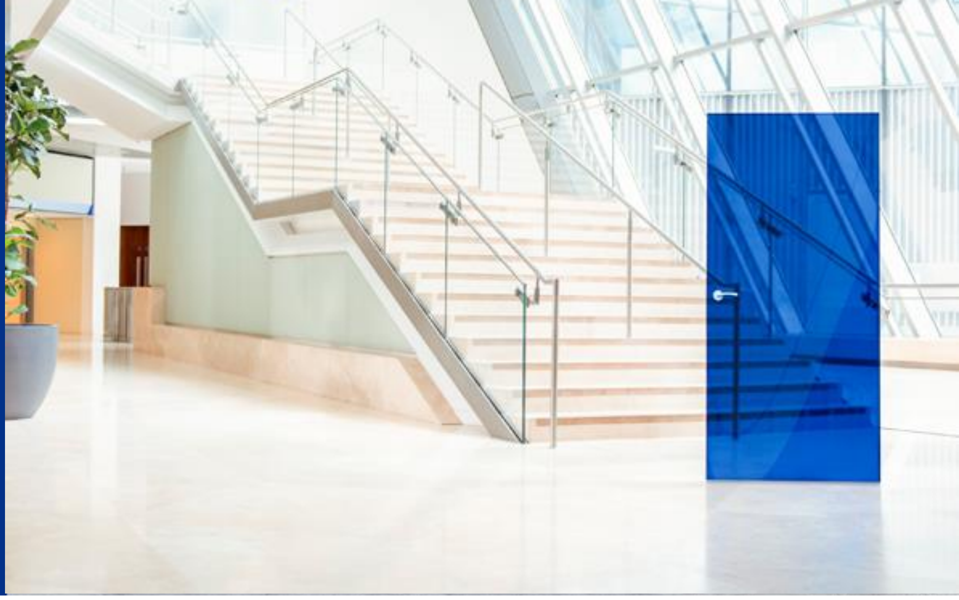
Viability and going concern

KPMG Board Leadership Centre



The Financial Reporting Council (FRC) has published Thematic Review: Viability and going concern , a summary of the key findings of their review of the viability and going concern disclosures for a selection of annual reports and accounts which have year ends between December 2020 and March 2021. It aims to provide useful guidance for preparers of annual accounts by identifying areas where viability and going concern disclosures could be improved, and by providing examples of better disclosures.

Although the effects of COVID-19 were uneven across the economy, all companies were impacted and many were, and still are, operating under severe pressure and high levels of uncertainty.

In the face of these challenges, users of accounts want to understand not only how companies intend to navigate through the pressures and uncertainties created by COVID-19 but also the way in which they intend to maintain their solvency and liquidity over the short, medium and longer term. Consequently, it is important that annual reports and accounts include clear and comprehensive viability and going concern disclosures - which is the focus of this FRC thematic review.

Summary of key observations

— The FRC highlight several areas where viability and going concern reporting can be improved and encourage preparers to consider carefully their findings when drafting their forthcoming annual reports.

— FRC suggest that companies should maintain a focus on providing better, more informative, company specific disclosure which is still clear and concise and avoids unnecessary clutter. In this respect, the FRC noted an opportunity for companies to cut duplication in the annual report through better use of cross-referencing between viability and going concern statements.

— The thematic review sets out that viability and going concern disclosures generally lack sufficient qualitative and quantitative detail in respect of the inputs and assumptions used in the scenarios prepared to aid the assessment of viability and going concern. The FRC note that companies can, and should, do a better job of providing more granular information, though they acknowledge that the amount of information provided should be proportionate to the uncertainties to which a company is exposed, and to its financial position. A company facing greater uncertainty and with less financial headroom should be providing more detail than one without such challenges.

Highlights

The review found that:

— the disclosure of inputs and assumptions used in forecast scenarios to support the viability and going concern assessments often lacked sufficient qualitative and quantitative detail; and

— in some cases, there was evidence to indicate that significant judgements may have been applied in determining whether a company was a going concern or whether this was subject to material uncertainty, but these judgements were not identified or explained.

— The FRC identified several circumstances where information in the financial statements indicated that significant judgement may have been applied in determining whether the company was a going concern or whether there was a material uncertainty in respect of going concern to disclose, yet no significant judgement disclosures were presented. The review clarifies that the FRC expect company specific significant judgement disclosures to be presented in cases where significant judgement has been exercised either in determining whether a company is a going concern or whether a material uncertainty in respect of going concern exists.

— All the annual reports reviewed noted that the principal risks and uncertainties identified in the strategic report had been considered when assessing viability. However, disclosure of how those risks and uncertainties had been modelled in the viability scenarios was not always clear. The best disclosures clearly mapped the principal risks identified to the viability scenarios tested.

— The thematic review notes that, for the most part, companies did not disclose information on how they were resilient to risks which could threaten either their going concern status or longer term viability. The FRC encourage companies to clearly disclose how they are resilient to principal risks and how the impact of such risks could be mitigated if they were to crystalise.

— The most common viability period selected by companies was three years. Although most companies disclosed why this was an appropriate viability period, the FRC note that the explanations provided often failed to fully identify and consider all of the relevant factors in determining this period. The FRC state that companies should consider debt repayment profiles, the nature of the business and its stage of development, planning and investment periods, strategy and business model and capital investment when selecting the viability assessment period.

— The recent BEIS White Paper [Restoring trust in audit and corporate governance] proposes a new resilience statement that includes *inter alia* a medium term assessment period covering five years rather than the three year period most commonly used now. The Government is currently reviewing responses to the consultation and will bring forward final policy proposals in due course.

  Notwithstanding this ongoing process, The FRC encourage companies to provide longer term information and extend their period of assessment where possible. They also set out that they do not expect the period of assessment to be shorter than the period covered by any detailed budgets or forecasts (before extrapolations) which have been approved by management and used in other forward-looking areas of the financial statements such as impairment testing.

— In many cases, the viability and going concern disclosures lacked sufficient detail to enable a reader to assess whether the assumptions used were consistent with those applied in other areas of the financial statements. We expect information provided within the viability and going concern disclosures to be internally consistent and consistent with other parts of the report and accounts. We also expect information to be presented in sufficient detail for the reader to appreciate the interrelationship between the various related disclosures.

FRC Corporate Reporting Reviews (CRRs)

The thematic review notes that the government intends to legislate to expand the FRC's existing powers so that its proposed power to direct a company to make changes to its report and accounts, extends to the entire annual report – thus bringing the viability statement within scope. (It should also be noted that the same government consultation also proposes to adopt and incorporate the viability statement within the new statutory resilience statement.

In the meantime, the government expects companies to engage voluntarily with the FRC and make necessary revisions to annual reports in respect of issues raised in areas which are currently outside of the FRC's formal enforcement remit. Given this direction, the FRC;s CRR teams have begun, on a sample basis, reviewing annual reports and engaging with companies in respect of areas which were previously outside remit where it appears that there is, or may be, a question as to whether there is a breach of the relevant reporting requirement; or in cases where there is an opportunity for a company to improve the quality of its reporting.

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