AUDIT FINALISATION

15.0 Introduction

After completing the planned audit work a final review of financial statement is carried out before the audit report can be drafted. The final review involves consideration of the following matters among others:

1) Presentation of the financial statement.
2) Appropriateness of the accounting policies adopted.
3) Whether all the planned audit work has been completed.
4) Whether sufficient appropriate audit evidence has been obtained to support the audit opinion.
5) Aggregating the errors.
6) Review of subsequent events.
7) Validity of the use of the going concern basis of accounting.
8) Opening balances and comparatives.
9) Other information in documents containing audited financial statements.
10) Final analytical review procedures.
11) Communication with those charged with governance.
12) Checking that all the necessary written management representations have obtained.

15.1 Going Concern

The Going concern is one of the fundamental accounting concepts where is assumed that the entity will continue in operational existence into the foreseeable future and that it has no intensions of either winding up or curtailing materially into scale of operation. Financial statements are normally prepared on the basis of the going concern assumption.

According to ISA 570, the auditor should obtain sufficient appropriate audit evidence regarding the validity of the management use of the going-concern as a basis for preparation of the financial statements. Throughout the audit, the auditor should remain alert to conditions and events that may cast significant doubts regarding the ability of entity to continue as a going concern.

Factors that may cast doubt about the going concern status of the entity

1. **Financial indicators**
   - ✓ Net liability.
   - ✓ Negative operating cash flows.
   - ✓ Fixed term loans approaching maturity with no realistic prospects of repayment or renewal.
   - ✓ Substantial operating losses over a number of years.
   - ✓ Inability to pay creditors on the due dates.
   - ✓ Inability to comply with the terms of loan agreements.
   - ✓ Denial of credit by suppliers, the suppliers have changed their terms to cash before delivery.
   - ✓ Adverse key financial ratios.
   - ✓ Substantial sale of fixed asset with no intension to replace.
   - ✓ Inability to pay salaries and benefits on a monthly basis.
   - ✓ Arrears or discontinuance of dividends
2. **Operational indicators**
   - ✓ Loss of a major customer.
   - ✓ Loss of key operating personnel without replacement.
   - ✓ Shortage of important supplies.
   - ✓ Denial of a major operating license.
   - ✓ Fundamental changes in the market or technology leading to obsolescence.
   - ✓ Emergence of a highly successful competitor.
   - ✓ Labour difficulties.

3. **Other indicators**
   - ✓ Breach of capital market regulations or other statutory or regulatory requirements, such as solvency or liquidity requirements for financial institutions.
   - ✓ Pending legal or regulatory proceedings against the entity whose potential claims the entity is unlikely to be able to satisfy.
   - ✓ Changes in law or regulation or government policy that may adversely affect the entity.
   - ✓ Occurrence of an uninsured or underinsured catastrophe.

Audit procedures when the going concern is doubtful

1) Enquire from the management about their assessment of the entity's going concern status and if they haven't carried out an assessment, discuss with them about the importance of conducting one.
2) If they have carried out an assessment, review the assessment
3) Enquire from the management their mitigating plans of action to address the going concern problems.
4) Evaluate the feasibility of each mitigating plan of action.
5) Analyze and discuss with the management the cash flow, profits and other relevant forecast. Evaluating the reliability of the underlying data generated to prepare the forecast and determining whether there is adequate support for the assumptions underlying the forecast.

6) Analyze and discuss with the entity's management the latest interim financial statement.
7) Read the terms of debentures and loan agreement to determine whether the entity has breached the terms.
8) Read the minutes of the shareholders and those charged with governance for reference to financing difficulties.
9) Consider whether any additional facts or information have become available since the date on which management made its assessment
10) Enquire from the company's lawyers regarding existence of litigations from lenders.
11) Confirm the existence, legality and enforceability of arrangements to obtain financial support from related or third parties.
12) Obtain and review the letter of comfort or support.
13) Evaluate the entity's plans to deal with any unfulfilled customers' orders.
14) Obtain written management representations regarding going concern.

Examples of mitigating plans of action

1. **A plan to obtain additional funding.**
   Audit procedures
   1) Review the loan agreement
   2) Review correspondences between the bank and the entity regarding the borrowings.
   3) Review any evidence of previous relationships with the entity.
   4) Circularize the lender to determine their willingness and ability to provide the loan.
   5) Inspect the company's articles of association to determine whether directors have the powers to borrow.
   6) Review minutes of the authorizing the borrowing

   If Funding from a Grant
   - ➔ Review the grant application
   - ➔ Correspondences with the government regarding the grant
   - ➔ Review the documents relating the anticipated grant to determine the terms and conditions of the grant
   - ➔ Discuss with the management to determine the ability of the company to meet the conditions of the grant and how the company will meet these conditions
   - ➔ Evaluate the managements plans about how the company will meet the terms of the grant
   - ➔ Review events after the balance sheet to determine whether any part grant has received and the progress made by the company to meet the conditions of the grant.

