

**EXPOSURE DRAFT**

**ED 23/05**  
(October 2005)

# **Proposed Auditing Standard: Going Concern (Re-issuance of AUS 708)**

Prepared and Issued by the **Auditing and Assurance Standards Board**



**Australian Government**

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**Auditing and Assurance Standards Board**

### **Commenting on this Exposure Draft**

Comments on this Exposure Draft should be forwarded so as to arrive by 15 December 2005. Comments should be addressed to:

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A copy of all non-confidential submissions will be placed on public record on the AUASB website: [www.auasb.gov.au](http://www.auasb.gov.au).

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## PREFACE

### **Reasons for Issuing ED 23/05**

The Auditing and Assurance Standards Board (AUASB) is proposing to re-issue Auditing Standard (AUS 708) *Going Concern* due to the requirements of the legislative provisions explained below.

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (the CLERP 9 Act) established the AUASB as an independent statutory body under section 227A of the *Australian Securities and Investments Commission Act 2001*, as from 1 July 2004. Under section 336 of the *Corporations Act 2001*, the AUASB may make Auditing Standards for the purposes of the corporations legislation. These Auditing Standards will be legislative instruments under the *Legislative Instruments Act 2003*.

### **Main Proposals**

This proposed Auditing Standard:

- (a) establishes mandatory requirements and provides explanatory guidance to auditors in fulfilling their responsibilities regarding the appropriateness of management using the going concern basis in the preparation of a financial report;
- (b) requires the auditor, as part of planning, to consider the risk of events occurring or conditions existing that may cast doubt on the entity to continue as a going concern;
- (c) establishes mandatory requirements and provides explanatory guidance to the auditor to evaluate management's assessment of the entity's ability to continue as a going concern;
- (d) requires the auditor to conduct further audit procedures upon identification of events or conditions that may cast doubt on the entity's ability to continue as a going concern;
- (e) establishes mandatory requirements and provides explanatory guidance to auditors on material uncertainty and audit reporting considerations in relation to going concern;
- (f) requires the auditor to communicate with those charged with governance or management the impact of going concern considerations in the auditor's report; and

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- (g) provides illustrations of auditor's reports modified regarding the going concern basis.

### **Proposed Operative Date**

It is intended that this proposed Auditing Standard will be operative for financial reporting periods commencing on or after 1 July 2006.

### **Main changes from existing AUS 708 (July 2002)**

The main differences between this proposed Auditing Standard and the Auditing Standard issued by the former Auditing & Assurance Standards Board of Australian Accounting Research Foundation that it supersedes, (AUS 708) *Going Concern* (July 2002), is that in this proposed Auditing Standard:

1. the word 'shall', in the **bold-type** paragraphs, is the terminology used to describe an auditor's mandatory requirements, whereas an auditor's degree of responsibility was previously described by the word 'should';
2. the explanatory paragraphs provide guidance and illustrative examples to assist the auditor in fulfilling the mandatory requirements, whereas previously some obligations were implied within certain explanatory paragraphs. Accordingly, such paragraphs have been redrafted to clarify that the matter forms part of the explanatory guidance.
3. the terminology and overall concepts have been aligned to the Audit Risk Standards. The issue and re-issue of the Audit Risk Standards in February 2004, comprising:
  - AUS 402 "Understanding the Entity and Its Environment and Assessing the Risks of Misstatement";
  - AUS 406 "The Auditor's Procedures in Response to Assessed Risks"; and
  - AUS 502 "Audit Evidence"gave rise to necessary conforming amendments to certain existing AUSs, including AUS 708.
4. the following additional specific mandatory requirements are included:

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- (a) if management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor shall consider the need to modify the auditor's report as a result of the limitation on the scope of the auditor's work (paragraph 47); and
- (b) the auditor shall communicate with those charged with governance or management, as soon as practical, the impact on the auditor's report where:
  - (i) there is a material uncertainty as described at paragraph's 39, 40 and 42;
  - (ii) the going concern assumption is inappropriate as described at paragraph 44;
  - (iii) management is unwilling to make or extend its assessment as required by paragraph 47 (paragraph 51).

A Table of Proposed Changes, excluding conforming amendments mentioned at point 3 above, is provided as an attachment to the Exposure Draft.

## **Request for Comments**

Comments are invited on this Exposure Draft of the proposed re-issuance of Auditing Standard (AUS 708) *Going Concern* by 15 December 2005. The AUASB would prefer that respondents express a clear overall opinion on whether the proposed Auditing Standard, as a whole, is supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on any matter. The AUASB regards both critical and supportive comments as essential to a balanced review of the proposed Auditing Standard.

### **AUTHORITY STATEMENT**

The Auditing and Assurance Standards Board (AUASB) makes Auditing Standard << >> *Going Concern* as set out in paragraphs 1 to 54 and Appendices 1 to 3, pursuant to section 227B of the *Australian Securities and Investment Commission Act 2001* and section 336 of the *Corporations Act 2001*.

This Auditing Standard is to be read in conjunction with the *Preamble to AUASB Standards*, which sets out the intentions of the AUASB on how the Auditing Standards are to be understood, interpreted and applied.

The mandatory requirements of this Auditing Standard are set out in **bold-type** paragraphs.

