

## Going Concern Uncertainty: What Do Firms Disclose?

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*We examine disclosure of going concern uncertainties by Australian companies. We begin by outlining the extant reporting framework applicable from accounting and auditing standards, and compare the approach to this issue taken across several different countries – Australia, New Zealand, the United Kingdom and the United States. We then examine reporting of going concern uncertainties for a selection of 127 Australian companies reporting at 30 June 2020 that also receive modified audit reports highlighting going concern issues. Our results indicate substantial variation in the specific requirements of audit and accounting standards impacting going concern disclosure across jurisdictions, with relevant disclosure guidance for Australian entities primarily contained in auditing, rather than accounting, standards. Not surprisingly then, we also observe significant variation in management reporting practices. These results inform our understanding of existing disclosure requirements and highlight how regulatory reliance on auditor discussion of going concern issues likely results in relatively limited management disclosure. We suggest that additional guidance may be required from accounting standard setters and also regulators with respect to management discussion of going concern uncertainty.*

Timely and transparent disclosure of uncertainties associated with the future, and especially the appropriateness of treating an entity as a going concern, have been on the agenda of international regulators and accounting standard setters for some time (FASB 2014; FRC 2014a, 2019a). Over the past decade, significant media attention directed towards high-profile corporate collapses in several countries has prompted not only criticism of the auditing profession (IAASB 2020), but also of the appropriateness of management disclosure guidelines and regulation. In Australia, a parliamentary inquiry also recently suggested the need to improve disclosure regarding management's assessment of going concern (PJC 2020). Although this inquiry was primarily focused on allegations of deficiencies in auditing processes, it also recommended that a formal review should be undertaken of the 'sufficiency and effectiveness' of existing Australian reporting requirements in relation to management's assessment of whether the entity should be regarded as a going concern. Our summary of existing regulatory practice in major international capital markets, as well as our review of reporting practice by a selection of Australian companies with significant going concern uncertainties, is intended to provide relevant background for assessing the likely need for further action.

The issue of going concern reporting and the associated financial statement impacts remain of interest to regulators, standard setters, preparers and users of financial statements (Bakarich and Baranek 2020). Key concerns have for some time related to the lack of specific guidance from accounting standard setters regarding the format and content of going concern disclosures, the appropriate accounting approach to adopt when the going concern assumption is not valid and the role of the auditor in going concern assessments (AASB 2021; FASB 2014). These concerns are potentially exacerbated by broader economic and social shocks such as those associated with COVID-19, potentially resulting in increased uncertainty which can, in turn, disproportionately affect the ability of many entities to continue as a going concern (AASB and AuASB 2020).

We consider relevant accounting and auditing standards across several jurisdictions relating to going concern reporting, identifying several areas of inconsistency

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that are likely to give rise to variation in reporting practice. Our survey of international regulations impacting management disclosures around going concern uncertainty covers Australia, New Zealand, the United Kingdom (UK) and the United States (US).<sup>1</sup> Across these countries, there is considerable variation in current requirements regarding management discussion of going concern uncertainty. However, while disclosure requirements facing preparers varies considerably, all countries have in common a history of relying primarily on guidance directed at the auditor rather than preparers. We note that this is arguably inconsistent with a basic tenet of the regulations in all of these markets wherein the primary responsibility for the veracity of the financial statements lies with preparers rather than auditors.<sup>2</sup> Overall, we characterise the Australian regulatory environment as being more 'auditor-reliant' than those of New Zealand, the US and the UK.<sup>3</sup>

We also provide descriptive evidence of management disclosures of going concern uncertainty from a selection of Australian listed companies with auditor going concern modifications for fiscal year-end June 2020. In doing so, we provide evidence of what Australian firms disclose, in an environment characterised by potentially heightened uncertainty due to the effects of the COVID-19 pandemic.<sup>4</sup> It is apparent from our analysis that there is substantial variation in what management reports, even though the examples we identify have a common auditor qualification regarding material uncertainty around the going concern assumption. This diversity supports the contention that further guidance is required to clarify management's responsibility to discuss such uncertainty.

The assessment of going concern uncertainty is both a management and auditor responsibility. In theory, management is responsible for assessing the entity's ability to continue as a going concern. This assertion by management should then be subsequently evaluated by the auditor. In practice, however, both management and auditor have obligations to assess uncertainty about the ability of an entity to continue as a going concern. Hence, we expect that management disclosures regarding going concern uncertainty and the content of the audit report can be considered as the result of a joint process involving the client management, auditor, audit committee and board of directors. Since we document variation in reporting practice, a case can be made for additional international reporting guidance to promote consistency. Such variation also creates opportunities for further research, which we discuss in later sections.

A key contribution of our study is to inform debate about the nature and extent of guidance required from regulators and standard setters on going concern reporting. The Australian Accounting Standards Board (AASB) staff paper (AASB 2021) collected feedback from outreach activities over the period July 2020 to

March 2021. This feedback suggests that there are issues with regard to inconsistency and inappropriate reporting of going concern disclosures. The report recommends that the International Accounting Standards Board (IASB) revisit IAS 1 to develop specific examples and guidance for preparers on how to assess and disclose going concern matters. Thus, our study provides timely empirical evidence to highlight the variation in reporting practice and the nature and type of reporting guidance required.

## Survey of International Regulation and Evidence

To better understand the current state of Australian regulation, we benchmark Australian regulatory requirements impacting the disclosure and discussion of material going concern uncertainty with the requirements applicable in New Zealand, the UK and the US. We briefly consider how current regulations have evolved in each setting, as well as relevant academic research.

### Australia

Three primary forms of disclosure requirements impact the disclosure and discussion of material going concern uncertainties for Australian firms. These are financial reporting requirements (i.e., accounting standards), legislative requirements directed at directors and auditing standards. We briefly discuss each of these in turn.

Following International Accounting Standard IAS 1 *Presentation of Financial Statements*, Australian Accounting Standard AASB 101 *Presentation of Financial Statements* requires management to assess the entity's ability to continue as a going concern when preparing financial statements (AASB 2015: paras 25–26). The IFRS Interpretations Committee (IFRIC 2014) discussed a situation in which management of an entity had considered events or conditions that 'may cast significant doubt upon the entity's ability to continue as a going concern' but management considered that no disclosure was required under paragraph 25 of IAS 1. The IFRIC observed that IAS 1 requires disclosure of the judgements (IASB 2007: 122) and estimations (IAS 2007: 125) made in applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.<sup>5</sup>

Entities must also consider the impact of any events that occur after the end of the reporting period up until the date of signing the financial report (AASB 2018: para. 3). If the entity determines after the reporting period that it intends to liquidate or to cease trading, it shall not prepare its financial statements on a going concern basis (see AASB 2018: paras 14–16). In such

instances, there is no specific guidance provided on the basis on which the accounts should be prepared.

In a recent Staff Paper, the AASB noted concerns around the inadequacy of going concern disclosures (AASB 2021). It also noted that this concern was a global issue and therefore needed to be addressed at an international level (AASB 2021). The subsequent local and international outreach undertaken by AASB staff focused on understanding the fundamental issues around the current going concern disclosures required by IAS 1. The results of this outreach were presented to the IASB to support a recommendation to improve IFRS.

In addition to requirements that arise directly from applicable accounting standards, the *Corporations Act* (2001) requires audited financial reports to include a statement by those charged with governance of the entity regarding its solvency. The *Corporations Act* (2001) defines 'solvency' as being able to pay all debts, as and when they become due and payable (section 95A(1)).

Consistent with IAS, Auditing Standard ASA 570 *Going Concern* details an auditor's responsibilities relating to going concern and the associated implications for the auditor's report (AuASB 2015). ASA 570 requires that auditors evaluate and conclude, based on the audit evidence obtained, the appropriateness of management's assessment of the entity's ability to continue as a going concern (AuASB 2015: paras. 6–7).

