

Snapshot 5: Going Concern

Introduction

This snapshot explores the reporting of going concern within auditor's reports. Auditors are required to conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

UK auditing standards and other regulations require reporting on going concern to be included within the auditor's report. These include a consideration on the use of the going concern basis for preparing the financial statements, as well as the directors' viability statement and consideration of principal risks. The auditor may also disclose that going concern was a Key Audit Matter for the audit of the financial statements.

2 Patterns of going concern reporting by audit firm and market segment

Of the two primary channels for reporting heightened risks on going concern to users in auditor's reports, the use of a Key Audit Matter on going concern was most used. The use of MURGC paragraphs was comparatively rare. GC KAMs were also most reported for large AIM and FTSE 250 companies than for FTSE 100 companies. There was also little difference in the propensity, in aggregate, for Big 4 and Challenger firms to issue GC KAMs.

Figure 2 shows the proportion of auditor's reports which include a MURGC or a GC KAM for FTSE 100, FTSE 250 and large AIM companies. Out of 396 reports, 7 (2%) included a MURGC paragraph. No MURGCs were issued for FTSE 100 companies.

A total of 57 (14%) auditor's reports included a GC KAM. There is a clear gradient between the different market segments, with GC KAMs issued least frequently for FTSE 100 companies, and most commonly for large AIM companies. Only 5% of FTSE 100 companies received a GC KAM, compared to 15% of FTSE 250 companies and 21% of large AIM companies.

There was no noticeable difference in the propensity for the different audit firm groups to include a GC KAM (**Figure 3**). The Big 4 issued GC KAMs in 14% of their reports. The equivalent figure for Challengers was 17%.

Fig. 2: Going Concern reporting by market segment

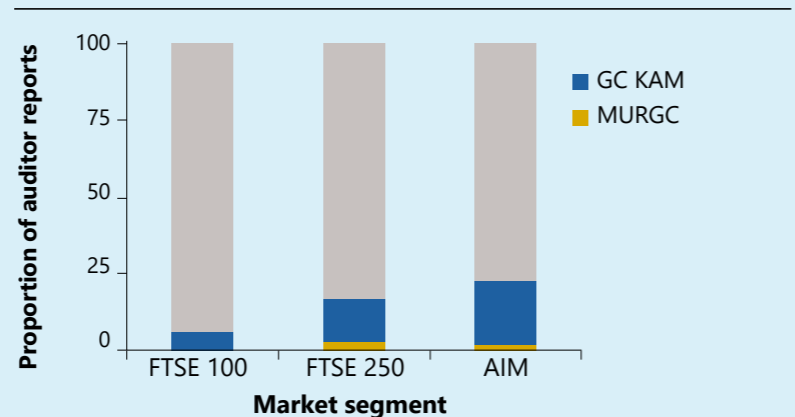
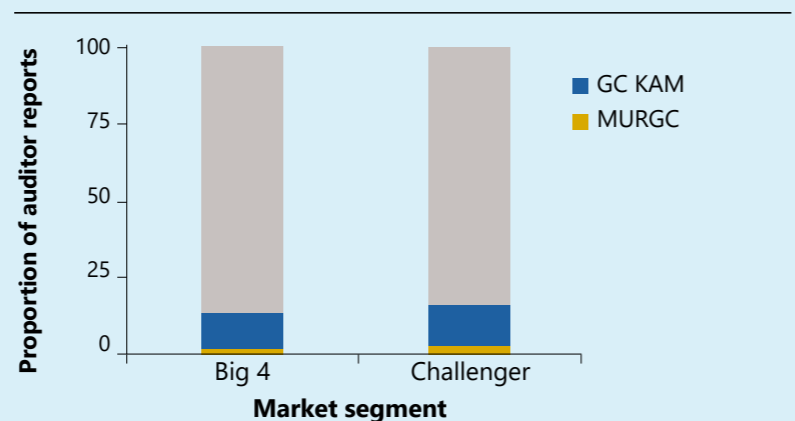


Fig. 3: Going concern reporting by audit firm



1 The structure of going concern reporting

UK audit firms used a variety of different approaches to structuring their disclosures on going concern. Many firms had a particular 'house style' when providing information to users, often split between different sections of the auditor's report.