# AUDITING STANDARD

## *Going Concern*

### Application

- 1 **This Auditing Standard applies to:**
  - (a) **an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with Part 2M.3 of the *Corporations Act 2001*; and**
  - (b) **an audit of a financial report for any other purpose.**
- 2 This Auditing Standard also applies, as appropriate, to an audit of other financial information.

### Operative Date

- 3 **This Auditing Standard is operative for financial reporting periods commencing on or after 1 July 2006.**

### Introduction

- 4 The purpose of this Auditing Standard is to establish mandatory requirements and provide explanatory guidance on the auditor's responsibility in the audit of a financial report with respect to the going concern assumption used in the preparation of the financial report, including considering management's assessment of the entity's ability to continue as a going concern.
- 5 **When planning and performing audit procedures and in evaluating the results thereof, the auditor shall consider the appropriateness of management's use of the going concern assumption in the preparation of the financial report.**

### Definitions

- 6 "Going concern basis" means the accounting basis whereby in the preparation of the financial report the reporting entity is viewed as a going concern: that is, the entity is expected to:
  - (a) be able to pay its debts as and when they fall due; and

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- (b) continue in operation without any intention or necessity to liquidate or otherwise wind up its operations.
- 7 “Relevant period” means the period of approximately 12 months from the date of the auditor’s current report to the expected date of the auditor’s report for:
- (a) the next annual reporting period in the case of an annual financial report; or
  - (b) the corresponding reporting period for the following year in the case of an interim reporting period.

**Management’s Responsibility**

- 8 The going concern assumption is a fundamental principle in the preparation of the financial report. Under the going concern assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations. 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.
- 9 Some financial reporting frameworks contain an explicit requirement<sup>1</sup> for management to make a specific assessment of the entity’s ability to continue as a going concern, and standards regarding matters to be considered and disclosures to be made in connection with going concern. For example, Accounting Standard AASB 101, “Presentation of Financial Statements”, requires management to make an assessment of an enterprise’s ability to continue as a going concern. In addition, certain legislation, for

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<sup>1</sup> The detailed requirements regarding management’s responsibility to assess the entity’s ability to continue as a going concern and related financial statement disclosures may be set out in accounting standards, legislation or regulation.

2 Accounting Standard (AASB) 101, “Presentation of Financial Statements,” states: “When preparing financial statements, management shall make an assessment of an entity’s ability to continue as a going concern. Financial statements shall be prepared 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. 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, those uncertainties shall be disclosed. When financial statements are not prepared on a going concern basis, that fact shall be disclosed, together with the basis on which the financial statements are prepared and the reasons why the entity is not regarded as a going concern. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which

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example the *Corporations Act 2001*, requires a formal statement as to the solvency of the entity to be made by members of the governing body and included as part of the financial report upon which the auditor's opinion is expressed.

- 10 In other financial reporting frameworks, there may be no explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern. Nevertheless, since the going concern assumption is a fundamental principle in the preparation of the financial report, management has a responsibility to assess the entity's ability to continue as a going concern even if the financial reporting framework does not include an explicit responsibility to do so.
- 11 When there is a history of profitable operations and a ready access to financial resources, management may make its assessment without detailed analysis.
- 12 Management's assessment of the going concern assumption involves making a judgement, at a particular point in time, about the future outcome of events or conditions which are inherently uncertain. The following factors are relevant:
- In general terms, the degree of uncertainty associated with the outcome of an event or condition increases significantly the further into the future a judgment is being made about the outcome of an event or condition. For that reason, most financial reporting frameworks that require an explicit management assessment specify the period for which management is required to take into account all available information.
  - Any judgment about the future is based on information available at the time at which the judgment is made. Subsequent events can contradict a judgment which was reasonable at the time it was made.
  - The size and complexity of the entity, the nature and condition of its business and the degree to which it is

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is at least, but is not limited to, twelve months from the balance sheet date. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, a conclusion that the going concern basis of accounting is appropriate may be reached without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate."

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affected by external factors all affect the judgment regarding the outcome of events or conditions.

- 13 Examples of events or conditions, which may give rise to business risks, that individually or collectively may cast significant doubt about the going concern assumption are set out below. This listing is not all-inclusive nor does the existence of one or more of the items always signify that a material uncertainty<sup>3</sup> exists.

*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 debtors and other creditors.
- Negative operating cash flows indicated by historical or prospective financial reports.
- 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.

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<sup>3</sup> The phrase “material uncertainty” is used in AASB 101 in discussing the uncertainties related to events or conditions which may cast significant doubt on the enterprise’s ability to continue as a going concern that should be disclosed in the financial statements. In other financial reporting frameworks, and elsewhere in the Auditing Standards, the phrase “significant uncertainties” is used in similar circumstances.

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*Operating*

- Loss of key management without replacement.
- Loss of a major market, franchise, license, or principal supplier.
- Labour difficulties or shortages of important supplies.
- Lack of strategic direction including appropriately documented policies, plans and forecasts such as forward budgets and cash flow projections.
- Deficiencies in the governing body e.g. lack of independent members, low level of involvement in key decisions, poor documentation and communication of decisions, imbalance or lack of expertise amongst members.
- Concentration of risk in a limited number of products or projects.
- Prolonged industrial relations difficulties.
- Deficiencies in management information systems, including blockages in information flows, or lack of management action in response to information received.
- Rapid or unplanned development of business (particularly in non-core activities) without commensurate developments in information systems, management expertise, financing structures, pricing policies, etc.
- Uninsured or underinsured disasters such as drought, flood, fire, fraud or sabotage.

