

Miles CPA Review: AUD

Q1 2018 Updates for 2017 Edition

Summary of updates:

- **“New version” CPA exam structure (w.e.f. April 2017) –**
Time management on the exam
- **AUD-6.1 (II B) – Going Concern Doubt [SAS 132]**

“New version” CPA exam structure (w.e.f. April 2017):

MCQ testlets

50% weightage

Recommended time:

- Testlet #1: 50 mins
- Testlet #2: 50 mins

TBS/WCT testlets

50% weightage

Recommended time:

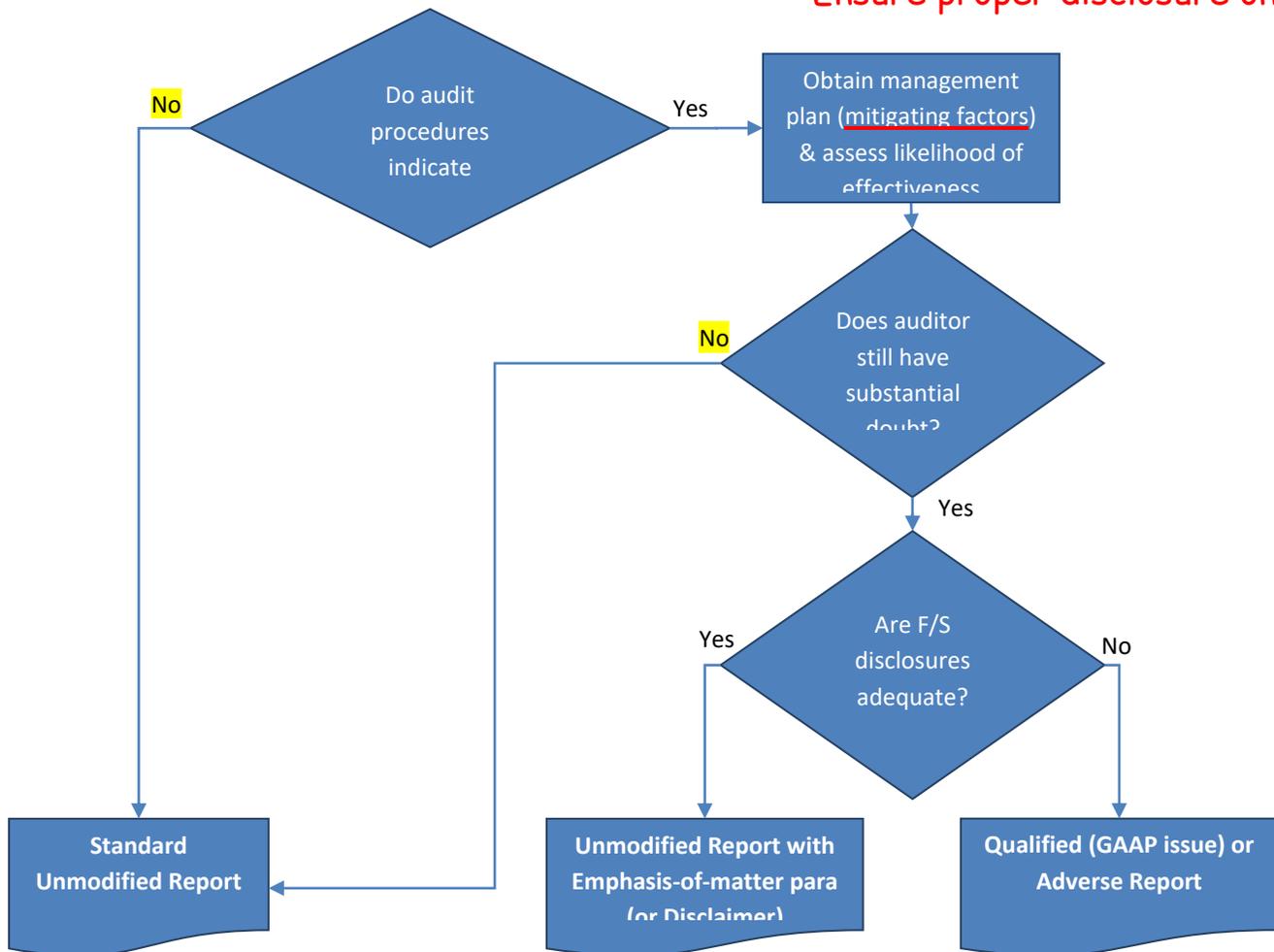
- Testlet #3: 35 mins
- Testlet #4: 50 mins
- Testlet #5: 55 mins

