Going concern reporting in financial statements

Guidelines for directors and companies

Securities and Exchange Commission of Pakistan

These guidelines are a compilation of requirements of the Companies Ordinance, 1984, corporate governance and accounting and auditing standards related to the topic of going concern as presently applicable in Pakistan. The objective is to assist companies' management/directors in making their assessment of going concern assumption as a basis of accounts preparation and to make appropriate reporting in the financial statements. These guidelines do not override the primary requirements of the law or the standards. In case of any inconsistency the requirements of applicable law and standards shall prevail.

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Introduction

Going concern assumption is a fundamental accounting principle used in preparation of financial statement which implies that a company shall continue in business for a foreseeable future. As per accounting and financial reporting frameworks, financial statements are prepared under an inherent presumption that the reporting entity[1] will continue in operation and that there is neither the intention nor the necessity to liquidate it or to cease trading[2]. In cases where a company faces difficult financial, economic or operating circumstances which may endanger its existence the directors are required to perform a comprehensive analysis of company's circumstance, make appropriate disclosures in financial statements and sometimes change basis of account preparation from historical cost to Net realizable valuation basis to enable the users of the financial statements to comprehend the true state of affairs of their company. This enables shareholders to make informed decisions about their investment.

Over the last few years the Corporate Supervision Department of the Securities and Exchange Commission of Pakistan (SECP) has observed deficient reporting by the companies as well as by their auditors regarding appropriateness of use of going concern assumption in preparation of financial statements. It was therefore considered necessary to issue these guidelines which are primarily a compilation of the requirements of the Companies Ordinance, 1984(Ordinance), corporate governance requirements and accounting and auditing standards[3] regarding going concern assessment and reporting. These guidelines have been prepared in consultation with the Institute of Chartered Accountant of Pakistan (ICAP). Cooperation extended by ICAP in finalization of these guidelines is hereby acknowledged with gratitude.

The objective of these guidelines is to assist companies as well as their auditors in following manner;

1. In providing guidance to company management[4] in line with its responsibilities under applicable financial reporting framework regarding;
    - assessment of appropriateness of use of going concern assumption as a basis of accounts preparation;
    - requisite disclosures in financial statements when material uncertainties about going concern ability of a company exist due to difficult economic, operational or other conditions; and
    - Preparation of financial statements on other than going concern basis when going concern assumption is not considered appropriate.
2. Performing assessment of company's going concern ability and its evaluation by the auditors in presence of a formal and duly documented going concern assessment by the company management.
3. Clarifying the respective duties of directors and auditors as well as regulator's expectation from each one of them with respect to the above mentioned actions.

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[1] Throughout these guidelines the term *entity* and *company* has been alternatively.
[2] Para 25 of IAS-1 and Para 3.8 of IFRS for SMEs and Para 1.4 of AFRS for SSEs.
[3] Currently applicable in Pakistan.
[4] Throughout these guidelines the term *management* and *directors* has been used alternatively.

Going Concern Assessment- Who is responsible:

Under the Companies Ordinance, 1984 the directors are responsible for presenting the financial statements of their company, giving true and fair view of its state of affairs, to its members and the regulator. They are accordingly responsible to assess, at each reporting date, the use of going concern assumption as a basis of accounts preparation and make related disclosures in the financial statements in accordance with the applicable accounting and financial reporting framework. The auditor is responsible for making an independent assessment of management's use of going concern assumption in the preparation of financial statements and forming an opinion on the appropriateness of use of going concern assumption by reviewing the director's evaluation and collecting sufficient appropriate audit evidence, and assessing adequacy of requisite disclosures.

Devising processes to facilitate going concern assessment and extent of application of those procedures:

In order to perform their obligations under the law to present true and fair state of affairs of a company to its members, the directors should seek to ensure that there are appropriate processes and systems in place to provide sufficient and timely information to them regarding the company's affairs enabling them to make timely and accurate assessment of going concern ability of their company.

While devising such processes and procedures the directors may take into account various factors, including the following;

i. There should be sufficient supporting documentation available on record that supports their conclusion regarding the use of going concern assumption in preparation of the financial statements;

ii. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. 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, the entity may reach a conclusion that the going concern basis of accounting is appropriate 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;[5]

iii. While the extent of directors' review for small companies may be much simpler than larger companies, however, the assessment must be carried out clearly detailing directors' plans to manage any risks and uncertainties faced by a company;

iv. Going concern assessment of large companies particularly those having complexity in operations either due to diversity of operations or wider geographical presence will require more judgment and vigorous analysis;

v. Some companies may be more sensitive to external financial and economic environment than others and thus require considerable judgment to be used while assessing the impact of such factors on survival of a company;

vi. Due to continuously changing economic and financial environment, assumptions used in the previous going concern assessment of the company may not remain valid under the current circumstances.

Events and conditions indicating doubts about going concern:

ISA-570 (Going Concern) gives following examples of events or conditions that, individually or collectively, may cast significant doubts upon a company's ability to continue as a going concern;

Financial

i. Net liability or net current liability position;

ii. Fixed term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long term assets;

iii. Indications of withdrawal of financial support by creditors;

iv. Negative operating cash flows indicated by historical or prospective financial statements;

v. Adverse key financial ratios;

[5] IAS 1 (Para 26)

vi. Substantial operating losses or significant deterioration in the value of assets used to generate cash flows;
vii. Arrears or discontinuance of dividends;
viii. Inability to pay creditors on due dates;
ix. Inability to comply with the terms of the loan agreements;
x. Change from credit to cash-on-delivery transactions with suppliers;
xi. Inability to obtain financing for essential new product development or other essential investments.

