IMPLEMENTATION GUIDE TO STANDARD ON AUDITING (SA) 570, GOING CONCERN

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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

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Foreword

Auditing Standards issued by the Institute of Chartered Accountants of India are important in ensuring quality in audit engagements. On the one hand they codify the best practices in the area of audit and thereby help the auditors enhance the value added by an independent audit. On the other hand, they are the performance benchmarks against which the performance of the auditors is measured by the stakeholders in the financial reporting process. It is therefore necessary that the auditors properly understand and implement these Standards in their audit engagements.

Implementation Guides to Auditing Standards are an important tool in the hands of the practitioners to appropriately understand the exacting requirements of these Standards and help them implement the Standards in an appropriate manner to meet the objectives which they are designed to achieve.

'Going Concern' is an important concept in the context of preparation and presentation of financial statements as well as the audits of financial statements. The Institute had issued a Standard on Auditing dealing with the concept of 'Going Concern' as back as in 1998. The Standard was revised in the year 2008. I am happy that the Auditing and Assurance Standards Board has brought out this Implementation Guide to Revised Standard on Auditing (SA) 570, 'Going Concern'. I am sure the Implementation Guide would be able to address the practical difficulties, if any, being faced by the members in implementing this Standard on Auditing.

I compliment CA. Abhijit Bandyopadhyay, Chairman, Auditing and Assurance Standards Board, committee members and officers of the Board for their efforts in developing and issuing guiding literature on auditing standards and other technical literature on auditing.

January 15, 2013 **CA. Jaydeep Narendra Shah**
New Delhi President, ICAI

Preface

Going concern is a critical assumption underlying the preparation and presentation of financial statements and is a major cause of concern alike for the internal stakeholders in an entity, like management, employees, etc., as well as the external stakeholders such as the vendors, investor community and the regulators. Many legislations, therefore, specifically require the auditor to directly or indirectly assess and report on the appropriateness of the going concern assumption or assess the impact of certain transactions on the going concern of the entity. For example, the Companies (Auditor's Report) Order, 2003 specifically requires the statutory auditor to report whether disposal of a substantial part of the assets has affected the going concern of a company. Similarly, the reporting requirement under CARO 2003 with respect to erosion of net worth and incurrence of cash losses is also aimed at assessing the financial health and as a corollary, the going concern of a company.

While SA 570, Going Concern, issued by ICAI contains fundamental principles that the auditors need to bear in mind while assessing the going concern assumption. The task is, none the less, challenging and requires careful application of, among other things, professional skepticism and judgment by the auditors, particularly so in situations of economic uncertainty/ downturn wherein there could be serious disagreements with the preparers of financial statements on the going concern issue.

Having regard to the above, I am happy to place in your hands this Implementation Guide to Standard on Auditing (SA) 570¸Going Concern. The Implementation Guide, developed by a team of experts in the area of auditing, provides a very practical and easy to follow approach to going concern assessment in the forms of questionnaire, templates and case studies, etc.

At this juncture, I wish to place on record my sincere thanks to CA. Ganesh Balakrishnan, Hyderabad and his team comprising, Ms

Swati Naik and Mr Ratan Kumar for taking time out of their professional and personal priorities to develop this Implementation Guide.

I also wish to thank CA. Jaydeep N Shah, President, ICAI as well as CA. Subodh K Agrawal, Vice President, ICAI whose vision, guidance and support I have been privileged to receive in the activities of the Board.

I am also grateful to the members of the Auditing and Assurance Standards Board, *viz.*, CA. Shiwaji Bhikaji Zaware, Vice Chairman, CA. Amarjit Chopra, CA. Anuj Goyal, CA. G. Ramaswamy, CA. Jayant P. Gokhale, CA. J. Venkateswarlu, CA. Naveen N.D. Gupta, CA. Nilesh S. Vikamsey, CA. Pankaj Inderchand Jain, CA. Pankaj Tyagee, CA. Rajendra Kumar P., CA. S. Santhanakrishnan, CA. V. Murali, Shri Gautam Guha, CA. Raj Agrawal, CA. Vinay Balse, CA. Purshotam Gaggar, CA. Pramod S. Shingte, CA. Partha Sarathi De for their dedication and support to the work plan of the Board and bringing them to fruition. I also wish to place on record my thanks to the special invitees to the Board, *viz.*, Prof. Manoj Anand, CA. B. Padmaja, CA. Amit Roy, Shri Sunil Kadam, CA. Khurshed Pastakia, CA. Gopal Mahadevan, CA. Anil Sharma, CA. N. D. Gupta, CA. Raj Kumar Aggarwal, CA. Jaideep Bhargava, CA. Shashi Gupta and CA. Santosh Gupta for their support to the Board.

I am sure that the readers would find this Implementation Guide useful and shall be happy to have their feedback on the same.

January 15, 2013
Kolkata

CA. Abhijit Bandyopadhyay
Chairman,
Auditing and Assurance Standards Board

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Snapshot of Revised SA 570

Revised SA 570

Going Concern (GC)

Effective for audits of financial statements for periods beginning on or after April 1, 2009

Replaces SA 570 (AAS 16), "Going Concern", issued in September 2001.

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- **Application & Other Explanatory Material on these Aspects**

Scope of this SA

Auditor's responsibility in Audit of FS

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With respect to management's use of GC Assumption

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In Preparation & Presentation of FS

GC Assumption

- Entity is viewed as continuing in business for the foreseeable future.

Responsibilities of Management

- GC - a fundamental principle in preparation of Financial Statements
- Management to make a specific assessment of GC Assumption
- Judgment about inherently uncertain future outcome of events/conditions
  - Period- at least 12 months from date of FS
  - Based on – Information available at particular point of time
  - Affected by –Size & Complexity of entity, Nature & Condition of business

Responsibilities of Management

- The financial reporting framework may require the mgt to make an assessment of the entity's ability to continue as a GC and prepare the financial statements on a GC basis unless the management intends to liquidate the entity or cease operations, or has no realistic alternative but to do so. In case in other financial reporting framework, there is no such explicit requirement for the mgt., mgt. is still required to prepare and present FS on GC basis.
- Appropriate disclosure together with the reason thereof, in case the FS are not prepared on a GC basis.
- The detailed requirements may also be set out in law or regulation.

Responsibilities of Auditor

Obtain Sufficient Appropriate Audit Evidence (SAAE) about appropriateness of management's use of GC assumption

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Conclude whether there is material uncertainty about entity's ability to continue as GC

Absence of any GC uncertainty reference in Auditor's report not to be viewed as guarantee to entity's ability to continue as GC

Auditor's Objective

- **Obtain SAAE:**
  - about appropriateness of use of GC Assumption in preparation & presentation of FS.
- **Conclude, based on evidence:**
  - whether a material uncertainty exists that may cast significant doubt on entity's ability to continue as GC.
- **Determine**
  - implications for the auditor's report.

