

# Going Concern

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# Going Concern

**Going Concern Assumption:** An entity is viewed as continuing in business for the foreseeable future.

General purpose financial statements are prepared on a going concern basis.

Assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

(Para 2)

# ISA 570: Going Concern

- Effective date; Financial periods ending on or after December 15, 2016
- The standard deals with the auditors responsibility in the audit of financial statements relating to going concern
- International Accounting Standard (IAS) 1 requires management to make an assessment of an entity's ability to continue as a going concern.

# Going Concern

## ISA 570 (Revised)

Deals with the **auditors responsibility** on the audit **relating to managements use of the going concern assumption** in the preparation of the financial statements

# Going Concern

## **Managements responsibility:**

IAS 1 requires management to make an assessment of an entity's ability to continue as a going concern (Para 3)

The assessment involves making a judgement, at a particular point in time about inherently uncertain future outcomes of events or conditions (Para 5)

# Going Concern

## **The objectives of the auditor are (para .9):**

1. To obtain audit evidence regarding the appropriateness of managements use of the going concern assumption in preparing the AFS
2. To conclude whether a material uncertainty exists that may cast doubt on the entity's ability to continue as a going concern.
3. To determine the implications for the audit report, i.e. to report in accordance with ISA 570 (R).

# Going Concern

## Planning Phase:

- Perform risk assessment procedures and consider whether there are **events or conditions** that may cast doubt on the entity's ability to continue as a going concern
- Determine if management already performed a preliminary assessment of the entity's ability to continue as a going concern
- Remain alert throughout the audit for evidence of **events or conditions** that may cast doubt on the entity's ability to continue as a going concern

# Going Concern Indicators

Events or conditions that may cast doubt on the entity's ability to continue as a going concern (Para A3)

- **Financial** events or conditions
- **Operating** events or conditions
- **Other** events or conditions

# Going Concern

## **Going concern assumption appropriate but a material uncertainty exists:**

- If adequate disclosure is made the auditor shall express an unmodified opinion including an emphasis of matter paragraph (Para 19)
- Include a separate section with the heading “***Material Uncertainty Related to Going Concern***”.
- **Key Audit Matters section:** include reference to the “**Basis for Opinion**” para where the matter is stated.
- If adequate disclosure is not made, the auditor shall express a qualified or adverse opinion. (**ISA 570 (revised) par 23 and par A.32: illustrative example 2**)

# Going Concern

## **Audit procedures when events or conditions are identified:**

- The auditor must obtain evidence to determine whether or not a material uncertainty exists
- Including considering mitigating factors

**Para 16 and A16**

# Going Concern

## **Audit Conclusions and reporting:**

The auditor will use his judgement and evidence obtained to conclude whether a material uncertainty exists relating to events or conditions that **individually** or **collectively** may cast doubt on the entity's ability to continue as a going concern. (**Para 17**)

# Going Concern

## **Going concern assumption appropriate but a material uncertainty exists**

The auditor shall determine whether the AFS:

- Adequately describe the event that may cast doubt on the entity's ability to continue as a going concern and managements plans to deal with these events
- Disclose clearly that a material uncertainty exists and therefore the entity may be unable to realize its assets or discharge its liabilities in the normal course of business

# Going Concern

## **Use of going concern assumption inappropriate:**

If the AFS are prepared on the going concern basis, but in the auditors judgement this basis is inappropriate, the auditor shall express an adverse opinion (**ISA 570 (revised) Par 21**)

# Going Concern

**Management unwilling to make or extend its assessment**

The auditor shall consider the implications for the audit report

# Going Concern

## **Communication with TCWG**

The auditor shall communicate with TCWG events or conditions that may cast doubt on the entity's ability to continue as a going concern.

The communication shall include:

- If events or conditions constitute a material uncertainty
- If the use of the going concern assumption is appropriate in preparation of the AFS
- The adequacy of related disclosures in the AFS

# Going Concern

## Factual Insolvency

- Liabilities > Assets fairly valued.
- An indicator but does not necessarily mean a going concern problems exists
- If trading under these conditions:
  - Possible reckless trading
  - Possible Fraudulent activity

## Commercial Insolvency

- Cannot pay debts even if assets > liabilities
- Stronger indicator for **likely** going concern problems
- The company's working capital cycle is impaired thus affecting its ability to trade

# Going concern: Practical steps:

- The auditor's responsibilities on going concern are
  - to obtain appropriate audit evidence & conclude on whether management have appropriately considered going concern
  - to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.
  - the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. The auditor cannot predict such future events or conditions.
  - Accordingly, the absence of any reference to a material uncertainty about the entity's ability to continue as a going concern in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

# Going concern : practical steps

- Request Management's plan of action
- Obtain management's plan of action or ask management to prepare a plan.
- This plan would include details of future sales, expenses and a cash flow forecast.
- The period covered would be a minimum of 12 months from the date of the financial statements.
- Where management does not have the resources or capability to prepare such a plan, discuss with management the medium and long-term financing of the entity and their key strategies for survival.
- Inspect the documentation that supports the strategy and assumptions (e.g., sources of finance, restructurings, asset disposals, future sales, expenses and investments).

