



Financial reporting and auditing alert

Updates on current issues

Issue 2 • March 2009

Dear members,

The Institute's Standards and Quality division is introducing a series of alerts drawing members attention to topical financial reporting and auditing issues that should be given particular attention. In view of the current global financial crisis the first few issues of the alerts will deal with the potential implications for our members involved in preparing and auditing financial statements. The focus of the alerts will change over time as circumstances change. The Institute believes that it is an important element of both its regulatory and member support functions that this channel of communication is established.

Going concern – Assessing an entity's ability to continue as a going concern

1. In this second issue of our new series of alerts, we would like to remind members who are preparers of financial statements and auditors of financial statements, the importance of carrying out an appropriate assessment of an entity's ability to continue as a going concern.
2. **In the context of the current global financial crisis it is clear that the judgment that management, those charged with governance and auditors must make on whether an entity is a going concern is emerging as a highly sensitive issue. Accordingly, addressing these challenges early in the process of the preparation of annual reports and financial statements and their audit are important to help avoid last minute problems or surprises that may unnecessarily unsettle investors, lenders, regulators and analysts.**
3. The requirements for management in relation to the going concern concept when preparing a set of financial statements are set out in HKAS 1 (revised) *Presentation of Financial Statements*. For auditors, HKSA 570 *Going Concern* sets out their responsibilities when auditing an entity's financial statements with respect to the going concern assumption, including considering management's assessment of the company's ability to continue as a going concern.
4. The standards acknowledge that entities with a history of profitable operations and ready access to financial resources may not need a detailed analysis to support the going

concern assumptions. However, the effect of the global financial crisis and the economic downturn are likely to be that such an approach will no longer be appropriate for many entities. For this reporting season preparers and auditors of financial statements need to be alert to issues regarding liquidity, credit and foreign currency risk. A company's position regarding matters such as funding sources and banking arrangements, the validity of cash flow and business plan assumptions, debtor recoverability, inventory valuation and currency fluctuations, may have altered substantially from previous reporting periods creating new uncertainties, or exacerbating those already existing. Many well-respected entities with a long-standing history of profits and availability of credit may find it difficult to obtain or renew financing.

5. Given the international scope of the crisis it is not surprising that there has been a lot of material recently published on the topic around the world. Two items that may be of assistance are an article in the January edition of *A Plus* aimed at preparers (http://www.hkicpa.org.hk/APLUS/0901/Jan09_GoingConcern.pdf) and a bulletin from IAASB for reference by auditors (http://web.ifac.org/download/IAASB_Staff_Audit_Practice_Alerts_2009_01.pdf).
6. Some of the key areas to note in HKAS 1 (revised) are:
 - when preparing financial statements management must make an assessment of the entity's ability to continue as a going concern unless management either intends to liquidate the entity or cease trading, or has no realistic alternative but to do so (HKAS 1.25).
 - When management is aware, in making assessment, of material uncertainties related to events or conditions that may cast doubt upon the entity's ability to continue as a going concern, those uncertainties should be disclosed (HKAS 1.25).
 - In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future. The information should cover at least twelve months from the balance sheet date **but not limited to that period** (HKAS1.26).
7. The main points for auditors to note from HKSA 570 include:
 - when planning, performing and in evaluating the results of audit procedures, auditors should consider the appropriateness of management's use of the going concern assumption in the preparation of the financial statements.
 - the guidance and implications on the appropriate format and wording of the auditor's report when the going concern assumption is appropriate but a material uncertainty exists; when the going concern assumption is inappropriate; and when management is unwilling to make or extend an assessment on going concern.
8. **We strongly recommend that HKAS 1 and HKSA 570 are read carefully.** The standards can be accessed at:

HKAS 1 (revised) *Presentation of Financial Statements*
http://www.hkicpa.org.hk/hksaebk/HKSA_Members_Handbook_Master/volumell/hkas01revdec07.pdf (Applicable for annual period beginning on or after 1 January 2009)

HKAS 1 *Presentation of Financial Statements*


http://www.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumell/hkas01.pdf

(Applicable for annual periods beginning on or after 1 January 2005 but before 1 January 2009)

HKSA 570 *Going Concern*

www.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumell/hksa570.pdf

Sincere regards,

A handwritten signature in black ink that reads "Chris Joy". The signature is written in a cursive style with a long horizontal stroke underneath the name.

Chris Joy
Executive Director
Hong Kong Institute of CPAs