

## NSA 10

# NEPAL STANDARDS ON AUDITING GOING CONCERN

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## **Introduction**

1. The purpose of this Nepal Standard on Auditing (NSA) is to establish standards and provide guidance on the auditor's responsibility in the audit of financial statements with respect to the going concern assumption used in the preparation of the financial statements, including considering management's assessment of the entity's ability to continue as a going concern.
2. This NSA is to be read in conjunction with the Preface to Nepal Standards on Auditing.
3. This NSA contains the basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material.
4. This NSA needs only be applied to material matters.
5. **When planning and performing audit procedures and in evaluating the results thereof, the auditor should consider the appropriateness of management's use of the going concern assumption in the preparation of the financial statements.**

## **Management's Responsibility**

6. The going concern assumption is a fundamental principle in the preparation of financial statements. 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.

7. Some financial reporting frameworks contain an explicit requirement for management to make specific assessment of 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, Nepal Accounting Standard (NAS) 01: "Presentation of Financial Statements" requires management to make an assessment of an enterprise's ability to continue as a going concern.
8. 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 statements, 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.
9. When there is a history of profitable operations and a ready access to financial resources, management may make its assessment without detailed analysis.
10. 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 judgement 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 judgement about the future is based on information available at the time at which the judgement is made. Subsequent events can contradict a judgement which was reasonable at the time it was made; and
  - 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 all affect the judgement regarding the outcome of events or conditions.
11. Examples of events or conditions, which 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 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 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*

- Loss of key management without replacement.
- Loss of a major market, franchise, license, or principal supplier.
- Labor difficulties or shortages of important supplies.

*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.

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.

## Auditor's Responsibility

12. The auditor's responsibility is to consider the appropriateness of management's use of the going concern assumption in the preparation of the financial statements, and 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 statements. The auditor considers the appropriateness of management's use of the going concern assumption even if the financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern.
13. 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 Considerations

14. **In planning the audit, the auditor should consider whether there are events or conditions which may cast significant doubt on the entity's ability to continue as a going concern.**
15. **The auditor should remain alert for evidence of events or conditions which may cast significant doubt on the entity's ability to continue as a going concern throughout the audit. If such events or conditions are identified, the auditor should, in addition to performing the procedures in paragraph 29, consider whether they affect the auditor's assessments of the components of audit risk.**
16. The auditor considers events and conditions relating to the going concern assumption during the planning process, because this consideration allows for more timely discussions with management, review of management's plans and resolution of any identified going concern issues.
17. In some cases, management may have already made a preliminary assessment at the early stages of the audit. If so, the auditor reviews that assessment to determine whether management has identified events or conditions, such as those discussed in paragraph 11, and management's plans to address them.
18. If management has not yet made a preliminary assessment, the auditor discusses with management the basis for their intended use of the going concern assumption, and inquires of management whether events or conditions, such as those discussed in paragraph 11, 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.
19. The auditor considers the effect of identified events or conditions when making preliminary assessments of the components of audit risk and, therefore, their existence may affect the nature, timing and extent of the auditor's procedures.

## Evaluating Management's Assessment

20. **The auditor should evaluate management's assessment of the entity's ability to continue as a going concern.**
21. **The auditor should consider the same period as that used by management in making its assessment under the 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 ask management to extend its assessment period to twelve months from the balance sheet date.**
22. 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 10, most financial reporting frameworks requiring an explicit management assessment specify the period for which management is required to take into account all available information.
23. In evaluating management's assessment, the auditor considers the process management followed to make its assessment, the assumptions on which the assessment is based and management's plans for future action. The auditor considers whether the assessment has taken into account all relevant information of which the auditor is aware as a result of the audit procedures.
24. As noted in paragraph 9, 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, however, the auditor performs additional audit procedures, as described in paragraph 29.

## Period Beyond Management's Assessment

25. **The auditor should inquire of management as to its knowledge of events or conditions beyond the period of assessment used by management that may cast significant doubt on the entity's ability to continue as a going concern.**
26. The auditor is 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 statements. The auditor may become aware of such known events or conditions during the planning and conduct of the audit, including subsequent events procedures.
27. 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 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.

28. The auditor does not have a responsibility to design 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 21, would be at least twelve months from the balance sheet date.

### **Additional Audit Procedures When Events or Conditions are Identified**

29. **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 should:**

- (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 procedures considered necessary, including considering the effect of any plans of management and other mitigating factors; and**
- (c) **seek written representations from management regarding its plans for future action.**

30. Events or conditions which may cast significant doubt on the entity's ability to continue as a going concern may be identified during the planning of the engagement or in the course of performing 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, certain procedures may take on added significance. The auditor inquires 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. The auditor also considers whether any additional facts or information are available since the date on which management made its assessment. The auditor obtains sufficient appropriate audit evidence that management's plans are feasible and that the outcome of these plans will improve the situation.

31. Procedures that are relevant in this regard may include:

- analysing and discussing cash flow, profit and other relevant forecasts with management,
- analysing and discussing the entity's latest available interim financial statements,
- reviewing the terms of debentures and loan agreements and determining whether any have been breached,

- reading minutes of the meetings of shareholders, the board of directors and important committees for reference to financing difficulties,
  - inquiring of the entity's lawyer 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,
  - considering the entity's plans to deal with unfilled customer orders and
  - reviewing events after period end to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern.
32. When analysis of cash flow is a significant factor in considering the future outcome of events or conditions the auditor considers:
- (a) the reliability of the entity's system for generating such information; and
  - (b) whether there is adequate support for the assumptions underlying the forecast.