2. **A plan to dispose off some assets to resolve cash flow deficiencies.**
   Audit procedures
   1) Verify the existence of the asset by physical inspection.
   2) Verify the ownership of the asset by inspecting the documents of title.
   3) Check to confirm that the asset is not charged or mortgaged.
   4) assess the marketability or sale-ability of the asset.
   5) Check that the realizable proceeds can resolve the cash flow deficiency.
   6) Check the sale of the asset will not materially affect the firm's operation.
   7) Check the accounting for Held for sale non- current assets procedures

3. **A rescue package negotiated with the creditors e.g. to convert the amount due into shares or loan stock.**
   Audit procedures
   1) Circularize the creditors to confirm their willingness to enter into such a rescue package and their commitment that they will take legal action against.
   2) Seek legal advice to understand the commercial effect of the rescue package.

4. **Financial support claimed to be available from the holding company.**
Audit procedures:
   1) Circularize the holding company to confirm their willingness and ability to provide the financial support.
   2) Confirm that the arrangement is legally binding and not just a mere expression of interest.
   3) Review the letter of comfort/support letters given to by holding company to a subsidiary committing to provide financial support to a subsidiary having a going concern problem.

5. **Financial strategies such as Franchising**
   Audit procedures:
   1) Inspect the minutes of the board to confirm authorization.
   2) Evaluate financial viability the franchise
   3) Obtain advice as to the technical and commercial viability.
   4) Communicate with the prospective Franchisee.

Other mitigating plans

6) Sale of unprofitable business units.
7) Issue of additional shares
8) Persuading the shareholders to inject more capital
9) Capital reconstruction scheme
10) Sale and leaseback of assets inject cashflows
11) Debt factoring.

'Support letters'

Consolidated financial statements are prepared on a going concern basis when a group, when the group is considered to be a going concern. However, the going concern basis may only be appropriate for certain separate legal entities (e.g. subsidiaries) because the parent undertaking (or a fellow subsidiary) is able and willing to provide support. Many banks routinely require a letter of reassurance from a parent company stating that the parent would financially or otherwise support a subsidiary with cash flow or other operational problems.
Support letter provides the following audit evidence in relating to the subsidiaries ability to continue as a going concern:

- ***Formal confirmation of the support*** will be sought in the form of a letter of support or 'comfort letter' confirming the parent company's intention to keep the subsidiary in operational existence (or otherwise meet its obligations as they fall due).
- The letter of support should normally be approved by a board minute of the parent company (or by an individual with authority granted by a board minute).

- ***The ability of the parent to support*** the company should also be confirmed, for example, by examining the group's cash flow forecast.
- ***The period of support may be limited*** (eg to one year from the date of the letter or until the date of disposal of the subsidiary). Sufficient other evidence concerning the appropriateness of the going concern assumption must therefore be obtained where a later repayment of material debts is foreseen.
- The fact of support and the period to which it is restricted should be noted in the financial statements of the subsidiary.
- Evaluation of loan or overdraft

Management's responsibility regarding going concern

1. International Accounting Standard (IAS) 1 requires management to make an assessment
of an entity's ability to continue as a going concern. In line with this the management of the entity has a responsibility of preparing financial statement on an appropriate basis and to make appropriate disclosure going concern in the financial statements.
2. 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. The further into the future an event or condition or the outcome will occur.
- The size and complexity of the entity,
- The nature and condition of the business
- The degree to which the entity is affected by external factors.
- The information available at the time at which the judgment is made.

Auditors responsibility regarding going concern

- The auditor has a responsibility to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern basis of accounting.
- To conclude on whether there is a material uncertainty about the entity's ability to continue as a going concern.
- In performing risk assessment procedures, the auditor should consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.
- The auditor should establish whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern.
- The auditor should discuss the assessment with management and determine whether management has identified events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, if there are, what the management's mitigating plans of action.
- The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern.

- 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
- The auditor shall inquire 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
- Consider the impact of the going concern on the financial statements and the auditor's report.
- To communicate with those charged with governance regarding going concern.

Impact of going-concern problems on the financial statements

1) Where there are gong-concern problems but the management is certain that the company will survive, the management may prepare the financial statement on a going-concern basis but make a disclosure in the notes to the accounts detailing:
   - ➔ Nature of the going concern problem.
   - ➔ The management's mitigating plan(s) of action to address the going concern problem.
2) Where there are going concern problems and there are significant doubts about the continuity of the entity as a going concern the management should prepare the financial statement on a liquidation basis/break-up basis.
   This means:
   - o There is no classification of current or non-current assets and liabilities. All are classified current.
   - o Assets are valued at Net Realizable Value (NRV).
   - o Liabilities are valued at the amount due and included in the liabilities are the liquidation costs and redundancy payments.

Impact of going concern problems of the auditor's report

1. Where there are going concern problems and the financial statements give sufficient disclosure of the going concern problems, the auditor should issue an unqualified report with an emphasis of the matter paragraph.
2. Where the auditor has evidence that the company may not be able to continue as a going concern and there are no disclosures or the disclosures in the financial statements inadequate, the auditor should issue an adverse opinion.
3. Where the going concern is doubtful and the auditor has requested the management to carry out an assessment the going concern problem, to which they have declined, the auditor should issue a disclaimer of opinion.