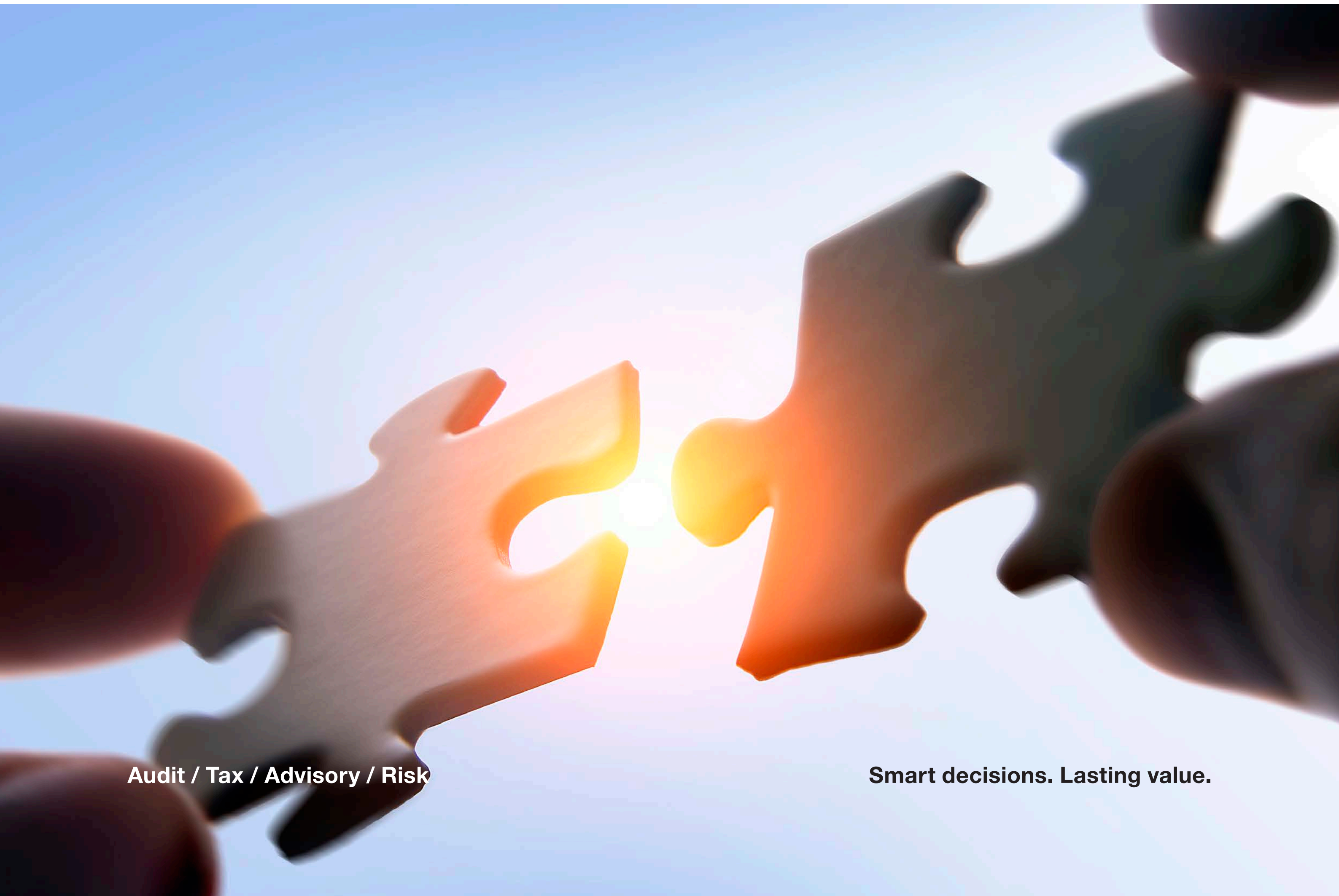
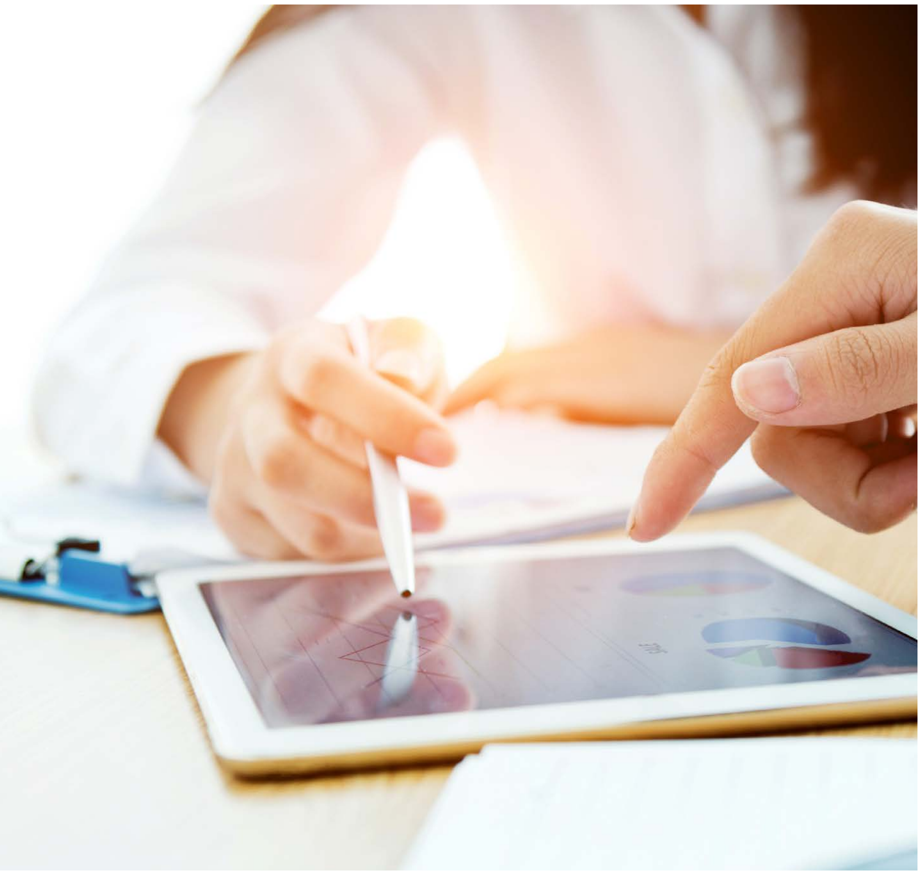
Charities: Going concern