	<u>MCQ testlets</u>		<u>TBS/WCT testlets</u>			
FAR	Testlet #1 33 MCQs	Testlet #2 33 MCQs	Testlet #3 2 TBSs	Break: 15 min	Testlet #4 3 TBSs	Testlet #5 3 TBSs
AUD	Testlet #1 36 MCQs	Testlet #2 36 MCQs	Testlet #3 2 TBSs	Break: 15 min	Testlet #4 3 TBSs	Testlet #5 3 TBSs
REG	Testlet #1 38 MCQs	Testlet #2 38 MCQs	Testlet #3 2 TBSs	Break: 15 min	Testlet #4 3 TBSs	Testlet #5 3 TBSs
BEC	Testlet #1 31 MCQs	Testlet #2 31 MCQs	Testlet #3 2 TBSs	Break: 15 min	Testlet #4 2 TBSs	Testlet #5 3 WCTs

* MCQ - Multiple Choice Question | TBS - Task Based Simulation | WCT - Written Communication Task

AUD-6.1 (II B) – Going Concern Doubt [SAS 132]

Ensure proper disclosure on F/S



- **Background:** In every audit, the auditor needs to determine separately
 - Appropriateness of management’s use of the going concern basis of accounting
 - ✓ Note - If an entity’s liquidation becomes imminent, need to use liquidation basis of accounting
 - Whether “substantial doubt” about an entity’s ability to continue as a “going concern” for a reasonable period of time exists, based on the audit evidence obtained
 - ✓ If yes, evaluate possible F/S effects including adequacy of disclosures (If inadequate disclosure, qualified GAAP or adverse opinion)
 - ✓ Reasonable period of time per SAS = 1 year after the date F/S are issued or are available to be issued [limit to be used for going concern doubts; same limit in US GAAP]
 - ⇒ US GAAP = 1 year after the date F/S are issued (or are available to be issued)
 - ⇒ IFRS = At least, but not limited to, 1 year from the end of the reporting period

➤ **Management responsibility per GAAP**

- **Management evaluation** - Whether there are conditions/events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within 1 year after the date F/S are issued
- **Management plans** - When management identifies conditions/events that raise substantial doubt about going concern, management should consider whether its plans that are intended to mitigate those relevant conditions or events will alleviate the substantial doubt
 - ✓ Considered only to the extent that it is probable that these can be effectively implemented, and would mitigate the relevant conditions/events
- **If conditions/events raised substantial doubt as to going concern, need to disclose** (whether or not the substantial doubt is alleviated):
 - ✓ Conditions/events that raised the substantial doubt as to going concern
 - ✓ Management's evaluation of the significance of the conditions/events
 - ✓ Management's plans (which alleviated the substantial doubt, or was intended to mitigate the substantial doubt)

➤ **Auditor Procedures to identify/evaluate/conclude whether conditions/events, considered in the aggregate, raise substantial doubt about an entity's ability to continue as a going concern**

- When performing **risk assessment procedures**, the auditor should consider whether such conditions/events exist
 - ✓ In doing so, the auditor should determine whether management has performed a preliminary evaluation of whether such conditions/events exist:
 - ⇒ If yes, auditor should discuss the evaluation with management and determine whether management has identified such conditions/events and, if so, understand management's plans to address them
 - ⇒ If not, the auditor should discuss with management the basis for the intended use of the going concern basis of accounting and inquire whether such conditions /events exist
- **Auditor's evaluation** should address management's evaluation of whether such conditions/ events exist
 - ✓ Cover the same period as that used by management in its evaluation as required by GAAP
 - ✓ Include consideration of whether management's evaluation includes all relevant information of which the auditor is aware as a result of the audit
- **Conditions/events** that may indicate "**substantial doubt**" about the entity's ability to continue as a "going concern" for a reasonable period of time include:
 - ✓ **Negative financial trends** - e.g., recurring operating losses, working capital deficiencies, negative cash flows
 - ✓ **Other indications of possible financial difficulties** - e.g., loan default, denial of trade credit from suppliers, debt restructuring, new financing needed, need to dispose substantial assets
 - ✓ **Internal matters** - e.g., work stoppages or labor difficulties, substantial dependence on one project, uneconomic long-term commitments, need to significantly revise operations
 - ✓ **External matters** - e.g., detrimental lawsuit or legislation; loss of a key franchise, license or patent; loss of a principal customer or supplier; catastrophic loss