However, ASA 570 also differs in some respects from the equivalent international standard. For example, ASA 570 paragraph Aus 13.2 defines the relevant period for going concern assessments to be 'approximately' 12 months from the date of the auditor's current report to the expected date of the auditor's report for the next reporting period. In contrast and as we see below, IAS refer to 'at least' 12 months, while US standards refer to 12 months from the date of the financial statements being issued.

ASA 570 *Appendix 1* usefully links going concern opinions to different types of audit reports, while *Appendix 2* of the standard provides examples of audit reports that conform to the *Corporations Act* (2001). ASA 570 requires that in circumstances where a material uncertainty exists, the *auditor* [emphasis added] shall determine whether the financial report:

- (a) Adequately discloses the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and
- (b) Discloses clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business. (AuASB 2015: para. 19)

Research has shown that a distinct feature of the Australian context is the frequent use of auditor reports identifying material uncertainties related to issues of going concern that do not rise to the level of a modified audit report (e.g., Carson et al. 2019). Appendix A contains a typical example of a note to the financial statements and the associated audit opinion when a material uncertainty related to going concern is identified. In such instances, the auditor's report typically refers to:

- a material uncertainty related to going concern;
- a reference to a note to the financial reports;
- a reference to a key issue such as losses, working capital deficiency, need for ongoing financing or other issues; and
- whether the opinion is modified with respect to this matter.

The notes to the financial reports that identify material uncertainties typically include:<sup>6</sup>

- a statement that the directors believe it is appropriate to prepare the consolidated financial statements on a going concern basis;
- a statement of the issues or events giving rise to the uncertainty, which repeats the information contained in the auditor's report and may or may not provide additional information on events or conditions;
- a statement of the directors' belief in the continuing viability of the company and its ability to meet its debts and commitments as they fall due conditional on plans or future events;
- a listing of plans or events upon which the future viability is dependent; and
- a statement of actions and plans to deal with these events or conditions such as raising additional equity, negotiations with lenders or creditors, cost saving measures or other relevant information.

Carson et al. (2019) document few incidences where listed companies fail without a previous going concern issue noted in the financial statements and audit reports, although we note that careful interpretation of this finding is required since there is less recent evidence of the large, high-profile listed company collapses in Australia that have occurred in other jurisdictions. Carson et al. (2019) also document high levels of audit reports emphasising going concern-related issues for listed companies that do not fail within a 12-month period. Contrary to concerns in the UK, Australian auditors issue far more warnings about future viability than the relatively few failures that have occurred.<sup>7</sup>

A contrast between the accounting and auditing standards is that AASB 101 includes only two paragraphs regarding the assessment of going concern, while ASA 570 provides considerably more guidance around going concern and the need for disclosure. For example,

ASA 570 refers to management 'making a judgement, at a particular point in time, about inherently uncertain future outcomes of events or conditions' (AuASB 2015: para. 5). ASA 570 also details factors relevant to the management judgement including the degree of uncertainty, the size and complexity of the entity and the need to consider events subsequent to when the judgement was made (AuASB 2015: para. 5).

An additional issue is that AASB 101 provides no guidance on the appropriate basis for accounting, including the measurement basis, when the going concern assumption is not made. A key implication of the going concern assessment is to determine whether most accounting standards apply or whether some version of 'liquidation accounting' should be used. However, accounting standards do not contain guidance on recognition and disclosure under liquidation accounting. While assessment of the going concern assumption is required by AASB 101, in the rare instance (at least for listed firms) when the going concern assumption is deemed as not appropriate, it is effectively left to management to choose accounting policies that should be applied in preparing financial statements which best meet the information needs of users.

Although ignored in most standard-setting documents, the going concern assessment with regard to interim reports is also a major issue. For example Grosse and Scott (2021) find a strong negative market reaction to going concern issues disclosed in the course of the review of interim financial statements, with no significant difference in market reaction to interim or annual going concern opinions. They also find that going concern opinions expressed in interim financial reports are significant predictors of similar opinions in annual financial reports. Overall, they conclude their results show that going concern conclusions contained in interim financial statements provide investors with new and relevant information (Grosse and Scott 2021).

## New Zealand

Like Australia, New Zealand applies accounting standards issued by the IASB. However, as part of its COVID-19 response, the New Zealand Accounting Standards Board (NZASB) decided to supplement the going concern requirements in IAS 1 with additional specific disclosure requirements. These requirements reflected concerns over diversity of information being disclosed in practice and the perceived disconnect between the requirements of accounting and auditing standards. The proposed requirements serve to better align the disclosure requirements in accounting standards with the requirements in auditing standards for auditors to assess the adequacy of going concern disclosures (NZASB 2020a). Narrow scope amendments were

achieved through adding further disclosure requirements to FRS-44 *New Zealand Additional Disclosures*, a standard that prescribes specific NZ disclosures required in addition to those required under New Zealand IFRS (NZASB 2020a, 2020b).

With regard to material uncertainties, FRS-44 requires:

When such material uncertainties exist, to the extent not already disclosed in accordance with paragraph 25 of NZ IAS 1, an entity that prepares its financial statements on a going concern basis shall disclose:

- (a) that there are one or more material uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern;
- (b) information about the principal events or conditions giving rise to those material uncertainties;
- (c) information about management's plans to mitigate the effect of those events or conditions; and
- (d) that, as a result of those material uncertainties, it may be unable to realise its assets and discharge its liabilities in the normal course of business. (NZASB 2020: para. 12A.1)

Feedback on the proposed changes to FRS-44 also provided some insight into auditor concerns that financial report preparers are 'not required to comply with auditing standards' (CA ANZ 2020: 1), therefore auditing standards should not be used to prescribe disclosure requirements. This can result in tension between management and auditors in practice (CA ANZ 2020). Feedback also highlighted some support for adding a project to the IASB agenda to look at going concern more comprehensively (CA ANZ 2020; CPA Australia 2020).

## United Kingdom

The 2014 UK Corporate Governance Code (FRC 2014a) includes a requirement for a 'longer term viability statement' (provision C.2.2). The code is applicable to listed firms with periods commencing on or after 1 October 2014. The Code also includes the following requirements:

a statement from the directors explaining how they have assessed the prospects of the company (taking account of the company's current position and principal risks), over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary. (FRC 2014a: C.2.2)

Under the Code, when providing a statement of the nature described above, the board of the entity must make a number of decisions:

1. The lookout period. The viability statement provides the board with the freedom to choose the period of their assessment but the FRC's Guidance indicates that this period should be 'significantly longer' than 12 months (FRC 2014b: 19).<sup>8</sup>
2. The principal risks to be factored into the analysis in terms of impact and timing. The Code requires the directors to explain 'how they have assessed the prospects of the company' taking account of 'the company's current position and principal risks' (FRC 2014a: C.2.1).
3. The nature and extent of supporting analysis the board will want to see. The Guidance states that the assessment should include 'sufficient qualitative and quantitative analysis, and be as thorough as is judged necessary to make a soundly based statement' and that 'stress and sensitivity analysis will often assist the directors making the statement' (FRC 2014b: 19).
4. The qualifications and assumptions to disclose within the statement (FRC 2014a: C.2.2). The board would be expected to draw attention to any assumptions, limitations or qualifications deemed necessary.
5. The location of the statement within the annual report (Deloitte 2015). The board has options as to the location of this statement within the financial reports. The statement can be included: 1) in the strategic report, typically near the discussion of the principal risks and other risk management disclosures; 2) in the corporate governance statement; or 3) in the directors' report with or near the going concern statement.<sup>9</sup>

UK auditing standards on going concern follow international standards (IAASB 2015). The FRC has proposed to increase the work required of auditors when assessing whether an entity is a going concern. The FRC proposed consultation on important revisions to ISA 570 (UK) following 'concerns about the quality and rigour of audit and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after as well as findings from recent FRC Enforcement cases' (FRC 2019a).

