

What is Going Concern?

Worksheet

Going concern is the assumption that a business will keep operating for at least the next twelve months; auditors assess it by reviewing liquidity, debt, losses, and management's mitigation plans.

Questions

1. What is the standard time horizon for a going concern assessment?
 - A) 3 months
 - B) 6 months
 - C) 12 months
 - D) 5 years
2. Which of these is a going concern red flag?
 - A) Rising profit margins
 - B) Recurring net losses
 - C) Growing cash reserves
 - D) Declining debt
3. Who first assesses going concern before the auditor?
 - A) The audit committee
 - B) Management
 - C) The regulator
 - D) Shareholders
4. If substantial doubt about going concern exists and is adequately disclosed, the auditor typically:
 - A) Refuses to issue any opinion
 - B) Adds an emphasis-of-matter paragraph
 - C) Ignores it
 - D) Restates prior years
5. A manufacturing company has reported losses for three consecutive years and its current liabilities exceed current assets by \$2 million. How should the auditor respond?
6. A retailer lost its main supplier contract and is in default on a \$500,000 bank loan due in 60 days. Is going concern doubt present?
7. A startup has \$100,000 cash, burns \$20,000/month, and has no signed funding commitment. How many months of runway remain, and what does that mean for going concern?
8. Define: What is the going concern assumption?
9. Define: Who is responsible for assessing going concern first?
10. Define: Name two common going concern red flags.

Answer Key

1. C) 12 months - Auditors assess whether the entity can continue for at least 12 months from the reporting date.
2. B) Recurring net losses - Recurring losses signal the company may not sustain operations.
3. B) Management - Management makes the initial going concern assessment; the auditor evaluates it independently.
4. B) Adds an emphasis-of-matter paragraph - A properly disclosed going concern issue usually leads to an emphasis-of-matter paragraph, not an automatic disclaimer.
5. Identify conditions: recurring losses + negative working capital are red flags Evaluate management's plan: check for a credible turnaround plan, e.g., asset sales or refinancing Assess feasibility: confirm financing commitments are documented and realistic Conclusion: if doubt remains after considering plans, add a going concern paragraph to the audit report
6. Loss of key supplier + loan default within 12 months are strong indicators Check if the bank has waived the default or extended terms Review alternate suppliers lined up If no resolution is documented, substantial doubt exists and must be disclosed
7. Runway = Cash monthly burn = $100,000 / 20,000 = 5$ months Five months is within the 12-month assessment horizon Without a funding commitment, this is a going concern red flag requiring disclosure
8. The assumption a company will continue operating for at least 12 months from the reporting date.
9. Management - the auditor then independently evaluates management's assessment.
10. Recurring operating losses and negative working capital (or loan covenant defaults).

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