



EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

XRB ALERT

2020-2



Spotlight on Going Concern Disclosures

For-profit Entities

HERE WE PROVIDE AN OVERVIEW OF DIRECTORS' RESPONSIBILITIES FOR THE ADEQUACY OF GOING CONCERN RELATED DISCLOSURES IN A COMPANY'S FINANCIAL STATEMENTS. IT INCLUDES COMMENTARY ON BOTH THE REQUIREMENTS IN THE ACCOUNTING STANDARDS AND AUDITOR EXPECTATIONS.

DISCLAIMER

This publication does not amend, interpret, or provide advice on the application of NZ IFRS or International Financial Reporting Standards (IFRS). Entities should view this publication as an overview of the requirement in the existing accounting standards and other commentary from XRB Staff. Entities must apply the principles in the existing accounting standards by applying professional judgement based on their own specific facts and circumstances. The contents of the publication are provided for general awareness raising purposes and does not constitute professional advice.

This publication does not represent formal authoritative guidance as approved by the XRB Board or its sub-Boards.

INTRODUCTION

Many companies¹ are currently facing unprecedented business disruption and uncertainty resulting from the impact of COVID-19 (coronavirus). The need for clear, concise, and effective communication of financial information is critical to maintain trust and confidence in company financial statements which are relied upon by investors, lenders, creditors, and other stakeholders.

OVERARCHING DIRECTOR RESPONSIBILITIES

Directors² are responsible for ensuring the financial statements relied upon by external users, fairly present the financial position, financial performance, and cash flows of the reporting entity. Fair presentation will require consideration of the impact of the coronavirus on all elements of the financial statements. Consideration should also be given to other information included in an entity's annual report to ensure a consistent understanding of the impact of the coronavirus is provided.

GOING CONCERN DISCLOSURES

The significant economic impacts of the coronavirus make it important for directors to give increased attention to assessing the company's ability to continue as a going concern, whether it is appropriate for the company's financial statements to be prepared using the going concern assumption and the adequacy of the related financial statement disclosures.

In the current environment, such going concern related disclosures will be:

- more prevalent – many companies are facing significant uncertainty about their ability to continue as a going concern, with the extent of that uncertainty varying across industry sectors and from company to company; and
- a key area of interest to investors, auditors and regulators – investors are looking for transparent and meaningful information to help them assess the company's financial position and its future prospects, including its ability to continue as a going concern, which also means that auditors and regulators will be closely examining such disclosures.

Going concern uncertainty is a reality for many companies; good disclosure is an opportunity to communicate that reality in a clear and transparent way.

¹ Reference to 'companies' in this document can be read as references to any entity that prepares financial statements in accordance with Tier 1 or Tier 2 For-profit Accounting Requirements as issued by XRB.

² Reference to 'directors' in this document should be read as including other terms used to identify those parties charged with governance of for-profit entities.

³ Reference to 'requirements' in this document includes applicable accounting standards and guidance in Agenda Decisions issued by the IFRS Interpretation Committee.

WHAT ARE THE DIRECTORS' RESPONSIBILITIES FOR GOING CONCERN DISCLOSURES?

The directors are ultimately responsible for determining whether it is appropriate for the company's financial statements to be prepared using the going concern assumption and for providing going concern related disclosures.

WHEN IS A COMPANY A GOING CONCERN FOR FINANCIAL REPORTING PURPOSES?

The going concern assumption is a fundamental principle that underlies the preparation of financial statements. Accounting standards require the company to assess its ability to continue as a going concern when preparing its financial statements at each reporting date (be that interim or year-end), up until the date when those financial statements are authorised for issue.

Financial statements must be prepared on a going concern basis unless the company either intends to liquidate or to cease trading or has no realistic alternative but to do so.