Operating

i. Management intentions to liquidate the entity or to cease operations;
ii. Loss of key management without replacement;
iii. Loss of a major market, key customer(s), franchise, license, or principal supplier(s);
iv. Labor difficulties;
v. Shortage of important supplies;
vi. Emergence of a highly successful competitor.

Others

i. Non-compliance with capital or other statutory requirements;
ii. Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy;
iii. Changes in law or regulation or government policy expected to adversely affect the entity;
iv. Uninsured or underinsured catastrophes when they occur.

The standard also highlights following important factors needed to be considered while determining existence of any uncertainties about an entity's ability to continue as a going concern;

- There cannot be an exhaustive list of all possible events and conditions capable of affecting going concern nor does the existence of one or more of the above events or conditions always signify that a material uncertainty exists i.e. an issue may be more or less significant for a company depending on its peculiar circumstances;
- The significance of these events or conditions often can be mitigated by other factors e.g. 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 disposing

of assets without material impact on operations, rescheduling 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;

- The size of an entity may affect its ability to withstand adverse conditions. Small entities may be able to respond quickly to exploit opportunities, but may lack reserves to sustain operations. Conditions of particular relevance to small entities include the risk that banks and other lenders may cease to support the entity, as well as possible loss of a principal supplier, major customer, key employee, or the right to operate under a license, franchise or other legal agreement;
- Management use of going concern assumption is also relevant to public sector entities. For example, International Public Sector Accounting Standard (IPSAS) 1 addresses the issue of the ability of public sector entities to continue as going concern. Going concern risks may arise, but are not limited to, situations where public sector entities operates on a for-profit basis, where government support may be reduced or withdrawn, or in the case of privatization. Events or conditions that may cast significant doubt on an entity's ability to continue as a going concern in the public sector may include situations where the public sector entity lacks funding for its continued existence or when policy decisions are made that affect the services provided by the public sector entity.

Whenever an event or a condition that casts significant doubt on company's ability to continue as a going concern is identified, the company must make an assessment to identify whether or not any material uncertainty exists that the company may not be able to discharge its obligations. During the assessment the management will account for the mitigating factors too, including those as mentioned above, that may completely remove the uncertainty, or reduce it to an acceptable level.

The cessation of operations or failure to commence operations does not necessarily imply that the company is not a going concern if the management's intent is to continue and funds are available to discharge company's obligations in the foreseeable future. In all such cases, the auditor shall assess the validity of the management's assessment, including evidence of availability of funds to discharge company's obligations.

Key areas to be reviewed by the directors:

The objective of conducting going concern assessment by the directors is to evaluate which of the following three potential conclusions is appropriate to the circumstances of their company;

i. There are no material uncertainties that cast significant doubts on company's ability to continue as a going concern; or
ii. There are material uncertainties that cast significant doubts on company's ability to continue as a going concern BUT the use of going concern assumption for preparation of the financial statement of the company is appropriate; or
iii. The use of going concern assumption for preparation of the financial statement of the company is not appropriate.

Following are key areas that may be reviewed by the directors, depending upon the specific circumstances of a company, to reach any one of the above conclusions;

Operating history and future prospects:
The directors should review profitability and cash flow forecasts along with underlying assumptions for at least 12 months from the expected date of approval of financial statements. The directors should review these forecasts to determine as to whether these projections are consistent with;

- Past performance;
- Existing and projected demand of the product, pricing structure and sales mix;
- Available stocks and expected production levels;
- BMR plans and working capital requirements;
- Expected trends of rise in production, overhead and financial costs;
- Variance of projected and actual results in past few years;
- Macro and micro economic factors;
- The risks faced by a company e.g. risk of losing key customers/suppliers or patent/franchise/contracts, labor issues, credit and market risk etc. and management's plans to manage these risks;

- Relative strength of company's product/service within its market and any material changes expected; and
- The marketing strategy of the company to achieve projected results.

Besides, the forecasts should also be tested by conducting sensitivity analysis for different assumptions underlying the projections especially considering different levels of productions/sales, variations in operational and financial costs etc.

Contingencies and commitments:

As part of their assessment, the directors should also analyze all contingent liabilities and commitments to which the company is exposed to as on the reporting date and their impact on its financial position. Such review may include possible outcome of legal proceedings, guarantees/securities issued, warranties offered for products, other contingent costs and contracts etc.

Cash flow management:

Sometimes significant cash flow difficulties may endanger the going concern ability of an otherwise profitable company. Therefore, a company's ability to meet all known liabilities and commitments existing on the balance sheet date is perhaps the most important factor to be analyzed very carefully. Director's review to evaluate reliability of company's cash generating capability should particularly focus on;

- Consistency and reasonableness of assumptions underlying the cash flow projections;
- Company's ability to arrange finance to meet gap between projected outflows unmatched by the expected inflows;
- Ability to meet any unexpected cash needs through disposal of assets or by deferring BMR, without affecting company's operations, or through other reliable sources ;
- Company's ability to alter the amounts and timings of cash flows, obtain new sources of finance, restructure loans, raise share capital etc.;
- Financial support from directors/sponsors, if any;
- Company's plan to deal with probable adverse financial or operational circumstances either by curtailing operations or using any alternative means;

- Support from parent company or other group companies and whether such support may be expected with reasonable certainty; and
- Significant exposures in other companies including group companies, risks faced by their financial and operating conditions and management plans to manage these risks.

Legal and Regulatory Compliance:

Compliance with legal and regulatory requirements having bearing on a company's ability to continue as a going concern should be analyzed thoroughly and impact, if any, should be evaluated and appropriately disclosed in the financial statements. Such legal and regulatory requirements may include following;

- Minimum Capital Requirements;
- Filing of winding up petition by creditor/shareholders/regulator;
- Preconditions of a license where a company is carrying on any licensed activity; and
- Any other applicable law or regulatory requirement that may have a detrimental impact on a company's ability to continue as a going concern.