Risk Assessment Procedures- I

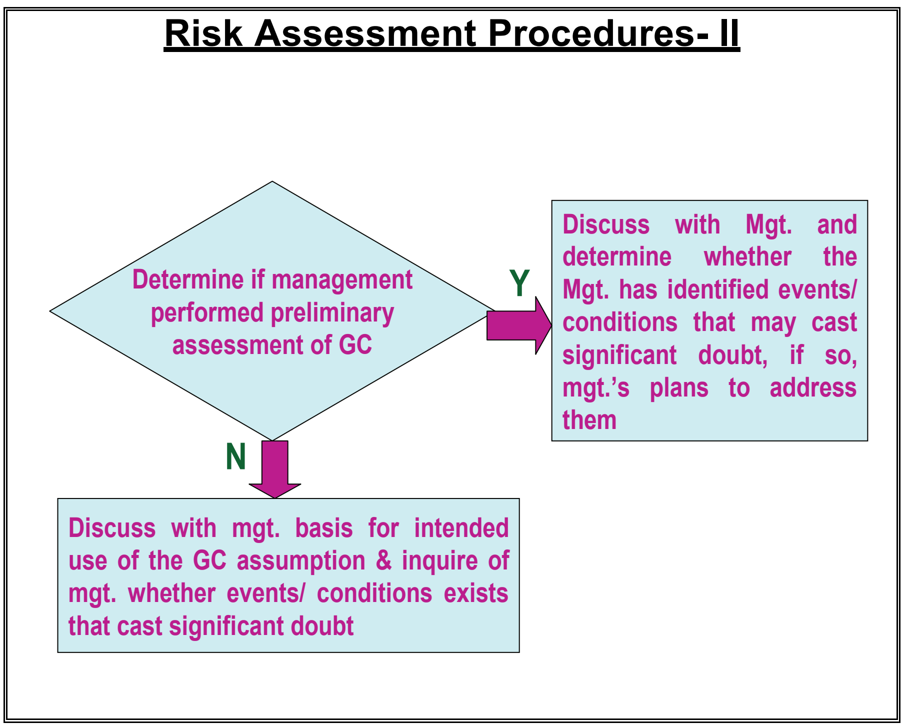
- Determine events/conditions that cast doubt on entity's ability to continue as GC:
  - Financial, Operating, Other.
- Auditor to remain alert throughout audit for these events /conditions.
- Smaller Entities:
  - Ability to withstand or respond quickly but may lack resources to sustain operations.
  - Risk of possible loss of principal supplier, major customer, key employee, right to operate under a license or withdrawal of support by banks or lending agencies.

Examples of Events/ Conditions

- Financial
  - Net liability or net current liability position.
  - Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
  - Indications of withdrawal of financial support by creditors.
  - Negative operating cash flows indicated by historical or prospective financial statements.
  - Adverse key financial ratios.
  - Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
  - Arrears or discontinuance of dividends.
  - Inability to pay creditors on due dates.
  - Inability to comply with the terms of loan agreements.
  - Change from credit to cash-on-delivery transactions with suppliers.
  - Inability to obtain financing for essential new product development or other essential investments.
- Operating
  - Management intentions to liquidate the entity or to cease operations.

  - Loss of key management without replacement.
  - Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
  - Labour difficulties.
  - Shortages of important supplies.
  - Emergence of a highly successful competitor.
- Other
  - Non-compliance with capital or other statutory requirements.
  - Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.
  - Changes in law or regulation or government policy expected to adversely affect the entity.
  - Uninsured or underinsured catastrophes when they occur.

Procedures under SA 315 and SA 330 need to be followed.



Evaluating Management's Assessment

- Evaluate management's assessment of entity's ability to continue as GC.
- Assessment period:
  - Cover same period as that used by management as per the FRF.
  - Or longer period if required by law/regulation.
  - If period less than 12 months from the date of FS then request management to extend it to at least 12 months from that date.
- Consider whether assessment includes all relevant information of which auditor is aware as result of audit.

1. Auditor is not responsible for rectifying the lack of analysis by mgt. to support its assessment for concluding whether management's use of the going concern assumption is appropriate in the circumstances. In this case, the auditor's evaluation of the appropriateness of management's assessment may be made without performing detailed evaluation procedures if the auditor's other audit procedures are sufficient to enable the auditor to conclude whether mgt.'s use of the going concern assumption in the preparation of the financial statements is appropriate in the circumstances.
2. Evaluation may include:
   - Evaluation of the process management followed to make its assessment
   - Assumptions on which the assessment is based and management's plans for future action
   - Whether management's plans are feasible in the circumstances.

Smaller Entities

- Evaluate management's assessment of entity's ability to continue as GC:
  - Discuss medium and long-term financing of entity with management – *consistent with auditor's understanding*.
  - Assess supporting documentation.
- Evaluate owner-manager's ability to meet the obligation under support arrangement.

Period beyond Management's Assessment

- Inquire of management as to its knowledge of events/conditions beyond period of management's assessment.
- If events/conditions identified - request management to evaluate potential significance.
- No responsibility to perform any other audit procedure except inquiry.

Additional Audit Procedures - I

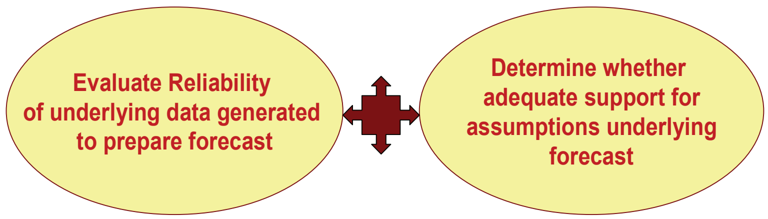
- Request mgt. to make GC assessment if not yet performed.
- Evaluate mgt's plans for future actions *(e.g., restructuring, expenditure reduction)*:
  - outcome likely to improve situation.
  - feasible in the circumstances.
- Consider whether any additional facts/information available since date of mgt assessment.

Additional audit procedures may include the following:

- Analysing and discussing cash flow, profit and other relevant forecasts with management.
- Analysing and discussing the entity's latest available interim financial statements.
- Reading the terms of debentures and loan agreements and determining whether any have been breached.
- Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties.
- Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications.
- Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds.
- Evaluating the entity's plans to deal with unfilled customer orders.
- Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern.
- Confirming the existence, terms and adequacy of borrowing facilities.
- Obtaining and reviewing reports of regulatory actions.
- Determining the adequacy of support for any planned disposals of assets.

