

SA 570 (Revised) "Going Concern"




INTRODUCTION AND SCOPE OF SA-570 (Revised)


This SA deals with the auditor's responsibilities in the audit of FS relating to the going concern assumption in the preparation of FS and the implications for the auditor's report.

Going Concern Basis of Accounting


The F.S. are prepared on the assumption that the entity is a going concern and will continue its operations for *foreseeable future*.



General purpose F.S. are prepared using the going concern basis of accounting, unless management either intends to liquidate entity, cease operations or has no realistic alternative but to do so.



Special purpose F.S. may or may not be prepared in accordance with a Financial Reporting Framework for which the going concern basis of accounting is relevant.



When use of going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will *realize its assets and discharge its liabilities in normal course of business.*

Auditor's responsibility

To obtain sufficient and appropriate audit evidence (SAAE) regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements;

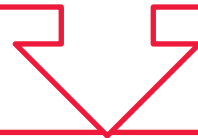
To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and

To report in accordance with SA 570

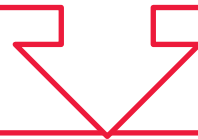
Material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as going concern is, by its nature, key audit matter per SA 701.

Responsibility for Assessment of the Entity's Ability to Continue as a Going Concern - WHOSE??

It is Management's responsibility 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 inherently uncertain future outcomes of events or conditions.



The following factors are relevant to that judgment:

Degree of uncertainty associated with the outcome of an event or condition

Size and complexity of the entity, nature of business & degree to which it is affected by external factors

Information available at the time at which the judgment is made.

At which stages is Going Concern assessed?

PLANNING STAGE

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graph TD; A[PLANNING STAGE] --> B[EXECUTION STAGE]; B --> C[CONCLUSION STAGE];
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EXECUTION STAGE

CONCLUSION STAGE

Risk Assessment Procedures (PLANNING STAGE)

While performing the risk assessment procedures, auditor should consider whether events and conditions exists that may cast significant doubt on entities ability to continue as a going concern.

If management has performed assessment, the auditor shall:

- discuss the assessment with management,
- determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern, and
- if so, management's plans to address them

If management has not performed assessment, the auditor shall:

- discuss with management the basis for the intended use of the going concern basis of accounting
- inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

Further, the auditor should remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

Stage 1 GC Checklist

To be filled based on the current year financial statements

The auditor should consider the risk that the going concern assumption may no longer be appropriate.

Evaluate the following events / conditions :

1. **Financial indicators** Such as Negative Net-worth, Net liability or net current liability position, negative operating cash flows, adverse key ratios, substantial losses etc.
2. **Operating indicators** Such as Loss of key management without replacement, Management intentions to liquidate the entity or to cease operations, Loss of a major market or principal supplier etc.
3. **Other indicators** Such as non-compliances with statutory or regulatory compliances, Changes in laws & regulations that is expected to have adverse effect on the entity, etc.

If the indicators are there, then evaluate the mitigating factors and management's plans.

Evaluating Management Assessment (EXECUTION STAGE)

It is not auditor's responsibility to rectify the lack of analysis by management. However, lack of detailed analysis by management to support the GC assumption may not prevent the auditor from concluding if the managements use of GC assumption is appropriate e.g. if the entity has history of profitable operations and ready access to financial resource, management can conclude on the GC assumption without detailed assessment.

Auditor shall consider whether management's assessment includes all relevant information of which the auditor is aware as a result of the audit.

Evaluating Management assessment includes

- 1) Evaluation of process followed by the management to make its assessment
- 2) Assumptions used by management
- 3) Future plans of the management
- 4) Feasibility of such future plans

Evaluating Management Assessment (Execution Stage)

Period of management Assessment

Auditor shall cover the same period as that used by management to make its assessment as required by the applicable financial reporting framework, or by law or regulation if it specifies a longer period.

If management's assessment of the entity's ability to continue as a going concern covers less than 12 months from the date of the F.S., the auditor shall request management to extend its assessment period to at least 12 months from that date.

Auditor should remain alert to possibility of events (known or otherwise) which will occur ***beyond period of management's assessment*** which may bring into question the appropriateness of GC assumption.

In such cases, auditor to request management to evaluate potential significance of such events or conditions

However, in such cases, auditor's responsibility is restricted to inquiries with management with respect to such events or conditions

Audit Procedures When Events or Conditions are Identified

Where management has not yet performed an assessment of the entity's ability to continue as a going concern - requesting management to make its assessment.

Evaluating management's plans for future actions (liquidate assets, raise capital, borrow / re-finance, reduce costs etc.), whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.