Adjustments and disclosure to be made in the financial statements:

When any events or conditions creating doubt about an entity's going concern ability have been identified, the directors must assess impact of these events on different financial statement elements and also determine appropriate adjustments and disclosures to be made in the financial statements in order to achieve true and fair presentation e.g.

- Assets (valuation, classification);
- Liabilities (valuation, classification);
- Revenue (whether current recognition criteria is appropriate); and
- Expenses (need for recognition of a provision e.g. when terms of a loan have been breached, or recovery of receivables becomes doubtful etc.)

Time period covered by the assessment:

The length of the review period is a matter of judgment based on facts and circumstances, however, accounting standards provides the minimum period[6] i.e. at least 12 months from the end of the reporting

[6] IAS 1 (Para 26)
IFRS for SMEs (Para 3.8)

period. In case the directors consider a period of less than 12 months from the reporting date the same should be disclosed and justified. While using a longer period it must be considered that the longer the period for which assessment is being made the greater the degree of uncertainty about the outcome of future events or conditions requiring more caution.

The listed companies which are required to prepare and circulate interim financial statements shall follow the requirements of IAS 34 (Interim Financial statements) which requires that same recognition and measurement principles shall be applied to interim financial statements as are applied to annual financial statements. Consequently, the minimum review period requirement for interim accounts is the same as that for annual accounts. i.e. 12 months from the end of the reporting period. However, the review performed at interim periods will not be as extensive as for annual periods unless there is any material change in the circumstances envisaged at the time of annual assessment.

The directors should always remain alert to events and conditions arising subsequent to the balance sheet date that may require reconsidering the going concern assumption. Inappropriateness of going concern assumption subsequent to the reporting period is considered so pervasive that IAS-10(Events after the Reporting Period) requires a fundamental change in the basis of accounting rather than an adjustment to the amounts recognized within the original basis of accounting. The standard requires that an entity shall not prepare its financial statements on going concern basis if the management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.[7]

Documentation of going concern assessment;

Whenever a company's management identifies such events or conditions that cast significant doubts on company's ability to continue as a going concern it shall make an assessment, in sufficient detail, explaining the basis of conclusion with respect to going concern ability of the company. However, in

AFRS for SSEs (Para 1.4)

[7] IAS 10(Para 14 and 15)
IFRS for SMEs (Para 3.8 and 3.9)

some cases management may make its assessment without detailed analysis e.g. when there is a history of profitable operations and a ready access to financial resources.

Going concern assessment, along with supporting documents, finalized and approved by the directors should be made available to company's auditor for performing review as required by the auditing standards.

Corporate Governance Requirements:

Significant issues to be placed before board of directors of a listed company under the CCG:

Code of Corporate Governance 2012 (CCG) requires following important issues to be placed before the directors that are also instrumental in enabling directors to make evaluation of their company's ability to continue as a going concern;

i. the CEO shall immediately bring before the board, as soon as it is foreseen that the company will not be in a position of meeting its obligations on any loans (including penalties on late payments and other dues, to a creditor, bank or financial institution or default in payment of public deposit), TFCs, Sukuks or any other debt instrument. Full details of the company's failure to meet obligations shall be provided in the company's quarterly and annual financial statements.
ii. annual business plan, cash flow projections, forecasts and strategic plan;
iii. budgets including capital, manpower and overhead budgets, along with variance analyses;
iv. matters recommended and/or reported by the committees of the board;
v. quarterly operating results of the listed company as a whole and in terms of its operating divisions or business segments;
vi. internal audit reports, including cases of fraud, bribery, corruption, or irregularities of a material nature;
vii. management letter issued by the external auditor;
viii. details of joint venture or collaboration agreements or agreements with distributors, agents, etc.;
ix. promulgation or amendment to a law, rule or regulation, enforcement of an accounting standard and such other matters as may affect the listed company;

x. status and implications of any lawsuit or proceedings of material nature, filed by or against the listed company;

xi. any show cause, demand or prosecution notice received from revenue or regulatory authorities;

xii. failure to recover material amounts of loans, advances, and deposits made by the listed company, including trade debts and inter-corporate finances;

xiii. any significant accidents, dangerous occurrences and instances of pollution and environmental problems involving the listed company;

xiv. significant public or product liability claims made or likely to be made against the listed company, including any adverse judgment or order made on the conduct of the listed company or of another company that may bear negatively on the listed company;

xv. report on governance, risk management and compliance issues. Risks considered shall include reputational risk and shall address risk analysis, risk management and risk communication;

xvi. disputes with labor and their proposed solutions, any agreement with the labor union or collective bargaining agent and any charter of demands on the listed company.

Similar requirements are also prescribed by Public Sector Companies (Corporate Governance) Rules, 2013 (PSC Rules).

Review of Going Concern assumption used in preparation of financial statements by the Audit committee of a listed company;

CCG as well as PSC Rules require[8] the audit committee to review quarterly, half yearly and annual financial statements with particular focus on, among others, going concern assumption used in preparation of the financial statements.