A guide for Trustees and management



The information and checklist in this document is designed to assist charity Trustees and management in preparing accruals-based financial statements to report on the financial position of their charity.

In particular, it will assist them in their responsibilities to assess whether the going concern basis of accounting is appropriate, to consider any judgements or uncertainties in relation to the future solvency and liquidity risks for the charity, and to provide clear and concise financial reporting disclosures that meet the statutory and other financial reporting requirements.



Background

Trustees and/or directors of charities, have a responsibility to ensure that the charity operates as a going concern. While this is a continuing responsibility, it is most relevant when preparing the charity's annual report and financial statements.

In preparing the report and financial statements to comply with Financial Reporting Standard 102 ('FRS 102') and the Charities SORP, the Trustees with management, are required to make an assessment of the charity's ability to continue as a going concern, as well as determining if there are material uncertainties in respect of going concern. In making this assessment they are required to take into account all available information about the future, covering a period of at least 12 months from the date on which the report and accounts are approved by the Trustees.

Significant changes to the entities operating environment, for example the COVID-19 pandemic, will require Trustees to reassess their financial position and the ability of their charity to continue to operate as a going concern. This may require considering a number of factors, including updating the charity's budgets and forecasts, and should cover any changes up to the date of sign off of the financial statements.

Where Trustees identify uncertainties, other than those with a remote probability of occurring, that could lead to the charity not being a going concern, they are required to disclose these in the financial statements. The Financial Reporting Council (FRC) has stated that it believes it is likely that more entities will disclose "material uncertainties" to going concern in the current circumstances.

The Charity Commission guidance "Managing financial difficulties & insolvency in charities" (CC12) stresses the importance for "a Trustee body to have a good knowledge and understanding of the charity and its finances so that, as far as possible, the continued viability of the charity and its charitable activities can be assured". This recurs in the Charity Commission's updates and alerts including its guidance on whether charities can use reserves and restricted funds to help the charity through the pandemic crisis.

