



# The Impact of COVID-19 on Going Concern and Related Assessments

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# 1 Introduction and purpose of this document

COVID-19 is having an unprecedented impact on the economic outlook for the Australian and global economy. For the first time, many entities will be required to consider their solvency and ability to continue operating as a going concern in more detail.

This publication provides an overview of directors<sup>1</sup> and management's:

- duties in relation to assessments of solvency and going concern, how these concepts interact and how these may be impacted by COVID-19; and
- responsibilities to assess whether the going concern basis of preparation is appropriate and how this impacts the preparation of and the disclosures in their financial statements.<sup>2</sup>

This publication has also been prepared to assist auditors by providing an overview of an auditor's obligations in relation to going concern and directors' declarations of solvency, as part of their overall responsibilities when conducting an audit of the financial report.<sup>3</sup>

This publication does not amend, interpret or provide advice on the application of Australian Accounting Standards, Australian Auditing Standards or international financial reporting or auditing standards. Entities and auditors should view this publication as a guide to identify areas for consideration in preparing and auditing financial statements. Entities must apply those authoritative pronouncements to their own specific facts and circumstances.

This publication is relevant to all types of entities preparing financial statements in accordance with Australian Accounting Standards. Where requirements vary between entity type – such as between for-profit and not-for-profit entities (NFP) – every attempt has been made to distinguish the requirements. Some terminology used might be specific to for-profit entities, but this does not indicate that it is irrelevant to not-for-profit entities in the private or public sectors.

Whilst the focus of the document is on the impact of COVID-19 on solvency and going concern assessments, it is also relevant for other circumstances where solvency and/or going concern issues arise.

<sup>1</sup> References to directors in this document should also be read as responsible persons or office holder in the not-for-profit private sector, and terms used in other sectors used to identify those charged with governance.

<sup>2</sup> The terms financial statements and financial reports are both used in this publication. The financial report consists of the financial statement plus the directors' declaration.

<sup>3</sup> Auditors should also refer to the IAASB's Staff Audit Practice Alert Going Concern in the Current Environment – Audit Considerations for the Impact of COVID-19

## 2 Solvency and going concern assessments

### Overview of responsibilities and duties of those charged with governance relevant to solvency and going concern

This table outlines the different responsibilities relevant to those charged with governance of the entity. Throughout this publication those various responsibilities are discussed in more detail.

Table 1: Overview of responsibilities and duties of those charged with governance relevant to solvency and going concern

	Directors's duties – solvency	Directors's statement – solvency	Financial reporting – going concern
<b>For-Profit</b>			
<p><b>Companies required by the Corporations Act 2001 to prepare Financial Statements</b></p>	<p>A company must not trade while insolvent.</p> <p>Directors must actively monitor the financial position of the company and regularly assess solvency.<sup>4</sup></p> <p><i>Coronavirus Economic Response Package Omnibus Act 2020</i> relieves liability under <i>Corporations Act 2001</i> s.588G(2) for 6 months from 25 March 2020, where a company trades while insolvent and a debt is incurred in the ordinary course of the company's business and before the appointment of an administrator or liquidator (civil action). It does not relieve the directors from criminal offense under s588G(3).</p> <p>This relief does not take away directors' duty to make a statement of solvency in the Directors' Declaration contained in the financial report (required by <i>Corporations Act 2001</i> s.295(4)).</p> <p>Refer to <a href="#">Australian Securities &amp; Investments Commission COVID-19 Implications for financial reporting and audit: Frequently asked questions</a> number 10 (ASIC's FAQs) for further details on the temporary relief for directors in connection with insolvent trading.</p> <p>(<i>Corporations Act 2001</i> s.588G and subsections)</p>	<p>A declaration whether, in the directors' opinion, there are reasonable grounds to believe that the entity will be able to pay its debts as and when they become due and payable.</p> <p>Must assess at date of signing the annual or half-year financial report, as authorised through the Directors' Declaration.</p> <p>Solvency statement may be positive, refer to a material uncertainty or negative (if insolvent).</p> <p>Refer to <a href="#">ASIC's FAQ number 11</a> for further details on qualified solvency statements. Also <a href="#">Regulatory Guide 22</a> Directors's Statement as to Solvency.</p> <p>(<i>Corporations Act 2001</i> s.295(4)(c))</p>	<p>When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern (AASB 101 <i>Presentation of Financial Statements</i> paragraph 25).</p> <p>Management shall take into account all available information about the future, covering at least – but not limited to – twelve 12 months from the end of the reporting period (AASB 101 paragraph 26, refer also to section 3.2 of this publication for the relevant period required by the Auditing Standards). The basis of accounting should be adjusted if management determines that the going concern basis is no longer appropriate, including if that is determined after the reporting period (AASB 110 <i>Events after the Reporting Period</i> paragraph 14).</p> <p>Solvency and going concern are related but separate concepts.</p> <p>A company can be solvent but not use the going concern basis of preparation if the entity is able to pay current debts but has decided (or has no choice but) to liquidate the entity, or to cease trading in the future. In rare cases, a company can be insolvent but continue using the going concern basis of preparation if they are expected to be able to become solvent again, avoid liquidation and continue trading.</p> <p>Refer to section 2.1 and <a href="#">ASIC's FAQ number 11</a> for further details on the interplay between solvency and going concern assessments.</p> <p>(AASB 101)</p>



	Directors's duties – solvency	Directors's statement – solvency	Financial reporting – going concern
<b>For-Profit</b>			
<b>Companies within scope of Corporations Act 2001 but not required to prepare Financial Statements</b>	Same as companies required by the <i>Corporations Act 2001</i> to prepare Financial Statements (above)	n/a	n/a
<b>Others types of entities registered with another regulator that are for-profit</b>	Refer to requirements of specific legislation.	Refer to requirements of specific legislation.	Same as companies required by the <i>Corporations Act 2001</i> to prepare Financial Statements (above) if: <ul style="list-style-type: none"> <li>• preparing General Purpose Financial Statements; or</li> <li>• required or choose (e.g. in Special Purpose Financial Statements) to comply with AASB 101.</li> </ul>
<b>Not-for-Profit</b>			
<b>Charities registered with ACNC under the Australian Charities and Not-for-Profits Commission Act 2010</b>	Responsible persons of a charity cannot allow the registered charity to operate while insolvent.  Assessment is an ongoing duty.  If a charity becomes insolvent, it should seek professional advice immediately, and notify the Australian Charities and Not-for-Profits Commission (ACNC), their members and their state or territory regulator if incorporated. <sup>5</sup>  (ACNC Governance Standard 5, paragraph 2(g)).	For medium and large charities, same as for-profit companies required by the <i>Corporations Act 2001</i> to prepare Financial Statements.  (ACNC Regulations s60.15)	For medium and large charities, same as for-profit companies required by the <i>Corporations Act 2001</i> to prepare Financial Statements (see above).  (ACNC Regulations s60.10 and s60.30)
<b>Companies limited by guarantee reporting to ASIC</b>	Same as for-profit companies required by <i>Corporations Act 2001</i> to prepare Financial Statements (see above).	Same as for-profit companies required by <i>Corporations Act 2001</i> to prepare Financial Statements (see above).	Same as for-profit companies required by the <i>Corporations Act 2001</i> to prepare Financial Statements. (see above).
<b>Incorporated associations</b>	Refer to requirements of specific legislation.  Generally, legislation requires 'office holders' to exercise reasonable care, skill and diligence in carrying out the role of a committee member. This means office holders must prevent insolvent trading by the association, which includes the duty not to incur a debt that will cause the association to become insolvent.  Assessment is an ongoing duty.	Refer to requirements of specific legislation.	Same as for-profit companies required by the <i>Corporations Act 2001</i> to prepare Financial Statements if: <ul style="list-style-type: none"> <li>• preparing General Purpose Financial Statements; or</li> <li>• required or choose (e.g. in Special Purpose Financial Statements) to comply with AASB 101.</li> </ul>
<b>Public Sector</b>			
<b>All</b>	Refer to requirements of specific legislation.	Refer to requirements of specific legislation.	Same as for-profit companies required by the <i>Corporations Act 2001</i> to prepare Financial Statements.

