

COVID-19 and going concern

GUIDANCE FOR DIRECTORS OF SME BUSINESSES



COVID-19 AND GOING CONCERN - HOW ACCOUNTS LOOK TO THE FUTURE AS WELL AS THE PAST

The coronavirus pandemic has changed dramatically the circumstances in which many businesses operate, and some are under threat. In this short guide we explain why it's important to assess the viability of your business for the purposes of your accounts and outline some factors to consider when making this assessment.

This guide is aimed primarily at the owners and directors of small and medium-sized businesses.

WHY ARE THE FUTURE PROSPECTS OF A BUSINESS RELEVANT WHEN PREPARING ACCOUNTS FOR THE PREVIOUS YEAR?

The accounts are generally seen as a record of transactions of the previous year and a snapshot of what the business owns and what it owes at the end of the year ie, a document that looks at past events. However, many items in the accounts are measured and classified on the assumption that the business will continue trading for the foreseeable future.

For example, equipment may be measured at 'cost' and classified as a 'fixed asset'; this implies that the equipment will generate at least as much income (or benefits) as the amount included in the balance sheet, and that the business will benefit from the equipment for more than one year. If the business were to cease trading, the equipment would have to be measured and classified on a different basis, for example the estimated selling price.

DO I NEED TO MAKE A FORMAL ASSESSMENT OF MY BUSINESS'S ABILITY TO CONTINUE TRADING?

It is the responsibility of directors when preparing the accounts to carry out an assessment to ascertain whether the company is a 'going concern'. The assessment should take into account all available information about the future, covering at least 12 months from the date on which the accounts are approved and signed-off by the directors.

There isn't a set process for this assessment, but in these uncertain times your accountant or auditor is likely to ask you to produce evidence to demonstrate that your conclusions are reasonable in the circumstances.

HOW CAN I DO THAT?

The future is of course uncertain and no one has access to a crystal ball, so assumptions will need to be made. Having enough cash (and/or access to loan facilities) is crucial. A good starting point is to prepare a cash flow forecast for at least 12 months from the expected date of sign-off.

This will help identify any possible shortfalls and what action you might need to take to prevent them; realistic mitigating actions may need to be considered if there is not enough headroom.

HOW DO I REFLECT THE IMPACT OF COVID-19 IN MY CASH FLOW FORECAST WHEN THERE ARE SO MANY UNKNOWNNS?

Unless it's business as usual, you will need to adjust the expected cash inflows and outflows to take account of the changes in circumstances, considering issues specific to your sector or business (for example, any threats to the supply chain and the timing and manner in which the business emerges from lockdown) as well as the broader economic environment (for example, the downturn in demand generally and the ability of customers to pay debts when due).

This is not a precise science, but make a note of any assumptions that you have made, and apply the assumptions consistently. For example, a reduction in turnover will also lead to a reduction in some (but probably not all) of your costs. Bear in mind that you may not be able to charge the same price for your products and services, and some costs may have risen. Keeping track of any assumptions (and on what they are based) will be helpful when providing evidence to your accountant or your auditor to support your conclusions. It may also be useful in the future when revisiting the forecast to take account of any new information that comes to light.

Remember that the purpose of this exercise is to identify crunch points, so a cautious approach is best.

ANYTHING SPECIFIC THAT I SHOULD BE LOOKING OUT FOR?

Listed below are some factors to consider. It is not a comprehensive list, and every business is different, so try to think as broadly as you can.

- **Revenue and debtors** – be mindful that you may not be able to trade at normal levels and customers may struggle to pay in accordance with the usual terms.
- **Payments to suppliers and to utility providers** – it may be that some costs are reduced while business is curtailed but others may increase because of difficulties within the supply chain.
- **Staff costs** – you will need to take account of any changes in staffing levels and related staff costs such as commission, bonuses, national insurance and pension contributions. Some of these costs might be mitigated by the Coronavirus Job Retention Scheme (furlough), but keep this separate as it could be that not all costs are covered, and the cash payments to staff and receipts from government may not coincide.
- **Rent and rates** – these may have changed if rent and/or rates holidays are available or contract terms have been renegotiated.
- **Taxes** – some payments of tax are being deferred, for example VAT, but they still need to be included when the deferred payment is due.
- **Loan repayments** – if you are increasing your borrowings there may be additional capital and interest to pay, as well as fees.
- **Bank covenants** – check the terms associated with your bank loans. If these have not been renegotiated it may be that loans become repayable immediately when certain conditions are breached.