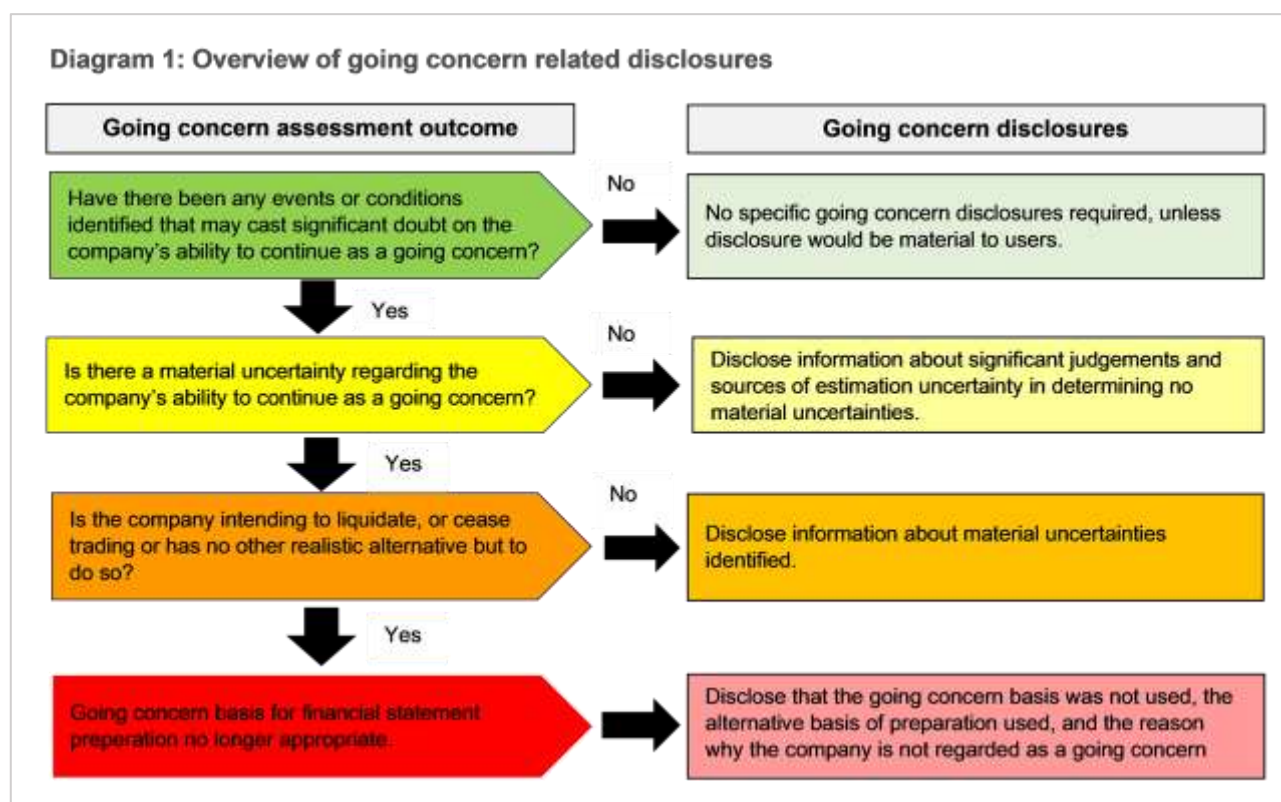
For some companies, the impact of the coronavirus may leave them with no realistic alternative but to liquidate or cease trading. Others may need to scale back operations or, seek additional finance. Some may not be significantly affected.

The assessment of whether the going concern assumption is appropriate requires consideration of both the director's intention and ability to continue operating the company as a going concern, taking into account all available information for at least, but not limited to, the next 12 months from the end of the reporting period. This assessment may require consideration of a wide range of factors, such as current and expected future profitability, debt repayment schedules and the availability of additional funding.

Given the rapidly evolving nature and effects of the coronavirus pandemic, the going concern assessment will need to be

WHAT DISCLOSURES ARE REQUIRED IN THE FINANCIAL STATEMENTS CONCERNING GOING CONCERN?

The nature and extent of going concern related disclosures will depend on each company's facts and circumstances. However, in general, it is expected that the going concern assessment will result in one of four possible outcomes. As outlined in Diagram 1 below each of these outcomes results in different disclosure requirement considerations.



The disclosure considerations for each of these four going concern assessment outcomes are discussed further below.

No events or conditions identified that may cast significant doubt on the company's ability to continue as a going concern.

Disclosures required by accounting standards	Other disclosure considerations *	Auditor's responsibility over adequacy of disclosures
- No specific disclosures on a company's going concern assessment are required. - General requirement to consider whether the coronavirus has had a material impact on the company's financial position or performance that should be disclosed.	Management's judgements applied in concluding that the coronavirus did not result in events or conditions being identified that may cast significant doubt on the company's ability to continue as a going concern.	- Evaluate the director's going assessment and the adequacy of relevant disclosures. - If the auditor does not agree with the company's going concern assessment or does not consider the disclosures are adequate, consider impact on auditor's report.