More specifically, the FRC has proposed

- auditors make greater effort to more robustly challenge management's assessment of going concern, thoroughly test the adequacy of the supporting evidence, evaluate the risk of management bias, and make greater use of the viability statement;
- improved transparency with a new reporting requirement for the auditor to provide a conclusion on

whether management's assessment is appropriate, and to set out the work they have done in this respect; and

- a stand back requirement to consider all of the evidence obtained, whether corroborative or contradictory, when the auditor draws their conclusions on going concern. (See FRC 2019a, also 2019b)

The UK has had a history of high-profile company failures. In the early 1990s 'scandals at Maxwell, Bank of Credit & Commerce International (BCCI), Polly Peck, Levitt, Dunsdale and Barlow Clowes raised concerns about auditor and director obligations, especially as apparently healthy companies seem to collapse within a short-period of receiving unqualified audit reports' (Sikka 2003: 196). The Cadbury Committee recommended in 1992 that '(a) directors should state in the report and accounts that the business is a going concern, with supporting assumptions or qualifications as necessary; (b) the auditors should report on this statement ...' (Cadbury Committee 1992: 43). These recommendations were essentially adopted in two auditing standards, SAS 600 *Auditors' Report on Financial Statements* issued in May 1993 and SAS130 *The Going Concern Basis in Financial Statements* issued November 1994. Citron and Taffler (2002) found a significant increase in auditor report modifications and disclosure for going concern issues after the issuance of SAS 600.

Wu et al. (2016) studied UK-incorporated, non-financial companies listed on the LSE that failed between 1997 and 2010. They found that only 34% of the failed companies received an auditor's going concern modification prior to failure. Klumpes et al. (2016) studied financial reporting for UK-listed firms during the transitional 2013–2014 reporting years following the update to the UK Corporate Governance code issued in 2012 and found that virtually no firm in their sample voluntarily provided a viability statement ahead of the prescribed implementation.

## United States

Prior to the FASB's issuance of ASU 2014–15 in August 2014, guidance in the US related to going concern uncertainties was contained only in the auditing standards. The FASB's Accounting Standards Update (FASB 2014) requires management to evaluate whether there is substantial doubt about the firm's ability to continue as a going concern. Management is required to provide disclosures regarding the firm's ability to continue as a going concern in the financial statements, typically in footnotes, effective for fiscal years ending after 15 December 2016.

ASU 2014–15 specifically requires financial statement disclosure of:

- conditions or events that raise substantial doubt about the entity's ability to continue as a going concern,
- management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations, and
- management's plans to mitigate substantial doubt about the entity's
- ability to continue as a going concern. (FASB 2014: 3)

The Public Company Accounting Oversight Board (PCAOB)<sup>10</sup> auditing standard AS2415 *Consideration of an Entity's Ability to Continue as a Going Concern*, establishes requirements for the auditor's evaluation of a company's ability to continue as a going concern (PCAOB 2015). Under AS2415, the auditor has responsibility to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited.<sup>11</sup>

An important difference between the accounting rule ASU 2014–15 and US auditing standards is in the definition of 'substantial doubt'. Whereas AU section 341 (PCAOB 2012) does not include a threshold (e.g., 'probable') or specific definition, ASU 2014–15 states that substantial doubt about an entity's ability to continue as a going concern exists when conditions and events, considered in the aggregate, indicate that it is *probable* [emphasis added] that the entity will be unable to meet its obligations as they become due within one year after the date the financial statements are issued (FASB 2014). However, practical differences were addressed by Staff Audit Practice Alert No. 13, which required auditors to look to the existing requirements in the then AU section 341<sup>12</sup> when evaluating whether substantial doubt regarding the company's ability to continue as a going concern exists in deciding whether the auditor's report should be modified to include an explanatory paragraph regarding going concern (PCAOB 2014).

Initially there was a difference between ASU 2014–15 and AU section 341 in the length of the period in the look-forward provision. ASU 2014–15 specified that management must assess the ability of the entity to continue as a going concern for a period of one year 'from the date that the financial statements are issued' (FASB 2014: 2), more consistent with IAS 1, whereas AU section 341 specified a period of one year 'beyond the date of the financial statements being audited' (PCAOB 2012: 2). This inconsistency appears to have been somewhat addressed in AS 2415, which specifies a 'reasonable' period of time, not to exceed one year beyond the date of the annual financial statements being audited (PCAOB 2015: 2).

PCAOB standards also cover audit procedures for specific aspects of the audit, including consideration of the ability of the entity to continue as a going concern.

According to AS 2415, paragraph 10, the auditor should consider the possible effects on the financial statements and the adequacy of the related disclosure, adding '... information that might be disclosed includes—

- Pertinent conditions and events giving rise to the assessment of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.
- The possible effects of such conditions and events.
- Management's evaluation of the significance of those conditions and events and any mitigating factors.
- Possible discontinuance of operations.
- Management's plans (including relevant prospective financial information).
- Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities.' (PCAOB 2015: 10)

Evident from the discussion in this section is that there is considerable variation in accounting and auditing standards relating to going concern assessments across jurisdictions. Some of these differences are subtle, while others are less so. We attempt to capture and summarise the essence of these differences in Table 1. Since Australia, New Zealand and the UK apply accounting standards issued by the IASB, the relevant requirements in these locations are relatively consistent. In contrast, the US applies accounting standards issued by the FASB and, for this reason, we see some additional variation in the requirements relative to the other locations.

The development of accounting guidance in the US regarding going concern disclosures in the financial statements was a lengthy process involving some controversy (Mayew et al. 2015).<sup>13</sup> Proponents argued that management is best placed to disclose uncertainties regarding an entity's viability and ability to continue as a going concern and that management and the board of directors are responsible for disclosure, not the auditor. Opponents, however, argued that managers already disclose sufficient information voluntarily in the management, discussion, and analysis (MD&A) section of the 10-K filing. As such, the FASB's going concern requirement would be an unnecessary imposition (Mayew et al. 2015).

Research has provided some evidence that management discussion of going concern is informative. Mayew et al. (2015) found that management discussion of going concern reported in the MD&A section and the linguistic tone of the MD&A provide significant explanatory power in predicting whether a firm will cease as a going concern. Such discussion has been found to be incrementally informative to the auditor's report.

There is relatively little research examining the most relevant ASU 2014–15 disclosures by management<sup>14</sup> regarding going concern uncertainty. Wang (2019) found

**Table 1 Comparison of reporting and auditing standards**

Item	Australian and international standards	US standards
Criteria for assessment of going concern	Assess ability to continue as a going concern; Significant doubt about the entity's ability to continue as a going concern (IAS 1, para. 25; AASB101, para. 25; NZ, IAS 1, para. 25)	Conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due Substantial doubt about the entity's ability to continue Requires quarterly reporting (ASU 2014)
Audit	Whether a material uncertainty exists about the entity's ability to continue as a going concern (ISA 570, para. 6; ASA 570, para. 6)	Substantial doubt about the entity's ability to continue as a going concern (AS 2415)
Other	A reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due (UK Corp. Gov. Viability statement, FRC 2014a Provision C.2.2)	
Time period for assessment	At least, but not limited to, 12 months from the end of the reporting period (IAS 1, para. 26; AASB101, para. 26; NZ, IAS 1, para. 26). The auditor to consider the appropriateness of management's going concern for a period of at least 12 months from the date of the financial statements Inquire beyond period of management assessment (ISA 570)	One year from the date the financial statements were issued (ASU 2014)
Financial reporting		The auditor has a responsibility to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited (AS 2415)
Financial reporting Audit		
Other	The period for the going concern assessment is approximately 12 months from the date of the auditor's current report to the expected date of the auditor's report for the next reporting period (ASA 570, Paragraph Aus 13.2) The board has the freedom to choose the period of their assessment but the FRC's Guidance indicates that this period should be significantly longer than 12 months (FRC 2014b) Recent additions to the U.K. Corporate Governance Code require assessments of viability over a longer period, which companies are typically implementing as a three-year look-ahead period (FRC 2014a)	

(Continued)

