# Technical Factsheet 187

## Going concern

CONTENTS





### 1. INTRODUCTION

The purpose of this factsheet is to provide guidance on the accounting and disclosure of accounting for going concern within statutory financial statements. This factsheet will consider the provisions within the Companies Act 2006 and the accounting and disclosure requirements within the related accounting regulations, FRS 18 Accounting policies, Financial Reporting Standard for Smaller Entities 2008 (FRSSE 2008), FRSSE 2015 and Financial Reporting Standard 102 (FRS 102) The Financial Reporting Standard Applicable in the UK and Republic of Ireland.

Throughout the factsheet notes and section references are relevant to Companies Act, Regulations and Standards as highlighted in each paragraph.

An entity prepares financial statements on a going concern basis when, under the going concern assumption, the entity is viewed as continuing in business for the foreseeable future. The term ‘foreseeable future’ is not defined within FRS 18, but IAS 1, Presentation of Financial Statements deems the foreseeable future to be a period of 12 months from the entity’s reporting date. It should be noted as explained more fully below that the going concern basis is effectively the default position for financial statements.

The concept of going concern is an underlying assumption in the preparation of financial statements, hence it is assumed that the entity has neither the intention, nor the need, to liquidate or curtail materially the scale of its operations. If management conclude that the entity has no alternative but to liquidate or curtail materially the scale of its operations, the going concern basis cannot be used and the financial statements must be prepared on a different basis (such as the ‘break-up’ basis).

The issue is further explored in ACCA’s Technical Factsheet 143: The impact of the credit crunch in the audit of small companies.

http://www.accaglobal.com/content/dam/ACCA_Global/Technical/fact/technical-factsheet-143.pdf

In addition to the reference material detailed above, the Financial Reporting Council (FRC) issued helpful guidance for directors issued in 2009:

https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/Going-concern-and-financial-reporting.aspx

and more recently FRC’s consultation paper on going concern and risk management issued in 2013:

http://www.frc.org.uk/Our-Work/Publications/FRC-Board/Consultation-Paper-Risk-Management,-Internal-Contr-File.pdf

This factsheet will not address the specific requirements of IAS 1.

## 2. LEGISLATIVE REQUIREMENTS

The accounting provisions are contained within two pieces of legislation, namely 'The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008' and 'The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008', along with the Companies Act 2006. There are no specific provisions in respect of going concern in any of these pieces of legislation, although the regulations do state that 'the company is presumed to be carrying on business as a going concern', as one of the main accounting principles.

Companies Act 2006 and the related provisions are accessible on the legislation website:

http://www.legislation.gov.uk/

### Disclosure issues under the legislation:

As the regulations assume that a business will be a going concern there is only a requirement for specific disclosure when an alternative basis for the preparation of the financial statements is used. This would only be the case where the directors believed that the business was not going to continue in the foreseeable future. Where that is the case the accounts should be drawn up on a break up basis where:

- All fixed assets are shown as current assets and are valued at the lower of cost and net realisable value;
- Long term liabilities are taken to current liabilities and any costs of early settlement are recognised; and
- Any other costs associated with winding up the business are recognised.

## 3. ACCOUNTING STANDARDS

The relevant accounting provisions are contained within 4 standards:

- FRSSE (2008) – contains the disclosure relevant to companies that qualify for the small company regime. This will be replaced by FRSSE 2015 for accounting periods commencing on or after 1 January 2015. There are no changes in the accounting requirements proposed by this update.
- FRS 18 Accounting policies.
- FRS 102 The Financial Reporting Standard Applicable in the UK and Republic of Ireland – this standard applies for all entities adopting UK GAAP for accounting periods commencing on or after 1 January 2015 where the FRSSE has not been used.

In addition there are other documents that should be considered when looking at this area:

- *Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009, published by the FRC*
- *Audit Bulletin 2008/10 - Going Concern Issues During The Current Economic Conditions*
- *Audit Bulletin 2010/2 - Compendium of Illustrative Auditor's Reports On United Kingdom Private Sector Financial Statements*

### Definitions

The definition of going concern as set out above is consistent across all of the standards.