*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 are unlikely to be satisfied.
- Changes in legislation or government policy expected to adversely affect the entity.

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- Undue influence of a market dominant competitor.
- Technical developments which render a key product obsolete.
- Failure of other entities in the same industry.
- Lack of adequate back-up and recovery capabilities for key financial or other information systems.

The significance of such events or conditions often can be mitigated by other factors. For example, the effect of an entity being unable to make its normal debt repayments may be counter-balanced by management's plans to maintain adequate cash flows by alternative means, such as by disposal of assets, rescheduling of loan repayments, or obtaining additional capital. Similarly, the loss of a principal supplier may be mitigated by the availability of a suitable alternative source of supply. Appendix 2 contains additional examples of mitigating factors.

**Auditor's Responsibility**

- 14 Pursuant to paragraph 5 of this Auditing Standard:
- (a) the auditor's responsibility is to consider the appropriateness of management's use of the going concern assumption in the preparation of the financial report,
  - (b) the auditor is required to consider whether there are material uncertainties about the entity's ability to continue as a going concern that need to be disclosed in the financial report, and
  - (c) the auditor is required to consider the appropriateness of management's use of the going concern assumption even if the financial reporting framework used in the preparation of the financial report does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern.
- 15 The auditor cannot predict future events or conditions that may cause an entity to cease to continue as a going concern. Accordingly, the absence of any reference to going concern uncertainty in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

**Planning the Audit and Performing Risk Assessment Procedures**

- 16 In obtaining an understanding of the entity, the auditor shall consider whether there are events or conditions and related business risks which may cast significant doubt on the entity’s ability to continue as a going concern.**
- 17 The auditor shall remain alert for audit evidence of events or conditions and related business risks which may cast significant doubt on the entity’s ability to continue as a going concern in performing audit procedures throughout the audit. If such events or conditions are identified, the auditor shall, in addition to performing the procedures in paragraph 31, consider whether they affect the auditor’s assessment of the risks of material misstatement.**
- 18 Pursuant to paragraph 16 of this Auditing Standard, the auditor is required to consider events and conditions relating to the going concern assumption when performing risk assessment procedures, because this allows for more timely discussions with management, review of management’s plans and resolution of any identified going concern issues.
- 19 In some cases, management may have already made a preliminary assessment when the auditor is performing risk assessment procedures. If so, pursuant to AUS 402, “Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement”, the auditor is required to review that assessment to determine whether management has identified events or conditions, such as those discussed in paragraph 13, and management’s plans to address them.
- 20 If management has not yet made a preliminary assessment, pursuant to paragraph 5 of this Auditing Standard, the auditor is required to discuss with management the basis for their intended use of the going concern assumption, and inquire of management whether events or conditions, such as those discussed in paragraph 13, exist. The auditor may request management to begin making its assessment, particularly when the auditor has already identified events or conditions relating to the going concern assumption.
- 21 Pursuant to paragraph 17 of this Auditing Standard, the auditor is required to consider the effect of identified events or conditions when assessing the risks of material misstatement and, therefore,

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their existence may affect the nature, timing and extent of the auditor's further procedures in response to the assessed risks.

**Evaluating Management's Assessment**

- 22 **The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern.**
- 23 **The auditor shall consider the relevant period, which may be 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 of the relevant period, the auditor shall ask management to extend its assessment period to twelve months of the relevant period.**
- 24 Management's assessment of the entity's ability to continue as a going concern is a key part of the auditor's consideration of the going concern assumption. As noted in paragraph 12, most financial reporting frameworks requiring an explicit management assessment specify the period for which management is required to take into account all available information.
- 25 In evaluating management's assessment, the auditor ordinarily considers the process management followed to make its assessment, the assumptions on which the assessment is based and management's plans for future action. Pursuant to paragraph 5 of this Auditing Standard, the auditor is required to consider whether the assessment has taken into account all relevant information of which the auditor is aware as a result of the audit procedures.
- 26 As noted in paragraph 11, when there is a history of profitable operations and a ready access to financial resources, management may make its assessment without detailed analysis. In such circumstances, the auditor's conclusion about the appropriateness of this assessment normally is also made without the need for performing detailed procedures. When events or conditions have been identified which may cast significant doubt about the entity's ability to continue as a going concern, pursuant to paragraph 31 of this Auditing Standard, the auditor is required to perform additional audit procedures.

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<sup>4</sup> For example, AASB 101, defines this as a period that should be at least, but is not limited to, twelve months from the balance sheet date.

### **Period Beyond Management's Assessment**

- 27 **The auditor shall 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.**
- 28 Pursuant to paragraph 27 of this Auditing Standard, the auditor is required to be alert to the possibility that there may be known events, scheduled or otherwise, or conditions that will occur beyond the period of assessment used by management that may bring into question the appropriateness of management's use of the going concern assumption in preparing the financial report. The auditor may become aware of such known events or conditions during the planning and performance of the audit, including subsequent events procedures.
- 29 Since the degree of uncertainty associated with the outcome of an event or condition increases as the event or condition is further into the future, in considering such events or conditions, the indications of going concern issues will need to be significant before the auditor ordinarily considers taking further action. The auditor may need to ask management to determine the potential significance of the event or condition on their going concern assessment.
- 30 The auditor does not have a responsibility to design audit procedures other than inquiry of management to test for indications of events or conditions which cast significant doubt on the entity's ability to continue as a going concern beyond the period assessed by management which, as discussed in paragraph 23, would be at least twelve months from the balance sheet date.