4 ASIC's Regulatory Guide 217 Duty to prevent insolvent trading: Guide for directors

5 See <https://www.acnc.gov.au/tools/guides/governance-good-acncs-guide-charity-board-members>



## 2.1 What is an assessment of solvency?

The *Corporations Act 2001*<sup>6</sup> defines “solvency” as being able to pay all one’s debts, as and when they become due and payable.

At least annually (and half-yearly for listed entities and disclosing entities), the *Corporations Act 2001* requires directors, as part of the annual financial report, to make a declaration of solvency. This declaration states that in their opinion “*there are reasonable grounds to believe that the company, registered scheme or disclosing entity will be able to pay its debts as and when they become due and payable*”. When making this declaration, directors must consider the capacity to pay debts which it has incurred at the time of the declaration.

As detailed in [ASIC’s FAQ number 11](#), while the solvency statement is made at a point in time, the requirements concerning solvent trading apply at all times. Therefore, directors have an obligation to monitor a company’s solvency throughout the year, not just at year end/half yearly reporting dates or when signing solvency resolutions.

There are a number of potential consequences if an entity becomes insolvent. Directors should seek legal advice immediately if they suspect their entity is insolvent or likely to become insolvent.

Refer to [ASIC’s Regulatory Guide 22](#) (RG22) for further details on directors’ responsibilities in relation to solvency statements, as well as the events or conditions to be considered by directors when assessing solvency. Also detailed in RG 22 and [ASIC’s FAQs](#), the directors’ solvency statement may either state that:

- the directors have reasonable grounds to believe that the entity will be able to pay its debts as and when they become due and payable;
- there is a material uncertainty as to whether the entity will be able to pay its debts as and when they become due and payable – for example, the ability to renegotiate loans due for repayment; or
- the directors do not have reasonable grounds to believe that the entity will be able to pay its debts as and when they become due and payable (negative declaration).

RG 22 also provides details on when a material uncertainty or negative statement may be appropriate, and the disclosures required in the statement and/or the financial statements.

This helps ensure that directors comply with their legal obligations. This includes where a company continues in operation in reliance on temporary relief for directors in connection with insolvent trading provided during COVID-19.

The *Australian Charities and Not-for-Profits Commission Act 2010* (ACNC Act) also requires registered charities to assess solvency and provide a declaration in the same manner as described above for for-profit entities. The ACNC has also made available relief for charities from investigations into breaches of Governance Standard 5, which requires Responsible Persons to not operate while insolvent<sup>7</sup>. Other entities not registered with ASIC or the ACNC, such as incorporated associations that are not charities, should consult their relevant legislation to understand the applicable requirements.

<sup>6</sup> Entities not governed by the *Corporations Act 2001* should look to their relevant legislation. For example, not-for-profit entities registered with the ACNC should consider the requirements of the *Australian Charities and Not-for-Profits Commissions Act 2010* where the *Corporations Act 2001* is referenced.

<sup>7</sup> See [ACNC webpage](#) Charity Operations and COVID-19



## 2.2 What is an assessment of going concern?

The going concern assumption is a fundamental principle that underlies the preparation of the financial statements. When preparing financial statements, AASB 101 requires management to assess an entity's ability to continue as a going concern. An entity (whether for-profit or not-for-profit) prepares its financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or it has no realistic alternative but to do so. When assessing whether the going concern assumption is appropriate, all available information about the future should be considered that is at least, but is not limited to, 12 months from the end of the reporting period (refer section 3.2 for the relevant period required by the Australian Auditing Standards).

If a company is not able to continue as a going concern, its financial report will need to be prepared on an alternative basis. Refer to section 6 for more detail. Under Australian Accounting Standards and the *Corporations Act 2001*, directors must satisfy themselves that it is appropriate to prepare the financial report on a going concern basis.

## 2.3 What is the interaction between the solvency and going concern assessment?

Directors have a responsibility to assess both solvency and going concern. Determining solvency is separate to assessing going concern, and whilst rare, it is possible that the outcome of these assessments will be different, in particular due to the current directors' temporary safe harbour relief on insolvent trading (refer [ASIC FAQ 10](#) for more detail).

As discussed above, an entity is assumed to be a going concern unless management either intends to liquidate the entity or to cease trading, or it has no realistic alternative but to do so. The going concern assessment is for a period of at least, but is not limited to, 12 months from the end of the reporting period (refer to section 3.2 of this publication for the relevant period required by the Auditing Standards). In comparison, a company is insolvent when it is unable to pay all its debts as and when they become due and payable. This considers the capacity to pay debts which it has incurred at the time of the declaration. An entity may be able to pay its existing debts but needs to wind-up its operations for other reasons, such as a loss of a major contract, and is therefore solvent but not a going concern. Alternatively, an entity may not be solvent but may elect to continue operations, and the directors may assess the going concern basis of preparation is appropriate.

If the solvency statement is different to the assessment of going concern, additional disclosures may be required in the financial statements to explain the reasons for the different conclusions. This information may be necessary for an understanding of the financial statements (AASB 101 para 112(c)) and to give a true and fair view (CA 297). ASIC's Regulatory Guide 22.11 states:

*"Where a qualified statement impinges upon the "going concern" assumption as the basis for preparing accounts, the directors should explain in the accounts their reasons for adopting the assumption in the light of the qualified statement. Similarly, where directors state that there are reasonable grounds to believe the company will be able to pay its debts as and when they fall due despite prima facie indications to the contrary from the accounts, the directors should disclose the reasons for that opinion in order to ensure that the accounts disclose a true and fair view".*



## **Overview of the auditor's responsibilities regarding solvency statements and going concern assessments**

### **2.4 What are the auditor's responsibilities regarding solvency statements and going concern assessments?**

The directors' solvency statement is contained in the directors' declaration on the financial report, and therefore auditors consider its compliance with the *Corporations Act 2001* when forming a view on the financial report as a whole.

