Covid-19 impact on the going concern assessment – the management perspective

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Abstract: *The pandemic outbreak has significantly impacted many businesses and their ability to continue operating as a going concern. Going concern is a basic accounting principle as well as one of the fundamental assumptions under the International Financial Reporting Standards. The management is responsible to determine whether the going concern assumption is relevant in the preparation of company's financial statements. With the progress of the novel coronavirus the focus on whether an entity is a going concern should be heightened. Taking into consideration the continuing uncertainty in the Covid-19 environment, the aim of the paper is to discuss the challenges through the lens of the company's management in the assessment of the going concern assumption. Few questions that should be considered when performing the analyses as well as some of the factors that contribute to a robust assessment are outlined. A special attention is given to disclosure requirements and their improvement in the Covid-19 context.*

Keywords: COVID-19, GOING CONCERN, UNCERTAINTY, DISCLOSURES, MANAGEMENT PERSPECTIVE

1. Introduction

Going concern is a basic accounting principle and one of the fundamental assumptions under the International Financial Reporting Standards (IFRSs). Referring to the latter, it is a responsibility of the management to assess it at the end of the reporting period when preparing company's financial statements. In case of material uncertainties related to the ability of the business to continue its operations as a going concern, the board should disclose those events or conditions. Moreover, it should take into consideration all the available information about the future that might cast significant doubt upon entity's ability to continue as a going concern.

The pandemic outbreak has significantly impacted many businesses and the consequences of Covid-19 might comprise of operational shutdowns, reduced demand of products/services, higher levels of indebtedness, reduced access to additional financing, etc. that deteriorate entity's operating results and financial position [1]. From the management's perspective, it is a challenge that should be approached accordingly and properly communicated with investors who seek clarity and it is important for them to receive complete information of a high-quality about company's future prospects and its ability to navigate through such uncertainty [2], [3]. The boards should disclose detailed and useful information in entity's financial statements and the going concern issue is one of the most impacted. Its assessment became a more complex task with the progress of the novel coronavirus [4].

Motivated by the new challenges in the assessment of the going concern assumption caused by the continuing uncertainty in the Covid-19 environment, the aim of the paper is to discuss them through the lens of the company's management and its responsibilities based on the requirements of IFRSs as the applicable financial reporting framework. Few questions that should be considered when performing the analyses as well as some of the factors that contribute to a robust assessment are outlined. Disclosure requirements and their improvement in the Covid-19 context are also highlighted.

2. Regulation on the going concern assumption

Management's responsibilities encompass not only the assessment of entity's ability to continue as a going concern, but also making and disclosing significant judgements related to the uncertainty associated with the future outcomes of events or conditions, the impact of external factors on entity's business and its future.

Going concern assessment requirements are provided in IAS 1 *Presentation of Financial Statements*, paragraphs 25-26. They are summarised on figure 1.

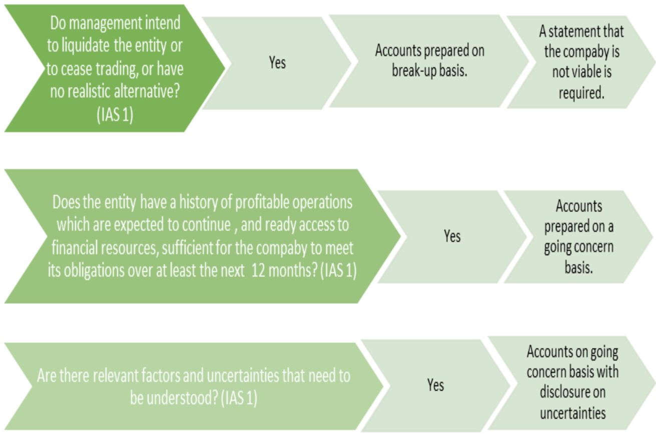

Fig. 1 *IFRSs regulation on the going concern, based on [4]*

If the management has no intention to liquidate the business or cease trading in the foreseeable future and there are no events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, then company's financial statements should be prepared on a going concern basis. According to IAS 1, paragraph 26, in all other cases, management should consider a variety of factors related to current and expected profitability, debt repayment schedules and potential sources of replacement financing in determining whether the going concern basis is appropriate [5]. For example, such factors might be any restrictions on entity's activity, imposed by the government as part of the Covid-19 measures, changes in customer behavior as a response to the pandemic, and other structural market changes in the longer-term [6], deferred payments of taxes, any changes in staffing levels and related staff costs as well as any government mitigating schemes [7]. For understanding any uncertainties and factors that might affect the board in assessing this fundamental assumption, relevant disclosures should be provided. Among the factors the management may need to consider in case of continuing uncertainties are 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).

IAS 1 requires all sources of estimation uncertainties to be disclosed. In regard of the going concern assessment, this implies providing information about the amounts that might lead to a material adjustment to the carrying amounts of assets and liabilities within the following reporting period. Moreover, entities are required to disclose some details of the nature and carrying values of those assets and liabilities at the end of the financial period.