Disclosures:

Appropriate disclosures are required to be made when there exists any event or condition that casts significant doubts on a company's ability to continue as a going concern. In such a situation, the directors shall ensure that comprehensive, balanced, and clear disclosures are made in the financial statements, so

[8] Clause xxix(b) of CCG

as to enable the shareholders and as well as other stakeholders to get a clear understanding of the state of affairs of the company. In order to achieve this objective, it must be ensured that;

- All the disclosures are made at a single place in the company's financial statements. If it is not practical to disclose all the information at a single place then at least it may be ensured that the main note concerning going concern includes cross referencing to other relevant notes to the accounts or other parts of the annual report where such information has been disclosed;
- The particular factors which the directors have considered in going concern assessment should be disclosed clearly and prominently in the financial statements;
- Whenever there are event or conditions that cast significant doubt on the Company's ability to continue as a going concern, the directors' conclusion as to whether the going concern basis of accounting used in the preparation of financial statements is appropriate shall be clearly stated explaining justification for the same;
- The directors should also ensure that only relevant and material information is disclosed. Disclosure of irrelevant and immaterial information should be avoided as it undermines the ability of the financial statements to provide a true and fair view of the state of affairs of a company. It also hampers the ability of the users of the financial statements to comprehend the consequences of the issues being faced by a company; and
- The directors will exercise objective judgment to determine which information is relevant and material to further the understanding of the users e.g. a company that has either suspended its operations, or has not commenced its business but consider itself as a going concern shall disclose following to enhance understanding of users of its financial statements;
    - Reasons for suspension/non-commencement of operations;
    - Management's plans for resumption/commencement of operations; and
    - How the company would be able to discharge its obligations.

Specific disclosure requirements regarding going concern reporting under different accounting and financial reporting frameworks, as applicable in Pakistan, are summarized below;

Disclosure requirements under IFRS/IFRS for SMEs/ISAs:

Para 25 of IAS 1(Presentation of Financial Statements) and Para 3.9 of IFRS for SMEs require following specific disclosures to be made in the financial statements;

i. Uncertainties, of which the directors become aware while making company's going concern assessment, that may cast significant doubt on the company's ability to continue as a going concern;
ii. When a company does not prepare its financial statements on a going concern basis, this fact shall be disclosed, along with reason(s) why the company is not regarded as a going concern; and
iii. The basis on which the financial statements have been prepared.

Para 17-C of IAS-1 further requires an entity to provide additional disclosures when compliance with specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events or conditions.

Para 18 of ISA-570, while explaining auditor's responsibility on the subject of going concern, specifies following qualitative disclosures in the financial statements, that may lead to an unmodified audit opinion, even in the presence of material uncertainty related to going concern;

a) Adequate description of principal events or conditions that may cast significant doubts on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and
b) Clear disclosure that there is 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, therefore, it may be unable to realize its assets and discharge its liabilities in the normal course of business.

Other disclosures:

Disclosures by public companies under Section 236 of the Ordinance;

The directors of a public company and a private company, which is a subsidiary of a public company, are required to disclose following information, in respect of the state of a company's affairs, in their report to the members under Section 236 of the Ordinance;

a) any material changes and commitments affecting the financial position of the company;
b) Any changes that have occurred during the financial year concerning the nature of the business of the company or of its subsidiaries, or in the classes of business in which the company has interest, whether as a member of another company or otherwise;
c) reasons for incurring loss and a reasonable indication of future prospects of profit, if any;
d) Information about defaults in payment of debts, if any, and reasons thereof.

Although these disclosures are required for all public companies and their subsidiaries however in case of going concern uncertainty more detail may be required by the users of the financial statements to comprehend the state of affairs of their company.

Risk disclosures required by IFRS; In case of going concern uncertainty following risk disclosures should be more comprehensive;

Para 18-19 of IFRS 7(Financial Instruments: Disclosures): disclosure of defaults and breaches of loan terms and conditions;

Para 33-42 of IFRS 7: both qualitative and quantitative disclosures to enable users of financial statements to evaluate nature and extent of risks arising from financial instruments, including but not limited to credit, liquidity and market risk;

Para 125 -133 of IAS 1: sources of estimation of uncertainty about the carrying amounts of the assets and liabilities of the entity;

Para 50 of IAS 7(Statement of Cash Flows): disclosure of undrawn borrowing facilities and any restrictions on their use.

CCG requires[9] following disclosures to be made in the directors report of listed companies**;**

i. There are no significant doubts upon the listed company's ability to continue as a going concern; and
ii. If the listed company is not considered to be a going concern, the fact along with the reasons shall be disclosed.

PSC Rules[10] also require detailed disclosure when a public sector company is reliant on a subsidy or other financial support from the government.

Disclosure of material information under listing regulations/Securities Act 2015;

Listed companies are required to immediately disseminate, to SECP and the stock exchange on which their shares are listed, all material information relating to the business and other affairs of the company

[9] Sub-clause (f) and sub-clause (a) of first proviso of clause (xvi) of CCG
[10] Rule 17(4) of PSC Rules

that may affect the market price of their shares. Going concern is a fundamental assumption for a business and any event which may affect the going concern ability of a listed company arising during the reporting periods would require immediate disclosure.

Annexure A to these guidelines summarizes applicable disclosure requirements for different classes of companies.

Going Concern Reporting in interim periods:

IAS-34 provides that the entities may elect to provide less information at interim dates, as compared with their annual financial statements, in the interest of timeliness and cost considerations and to avoid repetition of information previously reported[11]. The directors are, therefore, required to exercise judgment in determining the extent of disclosures about going concern assumption of their company, which they should include in interim financial statements. When there is no material change in the circumstance a brief statement referring the disclosures made in the annual financial statements would suffice. However in cases where new events occur or new circumstances arise affecting the going concern assessment of a company additional disclosures in the interim financial statements will be required to further the understanding of the users e.g.;

- New sources of financing have been arranged or cessation of financing by lenders;
- Existing liabilities have been renegotiated or any renegotiation has failed;
- Major assets have been acquired or disposed of;
- Operations have been closed or recommenced to be closed etc.

Understanding Auditor's responsibility on Going Concern:

ISA 570 establishes guidance with regard to auditor's considerations of appropriateness of management's use of going concern assumption in preparation of the financial statements. The standard lays down following objectives for the auditor;

a) Obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of going concern assumption in the preparation of the financial statements;

[11] Para 6 of IAS 34

b) To conclude, based on audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubts on entity's ability to continue as a going concern; and
c) Determine the implications for the auditor's report.

