Improving going concern disclosures in the financial statements

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Introduction

Various external events such as the state of the economy, the need for additional funding to meet strategic objects, or a pandemic, for example COVID-19, impact an entity's ability to continue its operations and meet its mandate. Despite there being requirements in the Standards of GRAP to disclose information on applying judgement in assessing going concern, , this information is mostly lacking from financial statements.

To achieve transparency, improve accountability, and to provide users with relevant information about an entity's ability to continue as a going concern, the ASB issued ED 198 on proposed *Amendments to GRAP 1 on Presentation of Financial Statements* that proposes:

- explanatory guidance on when preparing financial statements on a going concern is inappropriate; and
- additional disclosures on management's assessment of going concern.

The proposed amendments to GRAP 1 resulted in consequential amendments to GRAP 14 on *Events After the Reporting Date*.

The proposed amendments are discussed below.

Assessing going concern in preparing financial statements

When preparing financial statements, GRAP 1 requires an entity to assess its ability to continue as a going concern up until the point that the financial statements are authorised for issue. In making this assessment, management considers material uncertainties, and all available information about the future, including medium to long-term information.

When will preparing financial statements on a going concern basis be inappropriate?

Financial statements will be prepared on a going concern basis unless there is an intention, or no realistic alternative but to liquidate the entity, or to cease its operations. For an entity to be liquidated, or for its operations to cease, legislation should have been promulgated in Parliament or a provincial legislature, or a decision should have been taken by the appropriate authority, for example a municipal council.

Liquidation is the process where an entity converts its assets into cash or other assets, and settles its liabilities with its creditors in anticipation of the termination of all its operations.

As the Standards of GRAP do not prescribe the basis that should be applied when the financial statements are no longer prepared on a going concern basis, management should develop its own accounting policies. These policies should explain the specific principles, bases, convention, rules and practices that are applied to prepare the financial statements.

When will the going concern basis remain appropriate?

The entity should continue to prepare its financial statements on a going concern basis when a decision is taken to transfer some, or all of its functions to another entity, or to merge one or more entities. This is because the entity will continue to operate in a modified form even though the entity itself will no longer provide that functions. The guidance in the Standards of GRAP on *Transfer of Functions Between Entities Under Common Control, Transfer of Functions Between Entities Not Under Common Control* and *Mergers* should be applied.

Going concern disclosures

When management concludes that the going concern assumption remains appropriate, GRAP 1 requires the disclosure of the significant judgements and assumptions made by management as part of its going concern assessment.

Where material uncertainties exist that may cast significant doubt on the entity's ability to continue as a going concern, GRAP 1 requires management to disclose these uncertainties, along with the events and conditions that gave rise to them. Key assumptions concerning the future, and other key sources of information uncertainty at the reporting date, should also be disclosed in the financial statements.

To address the diversity about information presented in the financial statements on going concern and material uncertainties, ED 198 proposes the following additional disclosures to be presented as part of the notes to the financial statements:

- the fact that there is one or more uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern;
- information about the principal events or conditions that give rise to these uncertainties;
- the possible effects that the events or conditions resulting in uncertainties may have on current and future reporting periods; and
- information about management's plans to address the events or conditions that resulted in uncertainties, and their actions to mitigate the effect of the events or conditions.

If information about management's plans, and actions to mitigate the effect of events or conditions that result in uncertainties is published with the financial statements, for example in the annual report, a cross reference can be included to that information in the notes to the financial statements.

The disclosures presented about going concern and material uncertainties should be entity specific that provides information to users about the entity's unique and specific circumstances, relevant to its activities.

Management should not duplicate or repeat information about going concern and material uncertainties in different parts of the financial statements. Information should rather be cross-referenced.

How to comment in the proposals in ED 198?

If you are interested in commenting on the proposals in ED 198, the Exposure Draft can be accessed on the ASB's website at (GRAP| Comment on Proposals| ED 198). Comment in ED 198 is due on 15 July 2022.