Where the entity has prepared a cash flow forecast, evaluate the reliability of the underlying data used to prepare the forecast and determine whether there is adequate support for the assumptions underlying the forecast.

Analyze & discuss entities latest interim financial statements

Review regulatory reports

Audit Procedures When Events or Conditions are Identified - discussion points

Testing of projections

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graph TD; A[Testing of projections] --> B[Testing creditworthiness of parties providing Support Letter]; B --> C[Recoverability of Deferred Tax Assets];
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Testing creditworthiness of parties providing Support Letter

Recoverability of Deferred Tax Assets

Pointers

Evaluating credit worthiness of even promoter by performing following:

1. Obtaining net worth certificate preferably of latest date
2. Perform inquiry procedures with the Promoter/ Shareholder and Management their financial capacity to support and if there are any other obligations/ guarantees
3. Independent web search on the promoter/ shareholder

In case entity's ability to continue as a going concern is supported by the parent/ultimate parent company which is listed in India then ET shall consider following factors in addition to above:

1. A listed entity is required to comply with requirements of various SEBI regulations prescribed from time to time and is also governed by laws and regulations which are prescribed to be applicable to a listed entity.
2. Accordingly, ET to carefully consider the compliance with the requirements of laws and regulations and other procedural aspects like obtaining NOC from existing lenders that may need to comply with before the listed parent/ ultimate parent company can advance loans to the company on whose ability to continue as a going concern is supported.

Audit Evidences

Cash flow projections that show an ability to pay debts as and when they fall due after factoring realistic assumptions in the current market conditions.

If current conditions deteriorate further, detailed business plans covering the period under consideration.

Support for the entity's ability to obtain new funding upon the maturity of existing funding arrangements.

Evidence that debt covenants have been assessed and any risk of breaching them has been managed, such that they do not provide significant risk.

Management may consider having support of **'Support Letter'** from the parent company for financial support

Considering whether any additional facts or information have become available since the date on which management made its assessment.

Requesting written representations from management regarding their plans for future action and the feasibility of these plans

Support Letter (Points to remember)

It should cover a period of at least 1 year from the date of signing the financial statements

Such support letter should be unconditional NOT RESTRICTING TO ANY SPECIFIC AMOUNTS

Addressed to the Company (NOT TO US) Preferably on letter head of the parent / ultimate parent company and signed accompanied by round seal (if signed physically)

To be obtained near to date of signing of our report

Audit Procedures When Events or Conditions are Identified (continued)

Review minutes of meetings with shareholders, TCWG, relevant committees for financing difficulties etc.



Inquiries with entities legal counsel for significant litigation and claims, reasonableness of management assessment of outcomes & estimates of financial implications .



Considering whether any additional facts or information have become available since the date on which management made its assessment.



Obtain support letters / comfort letter from Holding / Ultimate Holding companies etc. (and testing their ability to support the said entity)



Requesting written representation from the management and, where appropriate, TCWG, regarding their plans for future actions and the feasibility of these plans.

Auditors Conclusion (COMPLETION STAGE)

Auditor should obtain sufficient appropriate audit evidence to conclude on appropriateness of GC accounting assumption by the management

Use of going concern basis of accounting is appropriate, no material uncertainty exists
- Unmodified opinion

Management unwilling to make / extend its assessment - qualified or disclaimer of opinion (as auditor will not be in a position to obtain sufficient and appropriate audit evidence)

Use of Going Concern assumption is not appropriate, FS prepared on alternate basis - EOM para if appropriate disclosures in notes with reasons for using the alternate basis for accounting (e.g. liquidation basis)

FS prepared on GC basis but in auditors opinion, the same is inappropriate - Adverse opinion (regardless of whether FS disclosures contain a note on the same)

Auditors Conclusion (Completion Stage)

1. Use of going concern basis of accounting is appropriate but a material uncertainty exists which has not been adequately disclosed in the financial statements then the auditor **should express a qualified opinion or adverse opinion (depending on the pervasiveness of the matter to the financial statements (i.e., the inadequacy of disclosures)). In the basis of qualified (or adverse) opinion, state that material uncertainty exists that may cast significant doubts on entities ability to continue as a GC and that FS does not disclose this fact.**
2. Use of going concern basis of accounting is appropriate but a material uncertainty exists which has been adequately disclosed in the financial statements then the auditor would express an unmodified opinion and the auditor's report would include a separate section under the heading 'Material Uncertainty Related to Going Concern'. In this case, draw attention to note in FS which describes the principal events or conditions that may cast a significant doubt on entities ability to continue as a GC, disclose clearly that disclose that material uncertainty exists that may cast a significant doubt on entities ability to continue as a GC and that it may be unable to realize its assets & discharge its liabilities in the normal course of business and that the opinion is not modified in that respect.