### **Further Audit Procedures when Events or Conditions are Identified**

- 31 **When events or conditions have been identified which may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall:**
- (a) **review management's plans for future actions based on its going concern assessment;**
  - (b) **gather sufficient appropriate audit evidence to confirm or dispel whether or not a material uncertainty exists through carrying out audit procedures considered**

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**necessary, including considering the effect of any plans of management and other mitigating factors; and**

**(c) endeavour to obtain written representations from management regarding its plans for future action.**

32 Events or conditions which may cast significant doubt on the entity's ability to continue as a going concern may be identified in performing risk assessment procedures or in the course of performing further audit procedures. The process of considering events or conditions continues as the audit progresses. When the auditor believes such events or conditions may cast significant doubt on the entity's ability to continue as a going concern, pursuant to paragraph 31 of this Auditing Standard, the auditor is required to:

- Inquire of management as to its plans for future action, including its plans to liquidate assets, borrow money or restructure debt, reduce or delay expenditures, or increase capital.
- Consider whether any additional facts or information are available since the date on which management made its assessment.
- Obtain sufficient appropriate audit evidence that management's plans are feasible and that the outcome of these plans will improve the situation.

33 Audit procedures that are relevant in this regard 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 report.
- Reviewing 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 lawyer regarding the existence of litigation and claims and the reasonableness of

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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.
- Considering the entity's plans to deal with unfilled customer orders.
- Reviewing events after period end to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern.

34 When analysis of cash flow is a significant factor in considering the future outcome of events or conditions the auditor ordinarily considers:

- (a) the reliability of the entity's information system for generating such information; and
- (b) whether there is adequate support for the assumptions underlying the forecast.

In addition the auditor ordinarily compares the:

- (a) prospective financial information for recent prior periods with historical results; and
- (b) prospective financial information for the current period with results achieved to date.

**Audit Conclusions and Reporting**

*Going Concern Basis Considered Appropriate*

**35 When the auditor is satisfied that it is appropriate, based on all reasonably foreseeable circumstances facing the entity, for management to prepare the financial report on the going concern basis, the auditor shall issue an unmodified audit report**

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in accordance with AUS 702 “The Independent Auditor’s Report on a Complete General Purpose Financial Report”<sup>5</sup>.

- 36** When consideration of mitigating factors, in particular management’s plans, have had a significant effect upon the auditor in forming the opinion that the going concern basis is appropriate, the auditor shall specifically consider the adequacy of the disclosure of the following matters in the financial report:
- (a) the principal conditions which caused the auditor to question the going concern basis, including as appropriate, management’s evaluation of their significance and possible effects; and
  - (b) management’s plans and other mitigating factors, including as appropriate, relevant prospective financial information.

If the disclosures considered necessary by the auditor are not made, the auditor shall express a qualified opinion on the basis of the lack of disclosure in accordance with AUS 702, “Modifications to the Independent Auditor’s Report”.

*Material Uncertainty*

- 37** Based on the audit evidence obtained, the auditor shall determine if, in the auditor’s judgment, a material uncertainty exists related to events or conditions that alone or in aggregate, may cast significant doubt on the entity’s ability to continue as a going concern.
- 38 A material uncertainty exists when the magnitude of its potential impact is such that, in the auditor’s judgment, clear disclosure of the nature and implications of the uncertainty is necessary for the presentation of the financial report not to be misleading.

*Going Concern Assumption Appropriate but a Material Uncertainty Exists*

- 39** When this uncertainty is adequately disclosed in the financial report, the audit report shall include an emphasis of matter section in accordance with AUS 702. An emphasis of matter section regarding a going concern uncertainty shall:

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<sup>5</sup> The proposed Auditing Standard, AUS 702 is being reissued as two separate standards: Part A - “The Independent Auditor’s Report on a Complete General Purpose Financial Report” and Part B – “Modifications to the Independent Auditor’s Report”.

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- (a) **state clearly that there is significant uncertainty whether the entity will continue as a going concern and, therefore, whether it will realise its assets and extinguish its liabilities in the normal course of business and at the amounts stated in the financial report;**
  - (b) **adequately describe, or refer to a note to the financial report that adequately describes:**
    - (i) **the principal conditions that raise doubt about the entity's ability to continue as a going concern; and**
    - (ii) **the extent to which the financial report includes appropriate adjustments, if any, relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that might be necessary should the entity not continue as a going concern.**
- 40 If adequate disclosure is made in the financial report, the auditor shall express an unqualified opinion but modify the auditor's report by adding an emphasis of matter paragraph that highlights 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 and draws attention to the note in the financial report that discloses the matters set out in paragraph 39.**
- 41 In evaluating the adequacy of the financial report disclosure, pursuant to the paragraph 40 of this Auditing Standard, the auditor is required to consider whether the information explicitly draws the reader's attention to the possibility that the entity may be unable to continue realising its assets and discharging its liabilities in the normal course of business. An illustration of modified auditor's report with such a paragraph when the auditor is satisfied as to the adequacy of the note disclosure is included as example 1 at Appendix 3. In extreme cases, such as situations involving multiple material uncertainties that are significant to the financial report, the auditor may consider it appropriate to express a disclaimer of opinion instead of adding an emphasis of matter paragraph.
- 42 If adequate disclosure is not made in the financial report, the auditor shall express a qualified or adverse opinion, as appropriate. The report shall include specific reference to the**

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**fact that there is a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern.**

- 43 An illustration of a modified auditor's report with the relevant paragraphs when a qualified opinion is to be expressed is included as example 2 at Appendix 3. An illustration of a modified auditor's report with the relevant paragraphs when an adverse opinion is to be expressed is included as example 3 at Appendix 3.