Under ASA 570 *Going Concern*, the auditor has an explicit requirement to conclude on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial report, and whether a material uncertainty exists in relation to going concern. ASA 570 also requires the auditor to assess whether going concern matters are adequately disclosed in the financial report.

### **2.5 What are the obligations of the auditor under section 311 in relation to solvency and going concern?**

In addition, the auditor is required by section 311 of the *Corporations Act 2001*, to notify ASIC where they have a reasonable suspicion regarding significant contraventions of the *Corporations Act 2001*. ASIC has specifically stated in Regulatory Guide 34<sup>10</sup> that they consider trading whilst insolvent and non-compliance with Accounting Standards if the auditor does not agree with the basis of preparation, to be considered significant contraventions. Refer to [ASIC FAQs](#) for further details on an auditor's responsibilities regarding section 311 under the current temporary relief for directors trading whilst insolvent.

There is also a requirement for auditors of charities under the ACNC Act s65 5(2) to notify ACNC of any significant contraventions of the ACNC Act.

### **2.6 What are the disclosure requirements outside of the financial statements?**

The following additional disclosure requirements outside the financial statements also become relevant where an entity identifies issues with solvency or its ability to continue as a going concern. These requirements are not set by the AASB and entities should refer to the specific requirements for more information.

<sup>10</sup> [ASIC's Regulatory Guide 34 Auditor's Obligations: Reporting to ASIC](#)



	Directors's disclosure requirements outside the financial statements	Auditor's responsibilities
<b>For-Profit</b>		
<b>Disclosing Entities (as defined by Corporations Act 2007)</b>	<p>Listed disclosing entities – ASX Continuous Disclosures</p> <ul style="list-style-type: none"> <li>Under listing rule 3.1, once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information.</li> </ul> <p>Unlisted disclosing entities – Corporations Act 2001</p> <ul style="list-style-type: none"> <li>Continuous disclosure requirements under s675 of the Corporations Act 2001</li> </ul> <p>See further <a href="#">ASX COVID-19 guidance</a>, <a href="#">ASX Guidance Note 8</a> and <a href="#">ASIC Regulatory Guide RG 198</a></p>	<p>The auditor does not provide assurance over whether the entity has complied with continuous disclosure requirements, however under ASA 250 <i>Consideration of Laws and Regulations in an Audit of a Financial Report</i> the auditor is required to respond appropriately if any non-compliance or suspected non-compliance is identified during the audit (refer to ASA 250 paragraph 19 for more detail). The auditor also considers its obligations under section 311 of the Corporations Act 2001. Refer to Regulatory Guide 34.<sup>11</sup></p>
<b>Companies required by the Corporations Act 2001 to prepare Financial Statements (including disclosing entities)</b>	<p>Corporations Act 2001 s299/299A Directors' Report</p> <ul style="list-style-type: none"> <li>Must include a review of operations, and for listed and disclosing entities additional specified information (Operating and Financial Review)</li> <li>Should <b>explain</b> (rather than repeat) the information in the financial report related to any doubt over the entity's solvency or uncertainties around its ability to continue as a going concern</li> </ul> <p>Refer to <a href="#">ASIC's FAQs</a> for further information (Corporations Act 2001 s.299/299A, RG247.45)</p>	<p>The Directors' Report will include important disclosures in relation to the impact of COVID-19 on the business and how they are responding to these risks. The auditor's report on the financial report does not include the Directors' Report, however the auditor is required by ASA 720 <i>The Auditor's Responsibilities Relating to Other Information</i>, to read and consider if there is a material inconsistency with the audited financial report, and or the auditor's knowledge obtained in during the audit.</p>
<b>Not-for-Profit</b>		
<b>Registered with ACNC</b>	No specific requirements.	
<b>Companies limited by guarantee reporting to ASIC</b>	Same as for-profit companies reporting to ASIC.	Same as for-profit companies required by the Corporations Act 2001 to prepare Financial Statements.
<b>Incorporated associations</b>	Refer to relevant legislation.	
<b>Public sector</b>		
<b>All</b>	Refer to relevant legislation.	

<sup>11</sup> ASIC's Regulatory Guide 34 Auditor's Obligations: Reporting to ASIC

### 3 Overview of going concern assessments

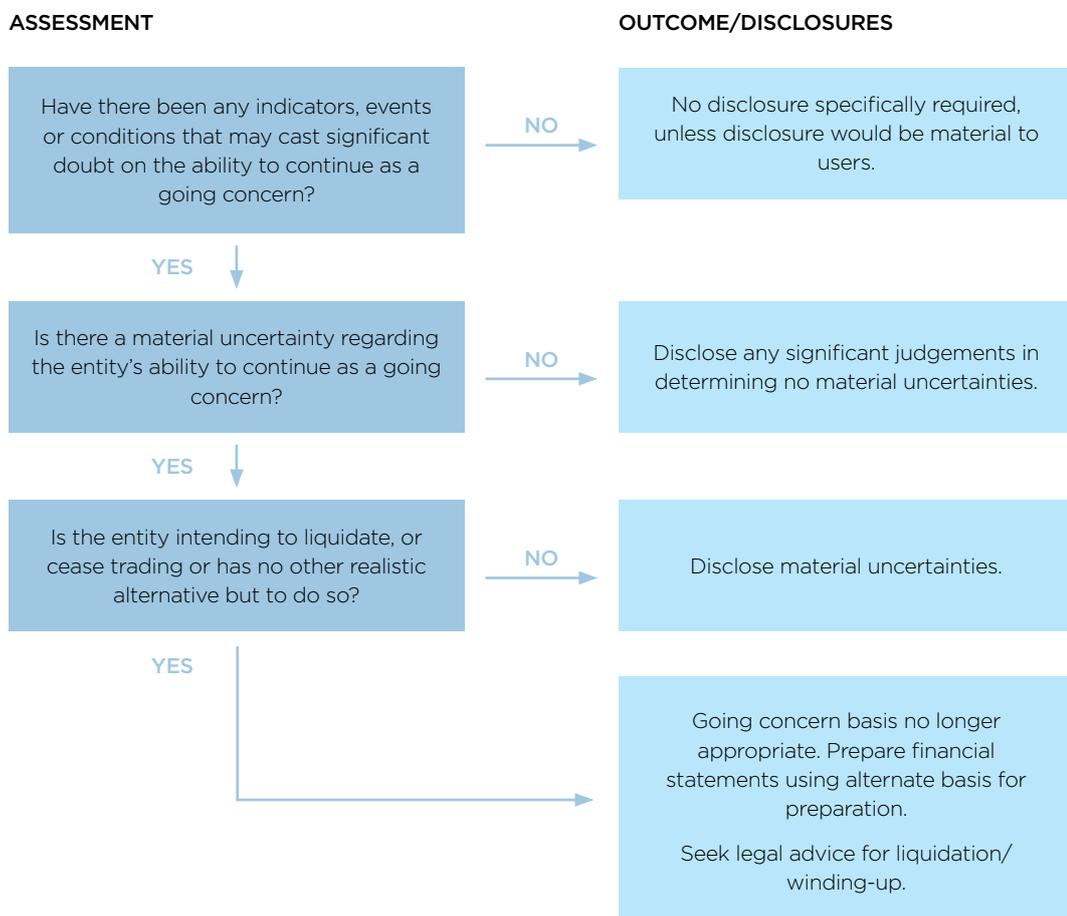
An entity's ability to continue as a going concern is a fundamental assumption underlying the preparation and presentation of the financial statements. When preparing financial statements, AASB 101 *Presentation of Financial Statements* requires management to make an assessment of an entity's ability to continue as a going concern.