Many charities face what are relatively fast-moving changes and it will be important that the Trustees consider not only the charity's budgets and forecasts but also the sensitivity analysis on these. Key considerations will be around reserves, liquidity and resilience.

Going concern - Basis of accounting and foreseeable future

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the charity is a going concern and will continue its operations for the foreseeable future.

While it is for the Trustees to determine what period they consider to be the 'foreseeable future', the minimum period is set within FRS102 as "at least, but not limited to, 12 months from the date on which financial statements are authorised for issue". This means, that where relevant information (such as key events or conditions) is available beyond this initial 12 months, Trustees will need to incorporate this into their going concern assessment.

The financial reporting frameworks applicable in the UK generally require the adoption of the going concern basis of accounting in financial statements, except in circumstances where Trustees intend to cease the charity's operations or to liquidate the charity, or have no realistic alternative to cessation of operations or liquidation. If the going concern assumption is not applicable, an alternative basis of accounting is appropriate.

The term going concern is the defining assumption about the condition of an entity for which adoption of the going concern basis of accounting is appropriate: Accordingly:

a) the term 'going concern' applies to any entity unless its management intends to liquidate the entity or to cease trading, or has no realistic alternative to liquidation or cessation of operations, and

b) the term 'ability to continue as a going concern' is equivalent to the term 'ability to continue to adopt the going concern basis of accounting in the future'.

This means that the going concern basis would normally be applicable even when there are uncertainties about events or conditions that may cast significant doubt upon the charity's ability to continue as a going concern in the future. However, such uncertainties are required to be disclosed in the financial statements when they are material.

Going concern – Trustees' assessment and material uncertainties

The nature of the going concern assessments by charity Trustees will vary widely between different charities depending on factors such as the funds structure of the charity, available reserves, income sources, the charity's activities, staffing levels, operating locations and potentially numerous other factors. It is not therefore possible to have a 'one-size fits all' approach to achieve an acceptable assessment.

Nevertheless, because the going concern basis of accounting is a fundamental principle in the preparation of financial statements, the preparation of the financial statements requires the Trustees to assess the charity's ability to continue as a going concern.

The Trustees' assessment of the charity's ability to continue as a going concern involves making judgments, at a particular point in time, about inherently uncertain future outcomes of events or conditions. The following factors are likely to be relevant to that judgment.

- The degree of uncertainty associated with the outcome of an event or condition will increase significantly the further into the future an event or condition or the outcome occurs.
- The size and complexity of the charity, including the nature and location of its activities and the degree to which it is affected by external factors, will affect the judgment regarding the outcome of events or conditions.
- Any judgment about the future is based on information available at the time at which the judgment is made. Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made.

In determining whether there are material uncertainties, the Trustees will need to consider:

- the magnitude of the potential impacts of the uncertain future events or changes in conditions on the charity and the likelihood of their occurrence;
- the realistic availability and likely effectiveness of actions that the Trustees could take to avoid, or reduce the impact or likelihood of, the uncertain future events or changes in conditions; and
- whether the uncertain future events or changes in conditions are unusual, rather than occurring with sufficient regularity for the Trustees to make predictions about them with a high degree of confidence.

Going concern - Insolvency

There are normally two tests of insolvency – the balance sheet test (positive net assets) and the cash flow test. The key issue is, can the organisation pay its debts as they fall due. The cash flow test is of particular importance and a charity can be insolvent even if it has positive net assets. Careful consideration is required of many factors, such as what values can be realised in time to meet debts and what assets can be used to meet liabilities. Understanding is needed of the implications of the different restricted and endowed funds held by the charity. The position for Trustees of an unincorporated charity is different and the risks are usually higher.

Directors and shadow directors can be guilty of wrongful trading if they continue to trade and incur liabilities they knew or ought to have known that there was no reasonable prospect of avoiding insolvent liquidation.

Fraudulent trading is also a risk. Section 213 of the Insolvency Act provides that on the application of the liquidator of a company the Court may order that any persons who were knowingly party to carrying on the business of the company with intent to defraud creditors must make a contribution to the company's assets. For a fraudulent trading action, intent to defraud creditors must be proved and the onus of proof is on the liquidator. There must be evidence of actual dishonesty. For an insolvent charitable company, senior management, and not just the Trustees, could also be made liable for fraudulent trading. The charity should avoid entering into preferential transactions which put another party in a better position to the detriment of other creditors. The court will recognise mitigating circumstances. For example, if the directors took proper steps to minimise the potential loss to the company's creditors.

