# GOING CONCERN - IFRS FOUNDATION PUBLISHES GUIDANCE ON DISCLOSURES

## INTERNATIONAL FINANCIAL REPORTING BULLETIN

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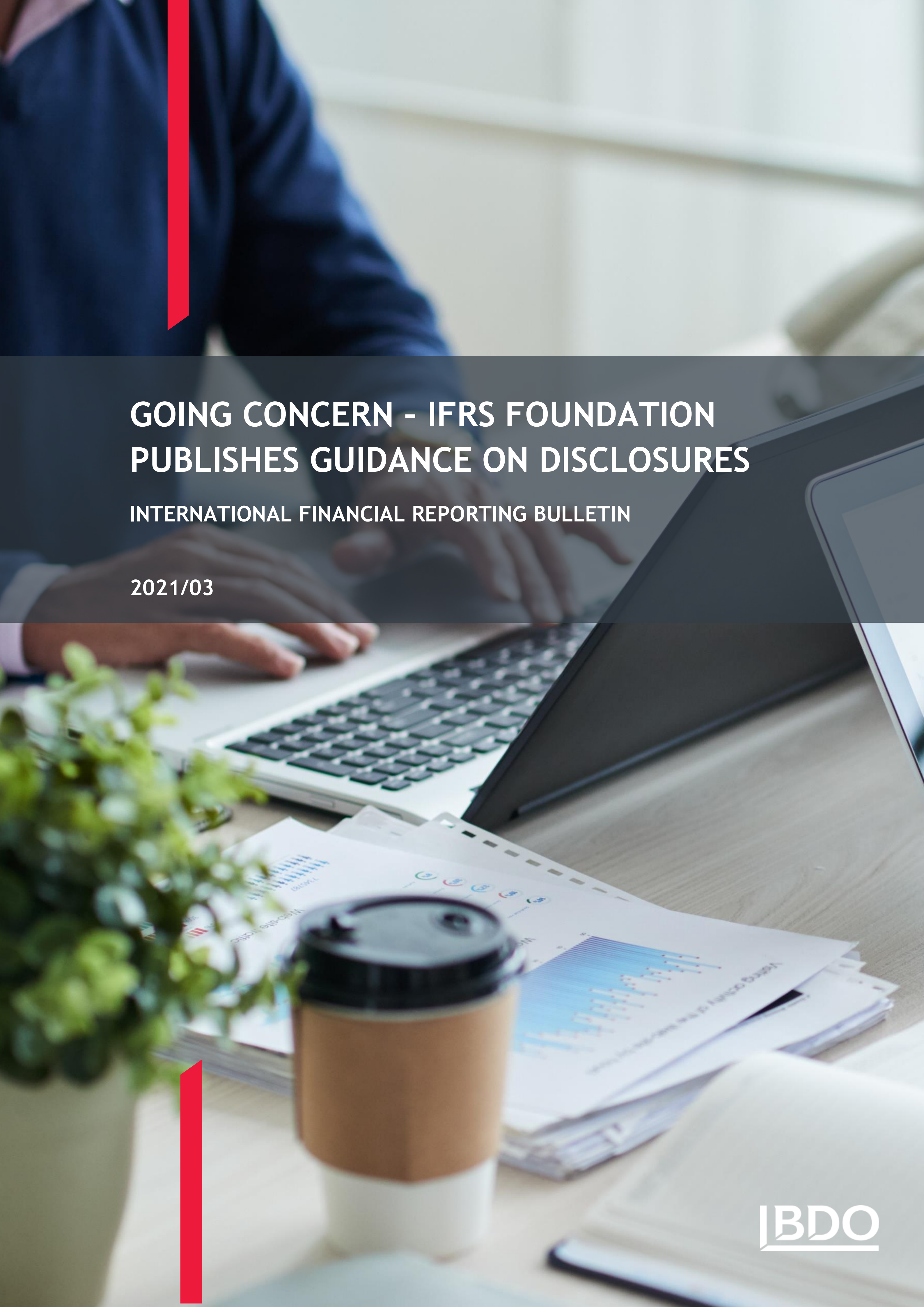

# BACKGROUND

The COVID-19 pandemic has resulted in a stressed economic environment on an unprecedented scale in recent history. Pervasive lockdowns and restrictions of movement have substantially affected overall economic activity. As a result, many entities are facing a significant downturn in revenue, profitability and liquidity. This may raise questions about their ability to continue as a going concern. Therefore, in the current scenario, determining the appropriateness of preparation of financial statements on a going concern basis requires a greater degree of judgement than usual.

IAS 1 *Presentation of Financial Statements* requires an entity to disclose material uncertainties related to its ability to continue as a going concern. However, IAS 1 also contains some overarching disclosure requirements that interact with specific going concern requirements.

To support consistent application of IAS 1 with respect to the specific going concern requirements and the overarching disclosure principles, the IFRS Foundation has published educational material. The educational material does not change or add to the existing requirements of IFRSs, and instead has been published to support the consistent application of those Standards.

**ACCOUNTING IMPACT**

In the current stressed economic environment, going concern assessments may require a greater degree of judgement than usual.

The IFRS Foundation has published educational material which highlights specific going concern disclosure requirements and overarching disclosure principles of IAS 1 *Presentation of Financial Statements.*

The educational material also makes reference to a 2014 Agenda Decision by the IFRS Interpretations Committee dealing with disclosure requirements relating to going concern assessment.