Additional Audit Procedures - II

- Analysis of cash flow forecast prepared by the entity



- Request Written Representations from mgt. or, where appropriate, TCWG regarding plans for future action and their feasibility

The Period of Management's Assessment

- In addition to the procedures required to evaluate mgt's plans for future actions, the auditor may compare:
  - The prospective financial information for recent prior periods with historical results; and
  - The prospective financial information for the current period with results achieved to date.
- Where management's assumptions include continued support by third parties and such support is important to an entity's ability to continue as a GC, auditor may need to
  - consider requesting written confirmation from those third parties; and
  - obtain evidence of their ability to provide such support.

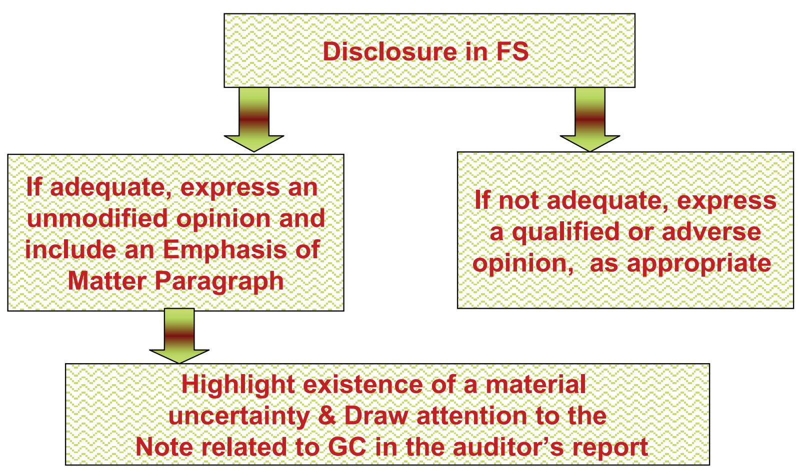
Audit Conclusions and Reporting

- Conclude whether in Auditor's judgment **material uncertainty** exists related to events/conditions which individually/collectively casts significant doubt on GC assumption.
  - Material uncertainty – Magnitude of potential impact & likelihood of occurrence is such that, in auditor's judgment, appropriate disclosure of nature and implications of uncertainty is necessary for disclosure of true and fair view.

Use of GC assumption appropriate but material uncertainty exists- I

- Determine whether FS:
  - Adequately describe principal events/conditions that cast significant doubt on entity's ability to continue as GC & Mgt's plans to deal with these events/conditions.
  - Disclose clearly that there is material uncertainty.
- Entity may be unable to realise its assets and discharge its liabilities in the normal course of business.

Use of GC assumption appropriate but material uncertainty exists-II



In situations involving multiple material uncertainties that are significant to the financial statements as a whole, the auditor may consider it appropriate in extremely rare cases to express a disclaimer of opinion instead of adding an Emphasis of Matter paragraph.

Use of GC Assumption Inappropriate

- If FS prepared on a GC basis but, in auditor's judgment, use of GC assumption in FS is inappropriate:
  - Express an adverse opinion.
- If mgmt is required/elects to prepare FS – then FS may be prepared on an alternative basis (e.g. liquidation basis).
  - Express unmodified opinion along with emphasis of matter paragraph highlighting alternative basis provided disclosure is adequate.

Management unwilling to Make or Extend its Assessment

- Failure to obtain SAAE.
- Management unwilling to make or extend assessment of entity's ability to continue as GC:
  - Consider implications for the auditor's report.
- Qualified opinion or Disclaimer of opinion.

Communication with Those Charged with Governance

- Unless all TCWG involved in managing entity, communicate with TCWG events/conditions that cast significant doubt on GC assumption:
  - Whether events/conditions constitute material uncertainty.
  - Whether use of GC assumption appropriate in preparation and presentation of FS.
  - Adequacy of related disclosures in FS.

Significant Delay in Approval of FS

Significant Delay in approval of FS by mgt. or TCWG after date of FS

Auditor to inquire reasons for delay

If delay related to events/conditions relating to GC assessment, auditor to perform additional audit procedures and consider effect on auditor's conclusion regarding existence of material uncertainty

Chapter 1
Introduction and Overview

1.1 The purpose of this Implementation Guidance is to provide practical guidance on implementation of the principles enunciated in the Standard on Auditing (SA) 570 (Revised), Going Concern, issued by the Institute of Chartered Accountants of India.

This SA 570 (Revised) is effective for audits of financial statements for periods beginning on or after April 1, 2009.

1.2 Certain fundamental accounting assumptions underlie the preparation and presentation of financial statements and going concern is one of those fundamental accounting assumptions. They are usually not specifically stated because their use is accepted and assumed. A disclosure is necessary if they are not followed. However, if the entity's management is required, or elects, to prepare financial statements when the use of the going concern assumption is not appropriate in the circumstances, the financial statements are prepared on an alternative basis (e.g., liquidation basis). The auditor may be able to perform an audit of those financial statements provided that the auditor determines that the alternative basis is an acceptable financial reporting framework in the circumstances. The auditor may be able to express an unmodified opinion on those financial statements, provided there is adequate disclosure therein but may consider it appropriate or necessary to include an Emphasis of Matter paragraph (Refer Q 10 in Chapter II below for details) in the auditor's report to draw the user's attention to that alternative basis and the reasons for its use. (Refer paragraph A26, SA 570).

1.3 The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidating or curtailing materially the scale of its operations. An entity's continuance as a going concern for the foreseeable future is assumed in the preparation of financial statements in the absence of significant information to the contrary. Accordingly, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business. If this assumption is unjustified, the amounts and classification of assets and liabilities in the financial statements may need to be adjusted. A few examples of situations of going concern are as under:

(i) An oil and gas firm operating in Nigeria is stopped by a Nigerian court from carrying out operations in Nigeria. The firm is not a going concern in Nigeria, because it has to shut down operations because of the said directions from the court.

(ii) A nationalized refinery is in cash flows problems but the government of the country provided a guarantee to the refinery to help it out with all payments, the refinery is a going concern despite poor financial position, since it has a support of the country's government.

(iii) A bank is in serious financial troubles and the government is not willing to bail it out. The Board of Directors has passed a resolution to liquidate the business. The bank is not a going concern.

(iv) A merchandising company has a current ratio below 0.5. A creditor of Rs. 5 crores demanded payment which the company could not make. The creditor requested the Court to liquidate the business and recover his debts and the court grants the order. The company is no longer a going concern.

However, under each of these cases, the auditor needs to review the underlying facts so as to conclude on the use of going concern assumption for the preparation of financial statements.