The going concern basis of accounting is no longer appropriate if management intends to, or has no realistic alternative but to:

- liquidate the entity; or
- cease trading

(See AASB 101 paragraphs 25-26)

Practically, it is expected that the going concern assessment will result in one of four possible outcomes, as illustrated below. This section discusses those possible outcomes in more detail.





### 3.1 What should management consider to identify going concern issues?

The vast majority of financial statements of Australian entities are prepared on the assumption that an entity is a going concern. Many entities that usually have profitable and sustainable operations may have never had to perform a detailed going concern assessment. However, COVID-19 is having a profound impact, and entities should be conscious of indicators that could cast significant doubt on their ability to continue as a going concern.

In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future. AASB 101 paragraph 26 specifies that management should consider information for at least, but not limited to, the next 12 months from the end of the reporting period<sup>12</sup>. If information about events occurring after 12 months is available, it must also be considered.

Entities must remember to consider the impact of any events that occur after the end of the reporting period up until the date of signing the financial report. Regardless of whether the event is considered adjusting or non-adjusting in accordance with AASB 110 *Events after the Reporting Period*, if the entity determines after the reporting period that it intends to liquidate the entity or to cease trading, it shall not prepare its financial statements on a going concern basis (see AASB 110 paragraph 14-16). Don't forget that even after signing the financial report, entities must continue to monitor their solvency and consider the legal consequences if the entity is insolvent at any time (as discussed in Section 2).

The degree of consideration by the entity in its going concern assessment will depend on its own facts and circumstances.

Accounting standards do not set out indicators or circumstances where a detailed review of the going concern assumption may be necessary. It is up to the entity to determine where these might exist. In the current environment, management might need to consider a wide range of factors before it can conclude that the going concern basis is appropriate. Practically, possible indicators that may lead to an entity assessing the appropriateness of the going concern assumption in more detail might include:

- temporary shut-down of operations (see also section 3.6 on hibernation);
- reduced demand for goods and service or other income streams, caused by:
  - o restrictions and shutdowns imposed by governments, or reduction in discretionary spending by customers;
  - o expectations of future restrictions that might affect future demand;
  - o uncertainty surrounding the length of current or future restrictions;
  - o expected changes to the 'status quo' following the pandemic – for example, possibilities of increased working from home or financial conservatism;
- unavailability of resources necessary to continue operations, including inventory and employees;
- inability to repay borrowings, creditors, lease payments or other debts which become due during the pandemic;
- reliance on obtaining financing or credit from another company that is suffering financial difficulty due to the pandemic, or has made restrictions on lending due to the pandemic;
- breaching loan covenants;
- likelihood of financial guarantees being called upon;

<sup>12</sup> However, ASA 570 *Going Concern* paragraph 13.2 requires auditors to request management to assess going concern for approximately 12 months from the expected date of the auditor's report to the expected date of the next auditor's report (refer 3.2)

- 
- failure of other companies with similar structures and comparable operations in the same industry;
  - financial difficulty or failure of debtors;
  - negative equity as a result of asset impairments and/or reduced trading volumes;
  - fair value losses on assets, particularly where such assets were expected to be realised in the short-term and are relied on for short-term cash management purposes;
  - reliance on intercompany funding or expected support from an overseas parent or subsidiary that may no longer be available;
  - additionally for NFP entities:
    - o termination of significant grants or other assets that were expected to be received at significantly less than fair value;
    - o inability to access volunteer services due to government restrictions;
    - o inability to hold major fundraising events (charity balls, sporting events, etc.);
    - o difficulties fundraising or attracting donations at expected levels due to reduction in discretionary spending;
    - o a government decision to wind-up a public sector entity.

The above illustrates only some of the possible indicators related to business disruption caused by COVID-19. It should not be considered, or used as, a checklist.

Appendix C of this publication contains additional examples of circumstances that may lead to an entity considering its ability to continue as a going concern in more detail.

The degree of going concern considerations depends on the facts in each case. For example, if an entity concludes in making its assessment that it is unaffected by COVID-19, has a history of profitable operations and ready access to financial resources, it may reach a conclusion that the going concern basis of accounting is appropriate without detailed analysis (see AASB 101 paragraph 26). In that case, the entity should consider whether any disclosure may be necessary (see section 4).

Entities that do identify indicators should consider their impact and related mitigating factors, as discussed in section 3.3.



### **3.2 What procedures does the auditor have to undertake when evaluating management's assessment?**

When conducting risk assessment procedures as required by ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment* paragraph 5, auditors consider if the business impacts to the specific entity caused by COVID-19 is resulting in events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. In doing so the auditor discusses with management whether they have considered the continued restrictions and business impacts of COVID-19 in their assessment and identified any events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, and if so, any mitigating factors and their plans to address these concerns. The auditor is required to evaluate management's assessment of the entity's ability to continue as a going concern. When doing so, the auditor is required to:

- evaluate whether management's assessment is for the relevant period (the period of approximately 12 months from the date of the auditor's current report to the expected date of the auditor's report for the next annual report period for an annual financial report, or the corresponding reporting period for the following year for an interim financial reporting period);
- consider whether management's assessment includes all relevant information of which the auditor is aware; and
- enquire of management as to its knowledge of events or conditions beyond the period of their assessment that may cast significant doubt on the entity's ability to continue as a going concern.<sup>13</sup>

Auditors shall remain alert throughout the audit for events or conditions relevant to going concern and exercise significant professional scepticism and judgement when considering the impact of COVID-19 on management's going concern assessments. When evaluating management's assessment, auditors consider if the examples of indicators in section 3.1 are relevant and if they are, whether management has included these in their going concern assessments. Also depending on the reporting period, if risk assessment procedures were performed before the deeper impacts of COVID-19 occurred, auditors should update their risk assessment procedures and continue this assessment right up to the date of the auditor's report.

The business impacts of COVID-19 will differ for each entity depending on specific circumstances and the level of disruption to the business. We expect that COVID-19 will result in the identification of more events or conditions that may cast significant doubt on the ability to continue as a going concern for many entities when compared to previous years. Auditors should remain alert throughout the audit as the environment is constantly changing and liaise regularly with management and those charged with governance.