*Going Concern Assumption Inappropriate*

- 44 **If, in the auditor's judgment, the entity will not be able to continue as a going concern, the auditor shall express an adverse opinion if the financial report had been prepared on a going concern basis.**
- 45 If, on the basis of the additional audit procedures carried out and the information obtained, including the effect of management's plans, the auditor's judgment is that the entity will not be able to continue as a going concern, the auditor concludes, regardless of whether or not disclosure has been made, that the going concern assumption used in the preparation of the financial report is inappropriate and expresses an adverse opinion.
- 46 When the entity's management has concluded that the going concern assumption used in the preparation of the financial report is not appropriate, the financial report needs to be prepared on an alternative authoritative basis. If on the basis of the additional audit procedures carried out and the information obtained the auditor determines the alternative basis is appropriate, pursuant to paragraph 44 of this Auditing Standard, the auditor is required to issue an unqualified opinion if there is adequate disclosure but may require an emphasis of matter in the auditor's report to draw the user's attention to that basis.

*Management Unwilling to Make or Extend Its Assessment*

- 47 **If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor shall consider the need to modify the auditor's report as a result of the limitation on the scope of the auditor's work.**
- 48 In certain circumstances, such as those described in paragraphs 20, 23 and 29, the auditor may believe that it is necessary to ask management to make or extend its assessment. If management is unwilling to do so, it is not the auditor's responsibility to rectify the lack of analysis by management, and a modified report may be

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appropriate because it may not be possible for the auditor to obtain sufficient appropriate evidence regarding the use of the going concern assumption in the preparation of the financial report.

- 49 In some circumstances, the lack of analysis by management may not preclude the auditor from being satisfied about the entity's ability to continue as a going concern. For example, the auditor's other procedures may be sufficient to assess the appropriateness of management's use of the going concern assumption in the preparation of the financial report because the entity has a history of profitable operations and a ready access to financial resources. In other circumstances, however, the auditor may not be able to confirm or dispel, in the absence of management's assessment, whether or not events or conditions exist which indicate there may be a significant doubt on the entity's ability to continue as a going concern, or the existence of plans management has put in place to address them or other mitigating factors. In these circumstances, pursuant to AUS 702, the auditor is required to modify the auditor's report.

### **Significant Delay in the Signature or Approval of the Financial Report**

- 50 When there is significant delay in the signature or approval of the financial report by management after the balance sheet date, the auditor considers the reasons for the delay. When the delay could be related to events or conditions relating to the going concern assessment, pursuant to paragraph 31 of this Auditing Standard the auditor is required to consider the need to perform additional audit procedures, as well as the effect on the auditor's conclusion regarding the existence of a material uncertainty, as described in paragraph 37.

### **Communicating with Those Charged With Governance and Management**

- 51 **The auditor shall communicate with those charged with governance or management, as soon as practical, the impact on the auditor's report where:**
- **There is a material uncertainty as described at paragraph's 39, 40 and 42.**
  - **The going concern assumption is inappropriate as described at paragraph 44.**

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- **Management is unwilling to make or extend its assessment as required by paragraph 47.**

52 See AUS 710, “The Auditor’s Communication With those Charged With Governance”.

**Other Considerations**

53 When at any stage of an audit conducted under the *Corporations Act 2001*, the auditor becomes satisfied that the entity is no longer a going concern, the auditor needs to be mindful of the requirements of section 311 of the *Corporations Act 2001*.

**Conformity with International Standards on Auditing**

54 Except as noted below, this Auditing Standard conforms with International Standard on Auditing ISA 570, “Going Concern”, issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants. The differences between this Auditing Standard and ISA 570 are:

- The following paragraph is provided as guidance in ISA 570, whereas in this Auditing Standard it has been expanded and is a specific mandatory requirement

When this uncertainty is adequately disclosed in the financial report, the audit report shall include an emphasis of matter section in accordance with AUS 702. An emphasis of matter section regarding a going concern uncertainty shall:

- ◆ state clearly that there is significant uncertainty whether the entity will continue as a going concern and, therefore, whether it will realise its assets and extinguish its liabilities in the normal course of business and at the amounts stated in the financial report;
- ◆ adequately describe, or refer to a note to the financial report that adequately describes:
  - the principal conditions that raise doubt about the entity’s ability to continue as a going concern; and

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- the extent to which the financial report includes appropriate adjustments, if any, relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that might be necessary should the entity not continue as a going concern (paragraph 39).
- The following specific requirement in this Auditing Standard is not included in ISA 570
  - ◆ When the auditor is satisfied that it is appropriate, based on all reasonably foreseeable circumstances facing the entity, for management to prepare the financial report on the going concern basis, the auditor shall issue an unmodified audit report in accordance with AUS 702 (paragraph 35).
  - ◆ When consideration of mitigating factors, in particular management's plans, have had a significant effect upon the auditor in forming the opinion that the going concern basis is appropriate, the auditor shall specifically consider the adequacy of the disclosure in the financial report of matters such as:
    - the principal conditions which initially caused the auditor to question the going concern basis, including as appropriate, management's evaluation of their significance and possible effects; and
    - management's plans and other mitigating factors, including as appropriate, relevant prospective financial information.