Preliminary assessment:

The auditor's duty in respect of going concern starts from the onset of planning phase of the audit when the auditor performs risk assessment procedures[12] to update information about the company and identify changes in the business since the last audit that may be relevant for the audit of the current period. At this stage, the auditor shall determine whether the management has made a preliminary assessment of entity's ability to continue as a going concern. If such an assessment has been performed by the management the auditor shall discuss the assessment with the management to determine whether any events or conditions which may cast significant doubts on company's going concern ability have been identified and how they plan to address them. However, in case the management has not performed such a preliminary assessment, the auditor shall enquire of management whether there are events or conditions that may significantly affect going concern, if so, the grounds on which they intend to use going concern basis in preparation of financial statements.

Evaluation of going concern assessment by the Auditor:

The evaluation of management's assessment of going concern is a key part of the auditor's work in the audit of going concern assumption used in the preparation of financial statements. While making such an assessment, the auditor's duty is to obtain sufficient appropriate evidence to evaluate the management assessment. Generally, in evaluating director's assessment the auditor will review and consider following;

1) The process followed by directors to make their assessment;
2) The reasonableness of the underlying assumptions on which the assessment is based;
3) Available documentation supporting the assessment;
4) Management plans for future action and whether management plans are feasible in the circumstances. It may require use of work of external advisors (legal advisors, valuation experts, consultants etc.).

[12] ISA 315(Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment)

ISA 570 provides following guidance regarding the responsibility in this regard;

- It is not the auditor's responsibility to rectify the lack of analysis by management. In some circumstances, however, the lack of detailed analysis by management to support its assessment may not prevent the auditor from concluding whether management's use of the going concern assumption is appropriate in the circumstances. For example, when there is a history of profitable operations and a ready access to financial resources, management may make its assessment without detailed analysis. In this case, the auditor's evaluation of the appropriateness of management's assessment may be made without performing detailed evaluation procedures if the auditor's other audit procedures are sufficient to enable the auditor to conclude whether management's use of the going concern assumption in the preparation of the financial statements is appropriate in the circumstances.
- In other circumstances, evaluating management's assessment of the entity's ability to continue as a going concern may include an evaluation of the process management followed to make its assessment, the assumptions on which the assessment is based and management's plans for future action and whether management's plans are feasible in the circumstances.
- While evaluating the management assessment the auditor shall cover the same period as that used by the management in line with the requirements of the applicable financial reporting standards (at least 12 month). If management's assessment covers less than 12 month the auditor shall request the management to extend its assessment period to at least 12 months. Besides, the auditor is also required to enquire of management as to its knowledge of event 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.
- In such cases where there is significant delay in the approval of the financial statements by management, the auditor shall inquire as to the reasons for the delay. If the auditor believes that the delay could be related to events or conditions relating to the going concern assessment, the auditor shall perform additional audit procedures necessary as well as consider the effect on auditor's conclusion regarding the existence of a material uncertainty.

Additional audit procedures when events or conditions casting significant doubts on company's ability to continue as a going concern have been identified as per ISA-570:

If events or conditions which cast significant doubts on company's ability to continue as a going concern have been identified, either in the preliminary assessment or evaluation of management assessment the auditor shall perform additional audit procedures, including consideration of mitigating factors, to determine whether or not a material uncertainty exist. These procedures may include;

i. Where the management has not yet performed going concern assessment, requesting management to make its assessment;
ii. Evaluating management's plans for future actions in relation to its going concern assessment to determine whether these plans are feasible in the circumstances and outcome of these plans is likely to improve the situation;
iii. Analyzing cash flow forecasts where analysis of forecast is important in considering the future outcome of events or conditions in the evaluation of management's plans for future action:
    - Evaluating the reliability of the underlying data generated to prepare the forecast; and
    - Determining whether there is adequate support for the assumptions underlying the forecast.
iv. Considering whether any additional facts or information have become available since the date on which management made its assessment;
v. Requesting written representation from management/director regarding their plans for future action and the feasibility of these plans;
vi. Analyzing and discussing cash flow, profit and other relevant forecasts with management;
vii. Analyzing and discussing the entity's latest available interim financial statements;
viii. Reading the terms of debentures and loans agreements and determining whether any have been breached;
ix. Reading minutes of the meetings of shareholders, directors and relevant committees for reference to financing difficulties;
x. Inquiring the company's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessment of their outcome and the estimate of their financial implications;

xi. 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;

xii. Evaluating the entity's plans to deal with unfilled customer orders;

xiii. Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern;

xiv. Confirming the existence, terms and adequacy of borrowing facilities;

xv. Obtaining and reviewing reports of regulatory actions;

xvi. Determining the adequacy of support for any planned disposals of assets;

xvii. Inquiries of management for its plans for future action including plans to liquidate assets, borrow money, or restructure debt, reduce or delay expenditure or increase capital;

xviii. Comparison of prospective financial information for recent periods with historical results;

xix. The prospective financial information for the current period with results to date; and

xx. Where management assumptions include continued support by third parties whether through subordination of loans, commitment to maintain or provide additional funding, or guarantees and such support is important to an entity's ability to continue as a going concern, the auditor may need to consider requesting written confirmation (including the terms and conditions) from those third parties and to obtain evidence of their ability to provide such support.

Audit Conclusions and Reporting:

The conclusion drawn by the auditor, on the basis of audit evidence obtained, from evaluation of director's going concern assessment will determine the type of audit opinion expressed by the auditor on company's financial statements. The auditor, depending upon the circumstances, may issue one of following five possible types of the audit opinions;

Unqualified audit opinion- Auditor agrees with management use of going concern assumption:

Clean or unqualified audit opinion is issued by the auditor when the auditor concludes that the going concern basis used by the management is appropriate and there are no material uncertainties that cast significant doubt on the company's ability to continue as a going concern.

