Educational material 2

APPLICATION OF IFRS STANDARDS IN LIGHT OF THE CORONAVIRUS DISEASE (COVID-19) UNCERTAINTY

Going concern

Issued April 2020

Ref: #762952

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1. Introduction

This educational material issued by SAICA's Accounting Practices Committee (APC) is prepared for educational purposes, highlighting the requirements within IFRS that are relevant for entities considering how the pandemic affects their accounting, for financial periods ending on or after 31 December 2019.

Entities are reminded to consider the impact of events related to COVID-19 on both interim and annual financial statements.

This guidance does not change, remove nor add to, the requirements in IFRS. It is intended to support the sound, consistent and robust application of requirements in IFRS. It is of importance that IFRS is applied consistently on the basis of the most robust reasonable and supportable assumptions in the current environment.

2. Going concern - Application of IAS 1 and IAS 10

When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern (IAS 1 paragraph 25) - this is particularly relevant in the context of the COVID-19 coronavirus outbreak, which has caused a significant deterioration in economic conditions for some companies, threatening their survival.

Read together with IAS 10 paragraph 14, this assessment needs to be performed up to the date on which the financial statements are authorised for issue. Management should also remember that events after the reporting date that indicate an entity is no longer a going concern are always adjusting events.

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 (IAS 1 paragraph 25). It is likely that more entities will disclose material uncertainties to going concern in the current circumstances.

Where management has concluded that there are no material uncertainties but arriving at this conclusion involved significant judgement, the disclosure requirements of paragraph 122 of IAS 1 would apply to the judgements made (IFRIC update, July 2014). Accordingly, the entity shall disclose the judgements that management have made in concluding that there are no material uncertainties (IAS 1 paragraph 122).

Financial statements shall be prepared on an alternative basis when the entity is no longer a going concern. This is when management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. 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 (IAS 1 paragraph 25). SAICA notes that an alternative basis could be a liquidation basis or any other basis deemed appropriate.

In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period (IAS 1 paragraph 26). Read together with IAS 10 paragraph 14, this assessment needs to be performed up to the date on which the financial statements are issued. This is particularly important due to the rapid pace at which events are unfolding. 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 before it can satisfy itself that the going concern basis is appropriate (IAS 1 paragraph 26). In this regard, this is a non-exhaustive list of considerations. The degree of consideration depends on the facts in each case.

Current and expected profitability

- Whether budgets and forecasts prepared in 2019 are still relevant for 2020 and 2021?
- What are the different scenarios that may arise as a result of the changing economic and business circumstances (both changing scenarios or changes within a scenario)?
- Expected impact on liquidity and profitability
  - Does the entity have access to liquidity?
  - What is the cash burn during the lockdown period, and the possibility of any further extensions?
  - Are there any significant payments due to creditors and shareholders? Does the company have the ability to reschedule these payments?
  - Impact on payment or return patterns of customers with long-term financing
- Has the company's supply chain been disrupted? Over what period has the company forecast this disruption to be in existence?
- How will the customer base be affected? Will this affect future sales? If it does not affect future sales, will this result in greater default rates?
- What is the impact on employees and employee benefits?
- How quickly will the entity be able to ramp up to normal capacity?
- Are there changes in overhead cost structures?
- Changes in markets impacting on import/export of raw materials and goods. Are travel restrictions and border closures expected to have a material impact on the ability to operate and achieve business goals?
- Impacts of commodity prices.
- Delays in project implementation resulting in penalties.
- Impact of labour shortages due to illness. Will operations be materially impacted by any constraints or other impacts on human capital resources and productivity?

- What is the impact on business continuity?

Debt repayment schedules

- Have any loan covenants been (or are expected to be) breached?
- Consider access to government support measures that have been announced.

Potential sources of replacement financing

- Will the entity have sufficient liquid funds and access to facilities to enable it to meet its obligations as they become due?
- Consider if the cost of or access to capital and funding sources has changed and whether it is likely to change or continue to change.

As a reminder, the assumptions used for the going concern assessment should also align or be an update to the forecast and forward looking assumptions used in the measurement of other balances on the statement of financial position e.g. IAS 36 – *Impairment of Assets* impairment assumptions, IFRS 9 – *Financial Instruments* expected credit loss forward looking assumptions.