**Table 1 (Continued)**

Item	Australian and international standards	US standards
Materiality of uncertainty	Events or conditions that may cast significant doubt (IAS 1, para. 25)	Substantial doubt exists when conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued
Audit	<p>A material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern</p> <p>A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgement, appropriate disclosure of the nature and implications of the uncertainty is necessary for:</p> <p>(a) In the case of a fair presentation financial reporting framework, the fair presentation of the financial report or</p> <p>(b) In the case of a compliance framework, the financial report not to be misleading</p> <p>(ISA 570, para. 18; ASA 570, para. 18)</p>	<p>An entity should weigh the likelihood and magnitude of the potential effects of the relevant conditions and events, and consider their anticipated timing (ASU 2014-15, amendment to para. 205-40-55-2)</p>



that management going concern disclosures required in quarterly reports with the adoption of ASU 2014–15 provide market-relevant information. Plans to mitigate uncertainty commonly cover new financing with debt or equity, restructuring, revenue generation, cost reductions, asset sales or mergers and acquisitions (Wang 2019). Krishnan et al. (2018) argue, however, that after controlling for changes in client characteristics, auditors became more conservative in the issuance of going concern opinions in the first year of the standard. Bakarich and Baranek (2020) also found an increase in going concern opinion (GCO) reports for financially stressed firms following ASU 2014–15 and an increase in the propensity of bankrupt firms to have received a GCO report.

One of the disclosure enhancements as a result of ASU 2014–15 was the requirement for management disclosure regarding going concern in interim reports. Arguably ASU 2014–15 has had a larger impact on quarterly 10-Q filings, rather than the annual 10-K filing. There is also some evidence from initial public offerings. Bochkay et al. (2018) provide support for the information content of *voluntary* management disclosures of GC uncertainties by IPO issuers. Kaplan and Taylor (2020) find that management discretionary going concern disclosures for IPOs do not substitute for the reduction in information uncertainty associated with the type of audit report. That is, the audit report types and references to going concern in the audit report provide information incremental to management disclosures about risks for financially stressed IPO firms.

Overall, research on management disclosures of going concern risk in the US suggests that auditors reported more going concern issues after ASU 2014–15 than before, and that the requirement of applying the standard to quarterly reporting improved the disclosure of going concern issues in interim financial statements. The key differences in regulations discussed in this section are summarised in Table 1.

In the next section, we consider the nature of management disclosures by a small selection of Australian entities in light of the recommendations in AASB-AuASB (2020).

## Evidence of Australian Reporting Practice

In this section we provide descriptive evidence regarding current going concern disclosure practices for fiscal year-end June 2020. An additional complication to disclosure regarding the viability of an entity arose with the development of the COVID-19 pandemic commencing from around March 2020. Not surprisingly, COVID-19 heightened concerns by users about the adequacy of going concern disclosures (IFASS 2020; Alebulescu 2021; Hao and Pham 2022). The various jurisdictions had

many companies facing extreme levels of uncertainty regarding their continued viability. The accounting and auditing standard setters have responded by issuing additional guidance on assessing and reporting uncertainties regarding the ongoing viability of entities.

The COVID-19 pandemic potentially exacerbates economic uncertainty, with more companies facing increased challenges that have impacted their ability to continue operating as a going concern. Those challenges include shutdowns, restrictions, regulations, supply chain disruptions, reduced consumer spending, the limited availability of government subsidies and the impact of the broader associated economic downturn. To determine the effect of these challenges on the business, management needs to document its consideration of the current position and the projections for the next 12 months.

In their joint paper, AASB-AuASB (2020) recommend the following disclosures for a material uncertainty regarding going concern:

- Nature and indicative financial impacts of indicators, for example, reduced revenue, increase in expenses, negative working capital, shutdowns, breaching covenants.
- Additional details of plans to deal with these the events or conditions, for example, negotiations with lenders and creditors, raising additional equity, implement cost saving measures, obtaining government support.
- Assumptions made by management, that is, strategies relied upon, longevity of cash reserves, expected period of hibernation.
- Outline reasons why a material uncertainty remains.
- Other relevant information. (AASB-AuASB 2020: 18)

It is noted that the above recommendations have not been endorsed via an amended standard or any other authoritative guidance. Regardless, we use these recommendations to frame our analysis of disclosures. To enable an enhanced understanding of disclosure decisions, ideally, we identify all companies where management or auditors have to ‘make a call’ regarding the level of uncertainty regarding going concern. However, we are unable to identify observations where there was a significant uncertainty but not sufficient uncertainty to warrant the auditor assessment of a material uncertainty related to going concern. Consequently, to identify companies where there was a significant issue relating to going concern, we selected companies where the auditor has assessed a material uncertainty related to going concern. We examine the form and content of management disclosures regarding that uncertainty for those entities. That is, the auditor reporting of a material uncertainty regarding a going concern issue in the auditor report is used to identify companies where management is

**Table 2 Selection**

Panel A: Selection of firms reviewed		
	Companies	
Initial selection <sup>(1)</sup>	137	
Exclude asset management funds	3	
Exclude companies with no material uncertainty regarding going concern	7	
Final selection	<u>127</u>	
Panel B: Industry representation		
GICS_industry_group	Frequency	%
Automobiles & components	1	0.8
Capital goods	8	6.3
Commercial & professional services	5	3.9
Consumer durables & apparel	2	1.6
Consumer services	2	1.6
Diversified financials	4	3.1
Energy	5	3.9
Food, beverage & tobacco	5	3.9
Health care equipment & services	8	6.3
Materials	36	28.3
Media & entertainment	5	3.9
Pharmaceuticals, biotechnology & life sciences	14	11.0
Real estate	5	3.9
Retailing	5	3.9
Software & services	13	10.2
Technology hardware & equipment	5	3.9
Utilities	<u>3</u>	<u>2.4</u>
Total	127	100.0

(1) ;The final selection comprises ASX listed companies following Australian Accounting Standards with 30 June 2020 fiscal year-ends having reported by 18 September 2020 with a MURGC identified in the audit report.

expected to include non-trivial disclosure regarding the nature of the going concern issue.

The selection criteria are summarised in Table 2. This selection is intended to provide examples of management disclosures by companies with going concern issues. These company reports provide an indication of current disclosure practice. Future research could however consider a more comprehensive sample of ASX companies. The initial selection comprises ASX listed companies with 30 June 2020 fiscal year-end having reported by 18 September 2020.<sup>15</sup> We initially selected companies with non-standard audit reports (*qualified, modified or emphasis of matter but not modified*), which resulted in a sample of 137 companies. We then excluded entities from the asset management industry and those with non-standard audit reports that arose for reasons other than going concern (e.g., restatements). The final selection comprises 127 observations with an audit report containing a material uncertainty related to go-

ing concern (MURGC).<sup>16</sup> The non-standard audit report for these companies typically includes a heading for a going concern issue, some brief discussion and a reference to a note to the financial statements. Our analysis is based on the management discussion in that note.

Panel B of Table 2 summarises the composition of the selection by GICS industry classification. Consistent with higher levels of uncertainty relating to exploration, research and development activities, our selection contains more companies from the Materials (mining and exploration), Pharmaceuticals, and Software & services industry groups.

Table 3 reports descriptive statistics for relevant company characteristics as well as the note disclosures. Most notably, although COVID-19 would appear to be a significant exogenous shock resulting in a substantial increase in uncertainty, a clear majority of the firms we identified (72%) also had a MURGC in the previous year.<sup>17</sup> Consistent with intuition, firms with a MURGC are also small, with only two companies in the ASX 300. Only 31 of the companies (24%) are audited by the Big 4.

Turning to the actual note disclosures, Table 3 reports that the average length of the management note disclosures (but excluding the words stating that the accounts will continue to be prepared on a going concern basis) is 403 words, although there is significant variation with disclosures ranging from 100 to 1331 words. The shorter disclosures generally only provide basic information on recent losses or cash flows and the ability of the company to continue as a going concern. The latter often refers to the ability of the company to raise capital or reduce expenditures, or the reliance on the future success of operations (or exploration activities in the case of firms broadly engaged in mining).

