

INTOSAI



*Practice Note to ISA 570*

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## *Going Concern*

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*This Practice Note in combination with the International Standard on Auditing (ISA) 570 "Going Concern" issued by the International Federation of Accountants (IFAC) constitute ISSAI 1570.*

*Practice Note to International Standard on Auditing (ISA) 570 (Revised)*

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# Going Concern

## Background

This Practice Note provides supplementary guidance on ISA 570 (Revised) – Going Concern. It is read together with the ISA. ISA 570 (Revised) is effective for audits of financial statements for periods ending on or after December 15, 2016. The Practice Note is effective the same date as the ISA.

## Introduction to the ISA

ISA 570 (Revised) deals with the auditor’s responsibilities in the audit of financial statements relating to management’s use of the going concern assumption in the preparation of the financial statements and the implications for the auditor’s report.

## Content of the Practice Note

- P1. The Practice Note provides additional guidance for public sector auditors related to:
- (a) Going concern assumption.
  - (b) Evaluating management’s assessment.
  - (c) Additional audit procedures when events or conditions are identified.
  - (d) Use of going concern assumption appropriate but a material uncertainty exists.

## Applicability of the ISA in Public Sector Auditing

- P2. ISA 570 (Revised) is applicable to auditors of public sector entities in their role as auditors of financial statements.
- P3. As explained in paragraph A2 of the ISA, management’s use of the going concern assumption is also relevant to public sector entities. Sovereign governments, and in particular, sovereign central governments, ordinarily do not become legally insolvent or bankrupt because these governments have wide-ranging powers to levy rates, fees or taxes and so are able to adjust their revenues to meet their obligations. Nevertheless, in some cases governments may have substantial net liabilities relative to the size of the economy or their ability to levy rates, fees, or taxes, or may be substantially dependent upon assistance from other governments. While not common, sovereign governments, including sovereign central governments, can become insolvent in the sense of not being able to meet their obligations when they become due when, for example, the rescheduling of obligations is not possible. The inability of a government to discharge its obligations may also be affected by the extent to which the currency issued by the government, or on its behalf by its central bank, continues to be accepted as a medium of exchange to discharge its financial obligations. For this reason, public sector auditors apply the requirements and guidance in the ISA.

## **Additional Guidance on Public Sector Issues**

- P4. ISA 570 (Revised) contains application and other explanatory material with considerations specific to public sector entities in paragraph A1 of the ISA.

### **Going Concern Assumption**

- P5. Public sector auditors may have responsibilities relating to going concern other than those to which ISA 570 (Revised) is directly relevant. Public sector auditors may be required to review and report upon the entity's arrangements to maintain its general financial standing.
- P6. Public sector entities may spend more in one year than they have resources to cover, such that their income may be less than their expenditure or there is an excess of liabilities over assets. However, it is uncommon for the operational existence of a public sector entity to cease or its scale of operations to be subject to a forced reduction as a result of an inability to finance its operations or of net liabilities.
- P7. Cessation of a public sector entity is most likely to result from a government policy decision. A policy decision may be taken to wind up and dissolve an entity in its entirety, to scale back its operations and transfer some of its functions to another public entity, merge with another public entity or privatize the entity. In each of these cases the operational existence of all or part of the entity ceases. Only in the case of dissolution without any continuation of the entity would the going concern basis cease to be appropriate. In the other cases public sector auditors consider the basis on which the activities are transferred, from the viewpoint of the entity that is relinquishing the assets and liabilities at the accounting date.
- P8. In forming a view of the entity's ability to continue its operations, public sector auditors' consideration of going concern embraces two separate, but sometimes overlapping, factors:
- The greater risk associated with changes in policy direction (for example, where there is a change in government); and
  - The less common operational, or business, risk (for example, where an entity has insufficient working capital to continue its operations at its existing level and is unable to raise additional capital).
- P9. To minimize the risk of changes in government policies not coming to the auditor's attention which could impact on the going concern assumption, the auditor ascertains whether:
- The government has declared its intention to review an area of policy affecting the audited entity;
  - A review has been announced and is in progress;
  - A review has indicated that the audited entity could be rationalized or that an entity's future may be re-examined; or
  - There is a government policy to privatize the activities of the audited entity.

## Evaluating Management's Assessment

- P10. Public sector auditors are aware that changes of government policies can have a significant impact on the status and functions of public sector entities. However, political decisions are often no more uncertain than those unforeseeable risks faced by private sector entities.