In addition the auditor compares:

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

### **Audit Conclusions and Reporting**

33. **Based on the audit evidence obtained, the auditor should determine if, in the auditor's judgement, 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.**
34. A material uncertainty exists when the magnitude of its potential impact is such that, in the auditor's judgement, clear disclosure of the nature and implications of the uncertainty is necessary for the presentation of the financial statements not to be misleading.

#### *Going Concern Assumption Appropriate but a Material Uncertainty Exists*

35. If the use of the going concern assumption is appropriate but a material uncertainty exists, the auditor considers whether the financial statements:

- (a) adequately describe the principal events or conditions that give rise to the significant doubt on the entity's ability to continue in operation and management's plans to deal with these events or conditions; and
- (b) state clearly that there is a material uncertainty related to events or conditions which may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business.

**36. If adequate disclosure is made in the financial statements, the auditor should 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 statements that discloses the matters set out in paragraph 35.** In assessing the adequacy of the financial statement disclosure, the auditor considers 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. The following is an example of such a paragraph when the auditor is satisfied as to the adequacy of the note disclosure:

"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. ... during the year ended Asadh 3X, 20XX and, as of that date, the Company's current liabilities exceeded its total assets by Rs. ... 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."

In extreme cases, such as situations involving multiple material uncertainties that are significant to the financial statements, the auditor may consider it appropriate to express a disclaimer of opinion instead of adding an emphasis of matter paragraph.

**37. If adequate disclosure is not made in the financial statements, the auditor should express a qualified or adverse opinion, as appropriate (NSA 08: "The Auditor's Report on Financial Statements," paragraphs 47-48). The report should include specific reference to the fact that there is a material uncertainty that may cast significant doubt about the entity's ability to continue as a going concern.** The following is an example of the relevant paragraphs when a qualified opinion is to be expressed:

"The Company's financing arrangements expire and amounts outstanding are payable on ... (specify date). 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 our opinion, except for the omission of the information included in the preceding paragraph, the financial statements give a true and fair view of (or are presented fairly, in all material respects,) the financial position of the Company at Asadh 3X, 20XX and the results of its operations and its cash flows for the year then ended in accordance with Nepal Accounting Standards or relevant practices and comply with (Quote the relevant statute or law)... (For example: Company Act, 2053/ Commercial Bank Act, 2031 etc.)"

The following is an example of the relevant paragraphs when an adverse opinion is to be expressed:

"The Company's financing arrangements expired and the amount outstanding was payable on ... (specify date). The Company has been unable to re-negotiate or obtain replacement financing and is considering filing for liquidation. These events indicate 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 our opinion, because of the omission of the information mentioned in the preceding paragraph, the financial statements do not give a true and fair view of (or do not present fairly) the financial position of the Company as at Ashad 3X, 20XX, and of its results of operations and its cash flows for the year then ended in accordance with Nepal Accounting Standards or relevant practices ..... (and do not comply with .....)."....."

#### *Going Concern Assumption Inappropriate*

- 38. If, in the auditor's judgement, the entity will not be able to continue as a going concern, the auditor should express an adverse opinion if the financial statements have been prepared on a going concern basis.** If, on the basis of the additional procedures carried out and the information obtained, including the effect of management's plans, the auditor's judgement 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 statements is inappropriate and expresses an adverse opinion.
39. When the entity's management has concluded that the going concern assumption used in the preparation of the financial statements is not appropriate, the financial statements need to be prepared on an alternative authoritative basis. If on the basis of the additional procedures carried out and the information obtained the auditor determines the alternative basis is appropriate, the auditor can 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*

- 40. If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor should consider the need to modify the auditor's**

**report as a result of the limitation on the scope of the auditor's work.** In certain circumstances, such as those described in paragraphs 18, 21 and 27, 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 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 statements.

41. 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 statements 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, the auditor modifies the auditor's report as discussed in NSA 08, "The Auditor's Report on Financial Statements," paragraphs 38-46.

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

42. When there is significant delay in the signature or approval of the financial statements 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, the auditor considers the need to perform additional audit procedures, as described in paragraph 29, as well as the effect on the auditor's conclusion regarding the existence of a material uncertainty, as described in paragraph 33.

#### **Compliance with International Standards on Auditing**

43. Compliance with this NSA ensures compliance in all material respects with ISA 570 (Going Concern).

#### **Effective Date**

44. This Nepal Standards on Auditing becomes operative for the audit commencing on or after 01 Shrawan 2061 corresponding to 16 July 2004. Earlier application is encouraged.

## **Public Sector Perspective**

The appropriateness of the use of the going concern assumption in the preparation of the financial statements is generally not in question when auditing either the government or those public sector entities having funding arrangements backed by the government. However, where such arrangements do not exist, or where government funding of the entity may be withdrawn and the existence of the entity may be at risk, this NSA will provide useful guidance. As government corporatise and privatise government entities, going concern issues will become increasingly relevant to the public sector.