A striking feature of the disclosures is that, despite the importance of the material uncertainty, few companies allocate a separate note for discussion of going concern uncertainty. Sixty-five (52%) companies include the uncertainty in note 1 (i.e., within the list of significant accounting policies) and 81% (104 companies) within either notes 1 or 2. While this treatment is consistent with the decision to rely on the going concern assumption, arguably, a discussion of the viability of the company within a lengthy list of significant accounting policies is not a sufficiently prominent placement to explain a material uncertainty regarding going concern.

AASB-AuASB (2020) recommends that companies describe the nature of the going concern uncertainty. In Table 4, Panel A we report on disclosures about the indicators of the going concern uncertainty. All companies in the selection provide some discussion of the current position/performance (CP). Ninety-one percent refer to recent losses, 82% refer to cash flow metrics, 35%

**Table 3** Descriptive statistics

	Mean	No. obs with this disclosure	Min.	25 percentile	Median	75 percentile	Max.
<i>Company characteristics</i>							
Previous year MURGC		91					
Total assets (\$m)	92.23	127	0.080	3.40	10.31	34.94	5675.90
Big 4 auditor		31					
<i>Note disclosure characteristics</i>							
Word count	403	127	100	286	376	510	1331
GC disclosure in note 1		65					
GC disclosure in note 1 or 2		104					

(1) The final selection comprises ASX listed companies following Australian Accounting Standards with 30 June 2020 fiscal year-ends having reported by 18 September 2020 with a MURGC in the audit report.

(2) For variable definitions refer to Appendix B.

**Table 4** Type of disclosure in going concern notes for companies with material uncertainty

Panel A: Disclosures of indicators of the uncertainty		
	Count	%
Disclosure of loss in the most recent fiscal year, revenue and expenses or other operating results or working capital issues relating to the current situation ( <i>CP loss</i> )	115	91
Disclosures mentioned current cash position, cashflow from operating activities, cashflow from investing activities or cash reserves ( <i>CP cashflow</i> )	104	82
Discussion of working capital	44	35
Discussion of net assets	25	20
COVID-19 mentioned in the discussion of the current position ( <i>CP COVID</i> )	45	35
Panel B: Disclosures about plans		
	Count	%
Operational ( <i>SP Operational</i> )	86	68
Operational – increase revenue	38	30
Operational – cut expenses	35	28
Additional funding ( <i>SP Funding</i> )	118	93
Funding – raising additional capital, equity	58	46
Funding – new debt or reorganising existing debt	39	31
Asset sales ( <i>SP Asset Sales</i> )	27	21
COVID-19 mentioned in any part of the plans or assumptions for the upcoming year ( <i>SP COVID</i> )	22	17
Panel C: Other disclosures		
	Count	%
Other discussion ( <i>SP Other</i> )	74	58
Mention of directors' considerations or confidence in the firm being able to continue as a going concern	51	40

Note: For variable definitions refer to Appendix B.

discuss issues relating to working capital or other recent performance and 20% discuss problems relating to net assets. Other disclosures (less than 10% of the observations) refer to impairments, trade receivables, revenue

and debt, while 35% make explicit reference to COVID-19.

An example of MURGC disclosure specifically focusing on cash flow metrics is the following:

During the year, the Group and net operating cash outflows of \$13.2 million (FY2019: \$19.8 million). As at 30 June 2020, the Group has cash and cash equivalents of \$14.7 million (FY2019: \$31.1m) ...

Pharmaxis Ltd, Annual Report 2020, note 1, page 29

AASB-AuASB (2020) also recommends discussion of plans to deal with the events or conditions. We summarise details of any future plans outlined as part of MURGC disclosure in Panel B of Table 4. All companies in our selection contain some reference to future actions or plans. Sixty-eight percent of these companies refer to future operational plans, with nearly an equal split between increasing revenue and cutting expenses. Ninety-three percent specifically refer to the need for future additional funding, with 46% (58 companies) specifically seeking to achieve this through equity and perhaps not surprisingly fewer (39 companies, 31%) indicate intention to do so through new or re-organised existing debt. Twenty-one percent of companies discuss asset sales that have or will occur, while COVID-19 is specifically mentioned in the MURGC disclosure as part of plans to address going concern uncertainties by only 17% of those companies.<sup>18</sup>

The level of specificity of the disclosures about plans varies. Some companies report expectations given particular assumptions. Others, however, only report a general need for future capital to be met with few or no assumptions. Two examples below are somewhat typical where less specific information and assumptions are disclosed:

These forecasts indicate that, in order for the Group to meet its operating requirements for the 12 months from the date of authorisation of these financial statements, the Group must raise additional capital or alternative funding. The cash flow forecast indicates this additional

funding would be required by the end of calendar year 2020.

Adherium Limited, Annual Report 2020, note 2, page 26

The ability of the consolidated entity to continue as a going concern is principally dependent upon one or more of the following:

- the consolidated entity continuing to generate growth in sales revenues and manage its operating expenditures in a manner that continues to reduce its operating loss after tax and achieve an operating profit;
- ongoing negotiation of contractual arrangement with key supplier and customers to better align the timing of cash received from the sales with payments for manufacturing and distribution costs; and
- the ability of the consolidated entity to raise sufficient capital if necessary.

BoD Australia, Annual Report 2020, note 1, page 38

The final recommendation from AASB-AuASB (2020) we examine is for firms to provide additional disclosure, including reasons, why the material uncertainty remains and including the directors' confidence about what the future might hold. We summarise these disclosures in Panel C of Table 4. Fifty-eight percent of firms we examine provided 'other discussion'. Only 40% of those companies explicitly mention directors' confidence or opinion that the company will continue as a going concern. The basis for the confidence of directors typically includes a reference to the assumed success in raising financing or other aspects. An example of such disclosure follows:

As a result of these matters, there is a material uncertainty that may cast significant doubt on the Group's ability to continue as a going concern and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business. However, the Directors believe that the Group will be successful in the above matters and, accordingly, have prepared these financial statements on a going concern basis.

Vault Intelligence Limited, Annual Report 2020, note 1, page 17

In Table 5 we provide a more granular analysis of the results reported in Table 4. We focus on the three largest industry groups in our selection, namely, Materials ( $n = 36$ ), Pharmaceuticals ( $n = 15$ ) and Software and Services ( $n = 14$ ). While they are markedly different economic activities, we observe a high degree of similarity in the frequency with which disclosures about the current position are mainly in reference to losses or cash position (Panel A), the extent to which substantive information about future plans is (or is not) provided (Panel B) and finally, other disclosures, such as the reasons why a material uncertainty remains (Panel C). An implication of this is that the focus and content of dis-

closures around MURGC do not appear to be driven by industry factors.

Although part of the motivation for our survey of practice is to gain a sense of the potential impact of COVID-19 on disclosure, we recognise from Table 3 that the majority of our observations had the same type of MURGC issue at least in the prior year. We therefore also report results in Table 6 which are restricted to those firms where a similar issue existed in the prior year. Once again, it would appear that disclosure practice, on average, is qualitatively similar regardless of whether we observe a first time MURGC including in conjunction with the onset of COVID-19, or whether the initial concern clearly pre-dates COVID-19.

Although COVID-19 represented a potentially significant exogenous shock with significantly raised uncertainty for business as a whole, Table 4 shows a minority of companies in our selection specifically include in their MURGC disclosure discussion of COVID-19 in relation to the current year uncertainties (35%) and future plans (17%). Discussions tended to reflect any disruptions to the business and the generally high level of uncertainty around the future at the time the disclosures were written. The example below is indicative of instances where COVID-19 was specifically mentioned:

The spread of COVID-19 has caused significant volatility in Australian and international markets. There is significant uncertainty around the breadth and duration of business disruptions related to COVID-19 and therefore the Company has taken precautionary measures by temporarily closing the Company's office and having arranged the employees to work remotely, as well as curtailing travel. Management believes that this will allow efforts to continue the feasibility studies and permitting activities. At the date of this report, the impact of these measures is not expected to significantly impact the completion of the current work being undertaken. However, as the circumstances continue to evolve, there may be disruptions to the future work timelines if employees, consultants or their respective families are personally impacted by COVID-19 or if travel and other operational restrictions are not lifted.