On 28 March 2020 the government announced changes to the insolvency regime aimed to provide companies breathing space and keep trading through the COVID-19 pandemic. A suspension of wrongful trading provisions to remove the the threat of personal liability during the pandemic has been enacted by the government, applied retrospectively from 1 March 2020 and ending on 31 March 2021. In addition, there is a temporary moratorium for companies undergoing a restructuring process so that they cannot be put into administration by creditors and will continue to be able to pay suppliers and staff, although it has been clarified that these measures do not impact the existing laws relating to matters such as fraudulent trading, transactions defrauding creditors and misfeasance.

Going concern - Reporting requirements

Except where an alternative reporting framework sets out in legislation or regulation, or another Statement of Recommended Practice applies, the Charities SORP applies to all charities in the UK that prepare accounts on the accruals basis to give a true and fair view of a charity's financial position and financial activities regardless of their size, constitution or complexity. In the Republic of Ireland the SORP sets out recommended best practice.

For a charity to state that its report and accounts are compliant with the SORP, both its Trustees' annual report and its accounts must be prepared fully in accordance with the reporting and accounting recommendations of this SORP.

We have previously published a Financial disclosure reporting checklist: Charities SORP (FRS 102) which includes all the SORP disclosure requirements, and this checklist is available on our website.

However, to assist Trustees to meet their reporting requirements specifically in relation to going concern, we have summarised as Section B in this document a checklist of the key disclosures that Trustees and management will need to consider as part of their going concern assessment.

This checklist is published for general guidance and therefore without responsibility on the part of Crowe U.K. LLP for loss occasioned to any person acting, or refraining from action, as a result of any information published herein.

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A. Going concern – Trustees' assessment

It will be important in making any assessment of going concern that charity Trustees evaluate whether the charity has access to sufficient liquidity and can remain solvent through the period of public health restrictions and beyond.

Trustees will need to take into account the charity's available reserves, the terms of any financing facilities or other support accessed and whether any such support taken on gives rise to future obligations. Deferral of payments or the receipt of grants to offset costs may alleviate liquidity challenges but may affect the charity's solvency if the support does not continue long enough for the charity to recoup those costs from future income.

Trustees will also need to consider the impact of different potential scenarios on their charity's income, costs (both fixed and variable) and cash flow requirements.

Some sector bodies in the UK and globally have produced projections for economic activity that may be relevant for Trustees to use as an anchor for their own scenarios.

Liquidity and solvency risks faced by the charity may be inter-related and either or both may affect its going concern status and whether it faces material uncertainties related to going concern.

Trustees will need to ensure that their assessment of going concern and the evidence that they need to gather in support of that explicitly considers both liquidity and solvency factors which may affect the ability of the Trustees to assert that the charity is a going concern and to identify elated material uncertainties.

A1

Budget and forecasts

A1: Budgets and forecasts

Key budget and forecast assumptions

Changes in the operating environment will have had a material impact on many of the future assumptions for most charities. It will therefore be very important that these have been appropriately updated.

- Do the financial budgets / forecasts appropriately reflect the latest information available?
- Have all the key assumptions used in the financial budgets / forecasts been updated to reflect the potential impacts on the activities and operating methods of the charity? In particular, do they fully reflect known and potential changes to:
  - income streams?
  - fixed and variable costs?
  - activities?
- Do the financial budgets / forecasts adequately reflect changes to asset realisable values, for example:
  - recoverable debtor amounts?
  - inventory values?
- Have the changes to the operating environment resulted in any key additional liabilities, for example:
  - final salary pension scheme liabilities?
  - onerous contracts?
  - redundancy payments?

Scenarios for the future of the charity

Trustees will need to consider the potential scenarios for the future activities of the charity and it will be important that the financial effects of any and all the potential scenarios are reflected into the financial forecasts.

- Have the budgets and forecasts been updated to address possible scenarios considering both what if and how likely?
- Do the budgets and forecasts adequately reflect the impact from any “what if?” questions that the Trustees should consider?