- **Inability to fulfil contracts and potential penalties** – check any existing contracts for performance obligations and assess whether you will be able to meet them.
- **Lack of funds** – if at any time in the period of the assessment it looks like you will have insufficient bank or other financing facilities, you will need to consider what you can do to mitigate the risks. The government has put in place a number of business support schemes, and you may be able to renegotiate banking facilities or certain contracts, or sell surplus assets.
- **Business strategy in the short and medium term** – you may find it helpful to undertake an analysis of the strengths, weaknesses, opportunities and threats (SWOT) that the business faces and its ability to adapt to the changing circumstances, taking account of what has been learned during the crisis and how the sector might change.

Actions to mitigate risks are generally specific to the business, but there are a number of important government initiatives to help you weather the storm, such as Bounce Back Loans. You can find out more about the financial support for businesses during the crisis at [gov.uk](https://www.gov.uk)

CAN THERE BE DIFFERENT ASSUMPTIONS WHICH ARE EQUALLY VALID?

Yes, and it can be useful to test forecasts according to different assumptions (both optimistic and pessimistic), for example assumptions around when physical distancing measures might be lifted or changes in pricing. Producing a range of forecasts can help identify what business-critical decisions need to be made, and when.

WHY AM I USING CASH FLOW FORECASTS RATHER THAN BUDGETS?

Many profitable businesses can still fail if they don't have the cash to meet their obligations when they fall due.

WHY DOES THIS ALL MATTER FOR THE ACCOUNTS?

Accounts are usually prepared on the basis that the business is a 'going concern'. This will be the case unless the directors either intend to liquidate the business or cease trading, or have no realistic alternative but to do so. The going concern assessment might suggest that the business will not survive – in some circumstances there is no realistic alternative other than to liquidate or cease trading. If the business is not considered to be a going concern for accounting purposes, an alternative basis of accounts preparation will be necessary.

Importantly, accounts must always give a 'true and fair view' of the financial position of the business, and in the current circumstances that may well necessitate the inclusion of a number of additional disclosures relating to going concern in the notes to the accounts and the directors' report (or, where applicable, the strategic report).

This will enable those using the accounts, for example shareholders or lenders, to understand the impact that COVID-19 has, or may have, on the business. This will be particularly relevant when significant judgements were made in preparing the forecasts and material uncertainties remain.

The clear disclosure of those uncertainties in the notes to the accounts, to ensure that the accounts provide a 'true and fair view', may well enable the auditors (where the accounts are subject to audit) to provide a 'clean' (or unqualified) audit report. Auditors are required to refer to any material uncertainties regarding going concern in their audit report, so you may find that an audit report, even if unqualified, includes an additional paragraph. This is likely to be a common feature, reflecting the difficulties faced when making assumptions about going concern. Should there be insufficient evidence to support the conclusion that the business is a going concern for accounting purposes, then the auditors will need to consider whether a qualified audit report is appropriate instead.

WORKING WITH YOUR ACCOUNTANTS AND AUDITORS

COVID-19 doesn't just change how you do business. It also affects how you interact with your accountant and/or auditor. The increased level of uncertainty and physical distancing will present new challenges and change historic work practices. Greater planning and assistance by all parties will be essential in the interests of efficiency and cost control.

WHERE CAN I FIND OUT MORE ABOUT THE REQUIREMENTS AND HOW TO MEET THEM?

The Financial Reporting Council (FRC) has published high-level guidance for companies on some of the most pervasive issues when preparing accounts. ICAEW and ICAS have dedicated hubs providing access to a wealth of resources on COVID-19 related issues. Visit [icaew.com/coronavirus](https://www.icaew.com/coronavirus) and [icas.com/coronavirus](https://www.icas.com/coronavirus)