Garbutt + Elliott

Chartered Accountants + Business Advisors

Going Concern in the Spotlight

Going Concern has long been a key focus area for auditors. 2020 has seen it once again thrust into the spotlight with many implications caused as a result of the Covid-19 pandemic.

Predating this however, the FRC had plans to revise the International Standard of Auditing that covers Going Concern (ISA 570) in response to a number of corporate failures, where auditors had potentially failed to warn that companies were on the brink of collapse.

The new standard is applicable for accounting periods beginning on or after 15 December 2019 with early adoption permitted. This therefore means that those companies with a December 2020 year end will be the first to be subject to the new standard.

Your responsibilities;

As directors of companies, you have a number of responsibilities under Company Law (or other financial reporting frameworks), which need to be undertaken in order to draw your own conclusions on the appropriateness of the going concern assumption. You must make your own assessment of;

- Whether a material uncertainty related to going concern exists;
- The appropriateness of the use of the going concern basis of accounting in the preparation of the financial statements;
- The expected trading and cashflow forecasts, including analysis of available facilities and covenant compliance for at least 12 months from the date of signing the accounts;
- The key assumptions, risks and available mitigation in respect of the 12 month forecast; and
- Justification for significant changes in trade, cashflow and working capital throughout the period and with regard to both past trends and future expectations.

The above requirements must be thoroughly documented, agreed by the board and made available to the auditor for review. Ultimately you need to expect your Auditor to ask you 'why do you think the business will be able to trade through the next 12 months' and you should be prepared to answer with granular and well thought through scenarios that stand up to robust review and scrutiny.

Our responsibilities;

ISA 570 Revised provides auditors with a clearer framework for challenging your assessment of going concern and to enhance communication of such matters with those charged with governance.

Key Changes:

- Definition of going concern has been strengthened to apply 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.
- The revised standard requires greater work on the part of the auditor to more robustly challenge management's assessment of going concern, thoroughly testing the adequacy of the supporting evidence, and evaluating the risk of management bias. As part of this our audit work will now document and evaluate:
    - The process by which management makes it assessment of going concern, including a detailed review and assessment of assumptions used and the risks behind the estimates within the budgets, cashflows and forecasts and how this fits in with our knowledge of your business and sector;
    - The oversight of this process by directors/trustees;
    - A 'stand back' requirement to consider all of the evidence obtained, whether corroborative or contradictory when we draw our conclusion.

In practice for most companies there may be little difference to the work undertaken where we have followed best practice and been robust in carrying out our going concern work. However the ISA is very prescriptive on the requirements to be documented and inevitably there will be additional documentation required to support the conclusions on the audit file.

Auditor reporting requirements;

Financial statements will refer to the going concern assessment in the Directors / Trustees' Report, in the accounting policies and in the Audit Report. All key messages and conclusions must be consistent throughout the financial statements. Management have to assess the going concern basis and provide evidence to support this 12 months from the signature date on the accounts – a shorter period is not sufficient.

Where there is no material uncertainty in relation to going concern the Audit Report will include:

- A statement that the auditor has not identified a material uncertainty that may cast doubt on the entity's ability to continue as a going concern for a period not less than 12 months from the date of approval of the financial statements.
- A conclusion that management's use of the going concern basis of accounting in the preparation of the entity's financial statements is appropriate.
- For PIES, listed entities and those applying Corporate Governance Code, further disclosure requirements on how this assessment has been evaluated.

Where the auditor considers that there is 'material uncertainty related to going concern' to be included in the auditor's report, or that it is necessary to issue a qualified, adverse or disclaimer of opinion in respect of matters related to going concern, they have to consider their requirements to report to a regulator or authority outside of the entity and how to manage this reporting requirement.

Our template Cash flow model tool can be found here

If you would like further information please contact:

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