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Need to know

IFRS Foundation publishes educational material on the requirements of IFRS Standards relevant for going concern assessments

Contents

This *Need to know* addresses the educational material **Going concern–a focus on disclosure** published by the IFRS Foundation in January 2021.

- The educational material, prepared as part of the IFRS Foundation's commitment to support stakeholders during the COVID-19 pandemic, highlights existing requirements of IFRS Standards on the assessment of whether the going concern basis of accounting remains appropriate and the disclosures that might be required about that assessment.
- Significantly, the educational material notes that:
  - Management's assessment of going concern is required to cover at least 12 months from the reporting date but that this is a minimum period, not a cap.
  - That assessment needs to reflect the effect of events occurring after the end of the reporting period up to the date that the financial statements are authorised for issue.
  - As well as the specific requirements to disclose the basis on which financial statements are prepared and any material uncertainties over going concern, disclosure of significant judgements made as part of a going concern assessment might be required under the general requirements of IAS 1.
- In most cases, compliance with the FRC's existing guidance on going concern will cover the requirements of IFRS Standards highlighted by the educational material.

For more information please see the following websites:

www.ukaccountingplus.co.uk

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Background

The COVID-19 pandemic has, along with other factors, led to a stressed economic environment and, for many entities, downturns in revenue, profitability and, importantly, liquidity giving rise to potential questions about their ability to continue as a going concern. For such entities deciding whether it remains appropriate to prepare their financial statements on a going concern basis may therefore involve a greater degree of judgement than is usual.

The IFRS Foundation's educational material does not change or add to the requirements of IFRS Standards in this respect, but rather highlights the existing requirements on assessing whether the going concern basis of preparation is appropriate and, importantly, the disclosures to be provided on that assessment.

Issues addressed by the educational material

The assessment of whether use of the going concern basis of preparation remains appropriate

The educational material highlights that:

- When preparing financial statements, whether annual or interim, IAS 1 *Presentation of Financial Statements* requires management to assess the entity's ability to continue as a going concern. The Standard defines going concern by explaining that financial statements are prepared 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.

- In making this assessment, IAS 1 requires management to look out at least 12 months from the end of the reporting period but emphasises that the outlook is not limited to 12 months. This is not inconsistent with some national regulations (for example, as discussed below, FRC requirements for UK companies) that require consideration of going concern for 12 months from the date that financial statements are authorised for issue.

Elaborating on these requirements, the educational material notes that management may need to consider factors that relate to the entity's current and expected profitability, the timing of repayment of existing financing facilities and potential sources of replacement financing and that, in the current stressed economic environment, an entity may be affected by a wider range of factors than in the past. For instance, the COVID-19 pandemic may give rise to factors such as 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).

The financial reporting effects of the COVID-19 pandemic, including in respect of going concern, are discussed in more detail in ***Need to know* – Accounting considerations related to the coronavirus disease**.

The educational material also highlights that IAS 10 *Events after the Reporting Period* explains that management's assessment of the use of a going concern basis of preparation needs to reflect the effect of events occurring after the end of the reporting period up to the date that the financial statements are authorised for issue. If, before the financial statements are authorised for issue, circumstances were to deteriorate so that management no longer has any realistic alternative but to cease trading, the financial statements must not be prepared on a going concern basis.

Observation

The reference to events after the reporting period may be particularly relevant in a dynamic environment which might arise due to changes in the severity of the COVID-19 pandemic and resulting actions by government or other parties (including the entity's own mitigating actions). It is important to note that developments after the reporting date but before the financial statements are authorised for issue should be factored into the assessment of going concern even if they are not themselves adjusting events under the general requirements of IAS 10.

The importance of disclosure

The educational material notes that the decision over whether to prepare the financial statements on a going concern basis is a binary one, but that the circumstances in which that basis is used can vary widely, from when an entity is profitable and has no liquidity concerns to when it is a 'close call' to prepare the financial statements on a going concern basis, even after considering any mitigating actions planned by management. In the current stressed economic environment, clear disclosure of where the entity sits within that spectrum and the assumptions and judgements made as part of management's assessment is likely to be a focus for users of financial statements.

In illustrating the disclosure requirements that might apply in different circumstances, the educational material presents a matrix of requirements that apply as an entity's circumstances deteriorate.

