



corporate | going concern issues

the team



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In the current economic climate, going concern will become an increasingly important consideration for companies in the hospitality industry. FRS 18 "Accounting Policies" requires management to make an assessment of an entity's ability to continue as a going concern when preparing financial statements.

It states:

"When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements 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. 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."

financial reporting requirements

For financial reporting purposes, the assessment of going concern is made at the date that the directors approve the annual report and accounts and considers the relevant facts and circumstances at that date. FRS 18 also notes that the degree of thought that may need to be given to the assessment will depend upon the facts of each case.

The directors assessment may include the preparation/review of:

- forecasts and budgets
- borrowing requirements
- bank and other facilities
- contingent liabilities
- products and markets
- financial risks
- financial adaptability

Forecast and budgets should be prepared to cover the period to the next balance sheet date as a minimum, with further periods generally covered by medium or long-term plans that give an indication of how directors expect the company to fare.

The assessment is based on what is known to the directors at the date on which they approve the annual report and accounts.

This includes events or circumstances they are aware of that arise after the end of the review period.

FRS 18 requires disclosure if the period considered by the directors is less than twelve months from the date of approval of the financial statements. In such a case the directors need to consider whether additional disclosures are necessary to explain adequately the assumptions that underlie the adoption of the going concern basis.

audit issues

The facilities available to the company should be reviewed and compared to the detailed cash flow forecasts for the next twelve months. Sensitivity analysis of the critical assumptions should also be used in the comparison.

The directors should seek to ensure that there are no anticipated:

- shortfalls in facilities against requirements
- arrears of interest
- breaches of covenants

Directors are responsible for managing borrowing requirements actively. Any potential deficits, arrears or breaches should be discussed with the company's bankers to determine whether any action is appropriate. This may prevent potential problems crystallising. The onus is on the directors to be satisfied that appropriate and committed financing arrangements are likely to be in place.

The directors may seek confirmation from their bankers regarding the existence and status of any financing arrangements which the company has entered into. In the present economic environment bankers may be reluctant to provide positive confirmations to directors that facilities will continue to be available. This may extend to companies with a profitable business and relatively small borrowing requirements.

There may be a number of understandable reasons, including:

- the bank responding that in the current economic environment, as a matter of policy, it is not providing such confirmations to its customers
- the entity and its bankers are engaged in negotiations about the terms of a facility (e.g. the interest rate). However there is no evidence that the bank is reluctant to lend to the company
- the bank renewed a rolling facility immediately prior to the date of the issuance of the annual report and accounts and is reluctant to go through the administrative burden to confirm that the facility will be renewed again in a year's time

The absence of confirmations of bank facilities does not of itself necessarily cast significant doubt upon the ability of an entity to continue as a going concern nor necessarily require auditors to refer to going concern in their reports.

conclusion

In forming their conclusion on going concern, directors will need to evaluate which of three potential outcomes is appropriate to the specific circumstances of the company.

The directors may conclude:

- there are no material uncertainties that lead to significant doubt upon the entity's ability to continue as a going concern
- there are material uncertainties that lead to significant doubt upon the entity's ability to continue as a going concern
- the use of the going concern basis is not appropriate

Directors will need to consider the position in light of information available to them and the assumptions as to the future availability of finance. Accounting standards do not define what constitutes a 'material uncertainty that may cast significant doubt upon the entity's ability to continue as a going concern'. This involves assessing the probability of an event occurring and the impact it will have if it does occur. The assessment may require a high degree of judgment both by the directors, and subsequently the auditors depending upon the circumstances.

disclosure

If the conclusion is that there are material uncertainties that lead to significant doubt upon the entity's ability to continue as a going concern then those uncertainties should be disclosed.

Directors will need to explain in the Business Review the principal risks and uncertainties facing the company arising from the current difficult economic conditions. One of the purposes of the Business Review is to help the members assess how the directors have performed their duties. It is therefore reasonable to expect that it will also contain an account of how the directors intend to respond to these risks and uncertainties.

Issues requiring disclosure depend upon individual facts and circumstances and may include:

- uncertainty about current financing arrangements (whether committed or uncommitted)
- potential changes in financing arrangements such as critical covenants; and any need to increase borrowing levels
- risks arising from current credit arrangements (including the availability of insurance, where relevant) with either customers or suppliers;
- a dependency on key suppliers and customers
- uncertainty posed by the potential impact of the economic outlook on business activities

audit reports

The audit report will include an "emphasis of matter" paragraph when the auditor concludes that material uncertainties exist that should be highlighted. This paragraph will include a reference to the disclosure in the accounts and some basic facts. It does not result in a qualified report. Such paragraphs will become a lot more common in the current climate.

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