### **3.3 If indicators of going concern issues have been identified what do management have to do next?**

When an entity identifies events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, it should consider all relevant information, including the feasibility and effectiveness of any planned mitigation. Just because an indicator exists does not necessarily mean that there is a material uncertainty over the entity's ability to continue as a going concern.

<sup>13</sup> ASA 570 paragraphs 12 - 15



The following are examples of mitigating factors that entities may be considering in response to going concern pressures arising due to COVID-19 business interruptions:

- government stimuli or other government incentives available to the entity to subsidise revenue or provide support otherwise;
- do management have a plan to sell liquid assets, is there a current market for these assets and are enough liquid assets available to meet debts and operational costs as they fall due;
- the entity's ability to defer the settlement of liabilities (such as repayment holidays on loans) or obtain new sources of financing, and its realistic ability to repay such sources of financing in the future;
- whether any financing has been guaranteed and the guarantor has the ability to assist (taking into account the terms of the guarantee and any repayment obligations to the guarantor) or whether borrowers have at least indicated a willingness to renegotiate terms and conditions and waive covenant breaches for a certain period;
- capability of entity in obtaining additional equity contributions;
- possibility of reducing overhead and administrative costs;
- possibility of liquidating surplus assets or other assets that are no longer essential;
- practical ability to alter strategies to access new revenue streams;
- additionally, for NFP entities:
  - possibilities of debt forgiveness to help the entity achieve its objectives;
  - the ability to remove restrictions from grants to allow funds to be spent on repaying the NFP's debts;
  - in the public sector, the assumption that the government will support the repayment of debts of public sector entities (and as such, a public sector entity would generally only be expected not to be a going concern if the government decides to wind-up the entity).

The mere existence or possibility of mitigating factors alone may not be sufficient to conclude whether the going concern assumption is appropriate. Judgement is required by management to assess the feasibility and effectiveness of mitigating factors, so that they can satisfy themselves that there is a realistic alternative to avoid entering liquidation or ceasing trading (i.e. that the going concern assumption is appropriate).

Whilst not specified by the accounting standards, in practice there can be generally three scenarios once events or conditions that may cast significant doubt on the entity's ability to continue as a going concern have been identified:

- Having considered all relevant information, management concludes that there are no material uncertainties. However, reaching that conclusion involved significant judgement;
- Having considered all relevant information, management concludes that there is a material uncertainty over the entity's ability to continue as a going concern. For example, there may be a material uncertainty as to management's ability to deliver on its strategies and successfully implement its plans to address the events or conditions that lead to the uncertainty, or on receiving support from third parties; and
- Mitigating factors are insufficient and as such management chooses to, or has no practical ability to avoid, liquidation or the permanent cessation of trading.



### **3.4 What procedures does the auditor undertake when going concern indicators are identified?**

If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor is required to perform additional procedures to obtain sufficient appropriate audit evidence to assess whether a material uncertainty exists (refer ASA 570 paragraph 16), or worse where the basis of preparation should be other than going concern. These procedures include:

- where management has not yet performed an assessment, requesting management to make its assessment;
- evaluating the feasibility of management's plans and whether the outcome is likely to improve the situation;
- where cash flow forecasts are a significant factor in considering the feasibility of management's plans, evaluating the reliability of the underlying data used in the forecast and determining whether the assumptions used are supportable;
- considering if any additional facts or information have become available since the date on which management made its assessment; and
- requesting written representations from management.

Refer to ASA 570 paragraph A16 - A17 for audit procedures the auditor may perform when evaluating management's plans. Assessing the reasonableness of cash flow forecasts may be challenging due to a rapidly changing environment and uncertainties as to the future. When assessing cash flow forecasts the auditor should ensure that management have factored in the impact of COVID-19 on the business, and that the assumptions are reasonable given the current circumstances. Also, if sensitivity analysis has been performed or if different scenarios have been prepared to reflect the uncertainty in the environment, consider how this impacts management's assessment.

Based on these procedures and audit evidence obtained, the auditor concludes whether a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgement, appropriate disclosure of the nature and implications of the uncertainty is necessary for the fair presentation of the financial report.



### **3.5 What if the entity is in hibernation?**

Some entities have been forced to suspend operations, or part operations as a result of government restrictions (i.e. are in hibernation). The impact on the entity depends on the extent of and length of business hibernation. Business hibernation, or the temporary cessation of providing goods or services, does not necessarily mean that an entity is no longer a going concern. As noted above, an entity should take into account all available information about the future in making its going concern assessment. Information available about the future may indicate that an entity will be able to return to normal trade and sustainable profits when they recommence operations.

For example, if an entity is required to temporarily cease the provision of its goods and services, it may still assess that the going concern basis is appropriate on the basis that an entity:

- has been operating profitably and generating positive operating cash flows prior to the pandemic;
- has the financial resources, or access to financial resources, to meet its debts and any remaining operating costs for the period of expected shutdown;
- expects to be able to re-open and re-commence operations at the conclusion of the pandemic (or restrictions imposed as a result of the pandemic); and
- reasonably expects that the level of trade when re-opening will be sufficient to continue as a going concern.

If an entity is in, or has been, in business hibernation which has had a significant impact on their results, this may be an indicator for going concern issues and might therefore require disclosure either as a significant judgement (where management has concluded that there is no material uncertainty) or as a material uncertainty that casts significant doubt on the entity's ability to continue as a going concern (refer to section 4).

### **3.6 What procedures does an auditor undertake when the entity is in business hibernation?**

If an entity is in, or has been in, business hibernation this may be an event or condition that may cast significant doubt on the entity's ability to continue as a going concern, and the auditor performs the procedures required by ASA 570 paragraph 16. Auditors consider the assumptions made by management when performing their going concern assessment and whether they agree they are feasible. Based on these procedures and audit evidence obtained, the auditor concludes whether a material uncertainty exists related to events or conditions that, individually or collectively may cast significant doubt on the entity's ability to continue as a going concern, and if the use of the going concern basis of accounting is appropriate. Auditors also consider if the disclosures are adequate (refer to section 4).

If an entity is in business hibernation at the time of signing the auditor's report, or has been during the year and its financial position has been negatively impacted, the likelihood that a material uncertainty exists, or that the going concern basis of preparation is not appropriate, is increased. However, this is dependent on the individual facts and circumstances. Refer to section 7 for details on concluding on going concern and the impact on the auditor's report.

