



# ***‘What good looks like’ Going Concern***

**PRESENTED BY JOHN SELWOOD**

# ***Today's presenter – John Selwood***



## **John Selwood**

- Independent training consultant
- Lectures for the major accountancy training companies, professional bodies, publishers and in-house for larger firms
- Member of ICAEW Technical and Practical Auditing Committee
- Previously been the technical partner for a top thirty firm of accountants and Head of an accountancy network



# ***‘What good looks like’***

## **INTRODUCTION**

# ‘What good looks like’

## Satisfactory

‘no concerns about **audit** quality although the QAD may identify some minor improvement points’



# ‘What good looks like’



## Ground rules

- To help auditors produce audit files that will stand up to scrutiny
- To encourage auditors to respond to the circumstances
- No gold plating

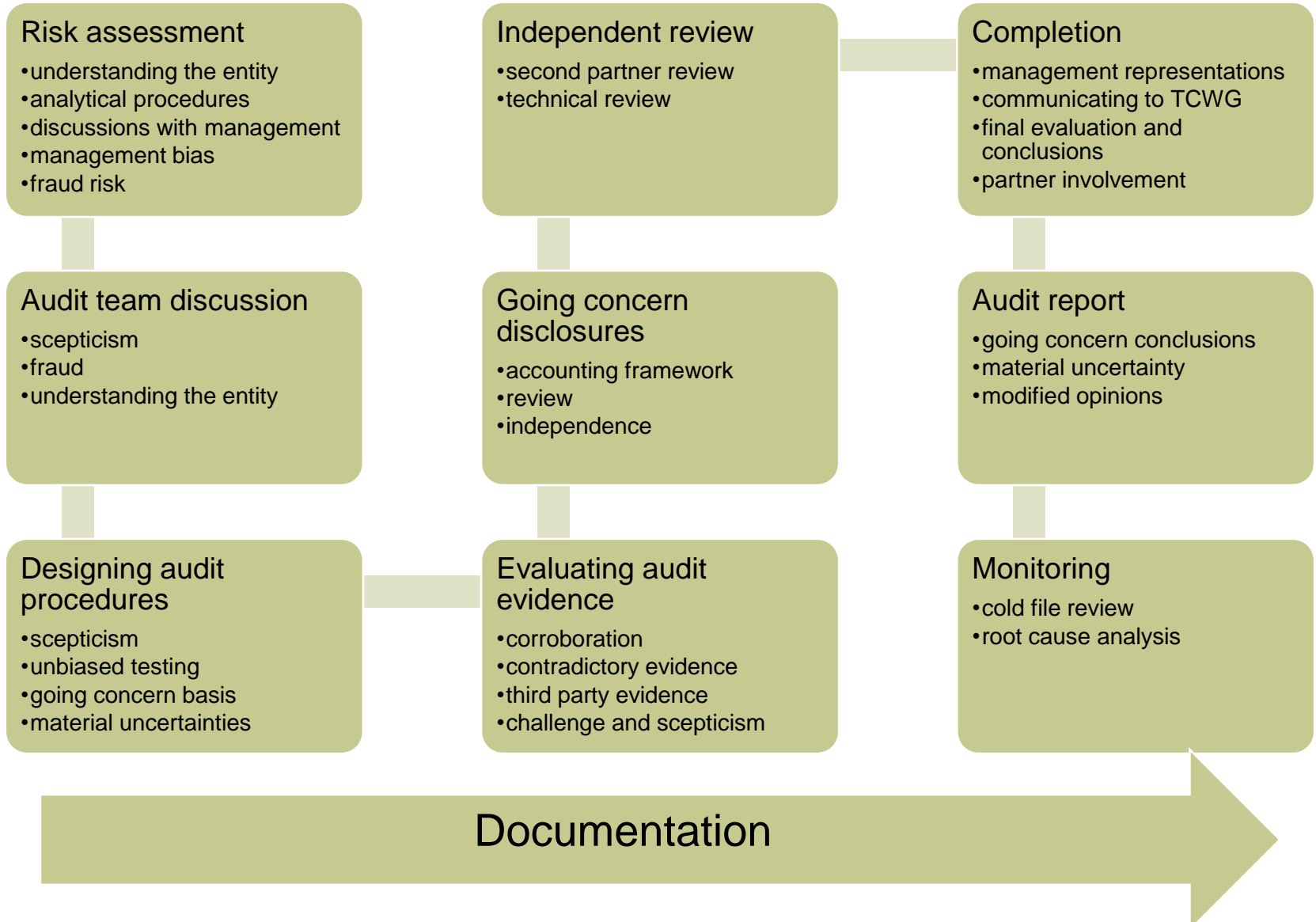
# ‘What good looks like’