Key budget and forecast sensitivities

There are many uncertainties and this means that most forecasts will include judgements and estimates. These should be subject to sensitivity analysis. The risk that one change can lead to others and the impact of this can be significant and should be recognised.

- Do the budgets and forecasts provide adequate flexibility to enable the Trustees and management to understand the key risks and uncertainties and the related impacts on the financial position of the charity from changes to any of the income or costs related to these uncertainties?

Reverse stress testing

Reverse stress tests identify pre-defined outcomes, such as the charity’s business model becoming unviable, then explores plausible scenarios that could result in that outcome. In general terms, reverse stress tests require considering the answer to three questions.

- What would it take for the charity to fail?
- What event or combination of events might lead to this outcome?
- What can we do now to avoid this happening?

Government support

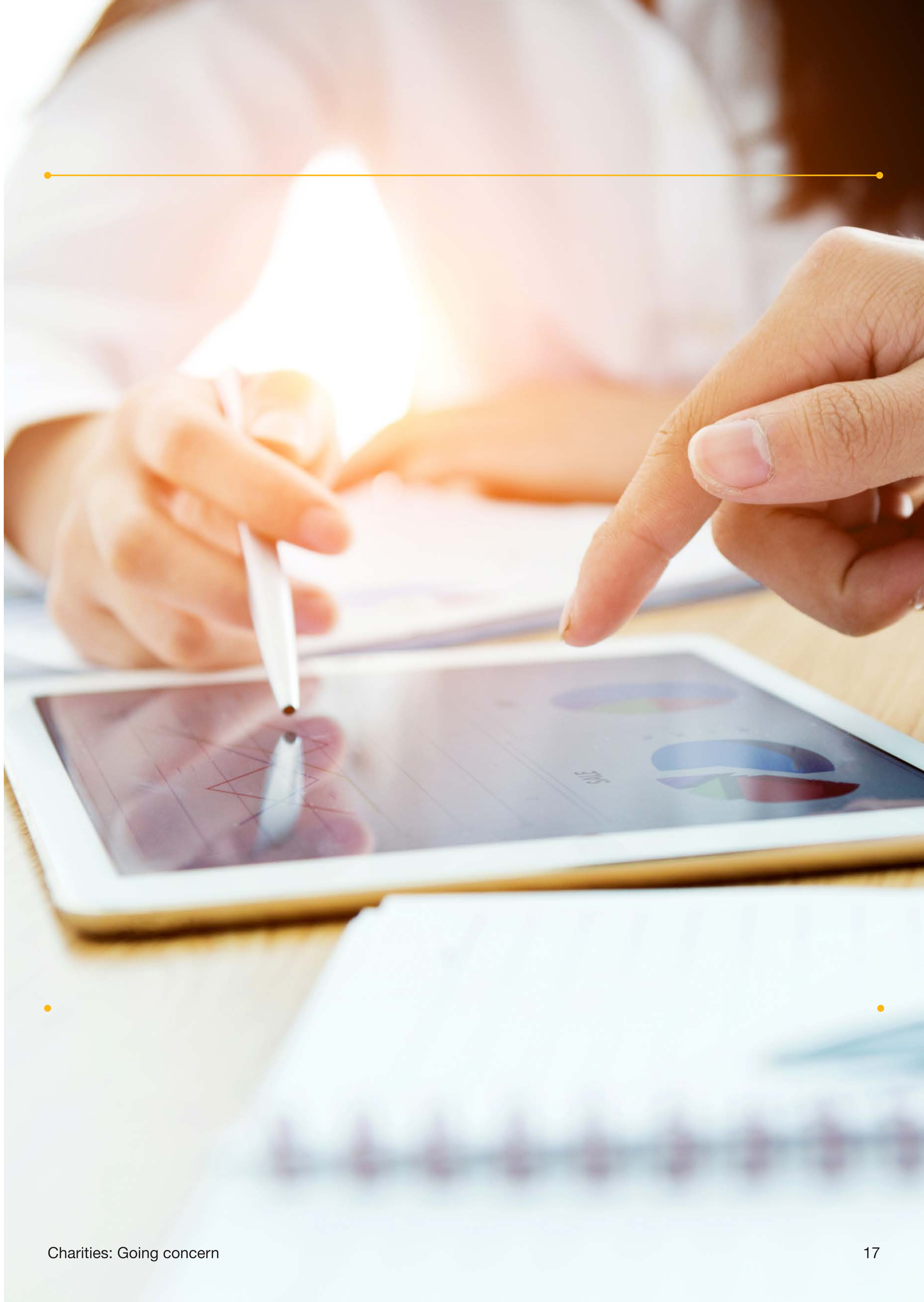
The charity may be benefiting from one or more forms of government support. Whilst this will be very welcome, it will be important that the nature of the government support and the subsequent withdrawal of this support are appropriately reflected in any going concern assessment.

