SESSION RULES

► THERE IS NO SUCH THING AS A SILLY QUESTION
► RESPECT CONTRIBUTIONS BY OTHERS
► SHARE EXPERIENCES
► PARTICIPATE
► CONTRIBUTE
► NONE OF US IS BETTER THAN ALL OF US !!!
SESSION OBJECTIVES

► ACKNOWLEDGEMENTS

► BACKGROUND TO TOPIC

► TECHNICAL OVERVIEW

► PRACTICAL CHALLENGES AND POSSIBLE SOLUTIONS

► SCENARIOS AND FAQs

► QUESTIONS
SESSION SUMMARY

“It is not about the numbers, BUT what you are doing about them AND your disclosures.”

David Marange
CA(Z) RPA
ISA 570 paragraph 2: “Under the 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, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.”
IAS 1 paragraph 25: “When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so....”
IAS 1 paragraph 25: “...When management is aware, ... of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties....”
IAS 1 paragraph 25: “...When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.”
The GOING CONCERN ASSERTION of an entity might be:

► Appropriate

► Not Appropriate, OR

► Uncertain
PRACTICAL CHALLENGES (cont…)

► THE EXPECTATION GAP – MARKET

► “WE DO NOT WANT A MODIFICATION, DON’T YOU BELIEVE US ?…” - BOARD

► “…I AM VERY UNCOMFORTABLE, HOW DO I WORD MY OPINION?…” AUDITOR

► WHAT IS THE PLAN TO CONTINUE AS A GOING CONCERN ?
PRACTICAL CHALLENGES (cont…)

► IF NOT A GOING CONCERN, WHAT FRAMEWORK IS AVAILABLE?

► ACCOUNTING CONSIDERATIONS

► PERCEIVED INCONSISTENCIES IN AUDIT REPORT IMPACT

► REASONABILITY OF ASSUMPTIONS USED BY MANAGEMENT
PRACTICAL CHALLENGES (cont…)

► SUFFICIENCY & APPROPRIATENESS (reliable and relevant) OF AUDIT EVIDENCE PROVIDED
CASE STUDY BACKGROUND

XYZ (Pvt) Ltd has been posting losses for the past 3 years. It’s current liabilities exceed it’s current assets and it’s net equity is less than the annual operating expenses.

Is the Going Concern Assertion for XYZ appropriate; not appropriate; or Uncertain?
Management explain that XYZ has been designed to make losses as part of the group tax plan and provide convincing evidence that the Holding Company, which is very sound financially, will continue to support XYZ to continue in business for the foreseeable future.
CASE STUDY SCENARIO 2

Management demonstrate that XYZ has plans at an advanced stage to raise fresh capital from the Holding Company, which is very sound financially. If these plans succeed, XYZ will continue in business for the foreseeable future.
CASE STUDY SCENARIO 3

Management demonstrate that XYZ has plans at an advanced stage to raise fresh capital from the Holding Company.

Recent press reports suggest that the Holding company is struggling financially.
CASE STUDY SCENARIO 4

Management admit that they are at a loss what to do next as the Holding Company and shareholders are also struggling financially. At present they are relying on the continued goodwill of bankers and suppliers.
Management explain that XYZ has applied for the bank to roll over it’s facilities, which will enable the company to continue operating and trade out of it’s loss position.

You are aware from other sources, that the bank has made a decision NOT to roll over the facilities.
DECISION TREE 1 – OPTIONS FOR AUDITOR

Evaluate the appropriateness of the going concern assumption when the financial statements have been prepared on the basis that the entity is a going concern

- Appropriate No concerns
- Appropriate but material uncertainty exists
- Inappropriate
- No or inadequate assessment of going concern

Appropriate but material uncertainty exists

- Adequate Disclosure
- Inadequate Disclosure

Adequate Disclosure

- Unmodified auditors report
- Emphasis of matter

Inadequate Disclosure

- Qualified
- Adverse

Qualified

- Limitation of scope
- Adverse

Note: Whether we express a qualified or an adverse opinion (ISA 570 paragraph 20) due to inadequate disclosure is a matter of professional judgment, depending on our judgment of the pervasiveness of the matter to the financial statements.
DECISION TREE 2 – OPTIONS FOR AUDITOR

Does a material uncertainty exist in relation to going concern?

- **NO**
  - **YES**
    - **Is the GC uncertainty mitigated**
      - Common mitigations include:
        - Letter of subordination with the necessary head room
        - Unconditional letter of guarantee
        - Subsequent events
        - Cash flow and other forecasts (RARE)
      - **NO**
        - **YES**
          - Unmodified audit report
        - **NO**
          - Adequately disclosed?
            - **YES**
              - Emphasis of matter paragraph
            - **NO**
              - Qualified audit report
DECISION TREE 3 – OPTIONS FOR AUDITOR

Events or conditions identified that may cast significant doubt on the entity’s ability to continue as a going concern?

NO

No further action

YES

Determined that a material uncertainty exists?