Some framework may require additional disclosures like

- a) Management's evaluation of significant events / conditions relating to entity's ability to meet its obligation
- b) Significant judgements used by the management (as a part of its assessment)

Auditors Conclusion (Completion Stage)

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 for:

(a) In the case of a fair presentation financial reporting framework, the fair presentation of the financial statements, or

(b) In the case of a compliance framework, the financial statements not to be misleading.

Communication with Those Charged with Governance (TCWG)



(a) Whether the events or conditions constitute a material uncertainty;

(b) Whether management's use of the going concern basis of accounting is appropriate in the preparation of the financial statements;

(c) The adequacy of related disclosures in the financial statements; and

(d) Implications for the auditor's report (where applicable)

CASE STUDY 1

You are the audit manager responsible for performing hot reviews on audit files where there is a potential disagreement between your firm and the client regarding a material issue. You are reviewing the going concern section of the audit file of Sunshine Ltd, a client with considerable cash flow difficulties, and other, less significant operational indicators of going concern problems. The working papers indicate that Sunshine Ltd is currently trying to raise finance to fund operating cash flows, and state that if the finance is not received, there is significant doubt over the going concern status of the company. The working papers conclude that the going concern basis of accounting is appropriate, but it is recommended that the financial statements should contain a note explaining the cash flow problems faced by the company, along with a description of the finance being sought, and an evaluation of the going concern status of the company. The directors do not wish to include the note in the financial statements.

The audit report should contain a qualified or an adverse opinion due to the disagreement. The auditors need to make a decision as to the significance of the non-disclosure of the uncertainty surrounding going concern basis of accounting. If it is decided that without the note the financial statements are not fairly presented, and could be considered misleading, an adverse opinion should be expressed.

CASE STUDY 2

If in Case study 1 the directors agree to give the disclosure note.

The auditor should ensure that disclosures are sufficiently detailed

The auditor should consider whether the disclosure explicitly draws the reader's attention to the possibility that the entity may not be able to continue as a going concern in the foreseeable future.

The note should include a description of conditions giving rise to significant doubt, and the directors' plans to deal with the conditions.

If the disclosure is considered adequate, then the opinion should not be qualified. (Material Uncertainty Para to be added).

Also, re-iterate that the audit opinion is not qualified

However, it could be the case that a note has been given in the financial statements, but that the details are inadequate and do not fully explain the significant uncertainties affecting the going concern status of the company. In this situation the auditors should express a qualified opinion. The auditor, however, may also consider expressing an adverse opinion, if it is warranted under the circumstances based on the auditor's professional judgment.

CASE STUDY 3

XYZ Inc. is a manufacturer of televisions. The domestic market for electronic goods is currently not doing well, and therefore many entities in this business are switching to exports. As per the audited financial statements for the year ended March 31, 20XX, the entity had net losses of Rs.120 million. At March 31, 20XX, its current assets aggregate to Rs.1,200 million and the current liabilities aggregate to Rs.1,500 million. Due to expected favorable change in the government policies for the electronic industry, the entity is projecting profits in the coming years. Furthermore, the shareholders of the entity have arranged alternative additional sources of finance for its expansion plans and to support its working capital needs in the next 12 months.

Should XYZ Inc. prepare its financial statements under the going concern basis of accounting considering management's assessment for next twelve months?

If the auditor concludes based on available evidence including reasonability of future profitability that there is no material uncertainty related to going concern for at least next twelve months, there is no need to include section on "Material Uncertainty Related to Going Concern". It is, however, recommended to include a suitable note in the financial statements. However, if matters deteriorate further instead of improving, then in the future another detailed assessment would be needed to ascertain whether the going concern basis of accounting is still valid and accordingly suitable disclosure may be made in the financial statements and the same shall be considered by the auditor vis a vis need to include a section on "Material Uncertainty Related to Going Concern" or Qualified or Adverse Opinion, as the case may be.

CASE STUDY 4

A company is an exclusive seller in the country for retail sale of imported branded garments and was setup two years ago having share capital of Rs. 1 lakhs and unsecured loans of Rs 200 lakhs has accumulated losses of Rs.50 lakhs. The unsecured loan has been granted by the promoter of company along with his family. The Company is having negative net-worth and negative working capital. The promoters have sufficient net worth and have plans to invest in the business in future.

How should the auditor gather sufficient and appropriate audit evidence to conclude on appropriateness of going concern basis of accounting?