## Focus areas

- Not PIEs
- Entities without sophisticated governance structures
- COVID19 and beyond



# Going concern – cradle to grave



# Introduction to the case studies

## Approach

- Realistic scenarios
- Demonstrate current expectations when auditing going concern
- Not based on any specific methodology
- Not to be copied and pasted!
- Each case study has a different focus

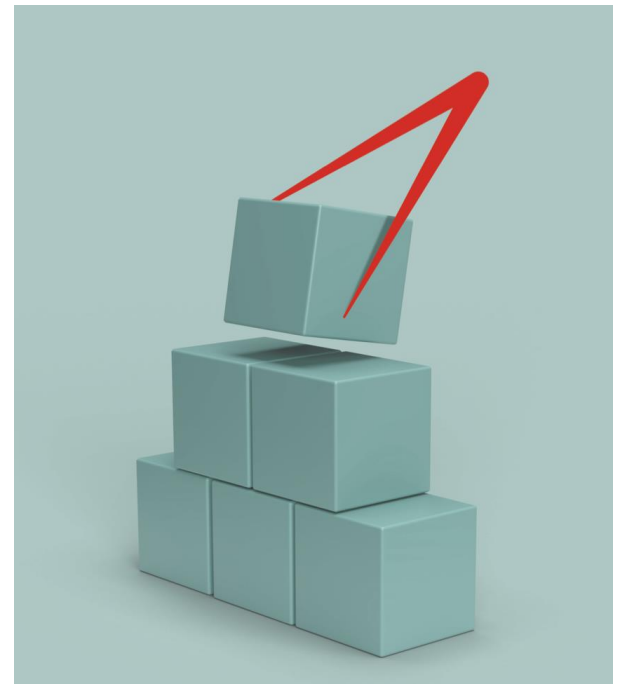
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5	This sheet provides a summary of the audit objectives that are suggested, and indicates which tests satisfy each objective. This should be prepared at the planning stage, tailoring as necessary; checked during execution that the testing meets the set objectives; and reviewed at the completion stage.																																																									
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9	<b>Audit objectives</b>																																																									
10	1 To obtain sufficient appropriate audit evidence and conclude on whether a material uncertainty related to going concern exists.																																																									
11	2 To obtain sufficient appropriate audit evidence and conclude on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.																																																									
12	3 To confirm that all necessary disclosures concerning going concern have been made and that the information is appropriately presented and described.																																																									
13	<b>Planning conclusion</b>																																																									
14	I am satisfied that from the tests planned sufficient appropriate evidence can be gained to satisfy the objectives.																																																									
15	Prepared by: _____									Date: _____																																																
16	Reviewed by: _____									Date: _____																																																
17	<b>Final conclusion</b>																																																									
18	From the audit work carried out I confirm that:																																																									
19	- the work has been performed in accordance with the audit programme.																																																									
20	- the work performed and the results obtained have been adequately documented.																																																									
21	- all necessary information has been collected for the presentation and disclosure in the financial statements.																																																									
	- sufficient appropriate evidence has been obtained to support the audit conclusion reached.																																																									
	- in my opinion (subject to matters highlighted on B6 or B9)* subsequent events are fairly stated/ * not fairly stated as described below.																																																									



# Focus on documentation

## Health warning!

‘It is important how these examples are portrayed as there is no silver bullet as to precisely what good looks like. It is very dependent on the unique circumstances of every entity and needs the appropriate exercise of professional judgment in applying ISA requirements.’





# ***Case Study 2***

WINCHESTER LTD

# Winchester Ltd – extract from planning memo

## **Illustration – Extract from the planning memo**

This is a first-year audit. There have been extensive planning discussions with management that have confirmed the following, to establish our knowledge of the company:

### **Background about the company**

Winchester Ltd was a new start up when it opened four restaurants in the Autumn of 2019.

