Going concern, climate and NOCLAR risks

MODULE 2 | 2.6.3 | STUDENT COMPANION

Statements are normally prepared on the **going concern** basis. Management assesses it; the auditor gets evidence about whether the basis is appropriate and whether a **material uncertainty** exists, starting at planning. **Climate-related risks** reach the statements through estimates and going concern, even where the word climate never appears. For **NOCLAR** (an entity not complying with the law), laws with a direct effect on the statements need evidence of compliance; other important laws need specific limited procedures, and a breach may bring a duty to report.

Who looks how far ahead

Who	The assessment
Management	Whether the going concern basis is appropriate, looking at least 12 months ahead from the reporting date, and disclosing any material uncertainties
Directors (Australia)	Declare whether there are reasonable grounds to believe the company can pay its debts on time
Auditor, current ASA 570	Looks roughly 12 months beyond the date of its own report
Auditor, revised ASA 570	For periods beginning on or after 15 December 2026: at least a year beyond the date the financial report is approved

Going concern warning signs

Financial

- Net current liabilities
- Borrowings due with no realistic way to renew or repay them
- Heavy reliance on short-term borrowing to fund long-term assets
- Lenders or a parent withdrawing financial support
- Negative operating cash flows
- Substantial operating losses
- Unable to pay creditors on time
- Breaches of loan conditions
- Suppliers that will only deal on cash terms

Operating

- Loss of key managers
- Loss of a major market, a key customer, a licence or a principal supplier
- Labour difficulties
- Shortages of important supplies
- A highly successful new competitor

Other

- Breaches of capital requirements
- Legal claims the entity couldn't meet
- Changes in law or government policy expected to hurt it
- Uninsured catastrophes

One sign rarely decides anything. Weigh the signs together with mitigating factors, such as plans to sell assets or raise new funding, which need evidence of their own.

Case note: Probuild

Probuild was one of Australia's largest building contractors, majority owned by the South African construction group Wilson Bayly Holmes-Ovcon. Through the pandemic years, many builders were locked into fixed-price contracts while the cost of materials and labour rose sharply. On 23 February 2022, Probuild's parent announced it would no longer provide financial support to its Australian business, and that same day Probuild entered voluntary administration, leaving projects stalled and subcontractors unpaid. **The lesson:** a parent's support is a powerful mitigating factor only while the parent is willing and able to give it. Past support proves nothing about the future; the auditor needs a written commitment, its terms and duration, whether it is legally binding, and evidence that the parent can afford to honour it.

Source: Wilson Bayly Holmes-Ovcon announcement (23 February 2022).

Voltana at planning

Voltana's $60 million bank facility matures in about 13 months (1 August 2027), inside the period the auditor must consider, and operating cash flow was negative because inventory grew. But it meets its loan conditions comfortably, with profit covering interest more than four times against a minimum of three. The team rates the going concern risk as **moderate** and plans to obtain management's cash flow forecast, test its assumptions against past performance and the order book, read the bank correspondence about refinancing, and watch events after year end. Whether there is a material uncertainty is a question for Module 4.

Climate in the financial statements

Climate risks can affect the statements even when the word climate never appears in them, and they are assessed like any other risk.

Source of the guidance	Where climate risks can reach the statements
Australian standard setters (AASB and AUASB joint bulletin)	Impairment testing, useful lives, fair values, provisions and expected credit losses on loans
International guidance (IFRS Foundation)	Adds the valuation of inventory and going concern
At Voltana	Extreme summer heat may shorten battery life (the warranty provision); a warehouse on a flood plain puts inventory at physical risk; the shift to renewables supports demand, but rebate changes can swing sales quickly

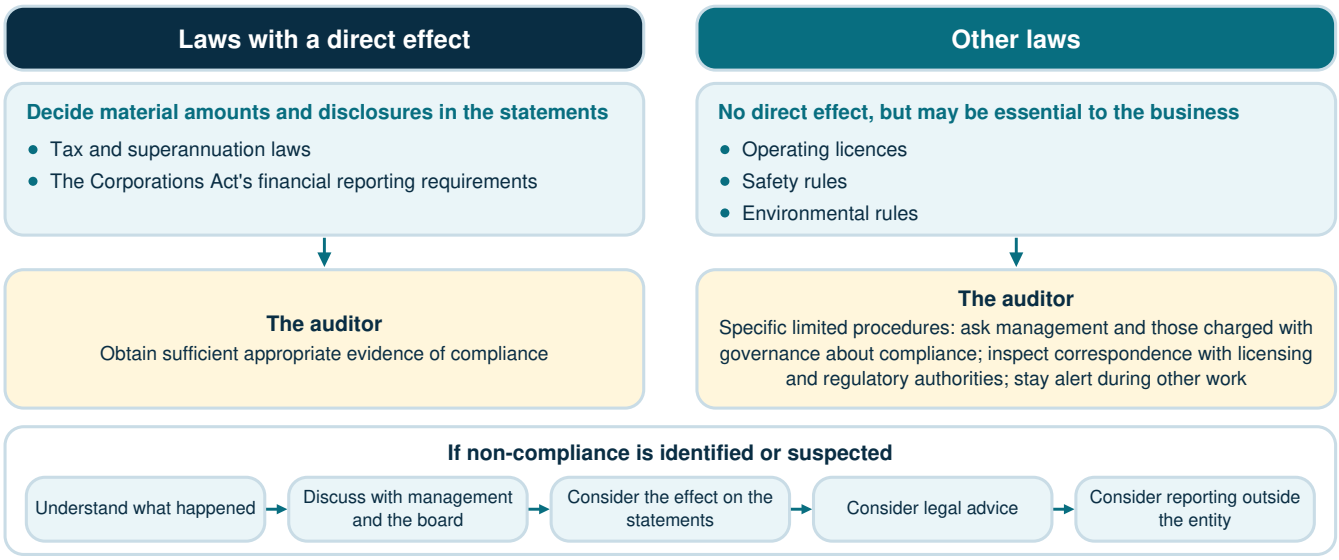
Reporting from FY2027. With revenue above $200 million and about 850 employees, Voltana falls in the second group of entities under Australia's mandatory climate reporting, so its first climate disclosures are for the year beginning 1 July 2026. There is no mandatory climate report for this year, but the climate risks management is preparing to report must fit the assumptions in this year's financial statements, and the auditor checks that they do.

