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COVID-19 | Impact on the going concern assessment and disclosures

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Current events and conditions may have a significant impact on a company's ability to continue as a going concern and therefore robust and entity-specific disclosures will need to be provided.

What's the issue?

The ongoing impact of the COVID-19 coronavirus pandemic continues to cause a significant deterioration in economic conditions for many companies and an increase in economic uncertainty for others. Management needs to assess whether these events or conditions, either individually or collectively, may cast significant doubt on the company's ability to continue as a going concern or, in severe cases, whether the going concern assumption is still appropriate as a basis for the preparation of the company's financial statements.

Although some sectors and jurisdictions are more affected than others, all companies across all jurisdictions need to consider the potential implications for the going concern assessment.

As companies start to prepare their year-end financial statements[1] under IFRS® Standards, disclosures around going concern will be especially important to achieve transparency and provide users with relevant information.

Getting into more detail

Going concern considerations, including financing challenges

Management is required to assess a company's ability to continue as a going concern. A company is no longer a going concern if management either intends to liquidate the company or cease trading, or has no realistic alternative but to do so. *[IAS 1.25]*

In assessing whether the going concern assumption is appropriate, management assesses all available information about the future, considering the possible outcomes of events and changes in conditions and the realistically possible responses that are available to such events and conditions. Those considerations include, among others, the current economic uncertainty and market volatility caused by the COVID-19 pandemic.

Given the rapidly changing economic and business circumstances and the impact of COVID-19, the period for which management takes into account all available information about the future may need to be extended beyond the minimum specified in IAS 1 *Presentation of Financial Statements* (which is at least, but not limited to, 12 months from the reporting date). This will depend on the company's specific facts and circumstances. *[IAS 1.26]*

1. The considerations included in this article will also apply to interim financial statements. For more information see our article on **What is the impact of COVID-19 on interim financial statements?**.

It is important that management's assessment considers different scenarios, including at least one severe but plausible downside scenario. The assumptions used in the going concern assessment should be consistent with those used in other areas of the company's financial statements.

Revising budgets and forecasts

In many cases, previously prepared budgets may now be of limited relevance given the rapidly changing economic and business circumstances. They may require significant revision – e.g. for forecast sales, gross margins and changes in working capital – to be able to support management's assessment in the current environment. After updating the forecasts, management will need to assess whether it expects to remain in compliance with financial covenants.

It will be critical for management to assess what impacts the current events and conditions have on a company's operations and forecast cash flows, with the key issue being whether a company will have sufficient liquidity to continue to meet its obligations as they fall due.

For example, a company may need to consider whether:

- it has sufficient cash and unused credit lines/borrowing facilities to meet short-term needs;
- further actions are needed by management to enable the company to generate sufficient cash flows to meet its obligations when they fall due;
- it needs to negotiate with lenders to restructure and/or increase borrowing facilities;
- to restructure operations to reduce operating costs;
- to defer capital expenditure; or
- to seek financial support from shareholders and/or government programmes designed to support businesses.

Financing challenges

Management should reassess the availability of financing because it may not be easily replaced and the costs may be higher in the current circumstances.

- Borrowers with weaker credit ratings may find it more difficult to access bond markets, and may find banks and other lenders less willing to renew or increase borrowing facilities.
- Lenders may demand new terms, such as significantly higher yields or improved collateral, particularly for companies in highly exposed sectors.
- Lenders themselves may be experiencing liquidity issues and may need central bank assistance to be able to continue to provide, or increase, financing.
- Borrowers with foreign currency-denominated debt may find that debt servicing costs increase significantly due to the depreciation of their local currency.
- Covenants in loan agreements may provide lenders with an opportunity to withdraw financing.

It is important for companies to consider not only traditional sources of financing but also other sources – e.g. supply chain financing and/or reverse factoring.

Subsequent events

If, after the reporting date, management concludes that the consequences of the pandemic result in a further deterioration in operating results and financial position that is so severe that the going concern assumption is no longer appropriate, then the financial statements would need to be adjusted – i.e. a change in the going concern assumption is considered an adjusting event. *[IAS 10.14–16]*

Disclosures

Given current market conditions and considering users' and regulators' expectations, it is critical that disclosures on going concern are clear and robust. The level of detail of disclosures will depend on the company's specific facts and circumstances, including the nature and extent of impacts on the company.

Material uncertainty scenario

While assessing the appropriateness of the going concern assumption, if management is aware of material uncertainties related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern, then the company should disclose those uncertainties. In our view, if there are such material uncertainties then a company should, at a minimum, disclose the following information:

- details of events or conditions that may cast significant doubt on the company's ability to continue as a going concern and management's evaluation of their significance in relation to the going concern assessment;
- management's plans to mitigate the effects of these events or conditions;
- significant judgements made by management in their going concern assessment, including their determination of whether there are material uncertainties; and
- an explicit statement that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, and therefore that it may be unable to realise its assets and discharge its liabilities in the normal course of business. *[IAS 1.25, IU 07–10]*

In our experience, if there are such material uncertainties then a company usually provides disclosure as part of the basis of preparation note in the financial statements.

Close-call scenario

In some cases, management may conclude that there are no material uncertainties related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. However, reaching that conclusion involved significant judgement. In these cases, the judgements made in concluding that there are no such material uncertainties are disclosed ('close-call' scenario). To meet these disclosure requirements, in our view similar information to that in respect of material uncertainties (as outlined in the first three bullet points above) may be relevant to the users' understanding of the entity's financial statements. *[IAS 1.122, IU 07-14]*

Liquidity risk disclosures

IFRS 7 *Financial Instruments: Disclosures* requires disclosure of quantitative data about liquidity risk arising from financial instruments. A company also needs to explain how it is managing this risk, including any changes from the previous period and any concentrations of liquidity risk. Disclosures addressing these requirements may need to be expanded, with added focus on the company's response to the impact of the COVID-19 pandemic. *[IFRS 7.33]*

Examples of specific disclosures required include:

- an explanation of how a company manages liquidity risk; and
- disclosures of defaults and breaches relating to the borrowings recognised during and at the end of the reporting period. *[IFRS 7.18–19, 39(c)]*

See our **Guide to annual financial statements – COVID-19 supplement**, which illustrates possible examples of going concern and liquidity risk disclosures.

Actions for management to take now

When assessing a company's ability to continue as a going concern, management may need to do the following.

- Update forecasts and sensitivities, as considered appropriate, taking into account the risk factors identified and the different possible outcomes. It is important to consider downside scenarios – e.g. taking into account the impacts of additional 'lockdowns', when relevant.
- Review projected covenant compliance in different scenarios.
- Assess its plans to mitigate events or conditions that may cast significant doubt on the company's ability to continue as a going concern. In particular, management would be expected to reassess the availability of financing. The company needs to assess whether its plans are achievable and realistic.
- Provide clear and robust disclosures, including disclosures about uncertainties identified in the going concern assessment where relevant.
- Consider relevant regulatory guidance.

References to 'Insights' mean our publication **Insights into IFRS**

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