- Is the charity currently benefitting from the government support that is potentially available to it?
- Do the forecasts appropriately reflect the support being received and the future changes / implications when this is withdrawn?

Staff / furlough scheme / redundancies

The Furlough scheme may have allowed the charity to retain its staffing structure during the initial lockdown period. Additionally, many organisations are recognising that the current enforced changes in working practices are likely to be at least in part retained going forward. It is important that the forecasts appropriately reflect the impact on the charity both of the withdrawal of the furlough scheme support and any other decisions on future staffing that the Trustees may need to consider.

- Are the financial impacts of the furlough scheme and its future withdrawal appropriately reflected in the future projections of staff costs?
- Have the Trustees identified any necessary changes to the charity's current or future staffing structure and have the financial impacts of these changes been fully integrated into the future forecasts?



A2

Future cash flow projections

A2: Future cash flow projections

Working capital and liquidity

A key part of a charity's going concern assessment will be its working capital / liquidity position

- Do the cash flow projections provide the Trustees with the information they need to assess the continuing adequacy of the charity's working capital / liquidity including any key points of stress?

Linking of cash flow timing and changes to budgets and forecasts.

Changes to the charity's operating environment may require a reassessment of the charity's budgets and forecasts up to the date of signing of the financial statements. Additionally, the changes may also impact on the timing of income and expenditure cash flows with cash flows being either later or earlier than previously anticipated. It will therefore be important that the future cash flow projections adequately reflect the potential timing changes.

- Do the cash flow projections reflect the changes made to the budgets and forecasts as well as the additional potential impact of these changes on the timing of the related cash flows?

Potential cash collection issues.

Changes to the operating environment will also impact the third parties who make payments to the charity. As a result, amounts that would previously have been received may now be deferred or potentially not recovered.

- Do the cash flow projections appropriately reflect the potential changes in the timing and amounts that will be received from non-contractual income sources, e.g. pledged future donations and grants?
- Have the risks of non-recovery or deferred recovery of contractual debtor balances (such as fees for services) been adequately reflected into the cash flow projections?

Cash flows from restricted funds

Charities with restricted funds may have cash inflows that are only available to fund activities within the purposes of the restricted funds.

- Do the cash flow projections adequately segregate the charity's cash flows, both in and out, between cash available for the unrestricted general purposes of the charity and cash which must be used for the limited purposes of its restricted funds?

Commitments and liabilities

Changes to the operating environment may have necessitated a reassessment of the charity's priorities and operating requirements. Any such changes may have created and / or reduced the charity's ongoing commitments and liabilities as well as the timing of the settlement of these.

- Have all potential changes to the charity's future financial commitments and liabilities and related cash flows been appropriately identified and reflected into the cash flow projections?

Loan repayment terms / facilities / headroom / covenants

Changes to the charity's operations may impact on its ability to meet its loan repayment terms, in particular if these result in potential breaches to the terms of any related covenants.

- Does the charity have any loan related covenants and if so have the risks of breaching these covenants and the potential impact on the future cash flows and liquidity been adequately reviewed?

Asset values

Future cash flows may depend on the realisation of investment or other assets. The value of any such assets at the point of disposal may therefore be a key input to the Trustees' assessment.

- Do the Trustees have sufficient information to assess the key assumptions that have been used to determine the valuations?
- Has the relative probability of different outcomes been adequately assessed?
- Where valuations rely on external experts, do the Trustees have sufficient information to ensure that the values are appropriate?

A3

Reserves and financing

A3: Reserves and financing

Reserves

The Charity Commission has recognised that reserves can be spent to help cope with unexpected events. However, in utilising the charity's reserves it is important that the Trustees have identified which of the charity's funds or assets have limits on their use.

- Do the Trustees have a clear understanding of the funds of the charity and of the related underlying assets to identify amounts available to be spent both in the short and longer term?