Strategic Energy Resources Limited, Annual Report 2020, note 2, page 21

Some companies provided further detail, linking the financial effects of COVID-19 to specific aspects of operating activities:

At the date of this report, the Directors have reviewed the Group's turnaround plan and detailed financial forecasts which assume significant revenue growth. In developing the forecasts consideration has been given to any potential future impacts arising from the COVID-19 pandemic. The forecasts also reflect the challenging conditions affecting the FY2020 harvest (completed

**Table 5** Type of disclosure in going concern notes for companies with material uncertainty

Panel A: Disclosures of indicators of the uncertainty						
	Materials ( <i>n</i> = 36)		Pharmaceuticals ( <i>n</i> = 15)		Software & services ( <i>n</i> = 14)	
	Count	%	Count	%	Count	%
Disclosure of loss in the most recent fiscal year, revenue and expenses or other operating results, or working capital issues relating to the current situation ( <i>CP Loss</i> )	34	94	15	100	11	79
Disclosures mentioned current cash position, cashflow from operating activities, cashflow from investing activities or cash reserves ( <i>CP Cashflow</i> )	31	86	14	93	12	86
Discussion of working capital	14	39	3	20	1	7
Discussion of net assets	4	11	3	20	5	36
COVID-19 mentioned in the discussion of the current position	5	14	4	27	4	29

  

Panel B: Disclosures about plans						
	Materials		Pharmaceuticals		Software & services	
	Count	%	Count	%	Count	%
Operational ( <i>SP Operational</i> )	19	53	9	60	9	
Operational – increase revenue	1	8	5	40	7	64
Operational – cut expenses	3	3	6	33	4	50
Additional funding ( <i>SP Funding</i> )	35	97	14	93	12	29
Funding – raising additional capital, equity	18	50	8	53	5	86
Funding – new debt or reorganising existing debt	10	28	0	0	1	36
Asset sales ( <i>SP Asset Sales</i> )	11	31	2	13	1	7
COVID-19 mentioned in any part of the plans or assumptions for the upcoming year ( <i>SP Covid</i> )	5	11	1	7	0	

  

Panel C: Other disclosures						
Other discussion ( <i>SP Other</i> )	20	56	8	53	5	36
Mention of directors' considerations or confidence about the firm being able to continue as a going concern	17	47	6	40	4	29

between March and June 2020) which have had an adverse impact on the Group's cashflow, mainly due to the FY2020 harvest yield being below expectations following the extreme heat over summer in the Sunraysia region, plus low water allocations and the high cost of spot market purchases to compensate. This was further compounded by a conversely wet weather period during the harvest period.

Murray River Organics Group Limited Annual Report 2020, Note 2, page 51

In other instances, reference was made to COVID-19, but in a relatively positive light:

The ability of the Group to continue as a going concern is principally dependent upon ... the ability to complete successful development and commercialisation of

the Group's software platform ... The Director's [sic] have considered the impact of COVID 19 and found that the pandemic has increased sales prospects due to the greater global need for businesses to manage employees remotely using HR platforms. In response to the onset of COVID-19, the Group has tightly controlled expenses immediately suspending all non-essential expenditure in March 2020. Savings have been made with the elimination of business travel, office running costs and the suspension of the establishment of an international office. The business deferred rent payments for the months April, May and June 2020 with a view to progressively repay in FY 2021. In addition, COVID 19 has not adversely impacted the collection of Trade Receivables and the Director's [sic] do not expected [sic] increased credit losses.

**Table 6** For firms with GC note prior year

Panel A: Disclosures of indicators of the uncertainty		
	Count	%
Disclosure of loss in the most recent fiscal year, revenue and expenses or other operating results, or working capital issues relating to the current situation ( <i>CP Loss</i> )	81	89
Disclosures mentioned current cash position, cashflow from operating activities, cashflow from investing activities or cash reserves ( <i>CP Cashflow</i> )	73	80
Discussion of working capital	30	33
Discussion of net assets	19	21
COVID-19 mentioned in the discussion of the current position ( <i>CP Covid</i> )	0	0
Panel B: Disclosures about plans		
	Count	%
Operational ( <i>SP Operational</i> )	54	59
Operational – increase revenue	26	29
Operational – cut expenses	21	23
Additional funding ( <i>SP Funding</i> )	84	92
Funding – raising additional capital, equity	43	47
Funding – new debt or reorganising existing debt	27	30
Asset sales ( <i>SP Asset Sales</i> )	19	21
COVID-19 mentioned in any part of the plans or assumptions for the upcoming year ( <i>SP Covid</i> )	0	0
Panel C: Other disclosures		
	Count	%
Other discussion ( <i>SP Other</i> )	49	54
Mention of directors' considerations or confidence in the firm being able to continue as a going concern	34	37

intelliHR Limited, Annual Report 2020, Note 1, page 42

Discussion of COVID-19 does, of course, appear in various areas of the annual report for fiscal year-end June 2020 for companies with and without material uncertainties. As an alternative to being considered in the footnote for going concern assessment, the disclosure could also appear in the discussion of operations, under a specific note to the financial statements perhaps in discussing the financial impact of COVID-19, or in the note for subsequent events. There was at least one example of an emphasis of matter specifically referring to COVID-19 in the auditor's report but not referring to any level of uncertainty regarding going concern. See below for relevant extracts from the financial statements and the audit report for the companies in question:

Emphasis of matter – COVID-19 We draw attention to Note 2 and Note 4.23 of the financial report, which describes the circumstances relating to COVID-19 and the uncertainty surrounding any potential financial impact

on the financials. Our opinion is not modified in respect of this matter.

Clean Seas Seafood Limited, Consolidate Financial Statements 2020,

Auditor's Report by Grant Thornton, page 76

It is anticipated that the COVID-19 pandemic will have an adverse impact on Group's business, profitability and cash flows in FY21. The Group has therefore impaired its Live Fish and Frozen by \$15.8 million at 30 June 2020. As at 30 June 2020, the Group had cash reserves of \$22.2 million, undrawn facilities of \$20.2 million ...

Clean Seas Seafood Limited, Consolidated Financial Statements 2020,

note 2, page 42

In summary, management disclosures are largely consistent with company auditors having ensured that ASX-listed companies comply with the auditing requirements contained in ASA 570. However, there is substantial variation in the nature and extent of management disclosures about plans to deal with the uncertainty. Further, our selection contains companies where the auditor has assessed a material uncertainty regarding going concern, but we do not expect that a similar level of disclosure is provided where the going concern issue was considered, but not determined to be material.

## Discussion

Regulators internationally appear concerned that large, high-profile bankruptcies continue to occur seemingly without warning from either the firm's management or the auditors. This is consistent with the descriptive evidence presented in our study and, taken together, suggests a need for improvement in management accountability regarding the assessment and disclosure of the continued viability of the entity. Proponents of increased disclosure requirements contend that management is responsible for informing investors and creditors of impending firm failure. Management has superior private information, and is in the best position to provide such a warning.

To the extent that management or the auditor views the assessment of going concern as merely ensuring the applicability of the going concern assumption for accounting purposes, the ongoing viability of the entity may not receive adequate attention and disclosure to other stakeholders. This has implications for the likelihood that the resulting financial statements will satisfy the objective of financial reporting as stated in the IASB's Conceptual Framework for Financial Reporting (2018).

The look-forward period specified in going concern disclosure guidance is typically constrained to 12 months from the issue of the audit report. The recent addition to the UK Corporate Governance Code

requiring an assessment of viability over a longer period (FRC 2014a), which companies are typically implementing as a three-year look-ahead period, provides an interesting development. Future research could usefully examine the costs and benefits of this disclosure to inform regulators who might presently be re-considering the look-forward period.

