What’s the issue?

The impacts of the COVID-19 coronavirus outbreak have caused a significant deterioration in economic conditions for some companies and an increase in economic uncertainty for others. Management needs to assess whether these events or conditions, either individually or collectively (‘current events or conditions’), 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 may be more affected than others, all companies across all jurisdictions need to consider the potential implications for the going concern assessment.

It is clear that companies in highly exposed sectors that are experiencing declining demand, falling sales and margin pressures will be more significantly impacted – particularly travel and tourism, hospitality/entertainment/sport, retail and the oil industry. Over time, impacts on sectors such as automotive may increase, if consumers defer large purchases until the uncertainty recedes.

Getting into more detail

Going concern considerations, including financing challenges

Under IFRS® Standards, 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 entity or cease trading, or has no realistic alternative but to do so. [IAS 1.25]

Companies are required to disclose material uncertainties related to events or conditions that may cast significant doubt on their ability to continue as a going concern. In addition, disclosure is required when management concludes that there are no material uncertainties but reaching that conclusion involved significant judgement (a ‘close call’). [Insights 1.2.80]

When management assesses the company’s ability to continue as a going concern, it will need to consider the current economic uncertainty and market volatility caused by the COVID-19 outbreak, which has been further exacerbated by a decline in oil prices.

In assessing whether the going concern assumption is appropriate, management assesses all available information about the future (which is at least, but not limited to, 12 months from the reporting date), considering the possible outcomes of events and changes in conditions, and the realistically possible responses to such events and conditions that are available. [IAS 1.26]
Revising budgets and forecasts

In many cases, 2020 budgets and forecasts prepared in 2019 may now be of limited relevance given the rapidly changing economic and business circumstances. These 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.

It is important that management’s assessment considers different scenarios, including a reasonably plausible downside scenario. 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 finance 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.

If management concludes that the consequences of the outbreak will result in a deterioration in operating results and financial position after the reporting date 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 10.14–15]

Disclosures

To the extent that events and conditions are identified that may cast significant doubt on a company’s ability to continue as a going concern, disclosure of uncertainties is required if these events constitute material uncertainties or management’s conclusion that there are no material uncertainties involved significant judgement. [Insights 1.2.80]
Supply chain, logistics and other disruptions or significant changes in demand can have implications for a company’s working capital. Many companies would need to adjust the way they manage liquidity to respond to the current market turmoil, including the use of alternative sources of funding. Additional disclosures will be needed, explaining those changes and how the company manages its liquidity in these difficult economic conditions.

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 COVID-19. [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)]

Given the significance and widespread impact of COVID-19, expanded disclosures may be necessary.

**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 a ‘lockdown’, 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 finance. The company needs to assess whether its plans are achievable and realistic.

References to ‘Insights’ mean our publication Insights into IFRS