Events or conditions have been identified that may cast significant doubt on the company's ability to continue as a going concern, but no material uncertainties.

Disclosures required by accounting standards	Other disclosure considerations *	Auditor's responsibility over adequacy of disclosures
Disclose significant judgements made in reaching the conclusion that there are no material uncertainties related to events or conditions that may significantly cast doubt upon the company's ability to continue as a going concern.	- Information about the nature of the events or conditions identified that may cast significant doubt on the company's ability to continue as a going concern – e.g. expected drop in future revenue. - Management's assumptions and judgements made as to the nature of any mitigating factors and why they lead to no material uncertainties – e.g. ongoing access to central government support.	- Obtain sufficient audit evidence to conclude whether or not a material uncertainty exists in relation to the company's going concern assessment, including consideration of mitigating factors. - Evaluate the adequacy of disclosures about the events or conditions that may cast significant doubt on the company's ability to continue as a going concern. - If the auditor does not agree with the company's going concern assessment or does not consider disclosures are adequate, consider impact on auditor's report.

When the directors have applied significant judgement in reaching the decision that the company is a going concern, the auditor is required to consider whether the financial statements provide adequate disclosures about how these decisions were reached. These situations are described by auditors as the "close-call situations"—when no material uncertainties are identified in relation to the going concern assessment, but events or conditions are identified that may cast significant doubt on the company's ability to continue operating as a going concern.

Material uncertainties identified in relation to events or conditions that may cast significant doubt upon the company's ability to continue as a going concern

Disclosures required by accounting standards	Other disclosure considerations *	Auditors responsibility over adequacy of disclosures
When the directors are aware, in making the going concern assessment, of material uncertainties related to events or conditions that cast significant doubt on the company's ability to continue as a going concern, the company shall disclose those uncertainties.	• The potential impact of material uncertainties identified. • Significant judgements considered by the directors as part of the assessment of the company's ability to continue as a going concern.	When material uncertainties are identified, the auditor is required to evaluate the adequacy of disclosures about: (a) that there is a material uncertainty; (b) the events or conditions that give rise to the material uncertainties; (c) management's plans to mitigate the effect of material uncertainties identified; and (d) that the company may be unable to realise its assets and discharge its liabilities in the normal course of business.

Given the current impact of the coronavirus and how rapidly the consequences of, and responses to, the pandemic are developing, it is likely that many entities will need to disclose the existence of material uncertainties in relation to a company's ability to continue as a going concern.

The accounting standards do not define 'material⁴ uncertainty', because it depends on the company's individual facts and circumstances. Instead, judgement is required to determine whether the extent of uncertainties about the company's ability to continue as a going concern are material. For example, there may be a material uncertainty about the company's ability to deliver its strategies and successfully implement its plans to address the events or conditions that lead to the uncertainty.

When assessing whether material uncertainties exist, directors should consider both the potential impact of the uncertainty and the likely success of management's plans to mitigate the impact of this uncertainty.

⁴ Accounting standards contain guidance on the meaning of the term 'material' for financial reporting purposes. IFRS Practice Statement 2 *Making Materiality Judgements* provides guidance for companies on how to make materiality judgements when preparing financial statements in accordance with IFRS Standards.

Going concern basis for financial statement preparation not appropriate.

Disclosures required by accounting standards	Other disclosure considerations *	Auditors responsibility over adequacy of disclosures
When a company does not prepare financial statements on a going basis, it shall disclose: - that fact; - the reason why the company is not regarded as a going concern; and - the basis on which it has prepared the financial statements.	- Description of events that give rise to management considering the going concern basis of preparation to no longer be appropriate. - Explanation of the changes in accounting policy and why.	Evaluate whether there is adequate disclosure in the financial statements as to the alternative basis for preparation and the reasons for its use.

In the current environment, many companies that were previously treated as a going concern may no longer be treated as such over the next reporting period.

When a decision is made to liquidate a company or to cease trading, or the company has no realistic alternative but to do so, the financial statements should no longer be prepared on a going concern basis. In these circumstances professional accounting and legal advice should be sought to confirm the company's ongoing financial reporting obligations.

If financial statements are no longer prepared on a going concern basis, matters to consider include determining an appropriate alternative basis of preparation and whether changes to the accounting policies may be required as a result.

* Not specifically required by accounting standards but which are examples of information that might be material to users; examples are not exhaustive.