1.4 The importance of 'going concern' assumption in the preparation of financial statements can be gauged from the fact that a number of important laws and regulations impose specific responsibilities on managements as well as auditors in relation to going concern. For example, Section 217(2AA) of the Companies

Act, 1956 *inter alia* requires the Directors to make a specific assertion in their Directors' Responsibility Statement under this section that the directors have prepared the annual accounts on a going concern basis. Similarly, clause 49 of the Listing Agreement envisages the Audit Committee had to review with management that the annual financial statements before submission to the board, focusing on the going concern assumption. In so far as the auditors are concerned, sub-clause (c) of clause (1) of paragraph 4 of the Companies (Auditor's Report) Order, 2003 (CARO, 2003) requires the auditor to specifically report whether the 'going concern' has been affected where the company has disposed off a substantial part of its fixed assets during the year. The auditor is therefore required to examine the reasons for disposal of a substantial part of the fixed assets and to give his opinion on whether the reporting of the financial statements on going concern concept is proper. Further, certain other clauses of CARO, 2003 may also be considered as indicators of appropriateness of going concern, for example, clause (x) of paragraph 4 requires the auditor to report whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than 50% of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year.

Similarly, Clause (xvii) of paragraph 4 requires the auditor to report whether the funds raised on short term basis have been used for long term investment.

1.5 This Implementation Guide provides a framework to assist in determining whether the use of going concern basis in preparation of the financial statements and the related disclosures are appropriate and in making balanced, proportionate and clear disclosures.

Chapter 2
The Implementation Guidance and Suggested Questionnaire

2.1 The going concern assumption is a fundamental principle in the preparation of financial statements. This Implementation Guide provides information and background material in relation to going concern considerations covering broadly the following areas:

- Accounting framework
- Auditing management's assessment of going concern
- Events or conditions that may cast significant doubts about the entity's ability to continue as a going concern
- Determining the implications for the auditor's report when reporting in accordance with the Standards on Auditing (SA) 570 (Revised)
- Consultation within audit team and with the client/management/audit committee
- Reviewing interim financial information in accordance with the Standard on Review Engagements

2.2 The following questionnaire could be relevant whilst testing the going concern assumption.

Q.1 **Who is responsible to assess going concern assumption?**

Ans.1 The assessment of an entity's ability to continue as a going concern is the responsibility of the entity's management. The auditor needs to evaluate management's assessment of the entity's ability to continue as a going concern.

Q.2 **Over what period is going concern assessed?**

Ans.2 In evaluating management's assessment of the entity's ability to continue as a going concern, the auditor covers the same period as that used by management.

If management's assessment of the entity's ability to continue as a going concern covers less than twelve month from the date of the financial statements as defined in SA 560, Subsequent Events, the auditor requests management to extend its assessment period to at least twelve months from that date.

Q.3 **What factors are taken into account by the management when assessing the entity's ability to continue as a going concern?**

Ans.3 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:

- The degree of uncertainty associated with the outcome of an event or condition increases significantly the further into the future an event or condition or the outcome occurs. For that reason, financial reporting frameworks normally require an explicit management assessment specify the period for which management is required to take into account all available information.
- The size and complexity of the entity, the nature and condition of its business and the degree to which it is affected by external factors affect the judgment regarding the outcome of events or conditions.
- Any judgment about the future is based on information available at the time at which the judgment is made. Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made.

Q.4 **What evidence does Management normally consider when assessing the entity's ability to continue as going concern?**

Ans.4 The evidence includes:

- 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' fro m the parent company for financial support for the next twelve month, as required, from the date of the latest balance sheet.
- In an unlikely situation, Support Letter may be given by the government or any other financial situation as well; however, this is a rare phenomenon. A standard template of Support Letter is given in Annexure II.

Q.5 **What are the auditor's responsibilities under going concern assumptions?**

Ans.5 The auditor's responsibilities are:

- To obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation of the financial statement;
- To conclude whether there is a material uncertainty about the entity's ability to continue as a going concern.

Q.6 **What should auditor do if Management has not performed a preliminary assessment?**

Ans.6 In such a situation, the auditor needs to:

- discuss with management the basis for the intended use of the going concern assumption
- 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.

Q.7 **How should auditor evaluate management's assessment of going concern?**

Ans.7 In evaluating management's assessment of going concern assumption, the auditor would 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. The period of assessment would be of at least twelve month from that date of the financial statements. In case it is less than that, the auditor would request the management to cover at least a 12 months period.

The auditor's procedures for evaluating management's assessment of going concern would also include:

- Ensuring management's assessment includes all relevant information of which the auditor is aware as a result of the audit.
- Inquiring of management as to its knowledge of events or conditions beyond the period of management's assessment that may cast significant doubt on the entity's ability to continue as a going concern.

Q.8 **What are the Additional Audit Procedures to be performed When Events or Conditions that may cast significant doubt on the going concern assumption Are Identified?**

Ans.8 In such a scenario, the auditor needs to perform additional audit procedures to obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists. In doing so, the auditor would also need to take into consideration, the mitigating factors, if any. These procedures include:

- 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 in relation to its going concern assessment, 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, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future action.
- Evaluating the reliability of the underlying data generated to prepare the forecast.
- Determining whether there is adequate support for the assumptions underlying the forecast.
- 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.

Q.9 **What should auditor do when use of Going Concern Assumption is Appropriate but a Material Uncertainty Exists?**

Ans.9 In such a situation, the disclosure made by the entity in its financial statements become very important. The auditor should, therefore, determine whether the financial statements:

- Adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and

- Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

For the above purpose the fact whether the information explicitly draws the readers' attention to the possibility that the entity may be unable to continue realizing its assets and discharging its liabilities in the normal course of business, would be an important factor for the auditor.

Q.10 **What are the auditor's reporting responsibilities if the auditor concludes that adequate disclosure is made in the financial statements in the scenario given in Q.9 above?**

Ans.10 In such a situation the auditor would express an unmodified opinion on the financial statements. However, his report would also need to include an Emphasis of Matter Paragraph. This Emphasis of Matter paragraph would:

- Highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern.

- Draw attention to the note in the financial statements that discloses the matters.

An example of such wording for paragraph that may be included on '**Emphasis of Matter for modification in the auditors' report**' has been given below in Annexure – I, Part A.

Note – while making conclusion on putting 'Emphasis of Matter for modification in the auditors' report, this Q 10, shall be read in conjunction with point no. 3 in Chapter I above.

Q.11 **How should auditor report if in the scenario mentioned in Q.9 above, adequate disclosure in respect of material uncertainty for going concern assumption is not made in the financial statements?**

Ans.11 In the absence of adequate disclosures in the financial statements in respect of existence of material uncertainty relating to going concern assumption, the auditor would need to express a qualified or an adverse opinion, as may be appropriate, in terms of principles enunciated in SA 705, "Modifications to the Opinion in the Independent Auditor's Report". The auditor's report should clearly state that there is a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern.

Examples for paragraph to be included in audit report for; Qualified opinion and Adverse opinion, have been given below in Annexure – I, Part B.

Q.12 **What should auditor do if Use of Going Concern Assumption is Inappropriate?**

Ans.12 If in the auditor's judgment, management's use of the going concern assumption in the financial statements is inappropriate, and auditor is of the opinion that accounts cannot be prepared on the going concern basis due to existing facts then the auditor shall express an adverse opinion.

