GOING CONCERN ASSESSMENT DURING COVID – 19

Introduction

The 2019 Novel Coronavirus infection or COVID-19 that was first reported in Wuhan in China in December 2019 has ravaged the world socially and economically. The outbreak was declared a Public Health Emergency of International Concern in January 2020, and a pandemic in March 2020. In Kenya, the first case was reported in March 2020. According to the National Emergency Response Committee on Coronavirus statistics as at 7 February 2021, Kenya had recorded 101,819 positive cases, 84,361 recoveries and 1,779 deaths. It is expected that the pandemic's impact on corporate reporting for 31 December year-end will be significant as well.

Financial reporting responsibilities in respect of Going Concern

Going concern is one of the fundamental principles of accounting; it is the basis of which financial statements are prepared. Under this principle, it is assumed that a business will continue to operate in the foreseeable future without the need to liquidate or curtail its operating activities.

Besides, Paragraph 472 of the Companies Act 2015, also imposes an obligation on the directors of a company to report on the going concern. The company directors are required to report the amount of financial resources available to the entity during the year and whether the business will continue as a going concern and pay its obligations as they fall due in the coming year.

Determining future cash flows

Governments across the world imposed different regulations that impacted the day to day running of several industries. For example, in Kenya, the hospitality, travel and education sectors were severely affected by COVID-19 19. The new regulations and disruptions resulted in drastic changes in how businesses are run and have created a new normal. This new normal has created uncertainty and doubt on some companies' ability to continue as a going concern for at least 12 months from the reporting date. This being the case, directors' and management of all companies must review the appropriateness of the going concern assumption at the reporting date. They are also expected to have well-documented assessments for cash flow projections that cover the next 12 months.

Determining future cash flows could prove challenging in the current business environment due to the uncertainty generated by COVID-19 19. Directors and management will need to assess:

- Current liquidity position – how long the business is expected to continue to operate with existing resources without breaching any covenants with its lenders;

- Forecasting of future cash flows from operations – The new normal has disrupted business operations leading to reduced revenues and in some cases increased costs of compliance with the new regulations. There is the resultantant uncertainty in cash flow forecasting especially due to businesses not able to forecast the quantum and timing of sales and debtor collections thereafter;
- Capital expenditure commitment – Management should consider conditional and unconditional obligations due or anticipated within the assessment period, regardless of whether they are recognized in the entity's financial statements; and
- COVID-19 has also impacted key stakeholders; for example, the business disruption on critical suppliers of businesses such as raw materials from overseas and delayed customers payments have impacted an entity's cash flows.

Where financial support for the company to continue as a going concern is required from either the shareholders or lenders, the availability of funds from those offering the financial support and the arrangements with lenders should be verified.

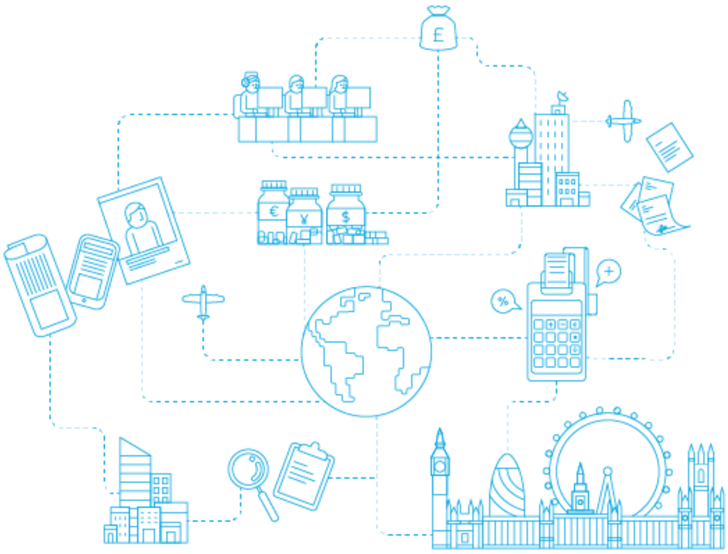
Impact on the audit report

The assessment of going concern has broader implication on business continuity and extent of disclosures may have an impact on the audit report. Where there is material uncertainty on the ability of the company to continue as a going concern, the auditor's report may be modified to include:

- An emphasis of matter paragraph relating to a significant uncertainty; or
- A qualified or adverse opinion in respect of inadequate disclosures in the financial statement.

Conclusion

The assessment of going concern requires significant judgment and estimates. The impact of COVID – 19 on businesses will continue to evolve, and there is a range of effects and outcomes that management and directors need to consider. The cash flow forecasts should also consider worst-case scenarios to identify how long the business would continue to operate with existing resources without breaching any covenants with lenders and settle its maturing obligations. Our team of experts in financial reporting are on hand to address any concerns you may have on the impact of COVID- 19 on your financial reports.



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