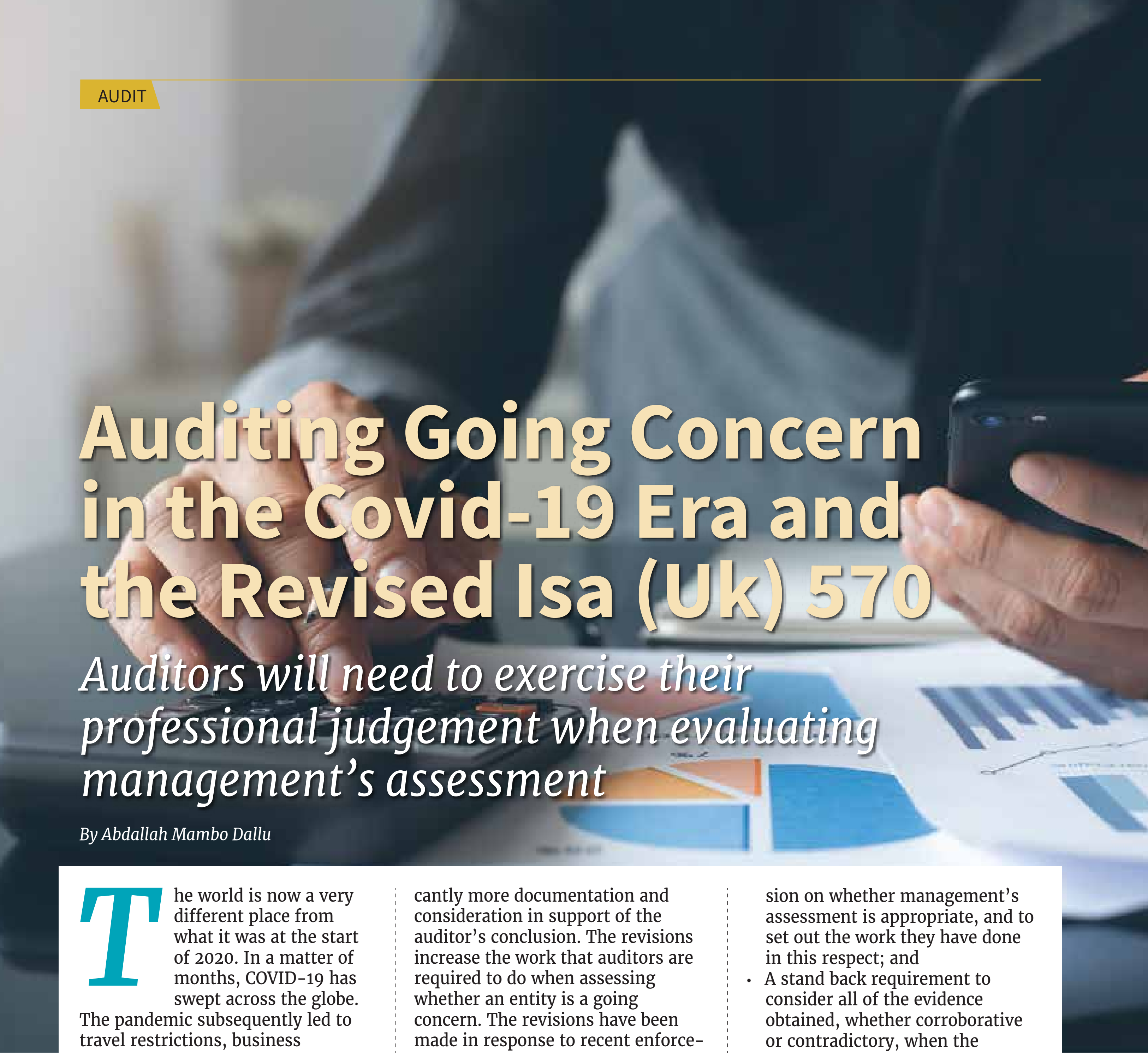

Auditing Going Concern in the Covid-19 Era and the Revised Isa (Uk) 570

Auditors will need to exercise their professional judgement when evaluating management's assessment

By Abdallah Mambo Dallu

The world is now a very different place from what it was at the start of 2020. In a matter of months, COVID-19 has swept across the globe. The pandemic subsequently led to travel restrictions, business closures, cancelled events, and lockdowns. Governments responded with a range of financial support in an attempt to support jobs and businesses. The impact of COVID-19, is very likely to form part of the directors' assessment when preparing their strategic reports and financial statements. Auditors will also need to assess the impact of any uncertainties on the audit report.

As always, auditors must remain professionally skeptical, and follow the requirements of International Standard on Auditing (ISA) 570 going concern. Important to note, is that ISA was revised in September 2019 for periods commencing 15th December 2019 onwards, and the new requirements require significantly more documentation and consideration in support of the auditor's conclusion. The revisions increase the work that auditors are required to do when assessing whether an entity is a going concern. The revisions have been made in response to recent enforcement cases and a number of corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after.

The revised standard requires:

- Greater work on the part of the auditor to more robustly challenge management's assessment of going concern, thoroughly test the adequacy of the supporting evidence, evaluate the risk of management bias, and make greater use of the viability statement;
- The standards require improved transparency with a new reporting requirement for the auditor of public interest entities, listed and large private companies to provide a clear, positive conclusion on whether management's assessment is appropriate, and to set out the work they have done in this respect; and
- A stand back requirement to consider all of the evidence obtained, whether corroborative or contradictory, when the auditor draws their conclusions on going concern.