The company is owned by the friends and family of a famous celebrity chef (John Bernie). Mr Bernie controls the company. There was a significant share issue of £2.5M to fund the business' start up and there are no shareholder/director loans.

### **Impact of COVID19**

Before the first COVID19 lock down in March 2020 all of the restaurants were proving very popular and had good reviews together with months of forward bookings (the booking system was reviewed as part of the walkthroughs). Trading in the summer of 2020 was similarly encouraging, as shown by the management accounts.

During the COVID19 pandemic, Winchester Ltd has taken advantage of all available government assistance including a Coronavirus Business Interruption Loan (CBILs).

# Winchester Ltd – risk assessment

## Illustration – Extract from going concern audit documentation

### **Risk factors and inherent risk assessment**

*A summary of the key indicators and events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.*

### **Updated risk assessment at xx/yy/2021**

#### Current and future trading

At the point that the financial statements are being finalised all four restaurants are open and trading well as seen through daily takings reports. In England the government's strategy remains to lift restrictions in June 2021. Whilst no further lockdowns are planned, uncertainties remain around future trading conditions.

There remain significant audit risks related to going concern. Because of strong trading figures the risks around the use of the going concern basis are reducing but the risks relating to material uncertainties existing and needing to be disclosed remain very high.

Management's delay in finalising the financial statements and management's motivation to avoid what they see as damaging going concern disclosures, both support this risk assessment.

Audit work is highly focused on this. Appropriate responses to these risks are recorded on Sch T1.

#### Post Brexit staff recruitment – new risk identified

It was identified, close to sign off, that a number of news stories were running that as a result of Brexit, foreign nationals working in hospitality had returned home and that there was a shortage of trained staff. see schedule T8 for discussions with John Bernie and T9 for revised cash flow forecasts taking into account the possibility of increased staff costs.

# Winchester Ltd – management bias

## **Illustration – Extract from planning memo relating to going concern**

### **Management bias**

John Bernie is very proprietorial about the restaurants. He considers them to be part of his brand as a TV personality and is very sensitive to anything that the public might view negatively. Because the governance structure is highly informal and John Bernie controls everything it is likely that his attitudes to the restaurants will give rise to strong management bias.

It is possible that this could lead to forecasts being optimistic and any necessary disclosures being overly positive. Also, management might be motivated to conceal evidence of current financial difficulties or future problems, creating a fraud risk. Fraud risks (including management override) are addressed in the risk assessment documentation.

This will have a significant impact on the audit approach and audit evidence, related to going concern, provided by management will have to be addressed with the appropriate level of scepticism.

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# Winchester Ltd – evaluation of management's going concern assessment

## **Illustration – Extract from going concern audit documentation**

### **Evaluation of management's going concern assessment**

Management have prepared a cash flow forecast for the next 12 months, using an extrapolation of the covers served from November 2019 to mid March 2020. This is not an unreasonable method to use but management were asked, by the auditor, to use scenario planning and to consider stress testing. They do not consider this necessary or useful and are confident that their targets are achievable.

Given the assessed inherent audit risks it is possible that management could be overly optimistic in their forecasts and they appear to be ignoring the inherent uncertainties in respect of the possibility of future lockdowns, the possibility of operating at under-capacity due to social distancing reequipments, the health of the economy in general and the prospects for their restaurants in particular. Management have been challenged over this approach but are very confident in their assessment.

The assumptions used by management in their cash flow forecasts have been consistently and properly applied in the cash flows, the cash flows cast, the base data used by management has been reconciled back to bookings when the restaurants first opened in 2019 and the starting point of the forecasts have been agreed back to the latest management accounts (Sch T3.3) The opening bank balance has been checked to the online banking (copied on Sch T4.1) and other

agreed back to the latest management accounts (Sch T3.3) the opening bank balance has been checked to the online banking (copied on Sch T4.1) and other working capital balances have been checked to underlying records.

