EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

XRB ALERT
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Spotlight on Going Concern Disclosures

Not-for-profit Entities

Here we provide an overview of the responsibilities of those charged with governance for the adequacy of going concern related disclosures in an entity's financial statements.

This publication will be useful for Tier 1 and Tier 2 registered charities and other not-for-profit entities that prepare financial statements in accordance with standards issued by the External Reporting Board (XRB).

JULY 2020

INTRODUCTION

Like many sectors, the NFP sector has been significantly impacted by the disruption and uncertainty caused by COVID-19 (coronavirus) and the ongoing impact on the economy and wider New Zealand society.

As a result, the financial and operating stability of many NFP entities[1] is currently under increased stress due to:

- pressure on securing future revenue inflows from funders and public donations;
- decrease in investment returns – for example, interest returns remain low;
- changes to the delivery of charitable activities as a result of post-lockdown operating norms;
- rising demand for services due to increased economic hardship; and
- pressure on the availability of staff including access to volunteers.

In this volatile environment, those charged with the governance[2] of NFP entities have a responsibility to explain to the readers of the financial statements[3] the entity's situation when there are uncertainties about the entity's intention and ability to continue operating for the foreseeable future.

The need for clear and concise disclosures about an entity's ability to continue operating as a going concern is critical for maintaining trust and confidence in financial statements which are used by individual donors, funding organisations and other stakeholders.

GOING CONCERN DISCLOSURES

The significant impacts of the coronavirus make it important for those charged with governance to understand the impacts on the future delivery of their activities and the ongoing financial stability of the entity. All governing bodies need to consider what information should be included in the financial statements to explain to the readers the impact of the coronavirus on the reporting entity.

A key consideration will be the governing body's assessment of the entity's ability to continue operating as a going concern, whether it is appropriate for the entity's financial statements to be prepared using the going concern assumption and the adequacy of the related financial statement disclosures.

In the current environment, the need for specific going concern related disclosures will be:

- more prevalent – many NFP entities are facing significant uncertainty about securing future sources of revenue; and
- a key area of interest to funders and individual donors who are looking for transparent and meaningful information to help them assess the NFP entity's operational and financial stability, including its ability to continue operating as a going concern — which also means that auditors and regulators will be closely examining such disclosures.

Disclosures should not only be provided on whether an entity continues to be treated as a going concern, but also information about how that view was reached – including any significant judgements and/or material uncertainties considered as part of this assessment.

[1] Reference to 'NFP entities' in this document can be read as references to any not-for-profit entity (including registered charities) that prepare financial statements in accordance with Tier 1 or Tier 2 PBE Standards as issued by the XRB.

[2] Reference to 'those charged with governance' in this document should be read as including other terms used to identify those parties charged with governance of NFP entities, such as 'officer' and 'trustees.

[3] Reference to 'financial statements' in this document can be read as financial reports which includes financial statements and, where applicable, service performance information prepared by an NFP entity.

WHEN IS AN ENTITY A GOING CONCERN FOR FINANCIAL REPORTING PURPOSES?

An entity is considered a going concern for financial statement preparation purposes unless those charged with governance of the entity either:

- intend to liquidate the entity or to cease operating; or
- there is no realistic alternative but to do so.

For some NFP entities, the impact of the coronavirus may leave them with no realistic alternative but to liquidate or cease operating. Others may need to scale back operations or seek additional funding. Some may not be significantly affected.

Financial statements are normally prepared on what is described as a 'going concern basis' or 'going concern assumption', that is, the entity expects to continue operating and meeting all of its obligations for the foreseeable future. In these circumstances the normal rules of accounting apply.

The need for a NFP entity to change how it operates or change the nature of its activities in response to the coronavirus does not necessarily mean the entity is no longer a going concern – the assessment is primarily based on the governing body's consideration of the intention and ability to continue operating in the future.

ASSESSING AN ENTITY'S GOING CONCERN ASSUMPTION

When assessing whether the going concern assumption is appropriate, those responsible for the preparation of the financial statements take into account all avaliable information about the future. This is at least, but not limited to,12 months from the balance date of the financial statements.

The going concern assessment may require consideration of a wide range of factors, such as the current and expected performance of the entity, stability of expected revenue inflows, any external obligations such as borrowing, and access to other sources of funding.

There is no set formula or process for assessing whether the going concern basis of preparation remains appropriate, rather judgement is required based on all the information avaliable at the time of this assessment. In periods of increased uncertainty, it is particularly important to document the basis and evidence for conclusions reached by those charged with governance.

Given the rapidly evolving nature and effects of the coronavirus pandemic, the going concern assessment will need to be updated regularly to reflect the latest information available at the date of approving the financial statements.

OVERARCHING RESPONSIBILITIES FOR THE ADEQUACY OF FINANCIAL STATEMENT DISCLOSURES

Those charged with the governance of NFP entities are responsible for ensuring the financial statements relied upon by external users fairly present the financial position, financial performance, cash flows, and service performance information (where applicable) of the reporting entity. Fair presentation will require consideration of the impact of the coronavirus on all elements of the financial statements and service performance information when presented.