Issues of disclosure in financial reports are typically dealt with in accounting standards. However, most guidance relating to going concern disclosure for Australian companies is currently contained in auditing standards. Under ASA 570, auditors are required to ensure that companies provide adequate disclosures regarding material going concern issues. There is a need to better align the auditing and accounting standards with respect to assessing ongoing entity viability and associated disclosures. Two documents that recommend company disclosures that are mostly consistent with current auditing standards are the AASB-AuASB (2020) recommendations for disclosures for a material uncertainty regarding going concern, and the New Zealand Accounting Standards Board's recently issued exposure draft with additional disclosure requirements to be added to FRS 44 (NZASB 2020a). This reflects standard setters' ongoing interest in tightening going concern disclosure practice.

Our review of company disclosures suggests considerable variation across companies in the specificity of plans to resolve material uncertainty in relation to going concern. Simply stating reliance on expected future capital raising, and that the company will continue as a going concern assuming that the raising will be successful, highlights the precarious nature of the financial position of some companies. The lack of further detail raises concerns as to whether such statements buried in the list of significant accounting policies provides sufficient warning to financial statement users.

An area of likely variation in disclosure is the 'grey area' where there was a 'close call' on a going concern decision by the auditor but the auditor chose not to include a note in the audit report.<sup>19</sup> In such instances, management appears to have three options:<sup>20</sup>

1. Make an explicit statement that a going concern issue was raised but then was either assessed as not being a material uncertainty, or was alleviated by management's plans.
2. Disclose that the current situation is uncertain and that management's plans are expected to alleviate the concern. Interestingly, such disclosure can avoid explicit mention of either 'a going concern' issue or that there is a material underlying uncertainty.
3. Make no explicit statement that the auditor considered but did not assess a material uncertainty regarding going concern, provided the minimum legal standard of solvency is met.

The auditor has the additional option to report a key audit matter (KAM) regarding the consideration of going concern and the auditor's response to that matter, without issuing a material uncertainty for going concern in the body of the audit report, but such examples are rare for Australian listed companies.<sup>21</sup>

The implications of the assessment of whether the going concern assumption is applicable for accounting purposes also needs further consideration. Companies adopt the going concern basis of accounting, except in rare circumstances where management intends to cease trading or liquidate the entity. Accordingly, the threshold for departing from the going concern basis of accounting is effectively a very high hurdle. There is no guidance in accounting standards as to where that hurdle should be, nor on the basis of accounting to be adopted when the going concern assumption is not appropriate. In such instances, inconsistency in practice is likely, as is the possibility that management might ratify the ongoing application of the going concern assumption even when the going concern uncertainty may be high.

Experimental and survey research has shown that differences in wording matter (e.g., Daugherty et al. 2016; Ponemon and Raghunandan 1994). For example, experimental evidence suggests that managers are more likely to recommend going concern disclosure when financial distress is high and the recovery plan focuses on additional debt and equity (Bierstaker and DeZoort 2019). Bierstaker and DeZoort (2019) also suggest that managers have higher 'substantial doubt' thresholds than auditors. Managers' perceptions regarding the fairness of the going concern standard also influences their decisions about disclosures of going concern issues. There is also some experimental evidence that the failure of management to disclose going concern uncertainty can increase auditor liability (Owens et al. 2020).

## Conclusion

The International Organization of Securities Commissions (IOSCO) recently observed the importance to stakeholders of receiving high-quality information about the existence of material uncertainties that may cast significant doubt on an entity's ability to continue as a going concern (IOSCO 2021). Despite the importance of going concern disclosures to diverse stakeholders, we have relatively little understanding of relevant standards or current reporting practice. We seek to address this gap by examining regulatory and standard-setting developments that have occurred across several jurisdictions in recent years and by offering descriptive evidence of reporting practice for a small selection of Australian ASX-listed entities.

We find that even though disclosures in financial reports are typically governed by accounting standards, guidance on going concern disclosures is most often found in auditing standards, the detail of which differs across jurisdictions. Further, relevant guidance is silent on the accounting approaches to adopt in instances where the going concern assumption is found not to apply. Our descriptive evidence of reporting practice shows considerable variation across companies particularly with respect to the extent of disclosure of assumptions and plans to address uncertainty related to going concern.

A key contribution of our study is to inform debate on the nature and extent of guidance required from regulators and standard setters on going concern reporting. The diverse relevant guidance, along with the variation we observe in reporting practice, suggests the need for an encompassing international standard to ensure a minimum level of disclosure and consistent reporting regarding the ongoing viability of an entity. Where any going concern uncertainty exists, greater consistency in disclosures around the causes of that uncertainty as well as the future plans in dealing with that uncertainty would seem an obvious way forward. This is consistent with the feedback received by AASB outreach (AASB 2021) and could readily be addressed by the IASB via amendments to IAS 1.

Finally, we identify a number of avenues for future research. These include further work on documenting going concern disclosure practice with consideration of the costs and benefits of different regulatory approaches. Research that considers the extent of management disclosure regarding viability by companies that are financially stressed but where the auditor has not assessed the uncertainty as material would also be useful to regulators and standard setters.

## Notes

- 1 We include New Zealand and the UK as comparators because they employ International Financial Reporting Standards (IFRS) (and hence will have similar disclosure requirements with regard to going concern). In doing so, we acknowledge that going concern assessments are also likely to be affected by local legislation, especially with regard to financial distress. We also include the US, as the Financial Accounting Standards Board (FASB) accounting standards are the other major well-established accounting regime.
- 2 We note in passing that the recent Australian Parliamentary Joint Committee on Corporations and Financial Services (PJC 2020) focus on going concern disclosure appears to have largely stemmed from concerns about audit quality in light of corporate failures, rather than the quality of financial reporting *per se*. However, the submission made by the Australian Securities and Investments Commission (ASIC 2019) recognises that ‘... if a company fails but its financial report did not properly show its declining financial position and results, or *going concern issues*, it is reasonable for questions to be asked about the role played by

- the *company directors and the auditor ...*’ (ASIC 2019: 1, emphasis added).
- 3 For further review and synthesis of earlier academic literature relating to audit reporting of going concern matters, refer to Carson et al. (2013) and Geiger et al. (2019).
- 4 As such, we provide some indication of the extent to which COVID-19 is seen as creating material uncertainty. At the same time, we note that the evidence collected for this study relates to the early onset of the pandemic. As such, our evidence in this regard is preliminary and speculative.
- 5 For further discussion of IAS 1 requirements to disclose material uncertainties and the relevance of the overarching disclosure requirements of IAS 1 refer to IFRS Foundation (2021).
- 6 As we show below, there is considerable variation in the types of going concern issues identified in financial reports and the exact means by which they are discussed by management.
- 7 Owing to the difficulties in accessing private financial statements lodged with the Australian Securities and Investments Commission (ASIC) (and the cost of such access), we are not aware of any research examining going concern uncertainty for private companies or other unlisted entities.
- 8 A small survey of 17 reports for fiscal year 2016 found that most companies chose a three-year lookout period, with a handful choosing a four- or five-year period (Deloitte 2017). An Investment Association study (TIA 2016) considered that three or five years had become standard practice reflecting the medium-term business plan.
- 9 For further discussion and summary of the requirements under the Code, refer to Deloitte (2015).
- 10 The PCAOB is the key US body with responsibility to oversee accounting professionals who provide independent audit reports for publicly traded companies. For more information about the PCAOB, please refer to: <https://pcaobus.org/>
- 11 For a comparison of management and auditor responsibilities for assessing going concern see Clikeman (2018) and CAQ (2020).
- 12 AU section 341 was replaced by AS 2415: *Consideration of an Entity’s Ability to Continue as a Going Concern* (PCAOB 2015), which aligns more directly with the requirements in ASU 2014–15.
- 13 Following high-profile corporate collapses and the global financial crisis of 2007–2008, in October 2008 the FASB issued an exposure draft requiring management to assess the entity’s ability to continue as a going concern. In January 2012, the FASB decided not to require management to perform an assessment of the entity’s ability to continue as a going concern. The FASB then reconsidered this requirement and issued a revised exposure draft in June 2013 requiring a going concern assessment by management. Finally, in August 2014, the FASB issued an accounting standards update requiring firms to make going concern assessments in each reporting period and to report going concern problems in the financial statements.
- 14 In looking at auditors’ communications related to going concern, Desai et al. (2020) examine a sample of 2921 first-time GCOs covering the years 1999–2015. Auditors’ communication of factors that led to the GCO cited profitability factors in 81% of GCOs and liquidity issues in 56% of GCOs. Desai et al. (2020) also found that 16.8% of first-time GCO clients entered bankruptcy within one year.
- 15 The cut-off of 18 September is merely used to select timely reporting for 30 June 2020 fiscal year-end companies. We do not seek to capture late reporting companies or all companies reporting for the year.
- 16 By way of comparison Carson et al. (2019) document 501 auditor reports with going concern issues for ASX companies for 2014. Our selection is not a comprehensive sample of ASX companies