For example

1. Company have opted to avail the "Easy Exit Scheme, 2011" pursuant to General Circular no. 6/2010 issued by the Ministry of Corporate Affairs (MCA) dated 03.12.2010 read with Section 560 of the Companies Act, 1956, and still prepares the accounts on going concern assumption without disclosing the facts in the financial statements. In such circumstances auditor would need to issue an adverse opinion.

2. The company's financing arrangements expire and amounts outstanding are payable on 30 August 20x2. The

company has been unable to re-negotiate or obtain replacement financing. This situation indicates the existence of a material uncertainty which may cast significant doubt on the company's ability to continue as a going concern and therefore it may be unable to realise its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact. In such circumstances auditor would need to issue an adverse opinion

Refer Annexure – I for audit report format.

Q.13 **What should auditor do if Management is Unwilling to Make or Extend Its Assessment?**

Ans.13 If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor should consider the implications for the auditor's report. The auditor might have to issue a Qualified opinion on account of limitation of scope.

Q.14 **What should be communicated to Those Charged with Governance (TCWG) and when?**

Ans.14 Unless all those charged with governance are involved in managing the entity, the auditor needs to communicate with those charged with governance events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern. Such communication with those charged with governance includes the following:

- Whether the events or conditions constitute a material uncertainty.
- Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements.
- The adequacy of related disclosures in the financial statements.

Generally, a meeting of the audit committee is not held in the interim except when it meets to approve the quarterly results and/

or annual financial statement. At that meeting auditors' report (with the going concern matter) should be placed before Those Charged With Governance. However, if considered, appropriate, the auditor may communicate with Those Charged With Governance before such a meeting of the Audit Committee.

Q.15 **What should the auditor do if there is Significant Delay in the Approval of Financial Statements?**

Ans.15 In such cases, the auditor should inquire as to the reasons for the delay. If delay relates to events or conditions relating to the going concern assessment, the auditor should perform additional audit procedures as necessary as well as consider the effect on the auditor's conclusion regarding the existence of a material uncertainty, as listed in paragraphs 16 and 17 of SA 570.

Q.16 **Does disclosure in terms of revised Schedule VI has any impact on going concern implication in Financial Statements?**

Ans.16 The manner of auditor's evaluation of a company's going concern assumption would not be effected due to changes in the disclosure in the financial statements on account of the Revised Scheduled VI. However, disclosure in terms of revised Schedule VI makes it easy for the reader of the financial statements to understand the rationale for their preparation on going concern basis. Some examples for such disclosure requirements are enumerated hereunder:-

(1) The revised Schedule VI requires specific disclosures for default in repayment of loans and interest. The revised Schedule VI does not require separate disclosure for other defaults, e.g., default in compliance with debt covenants. However, a company should consider the impact of such default on current and non-current classification and going concern implications;

(2) The revised Schedule VI introduces a number of other additional disclosures. Key examples are:

a. Rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital,

b. Terms of repayment of loans and period,

c. In each class of investment, details regarding names of the bodies corporate, indicating separately whether such bodies are (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities, in whom investments have been made and the nature and extent of the investment made in each such body corporate (showing separately partly-paid investments).

d. Aggregate provision for diminution in value of investments (separately for current and long-term investments)

Chapter 3
Template for Checklists for Testing Going Concern Assumption

An entity's continuance as a going concern for the foreseeable future is assumed in the preparation of financial statements in the absence of significant information to the contrary. Accordingly, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business. If this assumption is unjustified, the amounts and classification of assets and liabilities in the financial statements may need to be adjusted. A detailed analysis for testing of related indicators regarding uncertainty of going concern consideration is briefly enumerated in the below checklist:

Going-Concern Consideration Program

	Particulars	Going concern indicator present (Yes/No/Not Applicable and References, if any)
A:	Going Concern Considerations	
1.	Consider whether there is a risk that the entity will not continue as a going concern for the foreseeable future: **Consider Financial Indications** • Recurring operating losses • Working capital deficiencies	

- Continuing negative cash flows from business activities
- Excessive reliance on short-term borrowings to finance long-term assets
- Adverse key financial ratios
- Inability to pay creditors on due dates
- Default on loans or similar agreements
- Restrictions on usual trade terms
- Restructuring of debt
- Arrears or discontinuance of dividends
- Excessive or obsolete stock
- Need to seek new sources or methods of financing, or fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment
- Need to dispose of substantial assets.

Consider Operating Indications

- Loss of key management or staff
- Work stoppages or other labor difficulties
- Substantial dependence on the success of a particular project or on a particular asset
- Excessive reliance on the success of a new product
- Uneconomic long-term commitments
- Loss of a major market or principal supplier
- Loss of a key franchise, license, or patent.

Consider Other Indications

- Noncompliance with capital or other statutory requirements
- Pending legal proceedings or similar matters that might jeopardize an entity's ability to operate
- Changes in or establishment of new

legislation or government policy

- Technical developments that render a key product obsolete.

B: Consideration of Management's Assessment

1. Evaluate management's assessment of the entity's ability to continue as a going concern. (The auditor should consider the same period as that used by management in making its assessment under the applicable financial reporting framework. If management's assessment of the entity's ability to continue as a going concern covers less than twelve months from the balance sheet date, the auditor should request management to extend its assessment period to twelve months from the balance sheet date.)
2. Inquire of management as to its knowledge of events or conditions and related business risks beyond the period of assessment used by management that may cast significant doubt on the entity's ability to continue as a going concern.
3. Evaluate the information obtained above in conjunction with other information obtained throughout the audit that may impact auditor's assessment of the appropriateness of the going concern assumption.

C: Consideration of Management's Plans

1. If, after considering the identified conditions and events in the aggregate, the auditor believes that continuance as a going concern may be questionable, he/she should consider management's plans for dealing with the adverse effects of the identified conditions

and events, and assess the likelihood of effective implementation thereof.

2. Obtain information about management's plans and consider whether it is likely that the adverse effects will be mitigated for the foreseeable future. Evaluate the likelihood of effective implementation of such plans.

   Plans that the auditor would consider and discuss with management may include:

   - Plans to dispose of assets
   - Plans to borrow money or restructure debt
   - Plans to reduce or delay expenditures
   - Plans to increase revenues more than increases in related costs and expenses
   - Plans to increase ownership equity.

3. Consider the bases on which the plans have been prepared, giving consideration as to whether they conform with facts already known and to available independent evidence.

