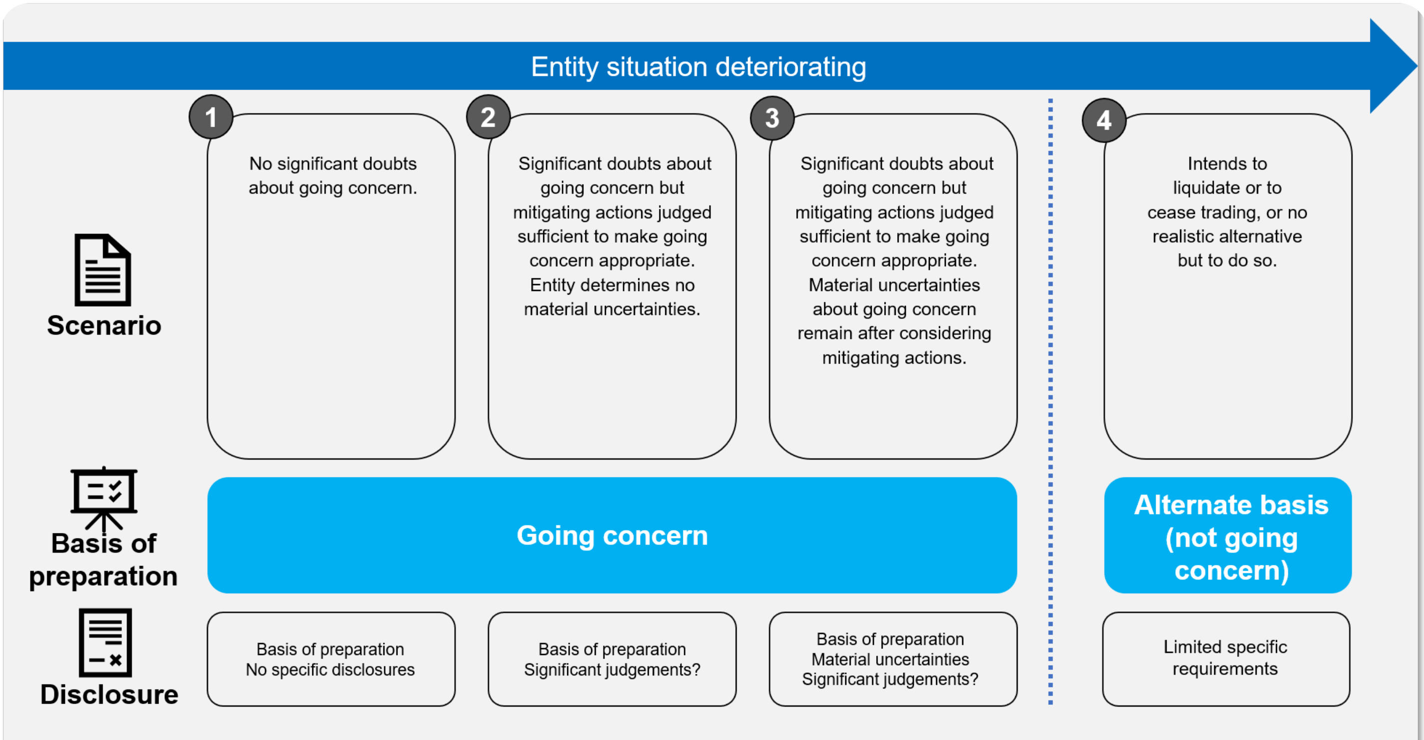
While assessing whether to prepare financial statements on a going concern basis, management is required to consider all available information about the future, for at least, but not limited to, 12 months from the end of the reporting period[1]. IASB in its educational material clarified that considering time periods longer than 12 months is not inconsistent with the requirements of IFRS, which establishes a minimum period, not a cap.

Management's assessment of the entity's ability to continue as a going concern might change rapidly in the current environment, therefore, management would be required to update the assessments of the going concern basis of preparation and decisions about which disclosures are necessary. If before the financial statements are authorised for issue, circumstances were to deteriorate so that management no longer has any realistic alternative but to cease trading, then the financial statements must not be prepared on a going concern basis.