### Accounting

Under FRS 18 the standard stipulates that 'an entity should prepare its financial statements on a going concern basis, unless:

(a) the entity is being liquidated or has ceased trading, or
(b) the directors have no realistic alternative but to liquidate the entity or to cease trading,

in which circumstances the entity may, if appropriate, prepare its financial statements on a basis other than that of a going concern. As noted above, this would be a break up basis and this would need to be disclosed in the accounting policies.

The standard does require that, when preparing financial statements, the directors assess whether there are significant doubts about an entity's ability to continue as a going concern. If the directors, when making this assessment, are aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, they should disclose those uncertainties. In making their assessment, the directors should take into account all available information about the foreseeable future.

The consideration in FRSSE 2008 paragraph 2.12 and 2015 paragraph 2.12 is the same, and states:

'THE COMPANY IS PRESUMED TO BE CARRYING ON BUSINESS AS A GOING CONCERN. When preparing financial statements, directors shall assess whether there are significant doubts about the entity's ability to continue as a going concern. Any material uncertainties, of which the directors are aware in making their assessment, shall be disclosed. Where the period considered by the directors in making this assessment has been limited to a period of less than one year from the date of approval of the financial statements, that fact shall be stated. The financial statements shall not be prepared on a going concern basis if the directors determine after the balance sheet date either that they intend to liquidate the entity or to cease trading, or that they have no realistic alternative but to do so.'

FRS 102 contains similar provisions albeit in a slightly different way. The provisions are as follows:

*Assessment*
When preparing financial statements, the management of an entity using this FRS shall make an assessment of the entity's ability to continue as a going concern. An entity is a going concern unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. 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 date when the financial statements are authorised for issue.

*Uncertainties*
When management is aware, in making its assessment of material uncertainties related to events or conditions that cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. 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.

Where the trade in a company ceases but the company is going to be maintained as a dormant entity it would be usual to continue to prepare such accounts on a going concern basis where the company is solvent and could re-commence trading at a point in the future.

### Other guidance
During the current economic downturn there has been other specific guidance on this area that should be considered when preparing accounts that are required to show a true and fair view.

Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009 (October 2009) requires within para 14 that the directors of a company evaluate which one of three potential conclusions is appropriate to the specific circumstances of the company. The directors may conclude:

- there are no material uncertainties that may cast significant doubt about the company's ability to continue as a going concern; or
- there are material uncertainties related to events or conditions that may cast significant doubt about the company's ability to continue as a going concern but the going concern basis remains appropriate; or

- the use of the going concern basis is not appropriate i.e. the company has no realistic alternative but to cease trading or go into liquidation or the directors intend to cease trading or place the company into liquidation.

Audit Bulletin 2008/10 – Going Concern Issues During the Current Economic Conditions provides guidance in respect of the steps that should be taken by the auditor to ensure that there is appropriate consideration and disclosure in respect of this area.

Audit Bulletin 2010/2 – Compendium of Illustrative Auditor's Reports on United Kingdom Private Sector Financial Statements provides specimens of audit report disclosure.

If the client is an audit client and there are issues in respect of going concern then the following should be considered:

- Where there are doubts in respect of going concern and there is adequate disclosure in the notes to the accounts then consider whether there should be an emphasis of matter in the audit report drawing the reader's attention to the note in the financial statements.
- Where there is doubt in respect of going concern and the disclosure in the accounts if missing, inadequate or misleading disclose the details in the audit report with an appropriate modification of the opinion.

### Disclosure
The disclosure requirements are consistent across all the standards.

Where there are no issues in respect of going concern there would be no need to have disclosure beyond the risk comment within the directors report where required.

However where required the following information should be disclosed:

- any material uncertainties, of which the directors are aware in making their assessment, related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, along with the action taken and confirmation that the directors believe that the going concern basis is appropriate.
- where the foreseeable future considered by the directors has been limited to a period of less than one year from the date of approval of the financial statements, that fact.
- when the financial statements are not prepared on a going concern basis, that fact, together with the basis on which the financial statements are prepared and the reason why the entity is not regarded as a going concern.

