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There will be a new national accounting standard

I. A new standard will be issued on going concern

The Ministry's of Finance Accounting Standards Committee (KSR) has released for public consultations a draft of the "Going concern and accounting for entities unable to continue as a going concern" standard. The purpose of the standard is to assist in the application of the provisions of the Accounting Act of 29 September 1994 in situations associated with the adoption – or lack thereof – of the going concern basis of accounting. The document deals with such matters as: valuation of assets and liabilities and their presentation in financial statements when the assumption of going concern is not appropriate, other accounting requirements for entities in situations of being unable to continue as a going concern or when the circumstances resulting in being unable to continue as a going concern cease to exist. Comments on the draft may be submitted until 4 May 2021.

II. Going concern is the basis of preparation of financial statements

The going concern assumption is a fundamental principle in the preparation of financial statements. Under this assumption, an entity is presumed to be able to continue its operations in the foreseeable future without reducing them materially or being placed in a state of liquidation or bankruptcy, unless this would be inconsistent with the factual or legal status. When the assumption of going concern is appropriate, the entity's assets and liabilities are recorded in its books of account and financial statements on the assumption that the entity will be able to realize its assets and discharge its liabilities in the normal course of business. The existence of material uncertainty with regard to the entity's ability to continue as a going concern is not a sufficient reason to depart from the preparation of its financial statements on a going concern basis.

> The pandemic-caused difficulties with assessing an entity's ability to continue as a going concern have become the reason for the Accounting Standards Committee to prepare a draft of a new standard – "Going concern and accounting for entities unable to continue as a going concern".

III. Earlier profitability may indicate ability to continue as a going concern

If an entity has been profitable and has had ready access to financing, then it may conclude that the assumption of going concern is appropriate and does not require a detailed analysis. In other cases, to become certain that the assumption of going concern is appropriate, the management must very carefully assess the entity's ability to meet its obligations as they become due, by considering many factors that define current and expected profitability, the schedule for the repayment of liabilities and the potential sources of alternative financing, which requires detailed cash flow and profit forecasts. In special situations such as social or economic crises, like for instance an economic downturn or recession, also caused by a pandemic, the management assesses the entity's ability to continue as a going concern by considering the following events and circumstances: operating (e.g. contingency plans, reorganization, etc.), regulatory, including legal, liquidity management and the related threats (e.g. payment delays, increased credit risk, etc.)

IV. New information obtained prior to financial statements approval must be considered

An entity should not prepare its financial statements on a going concern basis if the events occurring after the reporting period, but before the preparation of the financial statements indicate that the adoption of the going concern basis of accounting is not appropriate. The management treats all information obtained after the preparation but before approval of the financial statements, indicating that the assumption of going concern is not appropriate, as an adjusting event, informs the auditor (if applicable), opens the books of account and again prepares the financial statements on the assumption that the entity will not be able to continue as a going concern. All information obtained after the preparation but before approval of the financial statements, pointing to events or circumstances that may indicate material uncertainty as to the entity's ability to continue as a going concern, is analyzed by the entity's management.

V. Some circumstances clearly point to inability to continue as a going concern

Financial statements are prepared on the assumption of inability to continue as a going concern if one of the following circumstances exists at the date of their preparation: formal placement of the entity in a state of liquidation following the passing of a relevant resolution by its shareholders or the finalization of a court ruling to dissolve the company, unless this would be inconsistent with the factual or legal status; a court's declaration of the entity's bankruptcy, unless this would be inconsistent with the factual or legal status; the management's assessment that it is practically certain that the entity will not continue operations in the foreseeable future (this assessment being the result of an analysis of events or circumstances that may point to material uncertainty as to the entity's ability to continue as a going concern); significant reduction in operations resulting in the absence of a realistic alternative to liquidating or discontinuing operations.

VI. Lack of bases for continuing operations may result from financial circumstances

The standard lists the following as examples of financial events or circumstances that may individually or collectively point to material uncertainty as to the entity's ability to continue as a going concern: a situation where liabilities exceed assets; an approaching fixed-term loans maturity without realistic prospects of extension or repayment, or excessive reliance on short-term loans to finance long-term assets; indications of a possible withdrawal of financial support by creditors; negative operating cash flows indicated by historical or prospective financial statements; adverse key financial ratios; significant operating losses or significant reduction in the value of assets used to generate cash flows; delays in or suspension of dividend payments; inability to pay liabilities when due; inability to comply with credit terms; change from credit to cash-on-delivery transactions with suppliers; inability to obtain financing for essential new product development or other essential investments.

VII. Specific operating events may predetermine inability to continue operations

The standard lists the following as examples of operating events or circumstances that may individually or collectively point to material uncertainty as to the entity's ability to continue as a going concern: management's intentions to liquidate the entity or to discontinue operations; loss of key management personnel without replacement; management's inability to manage significant business risk or handle increased responsibility; failed expansion, control or diversification of operations; failed elimination of internal control weaknesses that may increase the risk of material misstatements caused by fraud, misappropriation of inventory, uncontrolled costs and reporting errors; loss of a major market, key client(s), franchise agreement, license or main supplier; significant reliance on the success of a specific project or new product; lack of personnel, interruptions in production or provision of services due to labor disputes; shortages of important supplies; appearance of a highly effective competitor; main area of activity in declining industries; operations in countries experiencing a recession, civil unrest or hyperinflation; impairment of goodwill or other intangibles.

VIII. Court proceedings may be indicative of inability to continue operations

In addition, the standard lists the following as examples of events, other than financial or operating in nature, that may individually or collectively point to material uncertainty as to the entity's ability to continue as a going concern: non-compliance with capital or other statutory requirements, such as those relating to solvency or liquidity for financial institutions; pending legal or administrative proceedings against the entity that may, if successful, result in claims that are unlikely to be satisfied; changes in law or regulations, or government policy, that may have a negative effect on the entity; lack of insurance or insufficient insurance against disasters; negative analyst report; the entity's book value is higher than its market value.

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IX. Change in operations does not always affect ability to continue as a going concern

Under the standard, when assessing the appropriateness of the assumption of going concern it is also necessary to make a judgement on whether the entity will be able to continue as a going concern despite a significant change in its operations. As a rule, a substantial reduction of operations signifies a lack of a realistic alternative to liquidating or discontinuing operations. An example of a lack of alternative to liquidating or discontinuing operations is a loss of ability to discharge liabilities. The intention of the owners or management, without supporting facts such as for example placement of the entity in a state of liquidation, is not in itself sufficient to conclude that the entity will not continue as a going concern. Operations may be significantly changed as a result of, for example, a split, or sale or transfer of a group of assets or part of the business, without leading to a significant reduction of operations in the context of the going concern assumption when there is a realistic alternative to liquidating or discontinuing operations.

NOTE: The standard's provisions on the valuation of assets and liabilities and their presentation in the financial statements on the assumption of inability to continue as a going concern will be described in one of the upcoming issues of our alert.
This information may also be obtained from our experts.

The information presented herein does not constitute comprehensive information or opinion. Consult your adviser before making any decisions.