## 4 Disclosure requirements in the financial statements

Scenario	Disclosure required by accounting standards or other guidance	Items to consider disclosing (not specifically required by standards but may be helpful for users. Not exhaustive examples.)	Auditor's responsibility
<b>No issues</b>	<p>No disclosures specifically required.</p> <p>Consider whether there is any material information related to going concern that should be disclosed<sup>14</sup>.</p> <p>See:</p> <ul style="list-style-type: none"> <li>• <a href="#">AASB-AUASB FAQ</a>.</li> <li>• AASB Practice Statement 2 <i>Making Materiality Judgements</i>.</li> </ul>	<ul style="list-style-type: none"> <li>• Management's judgements in concluding no indicators for going concern uncertainty were present.</li> </ul>	<ul style="list-style-type: none"> <li>• Evaluate management's assessment that there are no events of conditions, and the adequacy of the relevant disclosures.</li> <li>• If do not agree with management's assessment or disclosures are not adequate consider impact on auditor's report (refer to section 7 of this publication).</li> </ul>
<b>Events and conditions have been identified, no material uncertainty</b>	<p>Disclose significant judgements made in the process of applying the entity's accounting policies – that is, 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.</p> <p>See:</p> <ul style="list-style-type: none"> <li>• AASB 101 paragraph 122.</li> <li>• IFRS Interpretations Committee Agenda Decision<sup>15</sup> <i>Disclosure requirements relating to assessment of going concern</i> (IAS 1), July 2014 IFRIC Update.</li> </ul>	<ul style="list-style-type: none"> <li>• Nature of the events or conditions that may indicate a possible going concern uncertainty specific to the entity – e.g. reduced revenue, increase in expenses, shutdowns, other entities in sector struggling, etc.</li> <li>• Management's assessments and judgements as to the nature of the mitigating factors and why they lead to no material uncertainty, e.g. existence of financing, loan guarantees, government grants, etc.</li> <li>• Other relevant information.</li> </ul>	<ul style="list-style-type: none"> <li>• Obtain sufficient appropriate audit evidence to conclude whether or not a material uncertainty exists through performing additional procedures, including consideration of the mitigating factors – refer to ASA 570 paragraph 16 for required procedures. If you do not agree with management's assessment that mitigating factors are sufficient, consider impact on auditor's report (refer to section 7 of this publication).</li> <li>• Evaluate whether disclosures about the events or conditions are adequate and in accordance with the applicable financial reporting framework. See ASA 570 paragraph 20 and A24. If disclosures are not adequate consider impact on auditor's report (refer to section 7 of this publication).</li> </ul>

<sup>14</sup> For example, AASB 101 paragraph 17(c) requires entities to provide a fair presentation to provide additional disclosures when compliance with specific requirements in Australian Accounting Standards is insufficient to enable users to understand the impact particular transactions, other events and conditions on the entity's financial position and financial performance.

<sup>15</sup> Note that Agenda Decisions do not have the authority of accounting standards and they therefore do not provide mandatory requirements. They should be seen as helpful, informative and persuasive (IFRS Foundation *Due Process Handbook* paragraph 5.22).



Scenario	Disclosure required by accounting standards or other guidance	Items to consider disclosing (not specifically required by standards but may be helpful for users. Not exhaustive examples.)	Auditor's responsibility
<b>Material uncertainty</b>	<p>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.</p> <p>See:</p> <ul style="list-style-type: none"> <li>• AASB 101 paragraph 25</li> <li>• IFRS Interpretations Committee Agenda Decision<sup>16</sup> <i>Going concern disclosure</i> (IAS 1), July 2010 <i>IFRIC Update</i></li> </ul> <p>Auditors are further required to assess whether the disclosures not only explain the events and or conditions that cast doubt on the going concern assumption, but also management's plans to deal with these events or conditions, and whether the financial statements include a clear statement that there is a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern and therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business.</p> <p>See:</p> <ul style="list-style-type: none"> <li>• ASA 570 paragraph 19</li> </ul>	<ul style="list-style-type: none"> <li>• Nature and indicative financial impacts of indicators – e.g. reduced revenue, increase in expenses, negative working capital, shutdowns, breaching covenants.</li> <li>• Additional details of plans to deal with these the events or conditions – e.g. negotiations with lenders and creditors, raising additional equity, implement cost saving measures, obtaining government support.</li> <li>• Assumptions made by management – i.e. strategies relied upon, longevity of cash reserves, expected period of hibernation</li> <li>• Outline reasons why a material uncertainty remains</li> <li>• Other relevant information.</li> </ul>	<ul style="list-style-type: none"> <li>• Based on the audit evidence obtained the auditor concludes whether the management's use of the going concern basis of accounting is appropriate and whether a material uncertainty exists.</li> <li>• Evaluate whether disclosures about the events or conditions and management's plans are adequate, and clearly states that there is a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern and therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business.</li> <li>• See ASA 570 paragraph 19. If disclosures are not adequate consider impact on auditor's report (refer section 7 of this publication).</li> </ul>
<b>Going concern basis of preparation not appropriate</b>	<ul style="list-style-type: none"> <li>• Disclose that fact.</li> <li>• Disclose the reason why the entity is not regarded as a going concern.</li> <li>• Disclose the basis of preparation of the financial statements.</li> </ul> <p>See:</p> <ul style="list-style-type: none"> <li>• AASB 101 paragraph 25</li> </ul>	<ul style="list-style-type: none"> <li>• Description of events that give rise to management considering the going concern basis of preparation to no longer be appropriate.</li> <li>• Further explanation of the changes in accounting policies and reasons why.</li> <li>• Other relevant information.</li> </ul>	<ul style="list-style-type: none"> <li>• Assess whether the basis of preparation is acceptable in the circumstances, including the appropriateness of accounting policies.</li> <li>• Evaluate whether there is adequate disclosure in the financial report as to the alternate basis of preparation and the reasons for its use.</li> <li>• Consider if it is necessary to include an Emphasis of Matter paragraph to draw the user's attention to the alternate basis of preparation and the reasons for its use (refer to section 6 of this publication).</li> </ul>

<sup>16</sup> Note that Agenda Decisions do not have the authority of accounting standards and they therefore do not provide mandatory requirements. They should be seen as helpful, informative and persuasive (IFRS Foundation *Due Process Handbook* paragraph 5.22).



## 5 Does the going concern assessment also affect other areas of the financial statements?

An entity must consider how its going concern assessment is reflected in the rest of its financial statements, and that any assumptions made in its going concern assessment are consistent with other recognition, measurement and disclosure in the financial statements.

For example, entities should ensure that assumptions, such as cash flow projections or other estimates, used in impairment testing, fair value measurement and other estimations are consistent with the going concern assessment.

Examples of COVID-19 related accounting consequences that link to going concern assessments may include:

- impairments of assets, either financial or non-financial;
- fair value measurements;
- decreases in the net realisable value of inventory;
- recognition of provisions and onerous contracts; and
- write-off of deferred tax assets.

Further, entities should be mindful of the disclosure requirements in other accounting standards, including, but not limited to:

- disclosure relating to assumptions about the future and sources of estimation uncertainty (see AASB 101 paragraph 125);
- disclosures related to financial instruments in accordance with AASB 7 *Financial Instruments: Disclosures*, including but not limited to:
  - maturity analyses;
  - nature and extent of risks arising from financial instruments;
  - defaults and covenant breaches;
- assumptions used in impairment testing of non-financial assets (AASB 136 *Impairment of Assets*) and fair value measurements (AASB 13 *Fair Value Measurement*);
- undrawn borrowing facilities and any restrictions on the use of those facilities such as covenant requirements (AASB 107 *Statement of Cash Flows*);
- contingent liabilities and provisions (AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*);
- additional disclosures of material information if the requirements of other Australian Accounting Standards do not provide sufficient disclosure to give an understanding of the impact of particular events or conditions (AASB 101).



