features

Andrew Teague explains what steps you can take to ensure your next audit monitoring visit is free of any going concern issues.

the audit of going concern

On many of the files inspected during audit monitoring visits, the record of audit work on going concern is limited to ticks on a standard checklist, and a comment that the entity had net current assets at the balance sheet date. Does this sound like your audit files? If so, do they meet the requirements of International Standard on Auditing (UK and Ireland) 570 Going Concern (ISA 570)?

the responsibility of management and of the auditor

When preparing financial statements in the UK and Ireland, an entity's management should satisfy themselves as to whether the going concern basis is appropriate. This assessment involves making a judgment, at a particular point in time and taking account of all relevant information of which they are aware, about the future outcome of events or conditions which are inherently uncertain. Even if the going concern basis is appropriate, it may still be necessary for the financial statements to contain additional disclosures in order to give a true and fair view.

Some firms do not realise the need to perform any audit procedures at all on going concern. However, ISA 570 specifically requires the auditor, when planning and performing audit procedures and in evaluating the results, to consider the appropriateness of management's use of the going concern assumption in the preparation of the financial statements and the adequacy of any relevant disclosures in the financial statements.

the planning stage

ISA 570.11 states that, in obtaining an understanding of the entity, the auditor should consider whether there are events or conditions and related business risks which may cast significant doubt on the entity's ability to continue as a going concern. This is an important consideration when assessing the risks of material misstatement, because the existence of such events or conditions may affect the nature, timing and extent of the procedures which the auditor carries out in response to those risks.

Despite this, many audit plans do not take account of going concern issues, with the result that the firm does not gather the necessary information during the audit where the client is suffering difficulties. The auditor should therefore either review management's preliminary assessment of the appropriateness of the going concern assumption, or hold discussions with management in order to identify any relevant events or conditions which may cast doubt on its use. Armed with this information, the auditor can then plan the necessary further audit work.

evaluating management's assessment

The auditor should make enquiries of management and examine appropriate available financial information. The auditor should also plan and perform procedures specifically designed to identify any material matters which could indicate uncertainty about the entity's ability to continue as a going concern.

Because it forms the basis of the audit work, it is important that there is a clear record on the working papers of the information upon which management's assessment is based and their reasoning. The extent of the information available depends on the nature, size and complexity of the entity and, if the information relates to future events, how far into the future they lie. Although formal cash flow forecasts and budgets provide the most persuasive evidence, in smaller entities other evidence may be acceptable, such as discussing management's outline plans in the light of other information available.

ISA 570.8 lists examples of possible events and conditions which may affect going concern. This list begins with financial factors and the ISA recognises that the excess of an entity's available financial resources over those required is the primary influence on the extent of the auditor's procedures. However, it is a common misconception that going concern is simply a solvency test at the balance sheet date. The occurrence of certain events since the year end, for instance major losses, cash flow problems and an inability to meet liabilities as they fall due, must be considered. Operating factors, such as the loss of key markets, suppliers or staff, may also be relevant.

further audit procedures

What if events or conditions are identified which do cast doubt on the entity's ability to continue as a going concern? The auditor will need to review management's plans for future action, which may include liquidating assets, borrowing money, reducing expenditure, or increasing capital, in order to confirm that the plans are feasible and that their implementation will improve the situation. The auditor should also obtain written representations from management regarding those plans.

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The auditor should then carry out additional procedures to gather sufficient appropriate audit evidence which confirms or dispels whether or not a material uncertainty exists. For example, it may be appropriate to analyse cash flow projections and the underlying assumptions or examine interim financial statements. In some circumstances, it may be necessary to obtain confirmation of arrangements with other parties to provide or maintain financial support to the entity, and then assess the financial ability of such parties to provide the necessary funds.

concluding and reporting

If the auditor adjudges that a material uncertainty exists, they are required to document the extent of their concern about the entity's ability to continue as a going concern. Despite the existence of events or conditions which may cast doubt on this, the auditor may still conclude that the level of concern is not significant, in which case an unqualified opinion will be appropriate.

The auditor may conclude that the going concern basis is appropriate but a material uncertainty exists. They must then consider the adequacy of the disclosures in the financial statements, which must describe the events or conditions giving rise to the significant doubt and management's plans to deal with them, and include a clear statement that there is a material uncertainty.

If the disclosures are considered adequate, the auditor should express an unqualified opinion but add an emphasis of matter paragraph to the audit report which highlights the existence of a material uncertainty and which draws attention to the relevant disclosure in the financial statements.

If, however, the disclosures are not adequate, the auditor should express a qualified 'except for' or adverse opinion, as appropriate, and include in the report specific reference to the fact that there is a material uncertainty.

Lastly, if the auditor considers that the entity will not be able to continue as a going concern but the financial statements have been prepared on a going concern basis, the auditor should express an adverse opinion.

documenting the audit work

Whatever the circumstances of the entity and the level of information available, documentation of the audit work on going concern is often weak. The working papers should always record in positive terms the information and evidence which the auditor has obtained, including:

- a proper consideration at the planning stage
- a record of management's assessment and reasoning
- adequate detail of the information and evidence considered by the auditor
- adequate notes of discussions with management
- a clear record of any material uncertainty and details of the further audit procedures performed
- written representations concerning management's plans, if appropriate
- a clear evaluation regarding the appropriateness of the going concern basis and any related disclosures in the accounts, and any consequent effect on the wording of the audit report. ■

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