KEY AREAS OF FOCUS IN AUDITING GOING CONCERN DURING COVID-19

The key areas which auditors may wish to consider when auditing going concern, and in considering the challenges presented by the pandemic include;

i) The risk assessment process

The coronavirus pandemic has significantly increased going concern risk for a large number of entities. As there is an increased likelihood of material uncertainties in relation to going concern, this must be appropriately reflected in the auditor's risk assessment.

At the planning stage, auditors will more frequently assess going concern as a significant risk area (or an area of higher risk). It is important that this is appropriately reflected and weighted in the assessment of inherent risk and the auditor can demonstrate the impact on the audit approach. It is not enough that the risk is simply highlighted and left for consideration at the completion stage of the audit.

In conducting the risk assessment process, and the auditor's preliminary assessment of going concern, documented considerations may include:

a) The extent of pre-existing going concern issues in the business
b) Whether the principal activity of the audit client, or the business sector it operates in, gives rise to additional risk
c) Whether the business model of the audit client has been impacted
d) The extent to which cash flow has been impacted
e) Whether the entity's supply chain has been impacted
f) The extent to which staffing and employment has been impacted
g) Whether there are underlying legal or contractual issues
h) The type of assets held by the entity

ii) Evaluating management's assessment of going concern

When preparing financial statements, management assesses whether the entity is a 'going concern'. Note that the accounts will always be prepared on a going concern basis unless management either intends to liquidate the entity or cease trading (or has no realistic alternative but to do so). It is vital then that management has clearly considered the impact of the pandemic on the entity, with key consideration on whether the entity has sufficient funds to continue to meet its obligations as they fall due.

As there are implications for the audit opinion where the auditor is unable to obtain sufficient appropriate evidence, it may be helpful for auditors to set a clear expectation of the level of evidence required to support management's assessment, which will usually be supported by financial forecasts and cash flow projections.

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Any forecasts or projections must be revisited and revised regularly, and management's assessment should model a range of scenarios to assess the impact of different potential decreases in sales and increased costs on the cash and balance sheet position. Firms should also consider whether there will be practical difficulties in obtaining evidence given restrictions on travel and access to premises, and the extent of alternative procedures which can be performed remotely.

If the auditor cannot obtain sufficient appropriate audit evidence, the implications for the auditor's opinion on the financial statements should be considered in accordance with ISA (UK) 705 Modifications to the Opinion in the Independent Auditor's Report (Revised June 2016).

iii) Reporting a material uncertainty related to going concern

Where there are material uncertainties that cast significant doubt on going concern, further disclosure will be required in the financial statements and the audit report. A key consideration for auditors will be around the adequacy of disclosures made by management in their financial statements and strategic reports. These disclosures should set out the key information sources, judgments and assumptions as at the date of making the assessment and should provide sufficient information about the impact of COVID-19 on the entity to inform the users of the financial statements.

Disclosures should also clearly state that there is a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern. The quality of the disclosures made by the directors in the financial statements and the underlying supporting evidence will be key when the auditor considers the opinion that they will issue on the financial statements.

Where the auditor considers that the directors have appropriately disclosed the material uncertainty in the financial statements then the auditor does not modify the opinion but, under a separate heading relating to growing concern, draws attention to the note in the financial statements that discloses the matter and states that events and conditions indicate a material uncertainty exists and that the auditor's opinion is not modified in respect of this matter.

Where disclosure of material uncertainties by the directors in the accounts is considered inadequate by the auditor, a qualified or adverse opinion will be required, depending on the pervasiveness of the matter.

iv) Regular and effective communication

In the current climate, the auditor must communicate regularly with management and those charged with governance. The impact of the pandemic on entities is changing rapidly, and the validity of assumptions and conclusions can change over a very short time.

Auditors should consider how they will communicate to management and those charged with governance in a timely manner, on both reporting and other matters.

The revised ISA (UK) 570 sets out the requirements for communication when events or conditions are identified which may cast doubt on an entity's ability to trade as a going concern, including whether there is a material uncertainty, the appropriateness of management's use of the going concern basis, the adequacy of related disclosures in the financial statements, and the implications if any for the audit report.

v) Timing of the auditor's reassessment of going concern

The auditor must continue to reassess their conclusion over going concern and this will continue up to the point of signing the audit report. Before signing the audit opinion, this may require the provision of further evidence and/or information by management, and further consideration, by the auditor, of the disclosures in the financial statements.
It is crucial that the audit file fully documents all steps in arriving at the conclusion on going concern, including changes to the auditor's expected opinion over time. This is especially important where going concern has been highlighted as a risk area, but a clean audit opinion has ultimately been signed.

Conclusion

Given the intricacies involved in the constantly evolving situations of Covid-19 and the significant judgements and estimates that would be required to determine the potential impacts, management and those charged with governance must remain watchful to ensure risks posed by the pandemic remain high priorities. For some businesses, the implementation of the revised going concern standard will be a step-change that will result in changes to processes, controls, oversight arrangements and increased management input to prepare management's assessment of going concern.

For the auditor, greater audit effort will be required, resulting in additional time input throughout the audit process. Auditors will need to exercise their professional judgement when evaluating management's assessment, identifying the critical assumptions and data, considering whether sufficient appropriate audit evidence has been obtained, and concluding on going concern in the audit report.

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