Unqualified audit opinion with emphasis of matter paragraph:

Such type of audit opinion is issued when;

1. Auditor agrees with management use of going concern assumption but material uncertainties exist which are appropriately disclosed;

i. Preparing the financial statements on going concern basis is appropriate, but there are material uncertainties that cast significant doubt on the company's ability to continue as a going concern; and

ii. All material uncertainties, of which the directors became aware while carrying out going concern assessment of the company, which may cast significant doubt on the company's ability to continue as a going concern and directors plans to deal with those uncertainties have been appropriately disclosed in the accounts;

OR

2. Auditor agrees with management use of alternative basis which is appropriately disclosed in the financial statements

i. The Company is not a going concern and it has not prepared its financial statements on a going concern basis; and

ii. This fact has been disclosed in the financial statements, along with reasons why the company is not considered a going concern and the basis on which the financial statements have been prepared.

Qualified opinion:

1. Auditor agrees with directors' use of going concern assumption, however, the effect of inadequate disclosure of material uncertainties is not material and pervasive;

i. Preparing the financial statements on going concern basis is appropriate, but there are material uncertainties that cast significant doubt on the company's ability to continue as a going concern; and

ii. Such material uncertainties are not adequately disclosed in the financial statements but the effect of such inadequate disclosures are not so material and pervasive to the financial statements so as to require an adverse or a disclaimer of opinion.

2. Auditor is of the view that alternative basis used by directors in preparation of financial statements is an acceptable financial reporting framework in the circumstances but there is inadequate disclosure in the financial statements.

Adverse Opinion:

1. Auditor agrees with directors' use of going concern assumption, the effect of inadequate disclosure of material uncertainties is material and pervasive;

i. Preparing the financial statements on going concern basis is appropriate, but there exist material uncertainties that cast significant doubt on the company's ability to continue as a going concern; and

ii. Such material uncertainties are not adequately disclosed in the financial statements and the effect of such inadequate disclosures is so material and pervasive that a qualified opinion is not sufficient to disclose the incomplete or misleading nature of the financial statements.

OR

2. Auditor disagrees with directors' assessment that going concern assumption is appropriate;

The financial statements have been prepared on going concern basis, but the auditor has concluded that the use of going concern assumption is inappropriate.

Disclaimer of opinion:

i. When the directors either refuse to perform or to extend the period of their going concern assessment and thereby prevent the auditor from forming an opinion on the financial statements the auditor shall issue a disclaimer of opinion.

ii. In extremely rare circumstances when there are multiple uncertainties that are significant to the financial statements as a whole the auditor may consider it appropriate to express disclaimer of opinion.

ISA- 720 (The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements) requires auditor to review the directors' report and other information annexed with the financial statements to determine as to whether the information disclosed as aforesaid is consistent with the financial statements.

Annex-B annexed with this guide summarizes the connection between directors' assessment and implications of auditor's evaluation for audit report.

Application to Group Accounts/Consolidated Accounts:

While preparing the consolidated financial statements in compliance with the requirements of Section 237 of the Ordinance, the directors of the parent company shall take into account overall impact of the going concern assessment of each one of the individual companies forming the group in the context of the group taken as a whole. The auditor of the parent company while forming its opinion on the use of going concern assessment shall take a holistic view of the circumstances faced by the group in the preparation of consolidated financial statements and in case any of the group companies is audited by another auditor, seek guidance from **ISA-600**(Using the Work of another Auditor).

Alternative basis of accounting when going concern assumption is inappropriate:

ISA-570 requires that when the use of the going concern assumption is not appropriate, the financial statements are prepared on an alternative basis e.g. liquidation basis. However, no guidance in respect of alternative basis of accounting is provided in the said standard or in any another standard.

When preparing financial statements on a basis other than going concern, the valuation principal of both assets and liabilities shall be altered. Since a company which is not a going concern will not be able to realize its assets and discharge its liabilities in the normal course of business therefore, assets and liabilities should be measured at their net realizable value so as to reflect the amount of cash or other consideration that the company expects to receive from realizing its assets or pay to settle its liabilities. Subsequently, at each reporting date the company shall re-measure its assets and liabilities to reflect change in value since the previous reporting date. The accounting policies shall clearly explain the basis used in preparation of company's financial statements. Following adjustments to company's assets and liabilities shall be required to reflect true and fair view of its state of affairs;

Fixed Assets: Fixed assets will be assessed for their net realizable value (Fair value less cost to sell). Net realizable value may also include cash generated through use of fixed assets between the reporting date and final sale. Any impairment subsequent to the balance sheet date shall also be taken into account in accordance with IAS-10.

Inventories: Inventories shall be carried at net realizable values. In most cases the decision to close a business may adversely affect the net realizable value of inventories. This factor must be taken into account while determining net realizable values of inventories. Any impairment subsequent to the balance sheet date shall also be taken into account in accordance IAS 10.

In case where assets of a company are at different places, a location wise schedule of company's tangible assets along with their respective fair values may also be made part of the financial statements.

Goodwill and intangibles: Goodwill and intangibles, particularly intangibles without an active market, will be reassessed for impairment considering the closure of company's business.

Liabilities:

i. Liabilities shall be recognized at the estimated amount that the company expects to pay to discharge its obligations.
ii. Penalties for early settlement of liabilities or termination of contracts e.g. leasing contracts may also be determined and recognized.
iii. A company which may have received grants from the government for a specific purpose or period shall evaluate the possibility of repayment of such grants due to closure of its business. A liability shall be recognized if such grants become repayable.
iv. When a company is not considered a going concern it may give rise to some obligations which may not have existed when the entity was a going concern e.g. some legal costs. The Company, when deciding whether to recognize such costs shall follow guidance provided in applicable accounting standards.