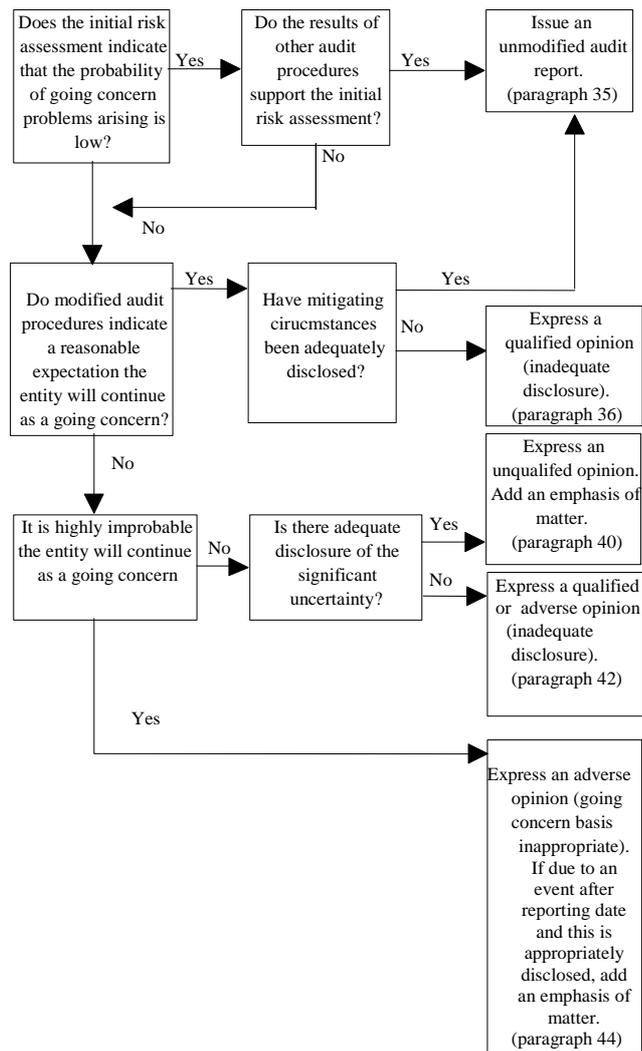
If the disclosures considered necessary by the auditor are not made, the auditor shall express a qualified opinion on the basis of the lack of disclosure in accordance with AUS 702 (paragraph 36).

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- ◆ The auditor shall communicate with those charged with governance or management, as soon as practical, the impact on the auditor's report where:
  - There is a material uncertainty as described at paragraph's 39, 40 and 42.
  - The going concern assumption is inappropriate as described at paragraph 44.
  - Management is unwilling to extend its assessment as required by paragraph 47 (paragraph 51).
- This Auditing Standard makes reference to requirements under the *Corporations Act 2001* (paragraph's 9 and 53). ISA 570 does not make reference to any specific legislation.
- This Auditing Standard includes appendices 1 and 2 which link going concern considerations with types of audit opinion and provides examples of mitigating factors. ISA 570 does not include these appendices.
- This Auditing Standard provides examples of Auditor's Reports Modified Regarding the Going Concern Basis at Appendix 3, whereas ISA 570 includes modification paragraphs (paragraph's 41 and 43).

Compliance with this Auditing Standard enables compliance with ISA 570.

**APPENDIX 1  
LINKING GOING CONCERN CONSIDERATIONS  
WITH TYPES OF AUDIT OPINIONS**



**APPENDIX 2  
EXAMPLES OF MITIGATING FACTORS**

The significance of those indications which are related to cash flow or solvency can often be mitigated by the existence of, and management plans with respect to, factors such as those listed below:

*Asset factors*

- (a) disposability of assets that are not operationally interdependent;
- (b) capability of delaying the replacement of assets consumed in operations or of leasing rather than purchasing certain assets; and
- (c) possibility of using assets for factoring, sale and leaseback, or similar arrangements.

*Debt factors*

- (a) availability of unused lines of credit or similar borrowing capacity;
- (b) capability of renewing or extending the due dates of existing loans; and
- (c) possibility of entering into debt restructuring agreements.

*Cost factors*

- (a) separability of operations producing negative cash flows;
- (b) capability of postponing expenditures for such matters as maintenance or research and development; and
- (c) possibility of reducing overhead and administrative expenditures.

*Equity factors*

- (a) variability of dividend requirements;
- (b) capability of obtaining additional contributions by owners; and
- (c) possibility of increasing cash distributions from subsidiaries or associates.

Similarly, the significance of those indications which are not directly related to cash flow or solvency may also be mitigated by other factors. For example, the impact of losing a principal supplier may be mitigated by the availability of a suitable alternative source of supply.

**APPENDIX 3  
EXAMPLES OF AUDITOR'S REPORTS MODIFIED  
REGARDING THE GOING CONCERN BASIS**

*EXAMPLE 1: MATERIAL UNCERTAINTY EXISTS AND IS ADEQUATELY  
DISCLOSED IN THE FINANCIAL REPORT*

**INDEPENDENT AUDITOR'S REPORT<sup>6</sup>**

To the members of [name of entity]

**Report on the Financial Report**

We have audited the accompanying financial report of [name of company/registered scheme/disclosing entity], which comprises the balance sheet as at 30 June 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes and the directors' declaration.

