

## Basics of Going Concern

- Going concern is a fundamental accounting assumption
  - Entity is normally viewed as continuing in operation for the foreseeable future
  - It is assumed that the enterprise has neither the intention or necessity of liquidation or curtailing operation
  - It is Used unless management intends to liquidate or cease operations, or has no realistic alternative
- Impact on assets and liabilities
  - Assets and liabilities recorded assuming entity will realize assets and discharge liabilities in the normal course of business
- Liquidation basis
  - When an entity is not viewed as a going concern, FS prepared on liquidation basis
  - Inventories may be written down, assets recorded at likely prices they will fetch

## SA 570 – Going Concern

SA 570 requires the auditor to evaluate and report on whether management's use of the going concern basis of accounting is appropriate and whether any material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern.

### Responsibility for assessment of the entity's ability to continue as a going concern

Management is required to **assess the entity's ability to continue** as a **going concern** even if the financial reporting framework does not include an explicit requirement to do so. Management's assessment of the entity's ability to continue as a going concern involves making a judgment, at a particular point in time, about future outcomes of events or conditions. Factors relevant for judgment about future outcomes of events or conditions are:

- Degree of Uncertainty increases as the timing of the event or outcome is further in the future.
- The **size** and **complexity** of the entity, the nature and condition of its business and the degree to which it is affected by external factors.
- **Information available at the time** at which the **judgment** is made.
- **A startup forecasting cash flows for 6 months is more reliable than forecasting for 3 years due to higher future uncertainty.**
- **A large multinational in a volatile industry like oil & gas faces more uncertainty than a small local grocery store.**
- **Management may judge the company stable based on current orders, but a sudden government ban later may change the actual outcome.**

### Responsibilities of the auditor (These are also objectives of auditor)

The auditor's responsibility is to

- **obtain SAAE**

- about the **appropriateness** of **management's use** of the going concern assumption.

He shall consider

- whether there is a **material uncertainty** related to events and conditions
- that may **cast significant doubt**
- about the **entity's ability to continue** as a **going concern**.

**Report** in accordance with this SA

### No Assurance of Future Viability (SA 200)

As per SA 200 The absence of any reference to going concern uncertainty in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

### Risk assessment procedures and related activities

#### Consider events and conditions

When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern

The auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern.

- If done – discuss it and check if doubt exists and what plans management has.
- If not – discuss the basis for using going concern and inquire about any such events or conditions.

Auditors must stay alert during the audit for evidence of such events or conditions.

### Evaluating Management's Assessment

- Auditor shall evaluate management's assessment of going concern.
- It is not the auditor's responsibility to fix lack of analysis by management.
- Lack of detailed analysis may still allow auditor to conclude if going concern basis is appropriate.
- Example: If there is a history of profits and easy access to funds, detailed analysis may not be needed.
- In other cases, auditor evaluates management's process, assumptions, and feasibility of plans.
- Auditor shall evaluate for the same period as management or longer if required by law.
- If assessment covers less than 12 months from FS date, auditor shall ask to extend it to at least 12 months.

**Additional audit procedures when events or conditions are identified**

When events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall perform procedures as follows:

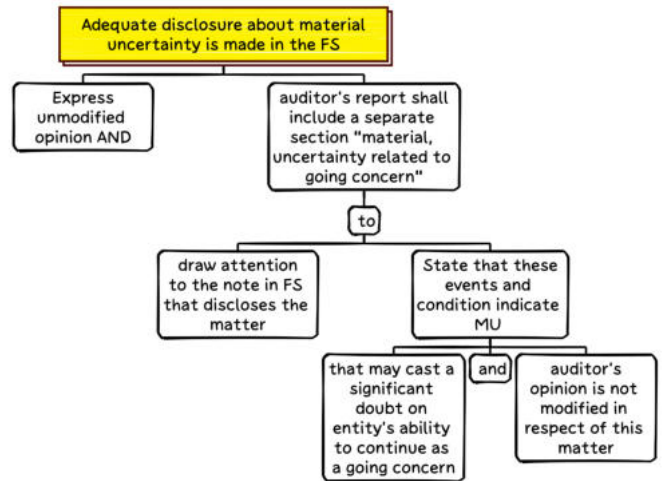
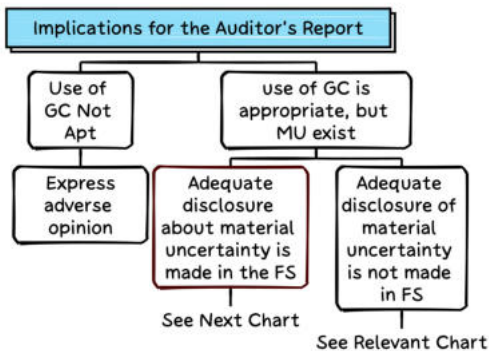
- If management hasn't assessed going concern, auditor shall request it.
- Evaluating **management's plans** for **future actions** in relation to its going concern assessment
- When the entity has prepared a **cash flow forecast**, then consider
  - its reliability and
  - also the underlying assumptions.
- Consider new facts or information after management's assessment.
- Requesting **written representations** from management or TCWG, regarding their plans for future action and the feasibility of these plans.

