Going Concern
To trade or not to trade

The impact of Covid 19 has, and will continue to have for the foreseeable future, a fundamental impact on Irish business. With that being said, the duties and obligations imposed on Company Directors under Company Law and Accounting standards as it relates to Going Concern have not, to date, changed as a result of the pandemic and the purpose of this article is to provide a timely reminder of the extent of these duties and obligations, and more importantly establish what are the practical steps that directors can take to protect themselves and their businesses, particularly where the ultimate outturn may be that a business cannot survive as a going concern.

So, what are the obligations imposed on Company Directors under Company Law & Accounting Standards as they relate to going concern?

Technically speaking, a Company is insolvent (no longer a going concern) when it is either unable to pay its debts as they fall due (Cash Flow Test) or where the Company's assets are insufficient to discharge its liabilities (Balance Sheet Test).

Company Law further provides that the Directors must not approve the financial statements unless they are satisfied they give a true and fair view of the Company's position with a key requisite that the financial statements must be prepared on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

Accounting standards further develop this concept requiring that in assessing a Company's ability to continue as a going concern, the Directors must consider a period of at least 12 months from the date the financial statements are to be approved (as distinct from the Balance Sheet date).

Considering the foregoing, it would be reasonable to conclude that Directors, in order to meet their fiduciary responsibilities (particularly in a time of economic crisis), must be able to reliably assess that their business has the ability to continue in operational existence (as a going concern) for at least one year ahead of present time to justify a decision to continue trading, or conversely, via the same assessment process, whether it might be appropriate to cease trading.

The gravity of this assessment cannot be understated, as should the unfortunate situation arise where a company enters into an insolvent liquidation, the question will be asked, and answered, by the appointed liquidator and others, including the Office of the Director of Corporate Enforcement ("ODCE") whether, when it became clear that the Company was in financial difficulty, that the Directors adequately assessed going concern and acted correctly in the best interests of the Company's creditors. Where this is judged not to be the case, sanctions can include the following measures against the Directors:

- Restriction from acting as a director for five years or disqualification.
- Personal liability for the Company's debts where business was conducted in a reckless manner.
- Both criminal and civil liability where a person is knowingly party to the carrying on of the business of the company with intent to defraud creditors of the company.

How should Directors prepare their Going Concern Assessment?

While the preceding paragraph makes for unsettling reading, it is important to note that Directors are entitled to continue to trade and draw on credit as long as they honestly believe there are reasonable grounds that the business can continue as a going concern.

Therefore, one of the key protections for Directors to demonstrate that they have always performed their duties and functions in good-faith, acting responsibly, is to have a robust and evolving Directors Assessment of Going Concern ("DAGC") in place to support the decisions they have taken and will continue to take.

The question is often asked by Directors – "Where do I start when it comes to preparing a DAGC?".

Of course, the form and content of a DAGC is unique to every company, but your accountant should be in a position to provide you with an example framework to at least begin with. In any case a DAGC should contain, at a minimum, the following information.

- **Current Management Accounts of the Business** – Any forecast or projection must have a sound and accurate starting point, and so if your current MIS/Accounting system cannot provide up to date information, these should be upgraded immediately. You can find more information from some of my colleagues on accounting options in our previously published articles below;
    - **The Importance of up to date financial data for your business**
    - **How to stream-line the process to get your financial information up to date**
- **Principal Risks and Uncertainties** that affect the business should be documented as these will help determine some of the key assumptions that will be embodied into the Company's forecasts. If your Company does not currently have a Risk Register, now would be a good time to put this in place.
- **Financial & Cashflow Forecast** – This should include a monthly Profit & Loss Account, Balance Sheet and Cashflow Forecast for at least a 12 month period and should be capable of operating on a rolling basis so that at least one years' forecast information is constantly available.
- **Sensitivity Analysis** – The forecast above should be constructed in such a way that the impact of changes in key assumptions can be easily accommodated – typical examples would be changes to expected sales volumes/prices, material/labour costs, and foreign exchange impacts.
- **Borrowing facilities** -The forecast must be able to quickly identify where a covenant breach might occur within sanctioned banking facilities. This is vital as it affords the opportunity for early engagement with lenders before a potential breach occurs.
- **Contingencies** – The DAGC should document contingency plans available to the Company, such as cost reductions, and when they should be implemented should forecasted results start to fall below expectation. This would also include developing an insolvency contingency plan should it become the case that the Company may no longer be a going concern. My colleague Declan de Lacy has published several recent articles advising Directors on how to deal with insolvency that can be accessed through the links below;
    - **Survival of the fittest**; **Schemes of arrangement**

- **Contingent Liabilities** – Its important that the assessment considers liabilities that might arise from a decision to change or curtail the activities of the business; redundancy costs and property lease terms would be good examples that Directors need to be mindful of.

Having prepared a DAGC, we would strongly advise that Directors:

- Hold regular, minuted, board minutes to continually review and update the Directors Assessment of Going Concern.
- Take regular legal and financial advice as matters develop and keep a record of that advice. It is particularly important that Directors gain an external perspective on their DAGC that challenges the key assumptions made, while at the same time offering solutions and alternative perspectives.
- Actively engage with lenders and other key stakeholders early and regularly.

Conclusion

In conclusion, the ODCE has recently released a guidance note entitled "Covid 19 and the insolvency related functions of the ODCE" which can be found **here**. While the document copper fastens the potential sanctions that we have discussed earlier in this article, it also very usefully provides clarity along the following lines:

"Provided that Directors decisions and judgments were;

- Made on the basis of objectively verifiable evidence;
- Based on assessments and assumptions that were reasonable in the context of the circumstances pertaining at the relevant times;
- Made in good faith and the directors otherwise acted honestly and responsibly,

It is unlikely that the ODCE will consider that the Company Directors should be restricted."

Taking all of the foregoing into account, we would hope that this article provides some valuable context to Directors in terms of;

- Knowing and understanding their obligations under Company Law and Accounting Standards, and
- Appreciating the importance of preparing a Directors Assessment of Going Concern as an important way to demonstrate that they have at all times acted honestly, responsibly, and in good faith in the interests of the Company and its Creditors.

How can PKF help you?

Our expertise can assist you successfully navigate these complex issues, so please do contact us at any stage and we will assist you. Please contact David McGarry, Audit Partner, or your normal firm contacts should you require further information.

d.mcgarry@pkf.ie

Right people.
Right size.
Right solutions.

If you have any questions on any of the information in this article or you need advice on how to remain compliant during the COVID-19 crisis please don't hesitate to contact our Audit or Insolvency team.

01 496 1444
info@pkf.ie
www.pkf.ie