Particularly during periods of increased uncertainty, it is important for those charged with governance to consider whether the going concern basis of preparation should be applied when preparing financial statements.

RESPONSBILITY TO ASSESS ADEQUACY OF GOING CONCERN RELATED DISCLOSURES

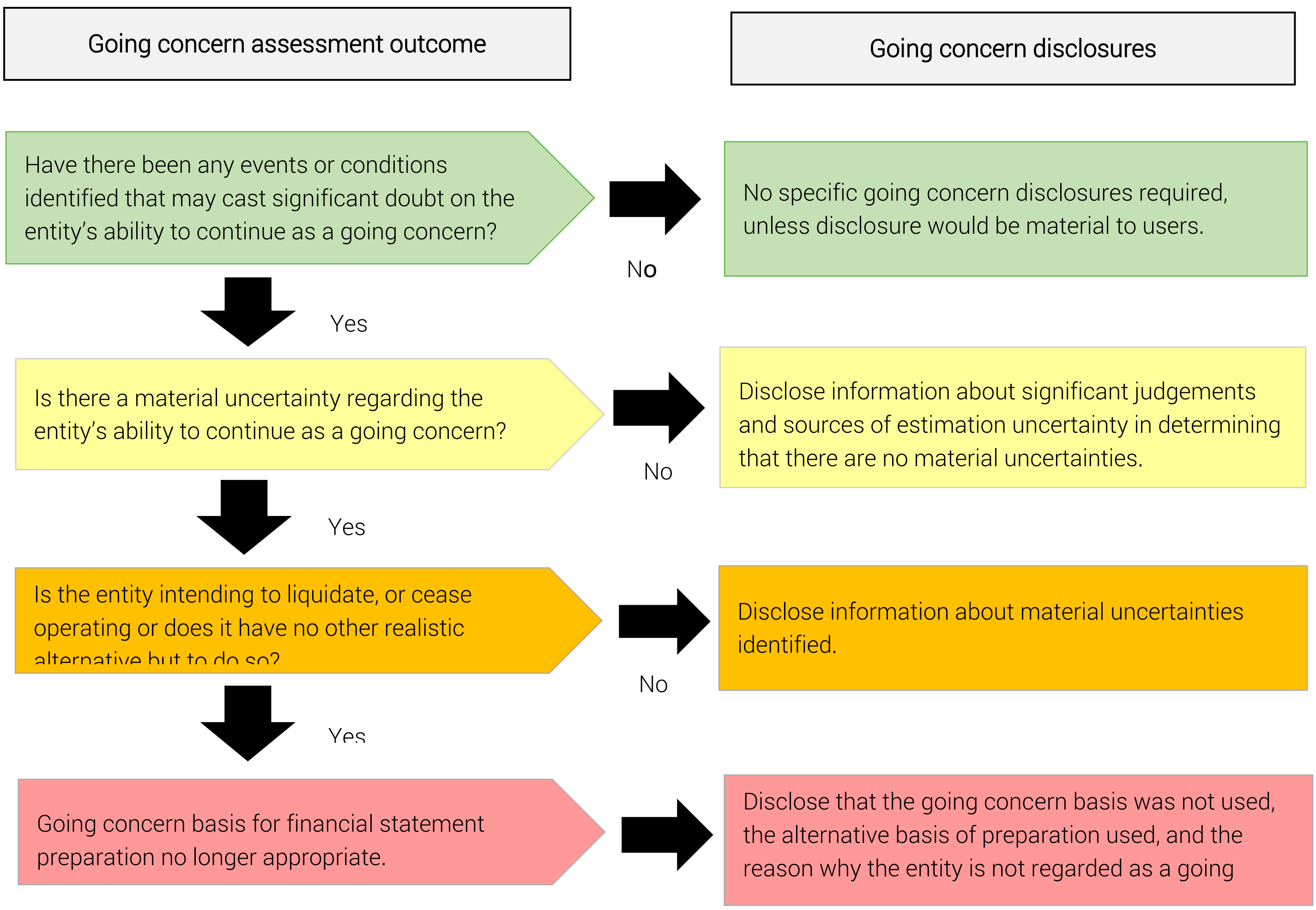
It is the responsibility of those charged with the governance of NFP entities to determine whether it is appropriate for the financial statements to be prepared using the going concern assumption and for providing adequate related disclosures.

When the financial statements are subject to audit or review, the auditor is required to assess whether the going concern related disclosures are adequate given the events and conditions identified by management.

WHAT DISCLOSURES ARE REQUIRED IN THE FINANCIAL STATEMENTS CONCERNING GOING CONCERN?

The nature and extent of going concern related disclosures will depend on each entity's facts and circumstances. However, in general, it is expected that the going concern assessment will result in one of four possible outcomes. As outlined in Diagram 1 below each of these outcomes results in different disclosure requirement considerations.

Diagram 1: Overview of going concern related disclosures



The disclosure considerations for each of these four going concern assessment outcomes are discussed further below.

