Auditors clash with directors over the question of 'going concern'

Businesses are under pressure to give full account of how pandemic has affected trade Pressure from the Financial Reporting Council is stoking tensions between audit firms and company directors

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UK companies in the retail, hospitality and construction industries are locked in a battle with auditors to prevent their accounts carrying warnings that risk making the fight to survive the coronavirus crisis harder. The country's accounting watchdog is pushing auditors to be tougher when judging whether a company can continue trading as a going concern for the next 12 months. The going concern test is one that companies must pass to secure a clean bill of health from their auditors.

The increased pressure from the Financial Reporting Council is stoking tensions between audit firms and company directors, who are worried that an official question mark in their accounts over whether they can keep trading — known as a qualified audit — would automatically trigger a breach of lending agreements with banks or bondholders. Several of the UK's six largest accounting firms, which include KPMG, Deloitte, PwC and EY, have put additional steps in place to review signing off companies as a going concern. PwC has introduced a panel to sign off on its audit opinions, while Grant Thornton is sending every one of its audits through its technical review team, which is usually reserved for its riskiest or complex audit judgments, according to people familiar with the matter. Both firms declined to comment. "If any of us are accused of not challenging management after all this is over, that will be hideously unfair," said one senior auditor. "We are having challenging conversations [with company directors] at colossal scale."

The pressure on auditors from the FRC comes after a series of accounting scandals led to criticism that the regulator has been too slow to act, lenient and too close to the audit firms it supervises. "We don't want boilerplate, we want specific circumstances and disclosure about judgments on going concern," said a senior official close to the FRC. "For corporates that means the trading environment, and now the audit environment is tougher than ever. It is creating tensions in the system."

With the government expected to extend the lockdown, senior auditors at a number of the UK's largest firms said they were asking companies in the hospitality, retail and construction sectors to stress test whether they could survive "zero revenues" for six months or longer. "It's not an impossible prospect," the head of audit at a major accounting firm said of the scenario. "We're saying you'll breach covenants in that situation and you need to tell the world that. Directors are pushing back and telling us that's not realistic. The issue is any consensus on how long this will last is quickly meaningless."

Acquirers may come to rue deals struck in happier times The economic turmoil unleashed by the government's effort to contain the virus has already upended the reporting calendar for companies. The Financial Reporting Council and the Financial Conduct Authority have given listed companies two extra months to file their accounts in order to better assess the impact of Covid-19 on their profitability. The FRC is also urging lenders and investors to react sensibly if the accounts of some large listed companies end up being qualified. "[There is a worry that] markets will overreact to what is a statement of the blindingly obvious," the senior official close to the watchdog said. The watchdog is holding talks with banks, shareholder groups and bondholders to warn them to prepare for a flood of going concern warnings in the companies they own or have lent to.

The Institute of Chartered Accountants in England and Wales, the profession's trade body, is expected to put out guidance this week that will "remind" accountants working in the finance departments of listed companies of their disclosure obligations on going concern, according to a person familiar with the matter. "Many boards are going to have to come to conclusions today that would have seemed absurd three months ago, and they are obliged to consider that in their results," the person said.