The auditing standards include several avenues by which matters relating to going concern could be communicated. These are described by the **guidance** published by the FRC in April 2020. Three avenues were used in the auditor's reports in the sample:

1. UK auditing standards require the inclusion of a 'Material Uncertainty relating to Going Concern' (MURGC) paragraph when factors or circumstances exist which may cast significant doubt on a company's ability to continue as a going concern. The inclusion of this paragraph does not represent a modification to the overall audit opinion.
2. The auditor may determine that going concern was a Key Audit Matter (GC KAM), as it was one of the matters which were of most significance in the audit of the financial statements for the period being reported on.
3. All auditor's reports are required to include a 'Conclusions on Going Concern' paragraph, even when no MURGC paragraph exists. This includes a statement that the auditor has not identified any material uncertainties in relation to going concern, a statement that the preparation of the financial statements on a going concern basis is appropriate, and (for companies that apply the UK Corporate Governance Code) whether the auditor has anything to add or draw attention to about whether the directors considered it appropriate to adopt the going concern basis of accounting. As this is required for all reports, these disclosures do not provide a means for differentiating the degree of risk around going concern between different companies.

Fig. 1: Approaches to Going Concern Reporting

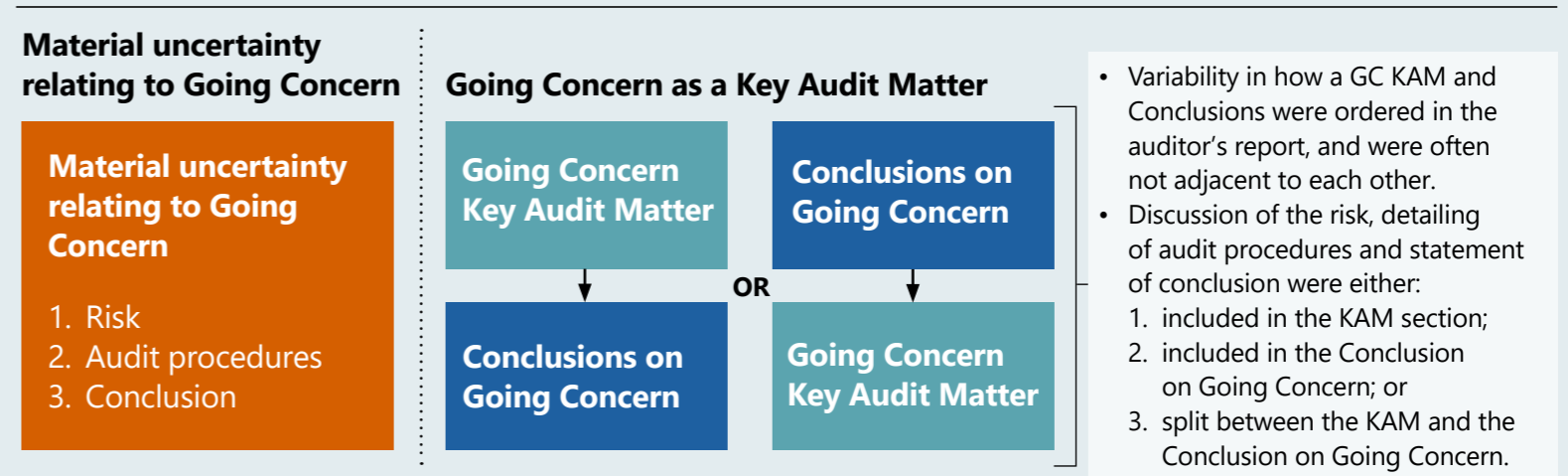


Figure 1 summarises the different approaches to disclosing information on going concern whether the auditor discloses that there is a material uncertainty on going concern, or that going concern was a key audit matter. For the instances where a MURGC paragraph was issued, this included disclosures by the auditor on the nature of the risk around going concern, the audit procedures performed in response to that risk, as well as the conclusion reached by the auditor.