## 4. EXAMPLES
The following are examples of the going concern disclosures required in a set of statutory accounts. The examples of the disclosure are consistent in each standard and will usually be included in the accounting policies.

### Example 1
### Going concern - Loss of major customer
In the last month of the financial year the equipment supply contract with the National Scientific Organisation reached its termination date and has now ended. This represented 40% of the annual sales for the current and previous year. After careful review of directors' projections, contract enquiries and the proposed partial restructuring of the business, the directors are confident that the end of this contract will not adversely affect the company in the long run. The directors have projected increased business from their existing client base that will account for half of the lost contract.

### Example 2
### Going concern
The major part of the company's working capital requirements are provided by a loan from XYZ Limited, a related company which is repayable on demand. It is anticipated this loan will be repaid from the sale of a property, the net realisable value of which is in excess of the borrowing. Directors of the related

company have indicated that they will not demand repayment; however no formal agreement is in place. The Directors have approached other finance providers who have indicated that they will be willing to finance or refinance this loan. This does not however take into account future fluctuation in the property market.

Support has also been provided by a loan from a director who has indicated that this support will continue for the foreseeable future.

The directors, having considered the above and made due enquiries, continue to adopt the going concern basis in preparing the financial statements which assumes that the company will continue in operation for the foreseeable future. To bolster the working capital reserves the directors have secured new overdraft facilities with their bank, this will be provided on a rolling basis and reviewed by the directors and bank every 24 months.

## 5. CHECKLIST

| Issue | FRS 18 | FRSSE 2008 | FRS 102 | FRSSE 2015 | Comment/Reference |
|---|---|---|---|---|---|
| Ensure that going concern risk has been considered within the principal risks set out in the directors' report | | | | | |
| Ascertain where there are any doubts in respect of the entity's ability to continue as a going concern | | | | | |
| Where doubts exist consider whether the going concern basis of preparation is appropriate or whether the accounts should be prepared on a break up basis | | | | | |
| Where accounts are prepared on a break up basis ensure that the following disclosure has been made:<br>• The accounting policies state that the break up basis has been used and why<br>• All fixed assets have been reclassified as current assets and are valued at the lower of cost and net realisable value;<br>• Long term liabilities have been reclassified as current liabilities and any costs of early settlement are recognised; and<br>• Any other costs associated with winding up the business are recognised | | | | | |
| Where material doubts exist but the directors believe that the going concern basis is appropriate, ensure that the following disclosure is made:<br>• Details of the circumstances giving rise to the uncertainty<br>• Details of the actual and proposed action being taken<br>• Confirmation that the directors believe that the going concern basis is appropriate | | | | | |
| Disclose where the foreseeable future considered | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| by the directors has been limited to a period of less than one year from the date of approval of the financial statements | | | | | |
| Where an audit is being undertaken consider whether any modification of the audit report is required | | | | | |

## 6. SOURCES OF INFORMATION

### Legislation

The legislation can be accessed at the following website:

www.legislation.co.uk

The following legislation should be referred to when required:

- Companies Act 2006
- The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008
- The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008

### Accounting standards

The relevant standards can be accessed on the Financial Reporting Council website at the following link:

http://www.accaglobal.com/uk/en/technical-activities/technical-resources-search/2014/april/accounting_standards.html#

The following standards should be referred to when required:

- FRS 18 – Accounting policies
- FRSSE (effective April 2008) – Financial Reporting Standard for Smaller Entities
- FRS 102 – The Financial Reporting Standard Applicable in the UK and Republic of Ireland
- FRSSE (effective April 2015) – Financial Reporting Standard for Smaller Entities

### Other guidance

The relevant guidance can be accessed on the Financial Reporting Council website at the following link:

http://www.frc.org.uk/Our-Work/Codes-Standards.aspx

- Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009, published by the FRC
- Audit Bulletin 2008/10 – Going Concern Issues During The Current Economic Conditions
- Audit Bulletin 2010/2 – Compendium of Illustrative Auditor's Reports on United Kingdom Private Sector Financial Statements