**Material Uncertainty**

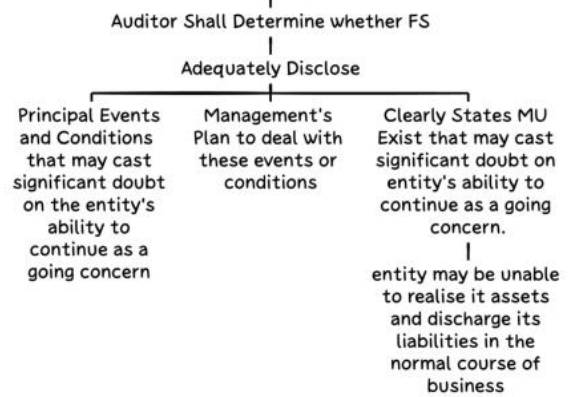
A material uncertainty exists when the

- **magnitude** of its potential impact and
- **Likelihood** of occurrence
- is such that,
- in the auditor's **judgment**,
- **appropriate disclosure** of the **nature** and **implications** of the uncertainty is **necessary** as per the AFRF.

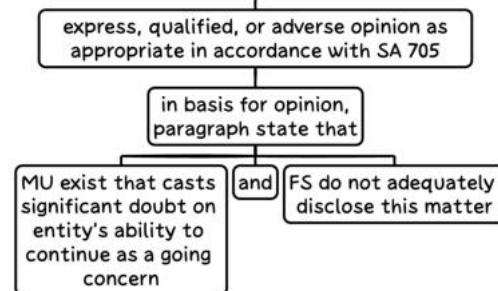
When the impact is big and the chance of happening is high Example: If a company is facing a major lawsuit that could lead to huge losses and has a high chance of losing, this creates material uncertainty and must be disclosed in the financial statements.



**Adequacy of Disclosures When Events or Conditions Have Been Identified and MU Exist**



**Adequate disclosure of material uncertainty is not made in FS**



**Adequacy of Disclosures When Events or Conditions Have Been Identified but No Material Uncertainty Exists**

The auditor shall **evaluate whether**, in view of the requirements of the applicable financial reporting framework, the FSs **provide adequate disclosures** about these events or conditions.

**Management Unwilling to Make or Extend Its Assessment**

If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor shall consider the **implications** for the auditor's **report**. A qualified opinion or a disclaimer of opinion may be appropriate, because the auditor is unable to obtain SAAE regarding management's use of the GC basis of accounting in the preparation of the F.S.

### Examples of audit procedures when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as going concern

- Analysing and discussing **cash flow**, profit and other relevant forecasts with management
- Analysing and discussing the **entity's latest available interim FSs**
- Reading the terms of **debentures** and **loan agreements** and determining whether any have been **breached**
- Reading **minutes** of the **meetings** of shareholders, TCWG and relevant committees for reference to financing difficulties
- **Inquiring** of the entity's **legal counsel** regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications
- **Confirming** the **existence, legality** and **enforceability** of **arrangements** to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds
- Evaluating the entity's **plans** to deal with **unfilled customer orders**
- **Performing** audit procedures regarding **subsequent events** to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern
- Confirming the **existence, terms** and **adequacy** of **borrowing facilities**
- Obtaining and reviewing **reports** of **regulatory actions**
- Determining the adequacy of support for any **planned disposals of assets**

### Examples of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern

#### Financial events or conditions

- Net liability or net current liability position
- Adverse key financial ratios
- Negative operating cash flows indicated by historical or prospective FSs
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets
- Inability to comply with the terms of loan agreements
- Inability to obtain financing for essential new product development or other essential investments
- Indications of withdrawal of financial support by creditors
- Inability to pay creditors on due dates
- Change from credit to cash-on-delivery transactions with suppliers.
- Arrears or discontinuance of dividends.
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.

#### Operating events or conditions

- Shortages of important supplies
- Management intentions to liquidate the entity or to cease operations
- Emergence of a highly successful competitor
- **Loss** of key management without replacement
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s)
- Labour difficulties

#### Other events or conditions

- **Uninsured** or **underinsured catastrophes** when they occur
- **Pending legal** or **regulatory proceedings** against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy
- **Statutory or regulatory requirements**
  - **Non-compliance** with capital or other statutory or regulatory requirements, such as solvency or liquidity requirements for financial institutions
- **Changes** in **law** or **regulation** or **government policy** expected to adversely affect the entity.