- **Additional audit procedures when conditions/events are identified:**
 - ✓ Request management to make an evaluation (if management has not yet done)
 - ✓ Consider if any additional info has become available since management's evaluation date
 - ✓ **Few relevant audit procedures:**
 - ⇒ Analytical procedures
 - Analyze and discuss cash flow, profit, and other relevant forecasts with management
 - Analyze and discuss the entity's latest available interim F/S
 - ⇒ Inspect (read) the terms of debentures & loan agreements and determine any breach
 - ⇒ Inspect (read) minutes of meetings of shareholders/TCWG for relevant info
 - ⇒ Inquire of the entity's legal counsel regarding the existence of litigation/claims and reasonableness of management's evaluations/estimates of their outcome
 - ⇒ Evaluate the entity's plans to deal with unfilled customer orders
 - ⇒ Events subsequent to the B/S date (that mitigate or exacerbate the "substantial doubt")
 - ⇒ Confirmation of the existence, terms, and adequacy of borrowing facilities
 - ⇒ Obtain and review reports of regulatory actions
 - ⇒ Determine the adequacy of support for any planned disposals of assets
 - ✓ When the entity has prepared a cash flow forecast
 - ⇒ Evaluate the reliability of the underlying data used to prepare the forecast
 - ⇒ Determine whether there is adequate support for the underlying assumptions, including consideration of contradictory audit evidence (e.g., if assumptions used in the cash flow forecasts are inconsistent with assumptions used to evaluate impairment of goodwill)
 - ⇒ Additionally, the auditor may compare:
 - Prospective financial info used in recent prior periods vs. historical results
 - Prospective financial info used in the current period vs. results achieved to date
- **Any "mitigating factors"** - If substantial doubt exists about going concern exists, auditor should obtain written representation about management plans (mitigating factors), and assess likelihood that the plans can be effectively implemented and would mitigate the relevant conditions/events
 - ✓ E.g.,
 - ⇒ Plans to dispose of an asset or business - Need to consider if any restrictions on disposal? Marketability of asset/business? Possible effects of disposal?
 - ⇒ Plans to reduce or delay expenditures - Need to consider feasibility of plans? Possible effects?
 - ⇒ Plans to borrow money or restructure debt - Need to consider availability and terms of new financing? Existing or committed arrangement for debt restructuring? Possible effect of existing restrictions on additional borrowing? Sufficiency of available collateral?
 - ⇒ Plans to increase ownership equity - Need to consider feasibility of plans? Existing or committed arrangement?
 - ✓ When management's plans include financial support by third parties or the entity's owner-manager and such support is necessary, auditor must obtain sufficient appropriate audit evidence about the intent and ability of such parties to provide the financial support. E.g.,
 - ⇒ Obtaining from management written evidence about the third-party commitment
 - ⇒ Confirming directly with the supporting party

➤ **Auditor's opinion:**

- **Substantial doubt as to going concern** which is properly accounted & **adequately disclosed** = Unmodified opinion with an **emphasis-of-matter paragraph [after opinion para]**
 - ✓ In certain "close-call" situations (e.g., entity's liquidity issues), even if the auditor concludes that substantial doubt has been alleviated by management's plans, the auditor may still include an emphasis-of-matter para to highlight the issues

GAAP
Issues

- Inadequate disclosure in F/S = Qualified opinion (GAAP issue) or Adverse opinion
- Management unwilling to perform evaluation required per GAAP when requested to do so by the auditor = Qualified opinion (GAAP issue) or Adverse opinion
- Use of going concern basis of accounting is inappropriate = Adverse opinion
 - ✓ E.g., GAAP requires F/S per liquidation basis of accounting (not going concern basis) when an entity's liquidation becomes imminent

GAAS
Issues

- Auditor unable to gather sufficient appropriate audit evidence = Qualified opinion (GAAS issue) or Disclaimer
- Extreme uncertainties such that the auditor is unable to form an opinion on F/S = Disclaimer

➤ **Illustration of Audit Report with Emphasis-of-matter para for substantial going concern doubt:**

[Introductory paragraph]

Management's Responsibility for the F/S

Auditor's Responsibility

Opinion

Emphasis-of-matter

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that **substantial doubt** exists about the Company's ability to continue as a going concern. **Management's evaluation** of the events and conditions and **management's plans** regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.