Other available designated funds

If the Trustees have previously decided to designate/earmark certain funds for a particular purpose they may be able to re-prioritise these.

- Does the charity have any designated funds earmarked for specific purposes and, if so, can these designations be released to make the funds available to fund the general operations of the charity?

Restricted funds

If the charity holds restricted funds, the Trustees should seek to maximise the use of these funds recognising that these may only be used for particular and defined purposes. The Charity Commission recognises that in some instances there may be ways to amend restrictions, although it has said that accessing or releasing restricted funds should only be considered if other options such as using unrestricted funds are not possible.

- Have the Trustees reviewed any fund restrictions and matched these against the charity's priorities and operating activities to ensure that costs are being allocated to such restricted funds where permitted?
- Have the Trustees considered seeking to amendment the restrictions, taking account the wider and longer-term impacts of on the charity's financial resilience and donor relationships?

Endowments / total return

Charities with permanent endowments held as investments have in the past been limited to spending the investment income only with any growth in the value of the investments remaining as part of the endowment capital.

However, since 2014 Trustees have been able to pass a resolution under S104A(2) of the Charities Act 2011 to apply a total return approach to investment for permanent endowment investments. This approach gives Trustees flexibility in the way they allocate the total return arising from the relevant investments between the permanent endowment capital and the amount they can apply for the purposes of the charity.

- Does the charity have any permanent endowment funds and, if so, do the Trustees operate / have they considered a total return approach to investment?

B

Reporting requirements

B. Going concern – reporting requirements

In making their assessment of going concern, where the Trustees are aware of material conditions that cast significant doubt upon the charity's ability to continue as a going concern, they are required to disclose those uncertainties in the charity's annual financial statements.

Additionally, disclosure is required giving details of the nature of any material events that occur after the balance sheet date with an estimate of their financial effect.

Should the Trustees conclude that it is not appropriate to prepare the financial statements on a going concern basis, they are required by FRS102 to disclose this fact, together with information to explain the basis on which the financial statements have been prepared and the reason why the charity is not regarded as a going concern.

The sections below are an extract of the relevant disclosures required on going concern, uncertainties and key judgements and assumptions from our separate Charity SORP disclosure checklist.

B1: Trustees' Report - Going concern

If, at the date of approving the report and accounts, there are uncertainties about the charity's ability to continue as a going concern, the nature of these uncertainties should be explained.

SORP 1.23

B2: Trustees' Report - Key risks and uncertainties disclosures

A larger charity MUST explain:

- the principal risks and uncertainties that the Trustees see as facing the charity and any subsidiaries, summarising the Trustees "plans and strategies for managing those risks"
- any factors that are likely to affect the financial performance or position going forward.

SORP 1.46

B3: Trustees' Report - Funds in deficit

The report MUST identify any fund or subsidiary that is materially in deficit, explaining the circumstances giving rise to the deficit and the steps being taken to eliminate it.

SORP 1.24

B4: Notes to the Accounts - Going concern material uncertainties

All charities MUST explain in the notes to the charity's accounts any material uncertainties related to events or conditions that cast significant doubt on the charity's ability to continue as a going concern. In making this explanation, charities should provide:

- a brief explanation of those factors that support the conclusion that the charity is a going concern; and
- a balanced, proportionate and clear disclosure of any uncertainties that makes the going concern assumption doubtful.

For accounts not prepared on a going concern basis, this fact MUST be disclosed, together with the basis on which the accounts are prepared and the reason why the charity is not regarded as a going concern.

SORP 1.23

B5: Notes to the Accounts - Going concern no material uncertainties

Where there are no material uncertainties about the charity's ability to continue, this should be stated in the notes to the charity's accounts.

SORP 3.39

B6: Notes to the Accounts - Key judgements and assumptions

- the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the accounts
- the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next reporting period
- in respect of those assets and liabilities where there is a significant risk of material adjustment within the next reporting period, the notes MUST include details of their nature and their carrying amount as at the end of the reporting period.

SORP 3.40

B7: Post balance sheet non-adjusting events

For each category of non-adjusting event, the notes to the accounts MUST provide details of the nature of the event and an estimate of its financial effect or a statement that such an estimate cannot be made.

SORP 13.8

Start the conversation

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