*Directors' Responsibility for the Financial Report*

The directors of the [company/registered scheme/disclosing entity] are responsible for the preparation and fair presentation of the financial report in accordance with Accounting Standards in Australia and the *Corporations Act 2001*. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

*Auditor's Responsibility*

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Auditing Standards in Australia. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of

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<sup>6</sup> See AUS 702 for the requirements for an auditor's report for audits conducted in accordance with the Auditing Standards and both the Auditing Standards and the *Corporations Act 2001*.

## **Proposed Auditing Standard: Going Concern (Re-issuance of AUS 708)**

material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Independence*

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*. We confirm that the independence declaration required by the *Corporations Act 2001*, provided to the directors of [name of company/registered scheme/disclosing entity] on [date], would be in the same terms if provided to the directors as at the date of this audit report<sup>7</sup>.

### *Audit Opinion*

In our opinion the financial report of [name of company/registered scheme/disclosing entity] is in accordance with the *Corporations Act 2001*, including:

- (a) giving a true and fair view of the [company/registered scheme/disclosing entity]'s financial position as at <<date>> and of its performance for the year ended on that date; and
- (b) complying with Accounting Standards in Australia and the *Corporations Regulations 2001*.

### *Material Uncertainty Regarding Continuation as a Going Concern*

Without qualifying our opinion, we draw attention to Note X in the financial report which indicates that the [company/registered scheme/disclosing entity] incurred a net loss of ZZZ during the year ended 30 June 20X1 and, as of that date, the [company/registered scheme/disclosing entity]'s current liabilities exceeded its total assets by ZZZ. These conditions, along with other matters as set forth in Note X, indicate the existence of a material uncertainty which

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may cast significant doubt about the [company/registered scheme/disclosing entity]'s ability to continue as a going concern.

**Report on Other Legal and Regulatory Requirements**

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

**Proposed Auditing Standard: Going Concern (Re-issuance of AUS 708)**

***EXAMPLE 2: MATERIAL UNCERTAINTY EXISTS BUT IS NOT ADEQUATELY  
DISCLOSED IN THE FINANCIAL REPORT – QUALIFIED OPINION***

**INDEPENDENT AUDITOR’S REPORT<sup>8</sup>**

To the members of [name of entity]

**Report on the Financial Report**

We have audited the accompanying financial report of [name of company/registered scheme/disclosing entity], which comprises the balance sheet as at 30 June 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes and the directors’ declaration.

*Directors’ Responsibility for the Financial Report*

The directors of the [company/registered scheme/disclosing entity] are responsible for the preparation and fair presentation of the financial report in accordance with Accounting Standards in Australia and the *Corporations Act 2001*. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

*Auditor’s Responsibility*

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Auditing Standards in Australia. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s

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<sup>8</sup> See AUS 702 for the requirements for an auditor’s report for audits conducted in accordance with the Auditing Standards and both the Auditing Standards and the *Corporations Act 2001*.

## **Proposed Auditing Standard: Going Concern (Re-issuance of AUS 708)**

internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Independence*

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*. We confirm that the independence declaration required by the *Corporations Act 2001*, provided to the directors of [name of company/registered scheme/disclosing entity] on [date], would be in the same terms if provided to the directors as at the date of this auditor's report.

### *Qualification*

The [company/registered scheme/disclosing entity]'s financing arrangements expire and amounts outstanding are payable on 9 March 20X2. The [company/registered scheme/disclosing entity] 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/registered scheme/disclosing entity]'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 report (and notes thereto) does not disclose this fact.

### *Qualified Audit Opinion*

In our opinion, except for the omission of the information included in the preceding paragraph, the financial report of [name of company/registered scheme/disclosing entity] is in accordance with the *Corporations Act 2001*, including:

- (a) giving a true and fair view of the [company/registered scheme/disclosing entity]'s financial position as at <<date>> and of its performance for the year ended on that date; and
- (b) complying with Accounting Standards in Australia and the *Corporations Regulations 2001*.

### **Report on Other Legal and Regulatory Requirements**

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

**Proposed Auditing Standard: *Going Concern (Re-issuance of AUS 708)***

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

**Proposed Auditing Standard: Going Concern (Re-issuance of AUS 708)**

*EXAMPLE 3: MATERIAL UNCERTAINTY EXISTS BUT IS NOT ADEQUATELY  
DISCLOSED IN THE FINANCIAL REPORT – ADVERSE OPINION*

**INDEPENDENT AUDITOR’S REPORT<sup>9</sup>**

To the members of [name of entity]

**Report on the Financial Report**

We have audited the accompanying financial report of [name of company/registered scheme/disclosing entity], which comprises the balance sheet as at 30 June 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes and the directors’ declaration<sup>1011</sup>.

*Directors’ Responsibility for the Financial Report*

The directors of the [company/registered scheme/disclosing entity] are responsible for the preparation and fair presentation of the financial report in accordance with Accounting Standards in Australia and the *Corporations Act 2001*. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

*Auditor’s Responsibility*

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Auditing Standards in Australia. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial report in order

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<sup>9</sup> See AUS 702 for the requirements for an auditor’s report for audits conducted in accordance with the Auditing Standards and both the Auditing Standards and the *Corporations Act 2001*.