# ASSESSING GOING CONCERN AND ASSOCIATED DISCLOSURES REQUIRED BY IAS 1

IAS 1.26 states that management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing when assessing the entity's ability to continue as a going concern. It also requires management to take into account all available information about the future, which is at least, but not limited to, twelve months from the end of the reporting period. Some national regulations require management to consider a period of 12 months from the date that financial statements are authorised for issue for going concern assessment. Consideration of a longer period is not inconsistent with the requirements of IAS 1, which set only a minimum period.

The going concern assessment is a dynamic assessment and is required to be responsive to changing circumstances. Paragraph 14 of IAS 10 *Events after the Reporting Period* requires that financial statements of an entity shall not be prepared on a going concern basis if management determines after the reporting period that either it intends to liquidate the entity or to cease trading, or it has no realistic alternative but to do so. The assessment of the appropriateness of the use of the going concern basis of preparation needs to extend up to the date on which the financial statements are authorised for issue.

In the current economic scenario, circumstances are changing rapidly and management is therefore required to update its going concern assessment to reflect the changed environment. The circumstances in which the entity will prepare financial statements on a going concern basis will vary widely; from a scenario of profitability and adequate liquidity to 'close call' situations. As a result of the heightened uncertainty, greater judgement may be involved in management's decision making about the appropriateness of the going concern basis of preparation of financial statements. Therefore, it is important that the entity consider the overarching disclosure requirements of IAS 1 relating to judgements.

The educational material depicts the requirements of IAS 1 as set out below:

...entity situation deteriorating...

| | | | | |
|---|---|---|---|---|
| Scenario | Scenario 1:<br><br>No significant doubts about going concern | Scenario 2:<br><br>Significant doubts about going concern but mitigating actions judged sufficient to make going concern appropriate<br><br>Entity determines no material uncertainties | Scenario 3:<br><br>Significant doubts about going concern but mitigating actions judged sufficient to make going concern appropriate<br><br>Material uncertainties about going concern remain after considering mitigating actions | Scenario 4:<br><br>Intends to liquidate or to cease trading, or no realistic alternative but to do so |
| Basis of preparation | Going concern | | | Alternate basis (not going concern) |
| Disclosure | Basis of preparation<br><br>No specific disclosures | Basis of preparation<br><br>Significant judgements? | Basis of preparation<br><br>Material uncertainties<br><br>Significant judgements? | Limited specific requirements |

In scenario 1, there are no significant doubts about the entity's ability to continue as a going concern due to profitable operations and adequate liquidity. In this case, there are no specific disclosure requirements relating to going concern, apart from the basis of preparation. It is also less likely that significant judgements were involved in this case in the assessment of whether the going concern basis of preparation was appropriate.

At the other end of the spectrum where the going concern basis of preparation is followed, in scenario 3, the entity is close to ceasing to be a going concern. In this case, after considering all relevant information, management has concluded that going concern basis of preparation of financial statements is appropriate. However, management concludes that there are material uncertainties relating to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. In this case, the entity is required to disclose the material uncertainties relating to its ability to continue as a going concern, as required by IAS 1.25. It is also likely that the going concern assessment involved significant judgement and the entity would then be required to disclose those significant judgements in accordance with the requirements of IAS 1.122. *(See Appendix A for the text of those paragraphs in IAS 1)*

In scenario 2, there are significant doubts about the entity's ability to continue as a going concern. However, management concludes that there are no material uncertainties after considering mitigating factors. If management's conclusion involves significant judgement, the disclosure requirements of IAS 1.122 will be applicable.

Another example of overarching disclosure requirements is IAS 1.125-133, which require an entity to disclose sources of estimation uncertainty. Disclosures are required about assumptions an entity has made about the future, together with other major sources of estimation uncertainty at the reporting date, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. This overarching disclosure may also be relevant in disclosures about the assessment of going concern, especially in close call situations.

If the entity is not a going concern, the financial statements are required to be prepared on an alternate basis. IAS 1.25 requires the entity to disclose this fact and the reasons why the entity is not regarded as a going concern, together with the basis of preparation that has been applied.

## GUIDANCE ISSUED BY OTHER STANDARD SETTING BODIES AND FUTURE DEVELOPMENTS

Accounting standard setting bodies globally are paying close attention to the requirements around the assessment of the appropriateness of the going concern basis of preparation and the related disclosures. The New Zealand Accounting Standards Board has amended its IFRS equivalent standards, to specify additional disclosure requirements relating to going concern.

In September 2020, the International Auditing and Assurance Standards Board (IAASB) published a Discussion Paper Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statement Audit, which is open for consultation until 1 February 2021. The Discussion Paper deals with the audit requirements and the requirements in IAS 1 when there are material uncertainties relating to going concern.

The topic of going concern has been identified as a potential agenda item to be covered in the IASB's upcoming agenda consultation. A request for information will be published in March 2021.

## CONCLUSION

Entities are required to ensure that appropriate disclosures are provided in their financial statements, not only with respect to the specific going concern requirements of IAS 1, but also in compliance with the overarching principles of IAS 1 dealing with significant judgements and material uncertainties.

The educational material published by IFRS Foundation may be accessed here.

## APPENDIX A – EXTRACTS FROM IAS 1

Paragraph 25 of IAS 1:

*When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.*

Paragraph 122 of IAS 1:

*An entity shall disclose, along with its significant accounting policies or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.*