Entity situation deteriorating →

Scenario	No significant doubts about going concern	Significant doubts about going concern but mitigating actions judged sufficient to make going concern appropriate. Entity determines no material uncertainties.	Significant doubts about going concern but mitigating actions judged sufficient to make going concern appropriate. Material uncertainties about going concern remain after considering mitigating actions.	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 No specific disclosures	Basis of preparation Significant judgements?	Basis of preparation Material uncertainties Significant judgements?	Limited specific requirements

The educational material then highlights disclosure requirements which may be relevant for entities in each of the illustrated sets of circumstances.

- If there are no significant doubts about going concern, apart from the need to describe the basis of preparation, there are no specific disclosure requirements relating to going concern. It is also less likely that significant judgements were involved in reaching the conclusion to prepare the financial statements on a going concern basis.

- If the going concern basis of accounting is applied but there are material uncertainties (for example, about management's ability to execute its turnaround strategy to address reduced demand for its products and/or to renew or replace funding), IAS 1 requires disclosure of those uncertainties.

- If there are material uncertainties over going concern or there are significant doubts about going concern but not to the extent that a material uncertainty is considered to exist (for example, management might have started executing a turnaround strategy that is showing sufficient evidence of success including identifying feasible alternative sources of financing), disclosure of the significant judgements made by management (on whether the entity is a going concern or whether there is a material uncertainty) is required under the general requirements of IAS 1.

- The overarching requirements of IAS 1 on disclosure of sources of estimation uncertainty could also be relevant if there are any major sources of estimation uncertainty at the end of the reporting period that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

As reported in the **July 2014 *IFRIC Update***, the IFRS Interpretations Committee discussed a circumstance in which management of an entity has considered events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. Having considered all relevant information, including the feasibility and effectiveness of any planned mitigation, management concluded that there are no material uncertainties that require disclosure in accordance with paragraph 25 of IAS 1. However, reaching the conclusion that there was no material uncertainty involved significant judgement.

In this circumstance, the Committee concluded that the disclosure requirements of paragraph 122 of IAS 1 would apply to the judgements made in concluding that there remain no material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

Entities that are not a going concern

The educational material notes that IAS 1 does not specify an alternate basis for preparing financial statements if the entity is no longer a going concern, but requires the entity to disclose the fact that the financial statements have not been prepared on a going concern basis and the reasons why the entity is not regarded as a going concern, as well as disclosing the basis on which the financial statements have been prepared.

FRC guidance for UK entities

The Financial Reporting Council (FRC) has previously issued ***Guidance on Risk Management, Internal Control and Related Financial and Business Reporting*** (published in 2014 and primarily directed to companies subject to the UK Corporate Governance Code) and ***Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks*** (published in 2016 and intended for directors of companies that do not apply the UK Corporate Governance Code).

This guidance is wider in scope than the educational material (covering how an assessment of going concern should be conducted as well as the financial reporting implications of that assessment), but does specify that the assessment should cover at least 12 months from the date of approval of financial statements, not only the minimum 12 months from the reporting date required by IAS 1).

The FRC's guidance also illustrates disclosures that might be appropriate in different circumstances with different levels of uncertainty about going concern. In most cases, compliance with the FRC's guidance will cover the requirements of IFRS Standards highlighted by the educational material, however it does not specifically reference the IFRS Interpretations Committee's consideration of the requirement for disclosure of significant judgements over whether a material uncertainty exists. When relevant, entities should consider whether discussion of the going concern assessment should be identified as forming part of the wider disclosure of significant judgements required by IAS 1.

The FRC also addressed the issue of going concern in its ***Guidance for companies on Corporate Governance and Reporting*** in the context of the COVID-19 pandemic, highlighting the requirements of IFRS Standards discussed in the educational material as well as elaborating on the term 'material uncertainties' in this context, stating that "[t]his term may not be widely understood. It refers to uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. In other words, if boards identify possible events or scenarios (other than those with a remote probability of occurring) that could lead to corporate failure, then these should be disclosed. When identifying such events or scenarios, boards may take account of realistically possible mitigating responses open to them. Events could lead to corporate failure because of the scale of their adverse impact on the company and its ability to avoid liquidation or because of their timing."

Status of the educational material

The IFRS Foundation specifies that the educational material is published to support consistent application of IFRS Standards and does not change, or add to, existing requirements. As it is only highlighted existing requirements, the educational material has no effective date and the IFRS Foundation is not requesting comments on that material. However, the educational material does note that the topic of going concern has been identified as a potential agenda item to be covered in the International Accounting Standards Board's upcoming agenda consultation, for which it will be publishing a request for information in March 2021.

Further information

If you have any questions about the educational material please speak to your usual Deloitte contact.

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