



M A L A Y S I A

The Malaysian Institute of
Certified Public Accountants

TECHNICAL INSIGHTS

AUDIT CONSIDERATIONS IN RESPECT OF GOING CONCERN DUE TO THE IMPACT OF COVID-19

The World Health Organisation declared the COVID-19 outbreak to be a pandemic. In Malaysia, the Government is monitoring the development of the COVID-19 pandemic closely as well as is taking stringent steps to contain the spread of the virus. Action taken in response to the COVID-19 outbreak in Malaysia, especially the introduction of the Movement Control Order, has resulted in significant business disruption and heightened the economic uncertainty. Many regulators have also introduced relief measures to help sustain the economy in Malaysia.

The uncertainty in the economy arising from the COVID-19 has also created an impact on the entities that have not been encountered before. This may result in significant financial reporting implications for preparers of financial statements. The same also impacts the work of auditors. In view of this, The Malaysian Institute of Certified Public Accountants (MICPA) wishes to highlight to auditors a specific matter relating to the going concern concept, arising from the changes due to the COVID-19.

Potential Impact of the COVID-19 on Going Concern and the Auditor's Report

The definition of going concern, management and auditor responsibilities relating to going concern and the implications for the audit report have not changed as a result of the COVID-19 pandemic. Nevertheless, this pandemic will have a significant impact on a large number of businesses. Some entities which were previously a going concern may no longer be. Many that continue to be a going concern may now face material uncertainties relating to their ability to continue as such. It is unlikely to be appropriate to take a blanket approach or use boiler-plate wording. Each entity must be assessed based on its own situation.

Is an Entity a Going Concern?

An entity is a going concern unless management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so. For some entities, the impact of COVID-19 may leave management with no realistic alternative but to liquidate or cease trading. Others may need to scale back operations or seek additional finance and some may not be significantly affected.

It is the responsibility of management to make the assessment as to whether the entity is a going concern. 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 date when the financial statements are authorised for issue. The assessment will be specific to the entity's circumstances.

In making its assessment, management would generally be expected to prepare detailed forecasts which, given the rapidly evolving nature of the pandemic, will need to be updated regularly until the financial statements are authorised for issue. These forecasts should reflect potential scenarios and management's plans.

Management should be considering the impact of COVID-19 on customers, suppliers and staff. For example, could the entity continue to operate if staff were not able to physically be present, and how long could the entity survive given the availability of cash resources and the flexibility of its cost base? Management should also consider whether the entity's insurance policies cover any losses arising from the COVID-19 pandemic and if so, how long it might take for a pay-out to be received.

Should the Financial Statements be Prepared on a Going Concern Basis?

If the entity is a going concern, the financial statements should be prepared on a going concern basis. If not, they should be prepared on a basis other than going concern.

An entity shall not prepare its financial statements on a going concern basis if events after the end of the reporting period result in the going concern basis becoming inappropriate. An entity with a year-end of December, 31 2019 may have been a going concern at its balance sheet date, but if now, because of the actual or potential impact of COVID-19, the entity is no longer a going concern, and the financial statements have not yet been authorised for issue, the going concern basis shall not be used.

What about Material Uncertainties?

When management is aware, in making its assessment, that the existing or potential impact of COVID-19 results in there being material uncertainties which may cast significant doubt upon the entity's ability to continue as a going concern, the Malaysian Financial Reporting Standards require those uncertainties to be disclosed in the financial statements.

There is an expectation that management's going concern assessment should take into consideration the existing and potential effects of COVID-19 on the activities of the business. Given the potential impact of COVID-19 and how rapidly the responses to the pandemic are developing, it is likely that the management, of many more entities than before, will now consider there is a material uncertainty relating to going concern. Please take note that this will depend on the specific entity concerned.

The Auditor's Responsibilities

ISA 570 (Revised) *Going Concern* confirms that the auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.

The auditor will only be able to form a conclusion relating to going concern once management has made its own assessment. The auditor should inquire of management and those charged with governance as to what information is available about the future, and determine whether this has been appropriately considered as part of management's

assessment. The auditor should apply similar considerations to those of management, as discussed above, in assessing the appropriateness of the going concern assumption.

If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists.

This should, for example, include a detailed and robust review of up to date forecasts, cash flows, sensitivity analyses and reviews of COVID-19 contingency plans and impact assessments conducted by management, taking into account the risk factors identified and the different possible outcomes. It is important to consider downside situations, for example the impact of the 'Movement Control Order'.

Implications for the Auditor's Report

The implications for the auditor's report will depend on the audit evidence obtained, the basis of preparation adopted and the disclosures made by management in the financial statements.

For example, in a situation where management concludes that the entity is a going concern but the management of the entity is aware of the existence of a material uncertainty. In this circumstance, if the auditor agrees that the entity is a going concern, and the material uncertainty is adequately disclosed in the financial statements, in the auditor's report, the 'conclusions relating to going concern' section should be removed and instead a 'material uncertainty related to going concern' section shall be included.

If management is unwilling to disclose material uncertainties, then the auditor may need to consider issuing a modified auditor's report. Given the unpredictable nature and impact of the COVID-19 outbreak, it might be appropriate to consider the possibility of delaying the approval of the financial statements until more certainty about the impact of COVID-19 is known.

MICPA wishes to thank The Institute of Chartered Accountants in England and Wales for allowing us to reproduce this article. (source: ICAEW insights: Coronavirus, going concern and the auditor's report).