but is chosen to allow us to focus on management disclosure for companies facing going concern issues as identified from auditor reports. Research is needed to more formally consider management disclosure regarding going concern issues, and the determinants of that disclosure, for companies with standard and non-standard audit reports.

- 17 It should be noted that at the time the data were collected COVID-19 was in its relatively early stages, and the potential longer-term implications for societies and businesses were less clear.
- 18 We note that it is also likely that COVID-19 is discussed by these companies in other parts of the financial statements. Our focus, however, is on the nature and content of MURGC disclosures by management.
- 19 Because our selection is based on companies with non-standard audit reports, we are unable to provide data on these occurrences in our selection.
- 20 An analogous issue is explicitly addressed by the FASB in ASU 2014–15 where disclosure is required where conditions or events raise substantial doubt about an entity's ability to continue as a going concern but the substantial doubt is alleviated by management's plans.
- 21 A few examples of KAMs for uncertainties regarding going concern occurred in the 2019 fiscal year, but some of these appear to have been alternate placement of material uncertainties regarding going concern. Clarification of the placement for reporting material going concern uncertainties ensures that material uncertainties are now disclosed separate from the KAMs.

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## Conflict of Interest

The authors have no conflict of interest to declare in relation to this research.

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## Appendix A

### Example Disclosure for an Australian Company

#### Example of material uncertainty related to going concern and note regarding financing

**Troy Resources Limited** (ASX: TRY) Group's annual report for the year ended 30 June 2019:

**Auditor's report**, page 92:

#### Material uncertainty related to going concern

We draw attention to note 1 in the financial report, which indicates that the Group incurred a net loss of \$45.8 million during the year ended 30 June 2019 and, as of that date, the Group had a net working capital deficiency of \$10.9 million. As a result the Group is dependent on receiving the continuing financial support of its shareholders and creditors. These conditions, along with other matters set forth in note 1, indicate that a material uncertainty exists that may cast significant doubt on the Group's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

PricewaterhouseCoopers, Perth, 29 August 2019

**Note to Financial Statements** Note 1, pages 52–53:

#### Going Concern Assumption

The Directors believe it is appropriate to prepare the consolidated financial statements on a going concern basis which contemplates continuity of normal business activities and the realisation of assets and settlement of liabilities in the ordinary course of business.

As at 30 June 2019, the Company has a net current asset deficiency of \$10,923,000 (2018: \$24,044,000) and recorded an after tax loss of \$45,832,000, which included a \$30,000,000 impairment loss (2018: \$9,611,000 and nil). The reduction in net current liabilities reflects payment of the scheduled Investec Bank Plc (Investec) loan principal repayments \$13,210,000 (2018: \$21,032,000). Other creditors have also been reduced to \$25,829,000 (2018: \$28,582,000).

Offsetting this is the fact that the Company had positive operating cash inflows of \$25,580,000 for the year to 30 June 2019 (2018: inflow of \$16,831,000).

The continuing viability of the Company and its ability to continue as a going concern and meet its debts and commitments as they fall due, are dependent upon the Company being successful in:

- Operational cashflows – Achieving positive operational cash flows over the next 12 month period, which

are forecast to exceed cash outflows including the final Investec loan repayment.

- Re-optimising pit designs and mine plans – The Company is in the process of re-optimising pit designs and the mine plan to incorporate recent grade control drilling information and current gold price. This may lead to an increase in mine life and production. Troy Resources Limited Annual Financial Report for the Financial Year Ended 30 June 2019 54 Notes to the consolidated financial statements 1. Basis of preparation (continued)
- Continued support of its creditors – Management in Guyana have regular contact with Troy Resources Guyana Inc.'s (TRGI) trade creditors and has in place plans for the repayment of outstanding amounts. To date support from creditors has been forthcoming.
- Support from the Company's financier, Investec – The Directors are confident that the Group will repay the final instalment of US\$1.792 million due to Investec Bank plc on 30 September 2019.

- Capital raising – The Directors consider that the Group has a demonstrated track record of successfully raising equity and expect that it will be able to do so in the future should it be required.
- Exploration Drilling – The Company has continued to announce strong exploration results from the Ohio Creek Prospect during the financial year which is located approx. 10 kms from the Karouni processing plant. Preparation of a mineral resource and mining plan for Ohio Creek is underway. Success in determining the mineral resources and converting into mineable ore reserves and a mine design would extend the mine life of the Karouni operation.

As a result of these matters, there is a material uncertainty that may cast some doubt on the Company's ability to continue as a going concern and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business. However, the directors believe that the Company will be successful in the above matters and, accordingly, have prepared the financial report on a going concern basis.

## Appendix B

### Variable definitions

Variable	Definition
<b>Company characteristics</b>	
Material uncertainty going concern (MURGC)	Material uncertainty regarding going concern in the auditor's report for fiscal year ended June 2020
MURGC previous year	Material uncertainty regarding going concern in the auditor's report for fiscal year ended June 2019
Total assets	Total assets at year end in millions of dollars
Big 4 auditor	The auditor signing the annual report for 2020 is one of KPMG, DT, EY or PWC
<b>Footnote disclosure characteristics</b>	
Word count	Word count for the specific paragraphs discussing going concern uncertainty in the relevant note to the financial statements; this does not include wording on the use of going concern as the basis for account
GC disclosure in note 1	Indicator variable for inclusion of discussion of going concern in note 1 to the accounts; note 1 often covers significant accounting policies; the going concern issue is frequently included as an item within the list of significant accounting policies
GC disclosure in note 1 or note 2	Indicator variable for inclusion of discussion of going concern in note 1 or note 2 to the accounts; significant accounting policies are typically grouped in note 1 or note 2
<b>Categories of disclosure</b>	
<b>Indicators of MURGC</b>	
CP Cashflow	Disclosure of indicators of the material uncertainty regarding going concern (MURGC), relating to the current position/performance of the entity, typically involving discussion of cash flow, losses, revenue or expenses
CP Loss	Disclosure of cash flow information relating to the current position
CP COVID	Disclosure of loss in the most recent fiscal year, revenue and expenses or other operating results, or working capital issues relating to the current situation
CP Working Capital	COVID mentioned as part of the discussion of the current position
<b>Specific plan</b>	
SP Operating	Discussion of working capital issues
SP Funding	Disclosures include some discussion about management plans or expectations about operations; disclosures frequently include a specific plan covering operating, funding, asset sales or other specific explanation
SP Sale of Assets	Disclosures include some discussion about management plans or expectations about operations, including discussion of increased revenue or sales, or cutting expenditures
SP Other	Discussion of new capital or equity including convertibles; discussion of new debt or restructuring exiting debt
SP Directors	Discussion of sale of assets, including asset sales that have occurred during the year with impact on future prospects
SP COVID	Directors' confidence or opinion that the company will continue as a going concern including summary of factors this confidence is based on, including the success in raising financing or other aspects of the plan
	Information about COVID-19 including its possible effect on the business, markets or the economy