4. Carry out additional procedures to update information obtained earlier.

   Such procedures may include:

   - Analysis and discussion of cash flow, profit, and other relevant forecasts with management
   - Review of events after the balance-sheet date for items affecting the entity's ability to continue as a going concern
   - Analysis and discussion of the entity's latest available interim financial

statements

- Review of the terms of debentures and loan agreements and determination whether any have been breached
- Reading of minutes of the meetings of shareholders, board of directors, and other important committees for reference to financing difficulties
- Request for information on relevant material legal matters from the entity's legal counsel
- Confirmation of the existence, legality, and enforceability of arrangements to provide or maintain financial support with related and third parties, and assessment of the financial ability of such parties to provide additional funds
- Consideration of the entity's position concerning unfilled customer orders
- Obtaining written representation from management concerning plans for future action whose outcome is expected to mitigate the situation.

5. Obtain written confirmation of the corresponding representations by the management.

6. When prospective financial information is particularly significant to management's plans, consider, based on the auditor's knowledge of the entity, its business and management, the adequacy of support for significant assumptions underlying that information. Compare the prospective data for recent prior periods with historical results and the prospective data for the current

period with results achieved to date. Consider the reliability of the entity's system for generating such information and give particular attention to assumptions that are:

- Material to the prospective financial information
- Especially sensitive or susceptible to change
- Inconsistent with historical trends.

D Management Representation

1. When additional disclosures are made in the financial statements relating to the entity's ability to continue as a going-concern, obtain a specific management representation stating that the disclosures contain all of the pertinent facts.

2. Consider whether particular matters need to be represented by management related to the considerations of the entity's ability to continue as a going concern.

E Consideration of Effects on the Financial Statements

1. If, after considering management's plans, the auditor concludes that the going-concern question is not satisfactorily resolved, the auditor would consider the possible effects on the financial statements and ensure the adequacy of the related disclosure. The disclosure should:

   - Describe the principal conditions and events that raised doubt about the entity's ability to continue as a going concern for the foreseeable future.

- Describe the possible effects of such conditions and events and management's evaluation of the significance of those conditions.
- Describe any mitigating factors and the management's plans (including relevant prospective financial information).
- State that there are doubts that the entity will be able to continue as a going concern and, therefore, may be unable to realize its assets and discharge its liabilities in the normal course of business.
- State that the financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or to amounts and classification of liabilities that may be necessary should the entity be unable to continue as a going concern.

2. If the auditor concludes that the going-concern assumption is appropriate because of mitigating factors (in particular management's plans for future action), evaluate the need for disclosure of the principal conditions and events that initially caused the substantial doubt. Disclosure considerations include the possible effects of such conditions and events and any mitigating factors, including management's plans.

F: Consultation

1. If the auditor concludes that an entity's continuance as a going concern for the foreseeable future is questionable, consider consultation within the firm to consider

management's plans or representations and financial statement effects.

G: Accounting Policies and Disclosures

1. Consider whether the presentation of the financial statements conforms with professional standards and the applicable legal or regulatory requirements. Consider whether:

   - Material transactions or items may require separate disclosure.
   - Accounting policies used in the financial statements are appropriate and are consistent with prior periods.
   - Balances and associated footnote disclosures are presented in accordance with the accounting policies.

H: Conclusion:

- Based on the tests performed and responses as noted above, a conclusion may be drawn that going concern assumption is appropriate.
- Also give reference to the type of audit report that may be issued based on the conclusion drawn under this section (Refer Annexure – I for audit report format).

Chapter 4
Practical Case Studies and Illustrative Examples

Section A – Case Studies

<u>Case Study 1: Going Concern Audit Report</u>

You are the 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 assumption 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.

Identify and discuss the implications for the audit report if:

(i) the directors refuse to give the disclosure note.

(ii) the directors agree to give the disclosure note.

Suggested Response

i) The Directors refuse to give the disclosure note:

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 assumption. 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.

ii) The Directors agree to give the disclosure note:

If the directors agree to give the disclosure note, it should be reviewed by the auditors to ensure that it is sufficiently detailed. In evaluating the adequacy of the disclosure in the note, 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. The auditors should, however, consider adding an emphasis of matter paragraph to highlight the existence of the material uncertainties, and to draw attention to the note to the financial statements. The emphasis of matter paragraph should firstly contain a brief description of the uncertainties, and also refer explicitly to the note to the financial statements where the situation has been fully described. The emphasis of matter paragraph should 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 2: Going Concern Audit Report

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.

Required:

Should XYZ Inc. prepare its financial statements under the going concern assumption?

Suggested Solution

In this case, the two factors that raise doubts about the entity's ability to continue as a going concern are:

- The net loss for the year amounting to Rs.120 million.
- The working capital deficiency (current liability of Rs.1,500 million Less: current assets of Rs.1,200 million) of Rs.300 million existing at the balance sheet date.

However, there are two mitigating factors:

- The arrangements made by the shareholders to fund the entity's expansion and working capital needs; and
- Projected future profitability due to expected favourable changes in government policies for the industry the entity is operating in.

Based on these sets of factors, it may be possible for the management of the entity to argue that the going concern assumption is appropriate and that any other basis of presentation of financial statements would be unreasonable at the moment. However, if matters deteriorate further instead of improving, then in the future another detailed assessment would be needed to ascertain whether the going concern assumption 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 give Emphasis of Matter Paragraph or, Qualified or Adverse Opinion, as the case may be.

Section B – Other Illustrative Examples

Illustrative Examples of the Auditor's Assessment of Whether Evidence Provided by Those Charged With Governance, Concerning the Attention They Have Paid to the Period One Year From the Date of the Financial Statements, is Sufficient.

The examples given below are illustrative only. The purpose of the examples is to illustrate the application of the SA 570 to assist in clarifying their meaning in a number of commercial situations. These examples focus on particular aspects of the situations illustrated and are not intended to be a comprehensive discussion of all the relevant factors that might influence either the management's or auditor's assessment of the appropriateness of the going concern basis. As the auditor would need to exercise judgment in the circumstances described, it is possible that different auditors may arrive at different conclusions. These examples neither modify nor override the related Standards on Auditing.

Example 1 - A small company producing specialized computer application software

Corollary from the auditor's risk assessment (Read with paragraph 10-11 of SA 570)

This owner managed company employs a few highly trained and highly paid computer system designers to design application software for use by transportation enterprises, such as airlines and bus companies, in preparing their timetables and fare structures. Few companies are engaged in this field and the supply of suitably trained staff is limited. The system designers, who met at University, have been with the company since its formation. They all have an equity interest in the company.

Although the company has only been in existence for five years it has established a reputation for excellence in its field. Its reputation derives from the skill and expertise of its individual employees rather than from anything attaching to the company itself.

A significant amount of time is spent by the designers in pure research activities for developing new products. In addition, the time needed to develop individual systems relating to an established product can be considerable. In addition to designing new systems, the company maintains those systems that it has installed, on a contractual basis and undertakes training courses in the use of the systems for the employees of its customers.

The company is thinly capitalized and relies primarily on advances from its customers supplemented by short term bank borrowings for its day to day cash requirements.

