JANUARY 2020

cpab exchange

Going Concern Project Overview

The financial health and ability of reporting issuers to continue as a going concern is important information for users of financial statements. The auditor's responsibility is to obtain sufficient appropriate audit evidence about management's use of the going concern assumption in the preparation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern.

The Canadian Public Accountability Board (CPAB) launched a project in 2019 on this topic. We gathered information to enhance our understanding of how auditors approach their work to review management's assessment of going concern risk. In 2020 we will continue to seek Canadian perspectives and are organizing a working group to further explore going concern. What else can companies, audit committees, auditors, and others do to better inform all relevant stakeholders when companies are faced with challenging financial conditions that may lead to unexpected business failures?

WHAT WE DID

CPAB reviewed a sample of Canadian reporting issuers where management (and the auditor's report) did not disclose a going concern risk but the company had shown some recent financial difficulties. We selected our sample files from publicly available information on all Canadian publicly listed companies in all sectors and looked for indicators of financial challenges, including:

- Significant declines in market capitalization.
- High and increasing debt as a percentage of assets.
- Weakening financial performance.
- Cashflow challenges.

We reviewed the audit files of 11 of these companies varying in size and sector, and looked at:

- How going concern risk was addressed in client acceptance or continuance.
- How the audit team evaluated management's assessment of going concern.
- Communication with those charged with governance.
- Consistency of the going concern evaluation with other parts of the audit file including auditing accounting estimates like goodwill or intangible asset impairment.

WHAT WE FOUND

Every file we reviewed complied with the Canadian auditing standard for going concern.[1] Based on this review, and consideration of changes to auditor requirements in other jurisdictions, we have the following observations and point out areas worthy of continued discussion.

[1] Canadian Auditing Standard 570, Going Concern

OUR OBSERVATIONS

1. Audit firms support their teams to objectively assess going concern risk

Overall, in the files we reviewed we found that audit firms encouraged objective assessments through proactive consultation and support to assess going concern risk. There was strong oversight and support by firm leadership through their quality management systems to monitor and support the work of audit teams. Examples include:

- **Audit teams identified and escalated going concern risk as part of the annual approval process** of reviewing whether to accept or continue with the audit. Going concern was a risk that teams were specifically asked to assess as part of their decision.
- **Firm leadership took part in the annual approval process** which transparently identified and assessed risks and uncertainties against the firm's plans to manage them.
- **Firm leadership included going concern as a factor in determining high-risk audits.** These engagements were subject to greater oversight to ensure the audit team had the resources needed to appropriately address going concern risk.
- **Firms supported the audit team with other activities to monitor their audit portfolio and identify going concern risk** such as tracking news media and scoring companies for the risk of business failure. These activities were ongoing, reflected risk identified in the prior year and were well integrated with their other audit quality management processes.
- **The audit team consulted with auditing experts within the firm** on their approach and execution for managing going concern risk. These consultations were independent of engagement quality control reviews.
- **Firm specialists were engaged to provide expert advice** on complex issues relating to going concern risk. Specialists who provided valuable input to audit teams included corporate finance and IT specialists to examine complex financial models, legal advisors to evaluate contingencies and forensic specialists to assess financial implications of major fraud allegations, in addition to accounting technical experts and firm risk management.

2. Challenging management on alternative scenarios

In the audit files we reviewed, auditors evaluated whether management's forecast supporting its assessment of going concern was anchored in accurate, historical cashflows. They looked for evidence such as contracts to support forecasted revenues and future commitments. Auditors also demonstrated they were corroborating evidence to evaluate whether management's analyses were consistent by comparing going concern assessments with management discussion and analysis, liquidity covenants, sensitivities and impairment testing, as required by the standards.

In some cases, we found there was an opportunity for auditors to increase their application of professional skepticism. This additional challenge to management and application of professional skepticism could be improved by:

- Critically evaluating whether key assumptions are optimistic, realistic or conservative.
- Obtaining and assessing alternative scenarios, such as severe but plausible scenarios to challenge the reasonability of management's assumptions.

3. Audit committee oversight

The audit committee plays a key role in overseeing the determination of whether going concern disclosure is necessary, encouraging open communication among management, the audit committee and the auditor. In the best examples, we saw evidence of robust written communication with audit committees to assess and conclude on the company's required disclosures.

AREAS FOR CONSIDERATION

1 Management's assessment of going concern

Management has the most relevant information to assess the company's future performance and viability and takes the first step in assessing going concern. In the best examples, management prepared a thorough assessment, which the auditor reviewed and challenged. The work that management prepared was similar in depth and nature to their assessments of asset impairment, providing balanced information and analysis that facilitated the auditor's independent evaluation. We noted a range of quality of assessments prepared by management.

The United Kingdom's revised going concern auditing standard (see page 4) requires auditors to obtain an enhanced understanding of the processes that oversee management's assessment. We believe a thorough and thoughtful assessment by management is an important precondition to high quality audit work in this area.

For discussion

- **Should the going concern standard emphasize the importance of understanding management's process for conducting its going concern assessment?**
- **What is the best approach to underscore the importance of a high-quality assessment by management?**

2 Consideration of longer-term assumptions

We saw examples where the audit team had access to longer-term management projections. But the detailed audit analysis was focused on a one-year time frame, as required by the auditing standard.

We understand the challenges of making longer term assessments, especially in industries where there is a high rate of change. However, we also see the reputational harm done when companies fail shortly after the one-year time frame has passed. Do the benefits of examining a longer-term projection to evaluate subjective risks and uncertainties relating to going concern outweigh the costs?

For discussion

- **Should auditors examine a longer time period in their going concern analysis (where that information has been prepared by management)?**
- **What are the challenges to taking this approach?**

ON THE INTERNATIONAL FRONT

Auditing standards in the United Kingdom were recently revised. These amendments enhanced the international auditing standard (the current basis for Canadian audit requirements).

Significant changes to the auditing standard included:

- A more structured risk assessment process.
- An enhanced understanding of the processes that oversee management's assessment.
- A greater emphasis on the evaluation of contradictory evidence.

Going concern is also being considered in other jurisdictions including:

- United States – the Public Company Accounting Oversight Board (PCAOB) is evaluating the impact of recent changes to the accounting standards on their going concern auditing standards
- International – Going concern is being considered by the International Auditing and Assurance Standards Board (IAASB) as part of its consultation on its 2020-2023 work plan.

We are gauging the level of interest internationally to review the going concern standard and will encourage further dialogue among stakeholders in Canada.

WHAT'S NEXT?

It is important to consider whether auditors should do more in the area of going concern and whether such a change would be in the public interest.

CPAB will continue to evaluate the impact of changes to auditor requirements in other jurisdictions and engage with stakeholders, including management, audit committees, auditors, investors, standard setters, other regulators, and academics to understand their perspectives on going concern.

HAVE A VIEW?

CPAB is organizing a multi-stakeholder working group to further explore Canadian perspectives on going concern, focusing on the actions of management, audit committees, auditors, standard setters, and regulators.

We want to hear from you. Please reach out to us at thoughtleadership@cpab-ccrc.ca with your thoughts about this project.

LEARN MORE

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