There was considerably more variety when a GC KAM was included in the auditor's report. Firms adopted different approaches in positioning the 'Conclusion on Going Concern' paragraph either before or after the discussion of Key Audit Matters. In addition, the description of risk, audit procedures, and conclusions could be split between or even duplicated in the Key Audit Matter section and the 'Conclusion on Going Concern' paragraph. While each audit firm tended to be consistent in how the disclosures were treated within their own auditor reporting 'house style', there is considerable variation in approach between the different firms.

3 Patterns of going concern reporting by industrial sector

The frequency with which auditor's reports included discussion of going concern varied considerably by industrial sector. Many sectors did not have a single GC KAM included in an auditor's report. For other sectors, GC KAMs were very common.

Figure 4 shows the proportion of companies in each industrial sector that had a GC KAM included in their auditor's report. Over half (56%) of companies in the Travel and Leisure sector received a GC KAM, with a similar proportion (50%) of companies in the Constructions & Materials sector. The high proportion of GC KAMs within these sectors reflects the ongoing impact of pandemic conditions during 2020 and 2021, which hit these sectors particularly hard. In addition, 29% of companies in the Technology sector also had GC KAMs within their auditor's report; these were disproportionately drawn from large AIM companies.

There were a number of sectors which did not include any auditor's reports with GC KAMs, including companies in the Banking, Insurance and Utilities sectors.

Fig. 4: Going concern reporting by industrial sector



4 The content of going concern reporting

Auditor's reports included specific procedures adopted by the auditor in response to risks posed by going concern. **Figure 5** shows the proportion of auditor's reports that include detailed information about audit procedures performed on going concern. A high proportion of reports include such information, and there is a similar propensity for both the Big 4 and Challenger firms to include this information. However, the inclusion of this information was marginally higher for FTSE 100 companies (96%), and less common for large AIM companies (89%).

The auditing standards require auditors to include further reporting where companies follow the UK Corporate Governance Code. Companies listed on the Main Market of the London Stock Exchange are required to follow the Code under the requirements of the Listing Rules, while companies listed on AIM are not required to adopt the Code. Unsurprisingly, almost all reports issued for FTSE 100 and FTSE 250 companies referred to the Listing Rules in relation to going concern (**Figure 6**). It is interesting to note that a number of large AIM companies follow these requirements despite not being required to.

Auditor's reports are also required to add or draw attention in relation to any inconsistencies identified between the directors' viability statement and disclosures on emerging and principal risks on the one hand, and the financial statements on the other (**Figure 7**). Just over one fifth (22%) of reports included a separate discussion of these matters, and they were primarily issued for FTSE 350 companies. Such reports were primarily issued by two audit firms. This section was typically separate from other parts of the auditor's report that considered going concern issues.