The auditor should obtain and review management's assessment of going concern basis of accounting, which includes:

1. Cash flow projections.
2. Detailed business plan covering the period of assessment.
3. Support for the entity's ability to obtain new funding.

The auditor may obtain a "Support Letter" from the promoter for financial support for at least next twelve months. In case of a support letter, auditor should assess intent and capability of promoters to provide financial support. However, in the present circumstances, material uncertainty exists. Accordingly, the financial statements should include adequate disclosures including availability of financial support from promoters. The auditor should report under a separate paragraph "Material Uncertainty Related to Going Concern" if adequate disclosures have been given in the financial statements.

Auditor Conclusions

Situation	Reporting requirements
Use of Going Concern Basis of Accounting in Financial Statements is inappropriate	Adverse opinion
Use of Going Concern Basis of Accounting in Financial Statements is appropriate, but a material uncertainty exists : Adequate disclosure of Material Uncertainty is made in Financial Statements	Unmodified opinion but a Separate Para “Material Uncertainty Related to Going Concern”
Adequate disclosure of Material Uncertainty is not made in Financial Statements	Qualified or Adverse opinion
Management Unwilling to Make or Extend Its Assessment	Consider the implications for the auditor’s report (disclaimer or qualified opinion)
Going concern assumption has been concluded to be inappropriate and financial statements have been prepared on alternate basis	May consider highlighting the same by way of an EOM.

No Going Concern Audit Report

EOM on No Going Concern


Management Responsibility Para

Auditor's Responsibility Para



POLLING QUESTIONS

When the management is required, or elects, to prepare the financial statements on another basis (e.g., liquidation basis), the auditor shall express _____highlighting alternative basis provided disclosure is adequate.

- a) Unmodified opinion along with emphasis of matter paragraph
 - b) Qualified or adverse opinion
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Suggested Draft wordings in the Audit Report

Matter	Opinion (Material Uncertainty Para)
Use of going concern basis of accounting is appropriate but a <u>material uncertainty</u> exists which <u>has been adequately disclosed</u> in the financial statements	<p>We draw attention to Note X in the FS which, states that the Company has accumulated losses of Rs. X and its net worth has been fully eroded, the Company's Current liabilities has exceeded its current assets by Rs. X as at the balance sheet date. These conditions indicate the existence of material uncertainty that may cast significant doubt about the Company's ability to continue as Going Concern. However, the management has provided us a comfort letter from the promoters for continued support to the company to meet its financial obligations. Further, the Company has favorable cash inflows from its operations during the current year & the previous year. In view of the above, the financial statements of the Company have been prepared on going concern basis.</p> <p>Our opinion is not modified in this respect</p>

Reporting u/s 143(3) h - The matters described under material uncertainty related to Going Concern paragraph may have adverse effect on the functioning of the Company