NO

Applicable financial reporting framework requires specific disclosure/disclosure is required to achieve fair presentation?

NO

Management has made appropriate disclosure in the financial statements in accordance with applicable framework?

YES

Unmodified audit opinion

No

Qualified or adverse audit opinion

Unmodified audit opinion with Emphasis of Matter Paragraph

Management has made appropriate disclosure in the financial statements relating to the material uncertainty?

YES

Qualified or adverse audit opinion (depending on impact of inadequate

No

Yes

No
FRAMEWORK TO USE WHEN GC IS NOT APPROPRIATE

IAS 1.25-1 and IAS 10.14-1 - Financial statements prepared on a basis other than a going concern basis

**Issue**:  
► Can financial statements prepared on a basis of accounting other than a going concern basis be described as in compliance with IFRS?  
► If yes, can an entity deviate from individual paragraphs of IFRSs as needed to reflect the application of a ‘non-going concern’ basis of accounting?
FRAMEWORK TO USE WHEN GC IS NOT APPROPRIATE (cont…)

Fact Pattern: An entity determines that it intends to liquidate or to cease trading, or that it has no realistic alternative but to do so. As a result, management determines that the going concern basis is not appropriate for the preparation of financial statements and elects to prepare financial statements under a liquidation basis or some other basis of accounting that does not assume that the entity recovers its assets and discharges its liabilities in the normal course of business. For example, the entity intends to recognise impairment of long-lived assets and recognise liabilities for such items as onerous contracts, restructuring costs, termination indemnities, and future operating losses. These items would likely have been recognised or measured differently (or at a different point in time) in financial statements prepared in accordance with IFRS on a going concern basis.
FRAMEWORK TO USE WHEN GC IS NOT APPROPRIATE (cont…)

Conclusion

► **Yes**, financial statements prepared on a basis of accounting other than a going concern basis **may** be described as in compliance with IFRS as long as that other basis for preparation is **sufficiently described in accordance with paragraph 25 of IAS 1 Presentation of Financial Statements**.

► **Yes**, deviation from specific sections or paragraphs of IFRSs **may** be appropriate in applying a non-going concern basis of accounting. **Significant judgment may be involved in determining the appropriate degree of deviation from going concern IFRS based on the facts and circumstances.**
FRAMEWORK TO USE WHEN GC IS NOT APPROPRIATE (cont…)

Reasons for conclusion

While IFRSs are generally written from the perspective that an entity is a going concern, they are also applicable when another basis of accounting is used to prepare AFS. Paragraph 25 of IAS 1, paragraph 14 of IAS 10 “Events after the Reporting Period” and para 4.1 of The Conceptual Framework for Financial Reporting clearly acknowledge that AFS may be prepared on either a going concern basis or an alternate basis of accounting. Entities preparing financial statements on a basis of accounting other than a going concern basis that follow the guidance in para 25 of IAS 1 or paragraphs 14-15 of IAS 10 are deemed to be preparing financial statements that comply with IFRS.
FRAMEWORK TO USE WHEN GC IS NOT APPROPRIATE (cont…)

► General purpose frameworks

► ISA 210 para A8: At present, there is no objective and authoritative basis that has been generally recognized globally for judging the acceptability of general purpose frameworks. In the absence of such a basis, financial reporting standards established by organizations that are authorized or recognized to promulgate standards to be used by certain types of entities are presumed to be acceptable for general purpose financial statements prepared by such entities, provided the organizations follow an established and transparent process involving deliberation and consideration of the views of a wide range of stakeholders.
FRAMEWORK TO USE WHEN GC IS NOT APPROPRIATE (cont…)

ISA 800 para 6(a): “...Special purpose framework – A financial reporting framework designed to meet the financial information needs of specific users. The financial reporting framework may be a fair presentation framework or a compliance framework…”

Different wording of the audit report is applied for a fair presentation framework and for a compliance framework:

- **Fair Presentation**: “... the AFS present fairly....”
- **Compliance**: “…the AFS are prepared in all material respects in accordance with…”
FRAMEWORK TO USE WHEN GC IS NOT APPROPRIATE (cont…)

**ISA 800 para 12:** “ISA 700 requires the auditor to evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework…”

**ISA 800 para 13:** “…ISA 700 deals with the form and content of the auditor's report. In the case of an auditor's report on special purpose financial statements:

► (a) The auditor's report shall also describe the purpose for which the financial statements are prepared and, if necessary, the intended users, or refer to a note in the special purpose financial statements that contains that information…”
1) The client entity, an insolvent company, is forecasting future profits and cash flows to the extent that it is anticipated that the entity’s insolvent position will reverse at some future point in time. Can the audit team rely on the entity’s forecast as sufficient appropriate audit evidence to effectively mitigate uncertainty regarding the entity’s going concern status?

2) The client is a start-up company, and expects to incur losses for the next couple of years. How does this impact the audit team’s evaluation of the entity’s status as a going concern?
3) Is it possible for a company to be technically insolvent and yet still be a going concern, even without there being any financial support from a third party, either by way of a letter of guarantee or a subordination agreement? The client is an intermediate holding company that incurs administration charges, but has not yet acquired its underlying investment.

