

Going Concern and Liquidity Risk (ASPE)

What you need to know (May 2020)

What's the issue?

1. Most private enterprises, unless they are an essential service, are likely in a situation where they've had a significant drop in their operations or are closed, which may call into question their long-term viability or ability to continue as a going concern.
2. Broadly speaking, "going concern" is an accounting term that means an enterprise has the resources it needs to continue operating for the next year. These resources may include sufficient cash flows from operations or access to financing to help fund operations.
3. When preparing annual financial statements in accordance with Part II of the CPA Canada Handbook, Accounting Standards for Private Enterprise (ASPE), management will need to assess whether there is material uncertainty about the enterprise's ability to continue as a going concern. ([Paragraph 1400.07](#))
4. Assessing an enterprise's ability to continue as a going concern includes various factors, some of which will be subject to significant judgment during these uncertain times. This judgment may include assessing the degree of government support management expects the enterprise to receive and management's best estimate of the pandemic's duration and magnitude. As a result, management may need to:
 - (a) prepare updated financial forecasts and sensitivities using recent data for sales, expenses, etc.;
 - (b) consider the enterprise's expected cashflows and how the enterprise will finance its operations;

- (c) review the enterprise's debt repayment schedules and potential sources of replacement financing; and
 - (d) consider other information, such as sharp declines in selling prices, from after the reporting period up until the statements are finalized that suggests the enterprise will not continue to operate as a going concern. ([Paragraph 1400.08](#))
5. To aid the preparation of financial forecasts and sensitivities, enterprises may consider applying the principles from the non-authoritative guidance *Future-oriented Financial Information*. This guidance was retained CPA Canada Standards and Guidance Collection as a helpful tool when Part V of the CPA Canada Handbook was removed.

How will this impact the year-end financial statements?

6. Enterprises are required to include disclosures in the annual financial statements about uncertainties that may cast significant doubt about the enterprise's ability to continue as a going concern. ([Paragraph 1400.17](#)) This could include the anticipation of a significant decline in sales or the inability to procure materials and services to maintain production.
7. In some cases, management may intend to liquidate the enterprise or have no realistic alternative but to do so. In this situation, we encourage enterprises to consult with an assurance professional to discuss alternative bases of presentation, such as the liquidation basis. ([Paragraph 1400.18](#))

What if an enterprise identifies an issue after the year-end?

8. After the reporting date but before the financial statements are issued, management may determine that the enterprise cannot continue as a going concern. In this case, management will need to consider the accounting or disclosure impact on the current financial statements. ([Paragraph 3820.05](#)) Refer to the resource "[Subsequent Events \(ASPE\)](#)" for additional guidance on how to determine whether events need to be accounted for or disclosed after year-end.

Is it just going concern that needs to be considered?

9. No. Enterprises should consider how COVID-19 may affect an enterprise's liquidity risk. For example, some enterprises may violate debt covenants during the pandemic, resulting in a change to their debt maturity analysis, or expect challenges renegotiating their debts as they mature. Similarly, some enterprises may obtain repayment deferrals which could affect their covenants now or their liquidity situation in the future. Enterprises may also be experiencing greater liquidity pressures due to the closure of their businesses and prolonged social distancing requirements.
10. These risks will need to be disclosed in the enterprise's year-end financial statements and how management is addressing those risks. ([Paragraphs 3856.53-.54](#)) The disclosures help users of the financial statements understand the immediate or future financial constraints of the enterprise in their decision making process. Refer to the resource "[Debt Modification \(ASPE\)](#)" to understand the implications of debt renegotiations and covenant violations on the financial statements.

Extracts from relevant ASPEs

Standard	Guidance
Section 1400	<p>.07 <i>When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. Financial statements shall be prepared on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.</i></p> <p>.08 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 balance sheet date. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, a conclusion that the going concern basis of accounting is appropriate may be reached without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.</p> <p>.17 <i>When management is aware, in making its assessment of an entity's ability to continue as a going concern, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, those uncertainties shall be disclosed.</i></p> <p>.18 <i>When financial statements are not prepared on a going concern basis, that fact shall be disclosed, together with the basis on which the financial statements are prepared and the reason why the entity is not regarded as a going concern.</i></p>
Section 3820	<p>.05 The effect of subsequent events may be so pervasive, however, that the viability of the whole or a part of the business of the enterprise is brought into question. A rapid deterioration in operating results or financial position after the date of the financial statements may indicate a need to consider whether it is proper to use the going concern assumption.</p>
Section 3856	<p>.53 <i>For each significant risk (see paragraph 3856.A66) arising from financial instruments, including derivatives, an enterprise shall disclose:</i></p> <p style="padding-left: 40px;">(a) <i>the exposures to risk and how they arise; and</i></p> <p style="padding-left: 40px;">(b) <i>any change in risk exposures from the previous period.</i></p> <p>.53A <i>An enterprise shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the enterprise is exposed at the end of the reporting period.</i></p> <p>.54 <i>For each type of risk arising from financial instruments, an enterprise shall disclose concentrations of risk. Concentrations of risk arise from financial instruments that have similar characteristics and are affected similarly by changes in economic or other conditions (see paragraph 3856.A67).</i></p>