## **Proposed Auditing Standard: Going Concern (Re-issuance of AUS 708)**

to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control<sup>12</sup>. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Independence*

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*. We confirm that the independence declaration required by the *Corporations Act 2001*, provided to the directors of [name of company/registered scheme/disclosing entity] on [date], would be in the same terms if provided to the directors as at the date of this auditor's report.

### *Qualification*

The [company/registered scheme/disclosing entity]'s financing arrangements expired and the amount outstanding was payable on 30 June 20X1. The [company/registered scheme/disclosing entity] has been unable to re-negotiate or obtain replacement financing and is considering filing for bankruptcy. These events indicate a material uncertainty which may cast significant doubt on the [company/registered scheme/disclosing entity]'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 report (and notes thereto) does not disclose this fact.

### *Qualified Audit Opinion*

In our opinion, because of the omission of the information mentioned in the preceding paragraph, the financial report of [name of company/registered scheme/disclosing entity] is not in accordance with the *Corporations Act 2001*, and does not:

- (a) give a true and fair view of the [company/registered scheme/disclosing entity]'s financial position as at <<date>> and of its performance for the year ended on that date; and
- (b) comply with Accounting Standards in Australia and the *Corporations Regulations 2001*.

**Proposed Auditing Standard: *Going Concern (Re-issuance of AUS 708)***

**Report on Other Legal and Regulatory Requirements**

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

<b>Table of Proposed Changes from AUS 708 <i>Going Concern</i></b>
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***Base Standard***

ISA 570, “Going Concern,” was used as the base standard when re-drafting this proposed Auditing Standard.

***Main differences between the Base Standard and the existing AUS 708***

The main differences between ISA 570 and the existing AUS 708 are:

1. the terminology and overall concepts have been aligned to the Audit Risk Standards. The issue and re-issue of the Audit Risk Standards in February 2004, comprising:
  - AUS 402 “Understanding the Entity and Its Environment and Assessing the Risks of Misstatement”;
  - AUS 406 “The Auditor’s Procedures in Response to Assessed Risks”; and
  - AUS 502 “Audit Evidence”
 gave rise to necessary conforming amendments to certain existing AUs, including AUS 708.
2. the following additional specific mandatory requirements are included:
  - (a) if management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor shall consider the need to modify the auditor’s report as a result of the limitation on the scope of the auditor’s work; and
  - (b) the auditor shall communicate with those charged with governance or management, as soon as practical, the impact on the auditor’s report where:
    - (i) there is a material uncertainty as described at paragraph’s 39, 42 and 42;
    - (ii) the going concern assumption is inappropriate as described at paragraph 44;
    - (iii) management is unwilling to make or extend its assessment as required by paragraph 47.

***Table of proposed changes from the Base Standard***

The table below details the proposed changes from the base standard, ISA 570 (excluding changes to reflect Australian terminology and references to Australian Auditing Standards).

Paragraph No. in Proposed Exposure Draft	Status (Requirement, Guidance, Footnote or Appendix)	Description of Proposed Change(s)
1, 2	Requirement / Guidance	New application paragraphs.
3	Requirement	Re-position Operative Date paragraph.

Paragraph No. in Proposed Exposure Draft	Status (Requirement, Guidance, Footnote or Appendix)	Description of Proposed Change(s)
5, 16, 17, 22, 23, 27, 31, 35, 36, 37, 39, 40, 42, 44, 47, 51	Requirement	Replace “should” with “shall”.
25, 29, 34	Guidance	Insert “ordinarily,” to remove implied obligations.
14, 18, 19, 20, 21, 25, 26, 28, 32, 41, 46, 50	Guidance	Insert: “pursuant to paragraph X of this Auditing Standard the auditor is required to” or “pursuant to AUS X the auditor is required to”.
35, 36, 39	Requirement	Elevate ISA 570 guidance that are requirements in the existing AUS 708.
9, 53	Guidance	Reference to the <i>Corporations Act 2001</i> requirements – formal solvency statement by members of the governing board of an entity and specific section 311 requirements.
51	Requirement	Insert a paragraph on the Auditors communication with those charged with governance or management of the impact on the Auditor’s Report where <ul style="list-style-type: none"> <li>• There is a material uncertainty as described at paragraph’s 37, 38 and 40.</li> <li>• The going concern assumption is inappropriate as described at paragraph 42.</li> <li>• Management is unwilling to make or extend its assessment as required by paragraph 45.</li> </ul>
31	Requirement	Replace “seek” with “endeavour to obtain”.
6, 7	Guidance	Insert definitions – “going concern basis” and “relevant period” from the existing AUS 708.
13	Guidance	Include additional examples from the existing AUS 708.

Paragraph No. in Proposed Exposure Draft	Status (Requirement, Guidance, Footnote or Appendix)	Description of Proposed Change(s)
13	Guidance / Appendix	Include of examples of mitigating factors from the existing AUS 708.
	Appendix	Update Appendix 1 using the existing AUS 708.
23	Requirement	Insert “relevant period”. Under the existing AUS 708, the auditor is required to consider the “relevant period” as defined, whereas under the ISA the period of review is 12 months from the balance sheet date.
41, 43	Guidance / Appendix	Replace modification paragraphs with specific examples of modified auditor’s report at Appendix 3 similar to the existing AUS 708.