## 6 The entity is no longer a going concern. What now?

### 6.1 What are the financial reporting obligations?

Where the going concern basis is no longer appropriate because the directors have no realistic alternative but to liquidate the entity and intend to appoint a liquidator or external administrator, the directors should consider whether and how this may affect the financial reporting obligations of the entity for the current reporting period. ASIC Regulatory Guide 174 *Relief for externally administered companies and registered schemes being wound up* explains when ASIC will grant relief from the financial reporting obligations of the *Corporations Act 2001*.

If the entity has concluded that it is no longer a going concern but still needs to prepare and lodge financial statements for the current reporting period, it must:

- disclose that fact;
- adjust the basis of preparation of the financial statements, and describe the revised basis of preparation; and
- disclose the reason why the entity is not regarded as a going concern (see AASB 101 paragraph 25).

The Accounting Standards do not specify an alternate basis of preparation where the going concern basis is not appropriate. There are different views on whether financial statements prepared on a non-going concern basis would still need to comply with the broad principles of the *Conceptual Framework for Financial Reporting* where an entity must still prepare financial statements that comply with Australian Accounting Standards (e.g. under Chapter 2M.3 of the *Corporations Act 2001*).

In many cases, entities may change the presentation of assets and liabilities in the balance sheet from a current/non-current to a liquidity basis, as this provides information about the order in which assets may be realised and liabilities settled.

As there is no defined or prescribed basis, it is important that entities clearly explain how this change has affected their accounting policies and the recognition, measurement and presentation of the amounts in the financial statements. It may also be necessary to highlight that some of the amounts disclosed for the prior period have been measured on a different basis and are therefore not necessarily comparable.

### 6.2 What is the impact for the auditor?

If the auditor agrees that the alternative basis of preparation is appropriate, including that the disclosures are adequate, the auditor issues an unmodified opinion and considers if it is necessary to include an Emphasis Of Matter (EOM) paragraph alerting users to the alternative basis of preparation and the reasons for its use.



## 7 Implications for the auditor's report

### 7.1 How does the auditor conclude on going concern?

The auditor evaluates whether sufficient appropriate audit evidence has been obtained and concludes on:

- the appropriateness of management's use of the going concern basis of accounting; and
- whether a material uncertainty exists related to events or conditions that individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

The adequacy of disclosures is critically important when considering if a modification to the auditor's opinion is required. In the current environment of uncertainty about the immediate future for many entities, more financial reports will likely include expanded disclosures about events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. However, the required level of disclosure will depend on the facts and circumstances of each entity. Refer to section 4 above for further detail on disclosures in the financial report. Also consider if disclosures are required above those specifically required by the financial reporting framework in order to achieve fair presentation of the financial report (if applicable).

A high level of professional scepticism and judgement is required when concluding on going concern and the adequacy of disclosures, considering the facts and circumstances of the entity and the audit evidence obtained. In the current environment there may be increased instances of modification of the auditor's opinion (qualified, adverse or disclaimers of opinion) and additional communications by the auditor (MURGCs, EOMs) with regards to going concern matters.

### 7.2 When should the auditor modify their opinion?

If the auditor disagrees with management's use of the going concern basis of accounting, or there is insufficient disclosure in the financial report on going concern matters, a modified audit opinion is issued. A modified audit opinion may be a qualified opinion, an adverse opinion or a disclaimer of opinion, dependent on the pervasiveness of the issues to the financial report. In accordance with ASA 570, a modified audit opinion is issued when:

- A Material Uncertainty Related to Going Concern (MURGC) exists which is not adequately disclosed in the financial report (qualified or adverse).
- The financial report is prepared using the going concern basis of preparation, however the auditor does not agree that the going concern basis of preparation is appropriate (adverse).
- The financial report is prepared using an alternative basis of preparation, however there is inadequate disclosure related to this (qualified or adverse).
- The auditor is unable to obtain sufficient appropriate audit evidence to conclude on management's assessment that the financial report is prepared using a going concern basis of preparation as management is unwilling to make, or extend, their going concern assessment (qualified or disclaimer).



In addition, if events or conditions that may cast significant doubt on the entity's ability to continue as a going concern have been identified, auditors are required under ASA 570 paragraph 20 to evaluate if the financial report provides adequate disclosure about these events or conditions. As detailed in section 4 of this publication, the financial report disclosures include the significant judgements made in the process of applying the entity's accounting policies – that is, 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. If in the auditor's view this disclosure is not adequate, the auditor considers the impact of this misstatement on their opinion on the financial report as a whole in accordance with ASA 705.

Refer to Appendix A "Linking Going Concern Considerations and Types of Audit Opinions" ASA 570.

### **7.3 How else may the auditor's report include additional communications in relation to going concern when issuing an unmodified opinion?**

When issuing an unmodified opinion, the auditor's report may include additional communications about going concern, as follows:

- If a MURGC exists that the auditor agrees is adequately disclosed in the financial report, the auditor's report includes a section titled "Material Uncertainty Related to Going Concern" (refer to ASA 570 paragraph 22 for further details).
- If the auditor concludes a MURGC does not exist and they are reporting key audit matters in accordance with ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*, the auditor considers if going concern is a key audit matter. In accordance with ASA 701 paragraph 15, a MURGC is by its nature a KAM however it is communicated as a MURGC and the introductory wording in the KAM section includes a reference to the MURGC paragraph.
- Where the financial report has been prepared using an alternate basis of preparation, and the auditor agrees with both the alternate basis of preparation and that there are appropriate disclosures in the financial report, the auditor considers if it is necessary to include an EOM to draw the user's attention to the alternate basis of preparation and the reasons for its use.

Refer to Appendix A "Linking Going Concern Considerations and Types of Audit Opinions" ASA 570.