The company employs a part time book-keeper to prepare the financial statements, cash flow forecasts and maintain the books of account.

The company has usually been in a position to choose which contracts it accepts and has not had difficulty in recovering its costs. The company is not economically dependent on any one transportation enterprise.

The company updates each month a rolling cash flow projection with a six month time horizon. The company does not prepare projections for a longer period as it perceives its management need is to be able to manage effectively its short term cash flow. The company has negotiated a line of credit with its bankers which it would be able to utilize to overcome short term cash shortages.

Assessment by the auditor When the auditor assesses whether the directors have, in assessing going concern, paid particular attention to a period of one year from the date of the financial statements, the auditor:

(a) Reviews the cash flow forecasts for the six month period from the date of the financial statements; and

(b) Enquires the directors about the steps they have taken to assess the appropriateness of the going concern basis for the subsequent six month period.

The directors inform the auditor that they do not consider there is any need for cash flow forecasts to be prepared beyond six months because:

- The cash flow forecasts show a net cash inflow for the period;
- They have reviewed in detail the assumptions implicit in the forecast with the bookkeeper and concur with them;
- The company has a significant back-log of orders which will occupy half of the designers for at least the next year;
- The company is actively tendering for both systems design and maintenance contracts in the United Kingdom and Europe and is considering expanding into the Americas;
- The company has recently renewed its arrangements with its bankers for a further year;
- The design employees seem to be settled and stimulated and there is no reason to believe that they will leave the company in the foreseeable future; and
- In the unlikely event that the company did not win many of the tenders it could modify its existing expansion plans which have been necessitated by an increase in maintenance contracts. Rather than employ new staff to undertake this work existing staff could be reassigned to it.

The auditor concludes that the directors have paid particular attention to the period ending one year after their approval of the financial statements.

Example 2 - An enterprise in the fashion (or seasonal) industry

Corollary from the auditor's risk assessment (Read with paragraph 10-11 of SA 570)

This company employing 1,000 people designs and manufactures ladies fashion wear. Its business is seasonal and it presents two major collections per year: one in the spring and one in the autumn.

The company has attracted established designers and they are regarded as one of the leading manufacturers.

Almost all of the company's sales orders are received from the major retailers when they show their collections. Although some of the garments are manufactured prior to the showing of the collection, a majority of them will be manufactured in the four months immediately following the showing.

The company's finance director is a qualified accountant with a staff of six persons. Because of the seasonal nature of the business, the company prepares its detailed budgets and cash flow forecasts until the end of the next season. The company's year-end is 30th June and the directors expect to approve the financial statements during October. Detailed cash flow forecasts are only available upto the end of February in the following year, i.e., a period of only four months from the approval of the financial statements.

The company which has been marginally profitable over the last few years has a small line of credit with its bank but is financed primarily through the factoring of its debtors.

Assessment by the auditor

When the auditor assesses whether the directors have, in assessing going concern, paid particular attention to a period of one year from the date of the financial statements the auditor would:

(a) Review the cash flow forecasts for the four month period from the date of the financial statements; and

(b) Then enquire of the directors the steps they have taken to assess the appropriateness of the going concern basis for the subsequent eight month period.

The directors inform the auditor that they do not consider there is any need for additional cash flow forecasts to be prepared beyond the end of February in the following year because:

- The cash flow forecasts show a net cash inflow for the period and the present cash position is strong because of a recent sale of debtors from the present collection;
- The directors have reviewed in detail the assumptions implicit in the forecast and concur with them;
- The designers are working on the next collection and they believe, based on discussions with some of the retailers, that they have some good general ideas which will appeal to their customers if translated into imaginative detailed designs;
- Discussions with the major retailers indicate that they expect demand to be high next season;
- The company's relationship with its factor is good and they do not expect any difficulties in selling their debtors in the future;
- The company anticipates no major capital expenditures in the next twelve months. Most of the machinery is less than five years old and in any event is financed by lease arrangements rather than by purchase; and
- The company has recently renewed its arrangements with its bankers for a further year.

The auditor concludes that the directors have paid particular attention to the period ending one year after their approval of the financial statements.

The auditor concludes that the directors have not paid particular attention to the period ending one year after the approval of the financial statements

The two examples above illustrate that the auditor may conclude that the directors have paid particular attention to the period ending one year after the approval of the financial statements, even though they have not prepared cash flow forecasts for that period.

The auditor may conclude differently in other situations that the directors have not paid particular attention to the period ending one year after the approval of the financial statements. If this is the case, the auditor needs to consider the impact on the auditor's report which may be either:

(a) The auditor may conclude that there is a significant level of concern about the entity's ability to continue as a going concern (but the auditor does not disagree with the use of the going concern basis). In which case the directors include a note to the financial statements and the auditor includes an emphasis of matter paragraph when setting out the basis of their opinion (in accordance with paragraph 21 of the SA 570); or,

(b) The auditor may conclude that the directors have not paid particular attention to the period ending one year from the date of approval of the financial statements but there is no significant level of concern. Then if the directors:

    (i) Refer to the period paid particular attention to, in the annual report, the auditor need not refer to the period in the basis of opinion; however

    (ii) If the directors do not refer to the period paid particular attention to, the auditor would do so in the auditors' report in accordance with paragraph 22 and A 27, of SA 570 ; or

(c) The auditor may conclude that the directors have not taken adequate steps to satisfy themselves that it is appropriate to adopt the going concern basis. Accordingly, there is a limitation of scope which gives rise to a qualified or adverse opinion in the auditor's report in accordance with paragraph A 21 to A 24, of SA 570.

Example 3 - A big company in manufacturing industry, at start up stage with certain facilities in project stage

Corollary from the auditor's risk assessment (Read with paragraph 10-11 of SA 570)

This company is a subsidiary of a multinational group and has two manufacturing plants, located at different places. The company employing around 3,000 people in both the units directly on its payroll and further deployed around 10,000 people through various contractors. The employment of the people considered to be in equal proportion among the two units. One unit (Unit A) of the company manufactures product which is a raw material for the other unit (Unit B).

The company has made huge investments for establishing facilities at both the units running in thousands of million dollars. For Unit A, the company is facing lot of hurdles and construction of facilities at the unit had to stop due to various related statutory and environmental clearances from certain authorities. However, the construction work at Unit B is completed and it is in running condition post trial run based on purchased raw material from other sources from domestic and international market, since there are uncertainty for the start of construction work at Unit A in next six month and further expects to get the production from Unit A within twelve month from the date of start of construction work. The company is hopeful that within the next six months, all the pending statutory and environmental clearance would be obtained for smooth operation. Until then and till the commencement of production at Unit A, the management expects that Unit B would continue its operation in this manner based on procured raw materials though it is costlier than the in-house production of raw materials.