Taxation: Estimation for deferred and current taxation may change with company's decision to cease operations.

Post-Retirement Benefits: Actual retirement liability of employees will be calculated and provided for any excess or deficit will be charged to profit or loss.

Events after the Balance sheet date: If use of going concern assumption in preparation of a company's financial statements becomes inappropriate subsequent to the balance sheet date the same shall be treated as an adjusting event and financial statements shall not be prepared on going concern basis.

Corresponding figures: Corresponding figures shall not be restated.

Classification of Assets and liabilities: Assets and liabilities shall be presented in the order of liquidity and classified as current.

Annexures:

Annexure-A Disclosure requirements for different classes of companies

Annexure-B Link between directors' assessment and audit opinion

Annexure-C Sample disclosures

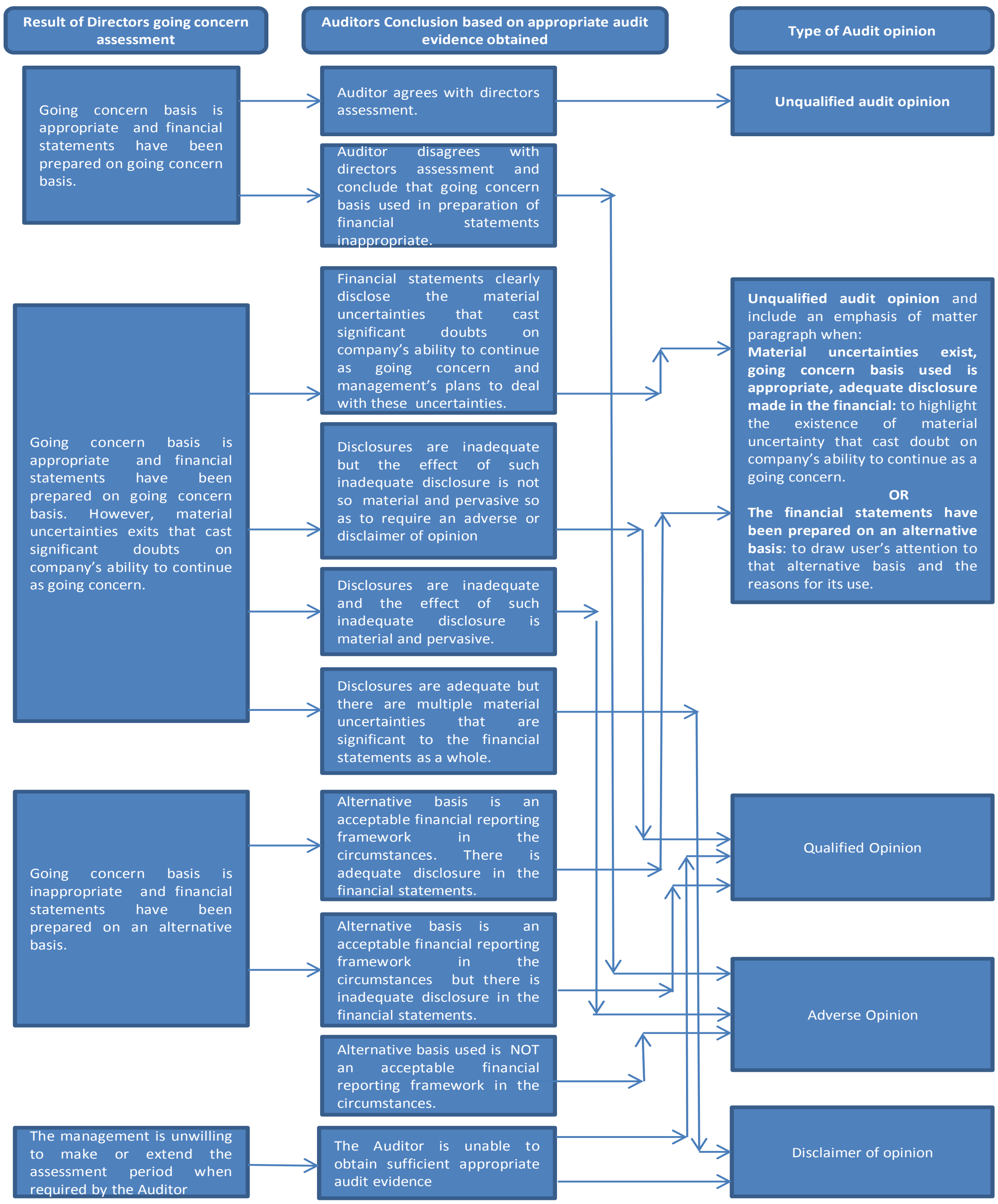
Annex-A (Disclosure requirements for different classes of companies)