Suggested Draft wordings in the Audit Report

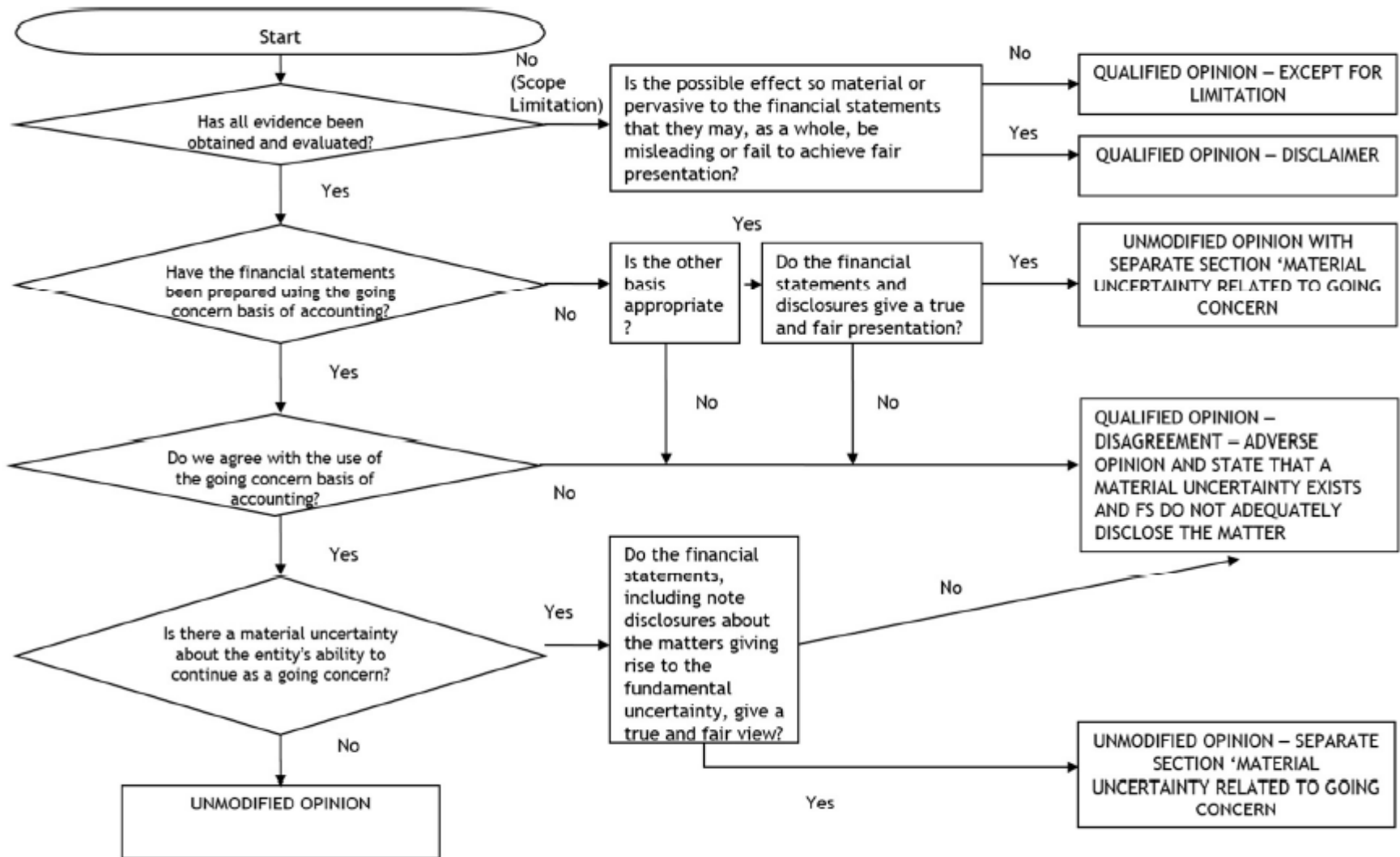
Matter	Emphasis of Matter Para
<p>Use of going concern basis of accounting is inappropriate, <u>management has used alternative basis of accounting</u> and management has <u>disclosed the same in the FS</u></p>	<p>We draw attention to Note XX to the financial statements, which states that the Company has discontinued its operations during F.Y. 2019-20. These events indicate the Company's inability to continue as a going concern. In the view of the same, the going concern assumption is not considered appropriate and current assets and current liabilities have been recorded at the values at which they are estimated to be realised / paid -off.</p> <p>Our opinion is not modified in respect of this matter.</p>

Reporting u/s 143(3) d - In our opinion, *except that the financial statements are prepared on net realizable basis of accounting*, the aforesaid financial statements comply with the Accounting Standards specified under Section 133 of the Act, read with Rule 7 of the Companies (Accounts) Rules, 2014

Suggested Draft wordings in the Audit Report

Matter	Opinion
<p><u>Use of going concern basis of accounting is inappropriate</u> and the auditor do not agree with the basis of accounting</p>	<p>The company's net worth has been fully eroded as on year ending March 31, XXXX. Further, the Company has obligations towards fund-based borrowings / non-fund-based exposure, operational creditors and statutory dues, subject to reconciliation/verification that have been demanded/recalled by the financial/operating creditors pursuant to ongoing Corporate Insolvency Resolution Process (CIRP). These conditions indicate significant uncertainty about the Company's ability to continue as a going concern and therefore the Company may be unable to realize its assets and discharge its liabilities in the normal course of business. However, the financial statements are prepared on going concern basis. Accordingly, we are unable to comment on the consequential impact, if any, on the accompanying financial statements. (Refer Note ___ to the Financial Statements)</p>

HOW TO DECIDE ?



Further reading / references



Standard on Auditing (SA) 570(Revised) Going Concern


Implementation Guide to Standard on Auditing (SA) 570 (Revised) Going Concern

Audit Manuals

Internal Guidance 13/ 2021 - Guidance on Evaluation of Going Concern Assumption

Going Concern - Key Considerations for Auditors amid COVID-19 (ICAI)



A close-up photograph of a blue marker writing the words "Thank you" in a cursive script on a white surface. The marker is positioned on the right side of the frame, with its tip touching the end of the word "you". The ink is a vibrant blue, and the handwriting is fluid and expressive. The background is a plain, light-colored surface, possibly paper or a whiteboard. In the top-left and bottom-left corners, there are red decorative elements consisting of a vertical bar and a diagonal cutout.

Thank
you