# Going concern: practical steps

- Overall feasibility of plan Based on our understanding of the entity and the assessed risks,
- identify any matters that would cast doubt on the feasibility of the plan.
- Consider matters such
  - as a recent history of being turned down for new financing,
  - deteriorating operating results,
  - loss of key customers,
  - uncompetitive products and services,
  - loans becoming payable in the near future,
  - breaches in loan covenants,
  - significant litigation or non-compliance with laws or regulations.

# Going concern: practical steps

- Review Management's forecast
- Evaluate the reliability of the data used to generate the forecast.
- Check the arithmetic accuracy of the information and computations.
- Ensure the information is internally consistent (i.e., the entity can physically generate the products/services in the sales forecast).
- Compare the forecast to actual prior period experience and assess the reasonableness of the forecast. Consider the forecasted cash generated/used in operations, debt repayments, investing activities and other known cash requirements.
- Consider whether the assumptions used about the economy, interest rates, industry trends, costs, staffing, sales and general market conditions are reasonable.
- Assess the reasonableness of management's assessments of the outcome of any legal actions and financial implications. Where the forecast includes the outcome, confirm with the entity's legal counsel the existence of such litigation and claims and the expected outcome.

# Going concern: practical steps

- Evaluate plan strategy
- Identify the key strategy that management plans to use to resolve the situation
- Perform the relevant procedures as described in the steps below.
- If more than one strategy is planned, use professional judgment to determine what audit procedures are required.

# Going concern: practical steps

- Key strategy: SALE OF ASSETS
  - Assess the marketability of the assets that management plans to sell.
  - Review loan agreements, mortgages, credit facilities and other agreements or liens to ensure there are no restrictions on the entity's ability to dispose of the assets.
  - Assess the effect of the planned disposal of assets on the entity's remaining operations.

# Going concern: practical steps

Key strategy: BORROW MORE MONEY OR RESTRUCTURE DEBT

- Assess the availability of debt financing and the entity's capacity to borrow. Review current loans, credit or other agreements for provisions or covenants which may restrict the entity's ability to borrow additional funds or restructure its debt.
- Assess whether the entity has sufficient collateral to obtain new financing. Consider accounts receivable; short-term investments; inventory; property, plant and equipment; or third-party guarantees.
- Determine the feasibility of obtaining any required guarantees from third parties (such as family members or friends).
- Assess the impact of new financing on the operations and timing of cash flows (e.g., interest payable and debt repayments).

# Going concern: practical steps

- Key strategy: ADDITIONAL/NEW SOURCES OF CAPITAL
- Consider whether the expected capital investment will be sufficient to address the needs over the next 12 months.
- Consider the impact of any terms associated with the new capital (such as new management, changes in the nature of operations or other restructuring of the entity).
- Assess whether the planned sources of capital (such as family, etc.) have the financial resources required and whether the finances can be obtained within the time frames required.
- Assess the effect of the plan (if any) on existing shareholders (e.g., if new shares are offered at a discount) and consider any approvals, etc. that may be necessary.

# Going concern: practical steps

- Consider subsequent events
- Consider the existence of additional facts, events or circumstances that were not addressed in management's plan of action. Where facts or events are identified:
- Ask management to extend its assessment to include the new information or perform procedures to evaluate the impact of these new events or circumstances on the entity's ability to continue as a going concern.
- If management is unwilling to extend the assessment and it is not possible to perform procedures to evaluate the impact, consider whether a modification of the auditor's report is required.

# Going concern: practical steps

- Conclusions
- Based on the evidence obtained, conclude whether the:
  - Events or conditions constitute a material uncertainty.
  - Use of the going-concern assumption is appropriate in preparation of the financial statements.

# Going concern: practical steps

- Presentation and disclosure
- Material uncertainty
  - Determine whether the nature/implications of the material uncertainty have been adequately disclosed in the financial statements and appropriately accounted for in accordance with the applicable financial reporting framework.
  - Going-concern assumption inappropriate Ensure that the financial statements have not been prepared on a going-concern basis and that appropriate disclosures have been made.

# Going concern: practical steps

- Auditor's report
- Emphasis of a matter Where a material uncertainty exists, add an Emphasis of Matter paragraph to the auditor's report that highlights the existence of the material uncertainty and draws attention to the specific note disclosure in the financial statements.
- Inadequate disclosure If adequate disclosure is not made in the financial statements, express a modified opinion, and state in the auditor's report that there is a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern

# Going concern: practical steps

- Reporting/communication
- Communicate to management and those charged with governance whether the:
  - Events or conditions constitute a material uncertainty.
  - Use of the going-concern assumption is appropriate in the preparation of the financial statements.
  - Related disclosures in the financial statements are adequate

# The End

- Questions / Comments
- Thank you