Disclosures on going concern

Currently, IAS 1 requires an entity to disclose material uncertainties related to events or conditions that may cast significant doubt upon an entity's ability to continue as a going concern, if the management is aware of those uncertainties. It also requires disclosure of the judgements made in applying an entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Basis above, the IASB requires companies to consider not only the specific disclosure requirements relating to going concern but also the overarching disclosure requirements of IAS 1, in particular disclosures relating to significant judgements to conclude its position on going concern assessment.



(Source: IASB's educational material on 'Going concern - a focus on disclosure' issued in January 2021)

1. International Accounting Standard (IAS) 1, *Presentation of Financial Statements.*

Also, the circumstances in which an entity prepares its financial statements on a going concern could vary widely. Accordingly, following guidance has been provided in each of the given scenarios:

Scenario 1: No significant doubts about going concern

Example: An entity with profitable operations and no liquidity concerns and for which there are no significant doubts about its ability to continue as a going concern.

Guidance: For such an entity apart from the need to describe the basis of preparation, there are no specific disclosure requirements relating to going concern. It is also less likely that significant judgements would be involved in reaching the conclusion to prepare the financial statements on a going concern basis.

Scenario 2: Significant doubts about going concern but mitigating actions judged sufficient to make going concern appropriate. Entity determines no material uncertainties.

Example: An entity is loss-making, demand for its goods or services has decreased rapidly and its funding facilities are due to expire in the next 12 months. After considering the feasibility and effectiveness of the planned actions, management concluded that the material uncertainties are expected to be mitigated. For example, management might have started executing a turnaround strategy that is showing sufficient evidence of success including identifying feasible alternative sources of financing.

Guidance: As per IASB, if, after considering planned mitigating actions, management concludes that there are no material uncertainties that involve significant judgement, then the disclosure requirements of IAS 1 would apply to the judgements made in concluding that no material uncertainties remain.

In such a close call scenario, an entity should also consider disclosing information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Scenario 3: Significant doubts about going concern but mitigating actions judged sufficient to make going concern appropriate. Material uncertainties about going concern remain after considering mitigating actions.

Example: An entity is loss-making, demand for its goods or services has decreased rapidly and its funding facilities are due to expire in the next 12 months. Management has concluded after considering all relevant information including the feasibility and effectiveness of the actions it plans to take that preparing the financial statements on a going concern basis is appropriate.

However, management has concluded that there are material uncertainties relating to events or conditions that may cast significant doubt upon an entity's ability to continue as a going concern - for example, there might be considerable uncertainty about management's ability to execute its turnaround strategy to address the reduced demand and to renew or replace funding.

Guidance: In such a situation, in addition to disclosing the material uncertainties, the entity is required to apply the disclosure requirements of IAS 1 relating to the judgement that the going concern basis is appropriate. The conclusion to prepare the financial statements on going concern basis is likely to have involved significant judgement. An entity would disclose material uncertainties and disclose judgement that going concern basis is appropriate. While applying these requirements, an entity should consider what information is material about:

a. The events or conditions that cast significant doubt upon an entity's ability to continue as a going concern and

b. The feasibility and effectiveness of management's actions or plans in response to those events or condition.

Scenario 4: Intends to liquidate or to cease trading, or no realistic alternative but to do so	**Example:** An entity which intends to liquidate or to cease trading, or no realistic alternative but to do so and is no longer a going concern. **Guidance:** In such a situation, going concern basis of accounting is not appropriate. However, IAS 1 does not specify an alternate basis for preparing financial statements if the entity is no longer a going concern. Companies are required to disclose the fact that the financial statements have not been prepared on a going concern basis and the reasons why the entity is not regarded as a going concern. Also, the basis on which the financial statements have been prepared need to be disclosed.

Conclusion

Given the rapidly changing economic and business circumstances and the impact of COVID-19, it is imperative for the companies to provide adequate disclosures about these judgements and the assumptions used in making the assessment including disclosures about uncertainties identified in the going concern assessment where relevant. The required disclosures will depend on the facts and circumstances of each entity and their exposure to the current evolving environment. Robust and entity-specific disclosures around going concern would help achieving transparency and provide users with the relevant information.