4) The client is a subsidiary in a group of companies, but is not actively trading. It has, historically, received support from the holding company to settle external liabilities. Management has not committed to a process of liquidation with a view to deregistering the company in future.
5) There are press reports that the Regulator will cancel / not renew the entity’s operating licence (e.g. Telecoms operator)

6) The entity is involved in gold buying. In his budget speech, the Minister of Finance announced that with immediate effect, only Fidelity will be allowed to buy gold.

7) The company offers specialist neurosurgery solutions. The only neurosurgeon in the company passes on.
“It is not about the numbers, BUT what you are doing about them AND your disclosures.”
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FRAMEWORK TO USE WHEN GC IS NOT APPROPRIATE (cont…)

Description of the Applicable Financial Reporting Framework (Ref: Para. 15)

ISA 700 para A5: ”As explained in ISA 200, the preparation of the AFS by management and, where appropriate, those charged with governance requires the inclusion of an adequate description of the applicable financial reporting framework in the financial statements. That description is important because it advises users of the financial statements of the framework on which the financial statements are based."
FRAMEWORK TO USE WHEN GC IS NOT APPROPRIATE (cont…)

Description of the Applicable Financial Reporting Framework (Ref: Para. 15)

ISA 700 para A6: A description that the AFS are prepared in accordance with a particular applicable financial reporting framework is appropriate only if the financial statements comply with all the requirements of that framework that are effective during the period covered by the financial statements.
Paragraph 25 of IAS 1 states:

"When preparing financial statements, **management shall make an assessment** of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so..."
Paragraph 25 of IAS 1 states:

“...When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare AFS on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.”
Paragraphs 14 and 15 of IAS 10 state:

“An entity **shall not** prepare its financial statements on a going concern basis if management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.
Paragraphs 14 and 15 of IAS 10 state:

“Deterioration in operating results and financial position after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern assumption is no longer appropriate, the effect is so pervasive that this Standard requires a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognised within the original basis of accounting.”
Paragraph 4.1 of *The Conceptual Framework for Financial Reporting* states:

► “The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations: if such an intention or need exists, the AFS may have to be prepared on a different basis and, if so, the basis used is disclosed.”
ACCOUNTING CONSIDERATIONS WHEN GC IS NOT APPROPRIATE

Preparing financial statements on a break-up basis

► If the accounts are prepared on a basis other than going concern, all the normal rules of accounting still apply, other than that of going concern.

► The following are factors that will require consideration when drafting financial statements on a basis other than going concern.

N.B. – IS THIS A FRAMEWORK / IS IT DEFINED ???

Fixed Assets

► Fixed assets will need to be assessed for impairment, and written down to the recoverable amounts.
ACCOUNTING CONSIDERATIONS WHEN GC IS NOT APPROPRIATE (cont…)

Inventory

► Inventory must be carried in the financial statements at the lower of cost and net realisable value at the balance sheet date.

Liabilities

► The decision to close an entity is likely to create obligations where one may not have existed when the entity was a going concern.

► The issue of reclassification of long term liabilities to short term liabilities also needs to be considered.
ACCOUNTING CONSIDERATIONS WHEN GC IS NOT APPROPRIATE (cont…)

Leases and hire purchase contracts
► Early settlement of these contracts may result in the entity incurring penalties. In addition, operating leases may give rise to onerous contracts.

Government grants
► If the company has received government grants in the past, you will need to consider if these grants have become repayable as a result of the decision to cease to trade.
ACCOUNTING CONSIDERATIONS WHEN GC IS NOT APPROPRIATE (cont…)

Disclosures required where the financial statements are not prepared on a going concern basis:

Basis of preparation

► The basis of preparation applied and the reason for the adoption of this basis need to be disclosed in the accounting policy notes.

Directors’ report

► The director’s report should outline the decision reached by the directors in relation to the future of the company and the implication of these decisions for the basis of preparation of the financial statements.
ACCOUNTING CONSIDERATIONS WHEN GC IS NOT APPROPRIATE (cont…)

Profit and loss account

The following narrative may be necessary at the foot of the profit and loss account:

► “All of the activities of the company are classified as discontinuing as the directors have the intent to wind up the company within 12 months from the signing of the financial statements.”
DECISION TREE 1 – OPTIONS FOR AUDITOR

Evaluate the appropriateness of the going concern assumption when the financial statements have been prepared on the basis that the entity is a going concern.

- Appropriate, no concerns
  - Appropriate, but material uncertainty exists
    - Inappropriate
      - No or inadequate assessment of going concern
        - Limitation of scope
  - Unmodified auditors report
    - Adequate disclosure
      - Emphasis of matter
        - B13_2
    - Inadequate disclosure
      - Qualified
        - Adverse
          - B13_4
      - B13_3

- B13_3

- B13_4

- B13_5

- B13_5
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