

Memo

To:	Judith Pinny, XRB
Subject	Accounting Standards Board on Going Concern Disclosures, in response to COVID-19
Date	27 July 2020

1. The purpose of this memo is to provide a handful of comments on the XRB Exposure Drafts on going concern disclosures. I have not commented on the technical details or specific questions raised for submitters. However, I did wonder whether the stance of not proposing a strict demarcation for Tier-1 entities might result in some pushback. Instead, I have simply provided a handful of observations from a lawyer (typically) advising directors and management – and who has also seen how preparers seek to meet their compliance obligations whilst thinking about the needs of users of financial statements.
2. My comments below are shaped by my recent experiences, including:
 - a. **For-profit entities:** advising the manager of a family of (distressed) managed investment schemes, governed by the FMC Act, and which are FMC reporting entities, whose problems have been exacerbated by COVID-19; and
 - b. **Not-for-profit sector:** working with a not-for-profit in the sports sector – which was tracking satisfactorily until COVID-19 brought its activities to a complete stop and which (in keeping with many community sports organisations) has only been kept alive by the Government support for the community sports sector.
3. As a result of those recent experiences, I am also aware that there is an apparent mismatch between the going concern disclosure requirements in accounting standards and those for auditing standards. To give this some context, I am aware that some licensed auditors (of FMC reporting entities) consider that, in some circumstances, they have no choice other than to include more specific information about “going concern issues” in the audit report – on the basis that there may be no other home for that information.
4. I would observe that this does not appear to be as a result of pushback from the preparers of the financial statements. Instead, this seems to be as a result of a view that the auditor is subject to more specific requirements and that there wasn't a specific/clear requirement (or guidance) for inclusion in the financial statements in what was a fluid/developing environment. Whilst I make no comment about the (technical) correctness of this view - I don't think there is any disagreement that the audit report is not the ideal home for disclosures of such information.
5. The factors listed in the Exposure Drafts as the drivers for the current proposals appear quite comprehensive. As is the description of the need to users of the financial statements with relevant and transparent information about:
 - a. material uncertainties affecting the ability to continue as a going concern; and
 - b. management's plans to mitigate those uncertainties,and do not need appear to need further comment.

6. And I was pleased to see that, whilst the interests of end users (when reading that such a material uncertainty has been flagged), are seen as the primary drive for reform – thought has also gone in to the need to provide management/preparers of financial statements with more guidance on this topic. That guidance will, I think, need to be ongoing and cover not only the decision-making process required to decide when to flag uncertainties about an entity’s ability to continue as a going concern but also cover disclosures about the sources of those uncertainties and the judgements made about them.
7. For this reason, my view is that even before the push provided by COVID-19 there has been a need for mandating more specific disclosure requirements when the going concern assessment has involved the consideration of material uncertainties.
8. From the preceding comments, it is clear that I think it would assist both the preparers and the audience – to have a set of more specific disclosure requirements when the going concern assessment has involved the consideration of material uncertainties. For this reason, my view of the current proposals is that they address what I see as the key elements surrounding disclosure of the existence of a problem (uncertainty). Specifically, that there is:
 - a. **problem identification:** disclosure of the principal events or conditions giving rise to the uncertainty;
 - b. **discussion about what is being done about the problem:** providing information about management’s plans to address the effect of the cause/s of the problem; and
 - c. **provision of adequate context:** clarity that, as a result of the problem, the entity may be unable to continue as a going concern - by realising assets and discharging liabilities in the normal course of business.
9. In this regard, the add-on in the form of the proposed paragraph 12A.2 to FRS 44 also seems particularly appropriate as it appears that one of the most immediate impacts of COVID-19 has been to generate great uncertainty about asset values. Prior to the impact of COVID-19, this may have been a factor that was relevant only to particularly industries (such as those undergoing rapid changes or prone to high levels of certainty). Today, this could be almost any industry – hopefully only for the duration of the period while the pandemic and the accompanying downturn in economic activity is at its apex.
10. Also on the topic of guidance, from a director/management perspective, I have recently had cause to make use of the joint publication by AICD, Chartered Accountants Australia and New Zealand and CPA Australia providing guidance for directors and preparers of financial statements and auditors on the impacts of COVID-19 on annual reporting disclosures. The concept of providing (in summary format) the key considerations when assessing how best to disclose the effects of the COVID-19 pandemic in annual reports for the upcoming reporting season is a very practical response to the needs of preparers. And by starting from a discussion about fundamental principles (such as the basis for an assessment of going concern status) and moving to worked examples – I think the three bodies have led the way for a wide range of entities. Because of experts’ views about the length and depth of the impact of COVID-19 it seems highly likely that there will need to be updates to this and similar guidance, next year – based on the learnings from the current reporting season.

11. The issue of guidance also led me to think about the proposal not to make disclosure concessions for Tier-2 entities because of the extent to which the going concern assessment (and uncertainties about the future) is likely to impact beyond just Tier-1 entities. However, this decision underlines the need for more guidance to be provided to preparers – with a particular emphasis on Tier-2 entities. In part, any such guidance should reflect not only the different resourcing and skillsets available to management in entities below Tier-1 but also the likelihood that the audience for those financial statements may have different resources, skillsets and needs.
12. I trust that these brief comments are of assistance.