## Additional Audit Procedures When Events or Conditions Are Identified

- P11. When considering the requirements of paragraph 16 of the ISA, public sector auditors consider whether to request that the entity secures direct confirmation from the department or executive body responsible for providing financial backing or future funding to the entity. When considering requesting such confirmation, public sector auditors take into account any constraints imposed by the political process. In such circumstances, a representation provided by the responsible financial officer of the entity that financial backing or future funding will be received may not be sufficient as meaningful assurance on the future of an entity. This is because the intentions of the financial backer might not be known by the entity.
- P12. In addition to the audit procedures set out in A16 of the ISA, public sector auditors may also read official records of changes in policy and relevant proceedings of the legislature and inquire about matters addressed in proceedings for which official records are not yet available.

## Use of Going Concern Assumption Appropriate but a Material Uncertainty Exists

- P13. When management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, paragraph 19 of the ISA contains requirements for the auditor to determine whether adequate disclosure is made in the financial statements. ISA 570 (Revised) Appendix Illustration 1 provides an illustration of a separate section in the auditor's report with a heading that includes reference to the fact that a material uncertainty related to going concern exists when adequate disclosure is made. ISA 570 (Revised) Appendix Illustration 2 provides an illustration of a qualified opinion when the auditor has concluded that a material uncertainty exists and that the financial statements are materially misstated due to inadequate disclosure. ISA 570 (Revised) Illustration 3 provides an illustration of an adverse opinion when the auditor has concluded that a material uncertainty exists and the financial statements omit the required disclosures relating to a material uncertainty.

Public sector related illustrations of these circumstances are provided in paragraphs P14 to P16 below.

P14. Illustration when the public sector auditors are satisfied as to the adequacy of the note disclosure:

### **Material Uncertainty Related to Going Concern**

We draw attention to Note X in the financial statements which indicates that the Government has undertaken a review of the Agency's future operations but has not yet decided on a course of action. This situation, along with other matters as set forth in Note X, indicates the existence of a material uncertainty that may cast significant doubt about the Agency's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

P15. Illustration of the relevant paragraphs when a qualified opinion is to be expressed because of inadequate disclosure of a material uncertainty:

### **Basis for Qualified Opinion**

The Government has undertaken a review of the Agency's future operations but has not yet decided on the course of action. This situation indicates the existence of a material uncertainty that may cast significant doubt on the Agency's ability to continue as a going concern and therefore the Agency may be unable to realize its assets and discharge its liabilities in the normal course of operations. The financial statements (and notes thereto) do not disclose this matter.

We conducted our audit in accordance with International Standards of Supreme Audit Institutions 1000-1810. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Agency in accordance with the ethical requirements that are relevant to our audit of the financial statements in [jurisdiction], and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

### **Qualified Opinion**

We have audited the financial statements of ABC Agency (the Agency), which comprise the statement of financial position as at December 31, 20X1, and the statement of financial performance, statement of changes in net assets and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the incomplete disclosure of the information referred to in the *Basis for Qualified Opinion* section of our report, the accompanying financial statements present fairly, in all material respects (or "give a true and fair view of"), the financial position of the Agency at December 31, 20X1 and (of) its financial performance and its cash flows for the year then ended in accordance with International Public Sector Accounting Standards.

P16. Illustration of the relevant paragraphs when an adverse opinion is to be expressed because of inadequate disclosure of a material uncertainty:

### **Adverse Opinion**

We have audited the financial statements of ABC Agency (the Agency), which comprise the statement of financial position as at December 31, 20X1, and the statement of financial performance, statement of changes in net assets and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, because of the omission of the information mentioned in the *Basis for Adverse Opinion* section of our report, the accompanying financial statements do not present fairly (or “give a true and fair view of”), the financial position of the Agency as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with International Public Sector Accounting Standards.

### **Basis for Adverse Opinion**

The Government has decided that the Agency will cease the operations and be dissolved within the next year. This indicates a material uncertainty that may cast significant doubt on the Agency’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 operations. The financial statements (and notes thereto) do not disclose this matter.

We conducted our audit in accordance with International Standards of Supreme Audit Institutions 1000-1810. Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Agency in accordance with the ethical requirements that are relevant to our audit of the financial statements in [jurisdiction], and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse opinion.