No events or conditions identified that may cast significant doubt on the NFP entity's ability to continue as a going concern.

Disclosures required by accounting standards	Other disclosure considerations *	Auditor's responsibility over adequacy of disclosures
• No specific disclosures on an entity's going concern assessment are required. • General requirement to consider whether the coronavirus has had a material impact on the entity's financial position or performance that should be disclosed.	• Judgements applied in concluding that the coronavirus did not result in events or conditions being identified that may cast significant doubt on the entity's ability to continue as a going concern.	• Evaluate the going concern assessment and the adequacy of relevant disclosures. • If the auditor does not agree with the going concern assessment or does not consider the disclosures are adequate, consider impact on auditor's report.

* Not specifically required by accounting standards but which are examples of information that might be material to users; examples are not exhaustive.

Events or conditions have been identified that may cast significant doubt upon the NFP entity's ability to continue as a going concern, but no material uncertainties.

Disclosures required by accounting standards	Other disclosure considerations *	Auditor's responsibility over adequacy of disclosures
• Disclose significant judgements made in reaching the conclusion that there are no material uncertainties related to events or conditions that may significantly cast doubt upon the entity's ability to continue as a going concern.	• Information about the nature of the events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern — e.g. expected drop in future revenue. • Assumptions and judgements made as to the nature of any mitigating factors and why they lead to no material uncertainties — e.g. ongoing access to funding through multi-year agreements.	• Obtain sufficient audit evidence to conclude whether a material uncertainty exists in relation to the entity's going concern assessment, including consideration of mitigating factors. • Evaluate the adequacy of disclosures about the events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. • If the auditor does not agree with the entity's going concern assessment or does not consider disclosures are adequate, consider impact on auditor's report.

When those responsible for the preparation of the financial statements have applied significant judgement in reaching the decision that an entity is a going concern, the auditor is required to consider whether the financial statements provide adequate disclosures about how these decisions were reached. These situations are described by auditors as the "close-call situations"— when no material uncertainties are identified in relation to the going concern assessment, but events or conditions are identified that may cast significant doubt on the entity's ability to continue operating as a going concern.

Material uncertainties identified in relation to events or conditions that may cast significant doubt upon the NFP entity's ability to continue as a going concern.

Disclosures required by accounting standards	Other disclosure considerations *	Auditor's responsibility over adequacy of disclosures
• When those charged with governance are aware, in making the going concern assessment, of material uncertainties related to events or conditions that cast significant doubt on the entity's ability to continue as a going concern, the entity shall disclose those uncertainties.	• The potential impact of material uncertainties identified. • Significant judgements considered as part of the assessment of the entity's ability to continue as a going concern.	When material uncertainties are identified, the auditor is required to evaluate the adequacy of disclosures including: (a) that there is a material uncertainty; (b) the events or conditions that give rise to the material uncertainties; (c) management's plans to mitigate the effect of material uncertainties identified; and (d) that the entity may be unable to realise its assets and discharge its liabilities in the normal course of operation.

Given the current impact of coronavirus and how rapidly the consequences of, and responses to, the pandemic are developing, it is likely that many entities will need to disclose the existence of material uncertainties in relation to an entity's ability to continue as a going concern.

The accounting standards do not define 'material[4] uncertainty', because it depends on the entity's individual facts and circumstances. Instead, judgement is required to determine whether the extent of uncertainties about the entity's ability to continue as a going concern is material. For example, there may be a material uncertainty about the entity's ability to successfully implement its future plans to address the events or conditions identified at the reporting date.

When assessing whether material uncertainties exist, those charged with governance should consider both the potential impact of the uncertainty and the likely success of any plans to mitigate the impact of the uncertainty.

[4] Accounting standards contain guidance on the meaning of the term 'material' for financial reporting purposes. Further guidance on the meaning of 'material' in the context of NFP entity financial statements can be found in the PBE Conceptual Framework and Explanatory Guide A7 *Materiality for public benefit entities*.

Going concern basis for financial statement preparation not appropriate

Disclosures required by accounting standards	Other disclosure considerations *	Auditor’s responsibility over adequacy of disclosures
When an entity does not prepare its financial statements on a going concern basis, it shall disclose: • that fact; • the reason why the entity is not regarded as a going concern; and • the basis on which it has prepared the financial statements.	• Description of events that give rise to those charged with governance considering the going concern basis of preparation to no longer be appropriate. • Explanation of the changes in accounting policy and why.	Evaluate whether there is adequate disclosure in the financial report as to the alternative basis for preparation and the reasons for its use.

In the current environment, many NFP entities that were previously treated as a going concern may no longer be treated as such over the next reporting period.

When a decision is made to liquidate an entity or to cease operating, or the entity has no realistic alternative but to do so, the financial statements should no longer be prepared on a going concern basis. In these circumstances, professional accounting and legal advice should be sought to confirm the entity’s financial reporting obligations.

In these circumstances, the financial statements are prepared under an alternative basis of preparation, which should reflect the entity’s particular circumstances, such as whether the entity’s operations are to be transferred to another entity, sold or liquidated.

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