Fig. 5: Specificity of procedures on Going Concern

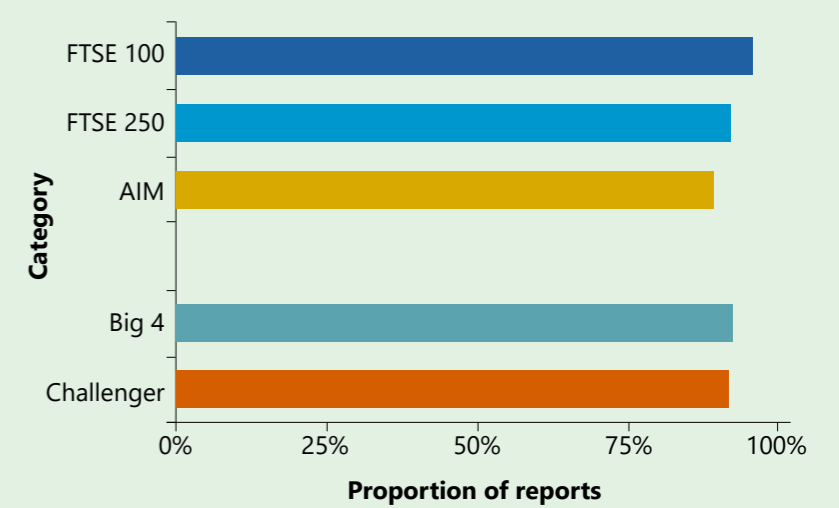


Fig. 6: Reference to Listing Rules on Going Concern

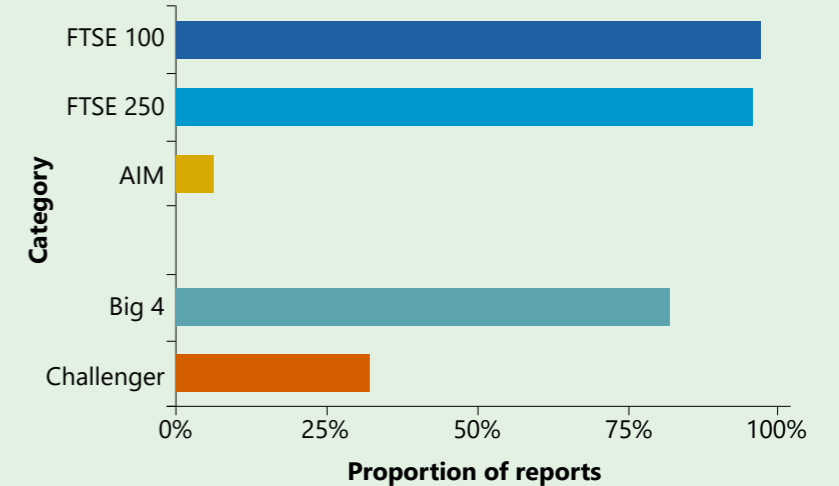
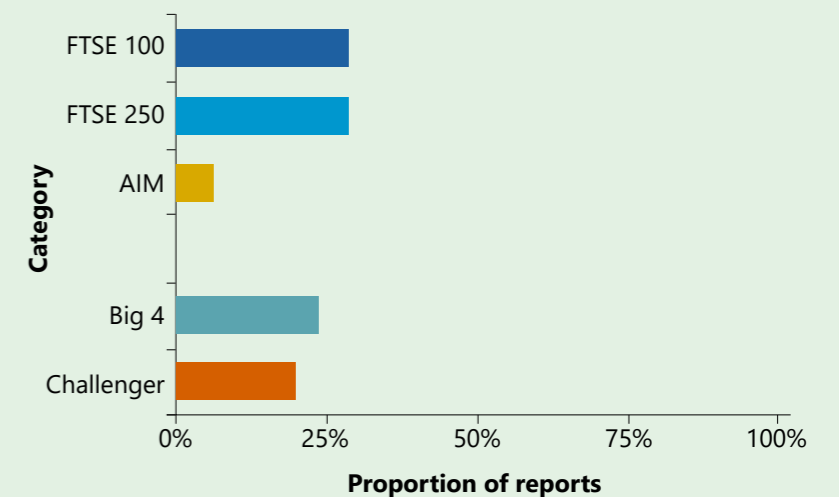


Fig. 7: Inclusion of separate section on viability statement



Summary

- **Key Audit Matters on going concern** were the main channel for reporting whether the auditor had identified heightened risks on this matter during the audit. **MURGC** paragraphs were rarely issued for companies within the sample.
- While firms adopted different approaches to how they **structured their reporting** on going concern issues when a GC KAM was identified, the content was broadly consistent between different reports. However, this detail was often fragmented between different sections of the auditor's report.
- **Key Audit Matters relating to going concern** are more commonly issued for FTSE 250 and large AIM companies than FTSE 100 companies, and for economic sectors which were most heavily affected by the pandemic.
- Auditor's reports also provide detailed information on **audit responses** to the risk of going concern.

Acknowledgements

This snapshot is based on an analysis of 396 auditor's reports issued during 2021, and commissioned by the FRC from a team of academics based at the Universities of Portsmouth, Southampton, and Brunel.



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