All key assumptions have been reviewed for reasonableness (Sch T3.4). The most critical assumptions made by management are:

1. As the restaurants fully open in June, it is assumed that the daily number of covers will be at the same level as when the restaurants first opened
2. The average revenue per cover will have increased by 5% since then
3. No further closures for lockdowns or social distancing protocols that might restrict the number of covers served

Management were asked to support these assumptions and provided the following:

- Trading figures from July to October 2020, for average daily covers and average revenue per cover are only 10% below the 2021 forecasts for those months
- The restaurant allows bookings up to 90 days in advance. The bookings diary was inspected and it shows most Fri/Sat/Sun fully booked until early August. Weekends amount to over 50% of revenue.
- The average cover charge for the past two weeks of trading is approximately in line with the forecast

This supports management's assumptions but remains well ahead of expectations in hospitality (see T6 for article in The Restaurateur). Mr Bernie was challenged as to why Winchester Ltd will perform better than other restaurants. He explained that his lockdown cookery TV show was very popular, as was his lockdown cookbook, which have raised his profile.

The assumption that the restaurants would not have to close in the foreseeable future or be forced to restrict the number of covers served due to social distancing protocols (assumption 3 above) was also challenged. Management were unwilling

The assumption that the restaurants would not have to close in the foreseeable future or be forced to restrict the number of covers served due to social distancing protocols (assumption 3 above) was also challenged. Management were unwilling to accept that there was a possibility of further restrictions – see conclusions below.

We have flexed management's forecasts for severe downside scenarios (Sch T7), which demonstrate inadequate headroom to meet obligations as they fall due.

We have also considered the impact of the 5% VAT rate that applied from July 2020. The restaurants did not pass on the VAT saving to their customers when the VAT was lower, so there is no expectation that this might have impacted on bookings or gross revenue, although it did improve the company's profitability.

Also, the basis period for the forecasts is 11/2019 to 3/2020, where the 20% rate applied which is consistent with the rate that management have assumed in all their forecasts. Therefore, the change in VAT does not have an impact on the going concern assessment.

## **Conclusion**

Whilst, management have some good evidence to support their forecasts, there is limited consideration of downside scenarios that might be severe but plausible, particularly in relation to the possibility of further forced closures or limitations to operating through social distancing protocols because of COVID 19.

There is contradictory evidence that suggests management's forecasts could be optimistic. Namely, the possibility of future COVID19 restrictions and the possibility that trading might not be as strong as is hoped. These issues are addressed in our flexed cashflows on T7. This audit work clearly supports the use of the going concern basis.

Therefore, from an audit perspective there is clear evidence of material uncertainties related to going concern because of this. This point has been taken forward to points for the partner to discuss with management.



# Winchester Ltd – documentation

## **Illustration – Extract from going concern audit documentation**

### **Section T Going concern – Contents list**

- T1 Going concern summary memo
  - T2 Source data for forecasts
  - T3.1 Management's cash flow forecasts
  - T3.2 E-mail response from management to questions
  - T3.3 Latest management accounts
  - T3.4 Audit work on cash flow forecasts
  - T4.1 Latest evidence of bank balance
  - T5 Going concern disclosure
  - T6 Supporting articles from industry publications
  - T7 Downside scenario cash flow forecasts
  - T8 Minutes of discussions with John Bernie on post-Brexit staff shortages
  - T9 Revised flexed forecasts with increased staff costs
-

# Winchester Ltd - documentation

Document the  
journey



**Be clear what  
the final  
position is**

Initial risk  
assessment

Changing  
circumstances

Final  
documentation

# Winchester Ltd – second partner review

## Illustration – Extract from going concern audit documentation

### Second partner review

#### Reason for review

Material uncertainty paragraph related to going concern in audit report and possible identified intimidation threat because management are applying pressure to avoid the material uncertainty para.

#### Work done

- Financial statements and audit report reviewed
- Schedule T1 reviewed in detail
- Selected elements of T section reviewed as necessary including communications with management – T3.2
- Meeting with audit partner and manager to discuss going concern issues – this included making some recommendations to improve audit documentation of the work done on management's cash flow assumptions

#### Conclusion

I agree with the conclusion reached by the audit team.

There is sufficient appropriate audit evidence to support that Winchester Ltd is a going concern and there was sufficient work done and challenge of management to identify any material uncertainties related to going concern.

The going concern disclosures are appropriate, as is the wording of the audit report.