When company's financial statements are not prepared on a going concern basis, this fact should be disclosed together with the applied alternative reporting basis. Information supporting such decision should be also revealed.

Company's management will be responsible for assessing entity's ability to continue as a going concern even if there are no explicit requirements but the going concern is still a fundamental assumption under the applicable financial reporting framework.

3. Questions to be considered from the company's management

There are few issues in respect of the going concern assessment that company's management should approach with due care in times of evolving uncertainty caused by the pandemic outbreak. Certain sectors are more affected as their business models are significantly disrupted by the spread of Covid -19. It has been highlighted that the board's decision should be grounded on relevant factors as the industry and geographic area of operations, customers' and suppliers' financial position, entity's liquidity and solvency [8], access to financing, terms and timing of funding, etc. Those factors might be impacted by expected future lockdowns, the government and market responses, for instance the short-term funding schemes provided by the government.

First, the management should identify all the risks and uncertainties caused by the global pandemic to the business, including entity's liquidity and solvency risks. The next step implies budgets' revision to guarantee their relevance in the current evolving environment. Further, the forecasts need to be revised and updated based on different scenarios regarding forecast sales, gross margins and changes in working capital. Sources of finance should be reassessed together with any covenant breaches, if applicable. In addition, management's plans for business restructuring or market expansion, new financing or restructuring of current debt is advisable to be reconsidered in light of the Covid-19 challenges and their impact on the global economy. [9]

The useful hint for assessing the adequacy of management assessment on the going concern are the auditors' expectations, set out in the auditing standard IAS 570 *Going concern* and we will change the lens for a while and for the sake of a more exhaustive discussion on the issue. The auditors' expectations where there are events or conditions that may cast doubt on company's ability to continue as a going concern as is the case of the pandemic outbreak implications on business, include the following:

- the events and conditions that might impact and cast doubt on entity's ability to continue operating as a going concern
- how the management plans to deal with such events and conditions
- if there is a material uncertainty in regard of those events and conditions, this fact accompanied by relevant information should be disclosed
- in case of identified material uncertainty about entity's ability to realise its assets and discharge its liabilities in the normal course of business operation, this fact needs to be disclosed [10]

Some examples of events and conditions resulting from the novel coronavirus pandemic and their potential impact on management's assessment on the going concern are outlined below:

- Loss of a major market, key customer(s), revenue, labour shortage
- Significant deterioration in the value of assets used to generate cash flows
- Significant deteriorations in the value of current assets – Inventory
- Delay in the launch of new products or services
- Foreign exchange fluctuations
- Measurements affected by increased uncertainty
- Counterparty credit risk
- The entity's solvency

For instance, if the entity has closed some of its physical stores and that caused a significant deterioration in the values of inventory, there might be significant write-downs and write-offs of inventories. In this regard the management has to consider how business disruption will further affect the entity after the restrictions have eased. As there are significant fluctuations in foreign exchange rates in the current stressed economic environment and some businesses with international transactions might be significantly affected, the board should take them into account, including their impact on any hedging arrangements aimed to reduce uncertainty arising from the Covid-19 pandemic. Sensitivity analysis of exchange rates movements should be also considered. [8]

Although the boards are not required to follow the auditing standards but only to comply with the applicable financial reporting framework, it is advisable for them to refer to them when assessing the adequacy of the provided disclosure on the going concern.

We would like to highlight that circumstances impacting board's assessment of the entity's ability to continue as a going concern might change rapidly in the current evolving environment and that might require assessment decision update. Paragraph 14 of IAS 10 *Events after the Reporting Period* states that any effects of events occurring after the end of the reporting period but before the authorisation of the financial statements for issue need to be reflected if they reveal that management has no other realistic alternative but to cease trading. [11]

4. Disclosure implications in the Covid-19 environment. Good practices.

The specific disclosure requirements relating to going concern, set out in paragraph 25 of IAS 1, should be complemented with the overarching disclosure requirements in the standard and in particular with paragraph 122. The latter requires disclosure of judgements that have significantly affected the amounts recognised in entity's financial statements [5].

If applying the requirements of IAS 1, four scenarios might be outlined, as follows [6]:

- Scenario 1 – there are no significant doubts about the going concern
- Scenario 2 – there are significant doubts about going concern but according to management's judgement going concern is appropriate due to mitigating actions; no material uncertainties are identified
- Scenario 3 – similar to Scenario 2, there are significant doubts about going concern but according to management's judgement going concern is appropriate due to mitigating actions; the difference, if compared to Scenario 2 is that there are material uncertainties about the going concern even after considering mitigating actions
- Scenario 4 – entity's management intends to liquidate or to cease trading, or has no other realistic alternative but to do so

In good times the first scenario is usually followed as there are no complications on board's assessment on the going concern assumption and related disclosure especially when the company has a history of profitable operations and guaranteed sources for fund raising. In contrast, the short-term disruption to business models makes the going concern assessment a much more complex task. Under both Scenario 2 and Scenario 3 more detailed analyses would be required and additional disclosures should be provided for supporting management's decision that the going concern basis is appropriate. In such cases a variety of factors related to profitability, access to additional funding, debt repayment schemes, etc. should be considered.