Assessment by the auditor

When the auditor evaluates whether the management have, in assessing going concern, paid particular attention to a period of one year from the date of the financial statements the auditor:

(a) Reviewed the cash flow forecasts for the twelve month period from the period end date for the financial statements; and

(b) Then enquired the management the steps it has taken to assess the appropriateness of the going concern basis for the subsequent periods.

The management informed the auditor that they do not consider there is any need for additional cash flow forecasts to be prepared beyond the end of twelve month period from the period end date for the financial statement for current year because of:

- The cash flow forecasts that show a net cash inflow for the period and the present cash position is strong because of a recent sale of debtors.
- Sanction of large long term loans from the lead banker with repayment terms starting in next 3-4 years.
- Infusion of long term loans from certain group company with repayment terms starting in next 3-4 years.
- Conversion of payment for creditors into long term buyer's credit facilities from the banks with option to rollover for maximum period available as per banking rules (e.g., three years from the date of shipment).
- Sanction of bill discounting limit with the bankers for the sale contracts.
- Various long term sale contracts in place.

Based on the above facts, there may not be a *prima facie* going concern issue. However, there may still be significant uncertainties in execution of the management's plan. In such scenarios, the auditor may conclude that the management has taken adequate steps to satisfy itself that it is appropriate to adopt the going concern basis and may feel it appropriate to include a detailed note in the notes to accounts as part of the financial statements. Further, the auditor should give 'Emphasis of Matter Paragraph in the auditors' report'. Refer Part A in Annexure – I for a format of such Emphasis of Matter Paragraph in the auditors' report.

Example 4 –A company in sugar industry

There are several aspects which differentiate Sugar Industry from any other normal manufacturing industry. Some of the peculiar aspects are as follows:

- Cyclicality in the business
- Government control on sugarcane procurement and several stringent regulations on pricing of sugar and sugarcane
- Manufacturing process
- Sales pattern (mostly unorganised despite huge consumption)

Corollary from the auditor's risk assessment (Read with paragraph 10-11 of SA 570)

The most peculiar aspect of sugar industry is its being seasonal in nature and cyclical variations. The sugar industry goes through a period of loss (when excess sugarcane is produced) and profit (when there is shortage of sugarcane). Such cycle can be understood with the following table.

<u>Sugar Industry – profit and loss making cycle</u>

Increased sugarcane produce Increase in sugar recovery Higher sugar production Increased availability of the sugar in retail markets Decline in sugar price Reduced profitability Delayed payment to farmers High sugarcane arrears Low area under cultivation		Period of losses
Low sugarcane produce Decline in sugar recovery Low sugar production Increase in retail sugar prices Improved profitability Prompt payment to growers Increased cash availability with growers Increase in area under cultivation		Period of profits

The cycle time normally ranges from 4 to 5 years. To reduce the effect of this cycle, now-a-days most of the new units are set-up with a cogeneration of power and distillery unit, so that they can be profitable even when the sugar unit is making loss.

Thus considering these peculiar aspects, it is important that any auditor conducting audit of a sugar industry should clearly understand the details of these processes so as to be able to conduct effective audit and to obtain sufficient appropriate audit evidence regarding compliance with the provisions of applicable laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements. Also to perform specified audit procedures to help identify instances of non-compliance with other laws and regulations that may have a significant impact on the functioning of the entity and conclusion drawn on their judgment for using the going concern assumption in the auditors' report. Refer Annexure – I in this guide for the format of various types of audit reports that may be used based on facts as applicable to the specific situation.

<u>**Annexure - I**</u>

An illustrative template for the format of auditors' report under different scenarios as illustrated in this Guide (e.g., in Q. No. 10 and Q. No. 11 in Chapter II):

Part A: An example of such wording for paragraph that may be included on 'Emphasis of Matter in the auditors' report' is given below:

"Without qualifying our opinion, we draw attention to Note X in the financial statements which indicates that the Company incurred a net loss of Rs. ZZZ during the year ended March 31, 20X2 and, as of that date, the Company's current liabilities exceeded its total assets by Rs. YYY. These conditions, along with other matters as set forth in Note X, indicate the existence of a material uncertainty which may cast significant doubt about the Company's ability to continue as a going concern."

Part B: An example of such wording for paragraph that may be included in a qualified or adverse opinion, as appropriate in the auditors' report:

(i) Qualified opinion

An example of such wording for paragraph that may be included on qualified opinion in the auditors' report for 'Disagreement on Required Disclosures relating to Going Concern is given below:

"Basis for Opinion

The Company's financing arrangements expire and amounts outstanding to the tune of Rs. …………are payable on March 31, 20X2. The Company has been unable to re-negotiate or obtain replacement financing. This situation indicates the existence of a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern, and therefore it may be unable to realize its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact.

Opinion

In our opinion, except for the omission of the information included in the preceding paragraph, the financial statements give the information required by the Companies Act, 1956, in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:

(a) in the case of the Balance Sheet, of the state of affairs of the company as at March 31, 20X2;

(b) in the case of the Profit and Loss Account, of the profit/ loss for the year ended on that date; and

(c) in the case of the cash flow statement, of the cash flows for the year ended on that date."

Adverse opinion

An example of such wording for paragraph that may be included on adverse opinion in the auditors' report for 'Disagreement on Required Disclosures relating to Going Concern' is given below:

"Basis for Opinion

The Company's financing arrangements expired and the amount outstanding to the tune of Rs. ……….was payable on March 31, 20X2. The Company has been unable to re-negotiate or obtain replacement financing and is considering filing for bankruptcy. These events indicate a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern, and therefore it may be unable to realize its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact.

Opinion

In our opinion, because of the omission of the information mentioned in the preceding paragraph, the financial statements do not give the information required by the Companies Act, 1956, in the manner so required and also do not give a true and fair view in conformity with the accounting principles generally accepted in India:

(a) in the case of the Balance Sheet, of the state of affairs of the company as at March 31, 20X2; and

(b) in the case of the Profit and Loss Account, of the profit/loss for the year ended on that date; and

(c) in the case of the cash flow statement, of the cash flows for the year ended on that date."

Annexure - II

Illustrative Format of Support Letter is given below:

On the Letter-head of the Parent Company (XYZ Limited)

Date: March 31, 20XX

M/s ABC Limited

Address: XXXX, India

Dear Sirs,

Sub: Letter of Support for financial assistance to M/s ABC Limited for ongoing projects and operations

We, XYZ Limited ('the Parent Company') confirms that we will provide financial support to M/s ABC Limited ('the Company') in order to meet the shortfall in its fund requirements over banks and other borrowings to meet out the projects which are in progress and other liabilities including loans from other group companies (if any), for a period of not less than 12 months from the date of financial closure of accounts of the Company for the year ended March 31, 20XX.

This letter is being issued at the request of M/s ABC Limited in respect of support for closure of their audit for the year ended March 31, 20XX.

Thanking you,

Yours truly,

Authorized Signatory