# Appendices

**Appendix A:**

Linking going concern considerations and types of audit opinions (covid-19 edition)

**Appendix B:**

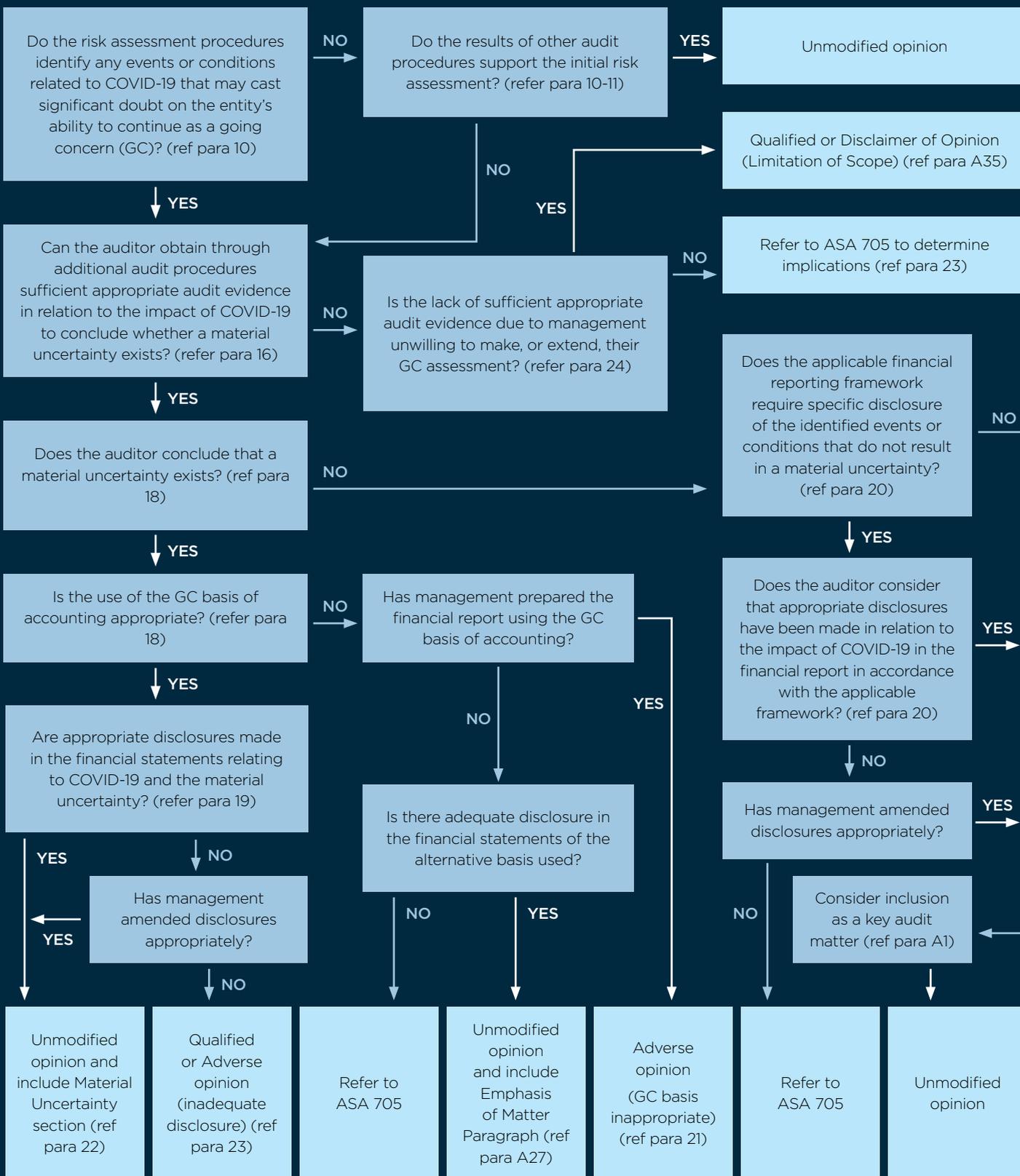
List of relevant legislation

**Appendix C:**

List of other possible going concern indicators

# Appendix A: linking going concern considerations and types of audit opinions (covid-19 edition)

NB – Unless stated, paragraph references are to ASA 570 Going Concern



Note: Audit opinions in this diagram must comply, as appropriate, with: ASA 700 *Forming an Opinion and Reporting on a Financial Report*, ASA 705 *Modifications to the Opinion in the Independent Auditor's Report* and ASA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*.

## **Appendix B: list of relevant legislation**

### **For-profit private sector**

*Corporations Act 2001* (Cth)

### **Not-for-profit private sector**

*Australian Charities and Not-for-profits Commission Act 2012* (Cth)

*Corporations (Aboriginal and Torres Strait Islander) Act 2006* (Cth)

*Associations Incorporation Reform Act 2012* (Vic)

*Associations Incorporation Act 2009* (NSW)

*Associations Incorporation Act 1981* (Qld)

*Associations Incorporation Act 2015* (WA)

*Associations Incorporation Act 1985* (SA)

*Associations Act 2003* (NT)

*Associations Incorporation Act 1991* (ACT)

*Associations Incorporation Act 1964* (Tas)

## **Appendix C: list of other possible going concern indicators**

Originally published in [Going Concern issues in financial reporting: a guide for companies and directors, 2009](#) (AUASB and AICD)

Some further examples of possible events and conditions that may be relevant to the assessment of going concern include the following, however this list is not exhaustive and should not be considered a checklist of all possible indicators.

### **Obtaining external finance:**

- Company has experienced difficulties in the past in obtaining external finance facilities and/or in complying with the related terms and covenants
- Borrowing agreements or executory contracts include clauses relating to debt covenants at call terms or subjective clauses (for example, a “material adverse change clause” or share price declines below a certain dollar value) that triggers full or partial repayment of the amount borrowed
- Company has breached some of the terms or covenants of the borrowing agreements giving rise to the risk that the facilities may be withdrawn or not renewed
- Finance facility is secured on assets (for example, properties) that have decreased in value below the amount of the facility
- Finance facilities are due for renewal in the next year
- Management have no plans for alternative arrangements should current facilities not be extended
- Company is dependent upon funding from a related or third party that is experiencing financial difficulties
- Financing is provided by a syndicate of banks and other financial institutions and there are concerns about the viability of one or more of the members of the syndicate

### **Management plans to overcome financing difficulties include disposal of assets or possible rights issues:**

- Plans developed prior to the onset of challenging or uncertain economic conditions have not been updated
- Lack of evidence that management can realise the assets to be disposed of at the expected values
- Shareholders’ support uncertain in relation to a planned rights issue
- Possible “lukewarm” reception of prospective investors to share issuance due to the company’s poor financial performance

### **Company provides significant loans or guarantees to related parties or third parties:**

- Guarantees that may be called in
- Borrowers who/which may be unable to make payments

**Company dependent upon guarantees or financial support provided by a third party:**

- Guarantor no longer able/prepared to provide the guarantee
- Financial support withdrawn or in doubt

**Future cash flows:**

- Reduction in cash flows resulting from unfavourable economic conditions
- Major customers taking longer or unable to pay
- Market for product or services has contracted significantly
- Terms or covenants of renewed financing are changed and become more difficult to comply with (for example, increased interest rates or charges)
- Company is subject to margin calls as a result of a decrease in fair market value of financial instruments that it holds
- Company has issued loans (or received borrowings) having an introductory period during which favourable terms are in force which revert to normal market rates in the forthcoming year

**Company heavily dependent upon particular counterparties:**

- Suppliers facing financial difficulties provide essential goods/services
- Company unable to find alternative suppliers
- Major suppliers tightening their credit terms
- Key customers experiencing financial difficulties
- Substantial reduction of orders from key customers
- Financial instrument counterparties are in default or experiencing difficulty to comply with terms due to cash flow problems