Due to the systemic uncertainties caused by the rapid spread of the novel coronavirus, the board might be less confident in stating that the company will be able to meet its obligations and will not cease its operations at least in a 12 months' period. Therefore, company's management is encouraged to provide relevant disclosures around those uncertainties and the impacts created by Covid-19 in medium and longer terms. These disclosures are summarised in table 1.

Table 1 *Disclosures on the going concern assessment in the Covid-19 environment*

• all significant judgements and estimates that were made by the company's management
• how the liquidity risk has been mitigated in the evolving economic environment impacted by the spread of the novel coronavirus
• all breaches or defaults in company's borrowing arrangements during the reporting period
• sources of uncertainty in estimating the carrying amounts of entity's assets and liabilities
• details on capital management – objectives, policies and procedures
• the timing and amount of entity's provisions and contingencies

Source: [9]

The going concern position should be clearly stated as well as the factors that support that decision, such as the cash position, support from others (including government schemes), current business activity etc. The management needs to provide details of the actions (both current and potential future) and their status. Disclosures should be enhanced with any details of the elements of uncertainty (specific to the business) and consideration of the impacts on the business where the position is subject to or impacted by uncertainty. The going concern disclosure should be connected to wider reporting within the report, such as risk and viability disclosures. [4, p. 6]

In particular, in a Covid-19 environment disclosures could be expanded by additionally providing useful forecast and assessments on any further lockdowns and restrictions imposed by the government on the industry, in which the business is operating. In addition, any information on government schemes and support packages as well as any details on the outcome of discussion with the fund providers, incl. banks, will be of investors' benefit. The short term implications on business operations comprise of impacts on customers and suppliers, expenses, prices and revenues, human capital, etc.

Another issue that should be considered is the depth of analyses performed [12] and whether the provided disclosures on the going concern assessment are sufficiently detailed. The issue implies:

- the relevance of disclosed information about the board's decision and the rationale behind it
- factors, uncertainties and contexts that must be understood
- interaction of the going concern disclosure with viability and risk disclosure [4]

In some jurisdictions, there might be implications regarding the period of assessment. For instance, in Australia, New Zealand and the UK, some modifications to the auditing standards have been introduced at a local level. From the management perspective, it implies consideration of no less than 12 months' period from the approval date of the entity's financial statements [10]. Such longer periods are consistent with the requirements in IAS 1, which establishes only the minimum period to be considered [6].

Some practice examples of going concern disclosures in a Covid-19 environment are provided in table 2.

Table 2 *Practice examples of going concern disclosures in the Covid-19 environment*

Company	Where?	What is useful?
Team 17 Group plc	Annual report for year ended 31 December 2019, p. 59	The company highlights that it has considered the impact of Covid-19 by carrying out a sensitivity analysis and as a result confirms that sufficient cash is available to meet its obligations over the relevant period.
G Barr plc	Annual report and accounts for the year ended 25 January 2020. p. 116	The company highlights that Covid-19 has been considered for assessing going concern and medium and longer-term viability. It confirms it has carried out scenario analysis, considering a number of factors. It also states the key assumption (Staying open) and confirms it has sufficient headroom on financing facilities.
Trainline plc	Annual report and financial statement for the year ended 29 February 2020. p. 55,57	The company provides some detail around how Covid-19 has been factored into the forecasts used to underpin its going concern assessment. It also highlights a number of actions. The statement is supported by detail in the audit committee report on oversight over the process.
Premier Oil plc	Annual report and financial statement for the year ended 31 December 2019. p. 55,57	The company details its base case and assumptions, and highlights that it has undertaken some sensitivity analysis. It highlights that Covid-19 has impacted one of its assumptions beyond the sensitivity conducted. It has considered this impact as well as a failure in corporate actions, and believes mitigating action could be taken. In the disclosure, it also considers circumstances where mitigations do not occur or are not effective.

Source: [4], pp. 9-13.

The aforeprovided examples reveal different management approaches in disclosing information about the going concern assessment, relevant to the entity's business and industry, factors of uncertainty and its future prospects in the evolving Covid-19 environment. What they have in common is the undertaken sensitivity analysis for confirming company's sufficient financing and viability under different scenarios and the disclosed mitigating actions. A good practice might be to include detail in the audit committee report on oversight over the process that supports the management statement.

5. Conclusion

Despite the degree of the Covid-19 impact on the business performance and future implication on the going concern, risk and viability, the board should provide sufficient information for the investors to understand which are the key factors that affect the level of uncertainty and the future of the company over the short, medium and longer terms.

Detailed disclosures about coronavirus-related uncertainties in the going concern assessment can help investors and other stakeholders understand different aspect of the company's prospects. However, it is not possible to address all investor questions in the entity's reports. Good comprehension might be gained through high quality, connected and holistic disclosure across the reports, both annual and interim [4].

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