Class of company	Status of going concern assumption	Disclosures requirements derived from
Listed companies	Going concern assumption appropriate	Section 236, CCG, Listing Regulations, Risk disclosures required by IFRS/IAS(IFRS-7,IAS-1, IAS-7)
	Going concern assumption appropriate but material uncertainty exists	Section 236, CCG, Listing Regulations, Risk disclosures required by IFRS/IAS IFRS-7,IAS-1, IAS-7), Disclosure of uncertainties along with management plans (IAS-1and ISA-570)
	Going concern assumption is not appropriate	Section 236, CCG, Listing Regulations, Risk disclosures required by IFRS/IAS IFRS-7,IAS-1, IAS-7), Disclosure of uncertainties, fact that entity is not a going concern and basis used for preparation of financial statements(IAS-1and ISA-570)
-PICs -LSCs -PICs/LSCs formed under Section 42 and 43 of the Ordinance	Going concern assumption appropriate	Section 236, Risk disclosures required by IFRS/IAS IFRS-7,IAS-1, IAS-7)
	Going concern assumption appropriate but material uncertainty exists	Section 236, Risk disclosures required by IFRS/IAS IFRS-7,IAS-1, IAS-7), Disclosure of uncertainties along with management plans (IAS-1 and ISA 570)
	Going concern assumption not appropriate	Section 236, Risk disclosures required by IFRS/IAS IFRS-7,IAS-1, IAS-7), Disclosure of uncertainties, fact that entity is not a going concern and basis used for preparation of financial statements(IAS-1 and ISA-570)
-MSCs -SMCs formed under Section 42 and 43 of the Ordinance	Going concern assumption appropriate	Section 236
	Going concern assumption appropriate but material uncertainty exists	Section 236, Disclosure of uncertainties along with management plans (IFRS for SMEs and ISA 570)
	Going concern assumption not appropriate	Section 236, Disclosure of uncertainties, fact that entity is not a going concern, basis used for preparation of financial statements(IFRS for SMEs and ISA-570)
SSCs	Going concern assumption appropriate	Section 236
	Going concern assumption appropriate but material uncertainty exists	Section 236, Disclosure of uncertainties along with management plans (ISA 570)
	Going concern assumption not appropriate	Section 236, Disclosure of uncertainties, fact that entity is not a going concern, basis used for preparation of financial statements(ISA-570)

Note:

1. Requirements of Section 236 of the Ordinance are only applicable on public company or a subsidiary of a public company.
2. Extent of disclosures will differ on the basis of type of business of an entity and severity and number of events and conditions giving rise to going concern uncertainty.

Annex-B (Link between director's assessment and audit opinion)



Annex-C (Sample disclosures)

Note: These examples are for illustration purposes only. Companies may tailor the disclosures to their specific circumstances.)

Example 1: Going concern assumption is appropriate. Directors have not identified any material uncertainty that case significant doubt about the ability of the company to continue as a going concern.

Contrary to the historical trends, this year your company has seen major drop in its gross profits mainly due to worsening economic conditions in the country and export markets. Furthermore, high finance cost because of sudden increase in interest rates has made the bottom line of your company negative first time in its history. However, these conditions are expected to be temporary and reversal is expected from the second quarter of this year. Moreover, the company has sufficient financial resources to go through this tough phase. The company has ability to satisfy all its obligations from reserve funds.

The directors are confident that the company has adequate resources to continue its operations in foreseeable future. Therefore, use of going concern assumption in preparation of these financial statements is appropriate.

Example 2: Going concern assumption is appropriate. However, directors have identified and disclosed material uncertainties that case significant doubt about the ability of the company to continue as a going concern.

During the year the company has experienced substantial decline in the sales mainly due to decrease in exports. This has resulted in net loss for the year and negative operating cash flows. Due to rising inflation and shortage of gas/electricity the production costs have increased significantly making the products of the company uncompetitive in the market. Moreover, due to difficult economic conditions of export markets the demand for your products has fallen sharply.

Due to losses during the period the company has not be able to make payments to two of its major creditors who have refused to renew the working capital facilities for the next year.

These circumstances represent material uncertainties that cast significant doubt upon the company's ability to continue as a going concern therefore the company may be unable to realize its assets and discharge its liabilities in the normal course of business. However, due to following factors the directors believe that the company has adequate resources to continue as a going concern in the foreseeable future;

- In the coming months raw material prices are likely to decline while prices and demand of finished goods are expected to increase gradually in local as well as international market.

Moreover, continuous devaluation of currency will offer a competitive edge to your company in the export market.

- To overcome this situation your management is working on war footings to explore all possible options including technological improvements for reduction in input cost. At the same time we are also looking for new markets and improvements in our products in terms of quality and design to secure a niche for the company.
- The Company is in the process of disposal of an extra piece of land to pay off the overdue liabilities of the banks. Negotiations with various financial institutions are also under way for working capital financing.
- The sponsors of the company have committed to provide bridge finance to the company to meet its working capital requirements until the negotiations with banks are finalized.

Due to the above mentioned factors the financial statements of the company have been prepared on going concern basis.

Example 3: Going concern assumption is not appropriate.

The operations of the company are closed since last three years due to lack of funds for working capital and BMR required for making the plant operational. Accumulated losses have eroded the company's equity. Negotiations with banks for restructuring of liabilities have failed. Creditors have gone into litigation to recover their overdue loans through sale of mortgaged assets. The management despite its rigorous efforts failed to arrange financing for BMR and working capital. Demand for company's products has also diminished in last few years due to cheaper imports from the neighboring countries. Company's business is not viable in these circumstances.

Our legal counsel has informed us that the cases filed by the banks may be decided against the company resulting in compulsory winding up of the company. Since compulsory winding up usually results in sale of assets at through away prices therefore the directors have decided to sale a portion of plant and machinery of the company to pay off liabilities of the banks. The company has submitted its proposal to its lenders who have agreed in principle to allow one year for settlement of their liabilities. Final approval from banks is expected in few weeks therefore directors have started identifying potential buyers. After final settlement with the banks the company shall file for voluntary winding up and proceeds from sale of land, building and remaining machinery will be distributed among shareholders.

In view of the above facts the company is unable to realize its assets and discharge its liabilities in the normal course of business and use of going concern assumption in preparation of these financial statements is considered inappropriate. Therefore, these financial statements have been prepared on liquidation basis. Adjustments made to company's assets and liabilities to reflect their realizable values have been described in detail in the notes to the accounts.