Sources: AASB and AUASB joint bulletin (December 2018, revised April 2019); IFRS Foundation educational material on climate-related matters (November 2020, republished July 2023).

Non-compliance with laws and regulations

Non-compliance means acts or omissions, intentional or not, by the entity, its governing body, management or others working for it, that are contrary to the law. Compliance is a job for management and those charged with governance, not the auditor; the auditor's duties depend on which category a law falls into.

Two categories of laws and regulations



Reporting outside the entity. In Australia an auditor must notify ASIC in writing, within 28 days, of circumstances that give reasonable grounds to suspect a significant contravention of the Corporations Act, or a contravention that won't be adequately dealt with through the auditor's report or by raising it with the directors. Beyond that, the Code (APES 110, section 360) expects the auditor to weigh the wider public interest, and in some cases to disclose the matter to an appropriate authority, usually after legal advice.

Voltana: going concern, climate and compliance

Risk	What the team sees	Planned response
Going concern **Rated moderate**	$60m bank facility matures in about 13 months (1 August 2027), inside the period the auditor considers; operating cash flow negative as inventory grew; loan conditions met comfortably (interest cover above 4 times; minimum 3)	Obtain management's cash flow forecast; test its assumptions against past performance and the order book; read correspondence with the bank on refinancing; watch events after year end
Climate **Through the estimates**	Extreme heat may shorten battery life; a warehouse on a flood plain; rebate changes can swing sales. First mandatory climate disclosures from FY2027 (the year beginning 1 July 2026)	Ask the engineer to allow for heat in the warranty range; consider flood exposure in inventory values and insurance; check the climate risks being prepared for FY2027 reporting fit this year's assumptions
Compliance **Lapsed electrical licences**	Some batteries installed by workers whose licences had lapsed: a breach of safety laws, rebate claims that may be invalid, and possible penalties	Understand what happened; discuss with management and the board; test the rebate receivable and any penalty provision; consider legal advice and any duty to report

Practice questions

MODULE 2 | 2.6.3 | TRY THESE BEFORE THE WORKED ANSWERS

Question 1 - Spot the warning signs

Yarrabee Freight Pty Ltd (imagined) runs a fleet of trucks carrying groceries and building materials across two states. Which facts are going concern warning signs, and of which type?

Fact	Warning sign?	Financial, operating or other?
(a) At 30 June, current liabilities exceed current assets by $3.1 million		
(b) Its largest customer, a supermarket chain providing 35% of revenue, will move its contract to a rival in October		
(c) The operations director and the fleet manager resigned in May and haven't been replaced		
(d) The fuel supplier now wants payment on delivery instead of 30-day terms		
(e) Yarrabee signed a five-year lease on a new depot in March		
(f) The state government will charge heavy vehicles a new road-user fee from January, which will cut Yarrabee's margin		
(g) Its depot was flooded in February, and the insurer has rejected the claim		
(h) Revenue rose 8% this year, and the company made a profit of $1.2 million		

Question 2 - Sort the laws

Sort each law into the two categories and describe the auditor's procedures for each.

Law affecting Yarrabee	Direct or other?	The auditor's procedures
(a) Payroll tax law		
(b) Fringe benefits tax law		
(c) The Corporations Act's financial reporting requirements, including accounting standards		
(d) Heavy vehicle law on driver fatigue and vehicle mass limits		
(e) Work health and safety laws		
(f) The environmental licence for the depot's fuel storage		

Question 3 - Voltana's lapsed licences

The team discovers that some Voltana batteries were installed by workers whose electrical licences had lapsed. Plan the response, from the first conversation to any reporting duty.

Stage	Your planned response
The first conversation	
Understanding what happened	
Effect on the financial statements	
Effect on the rest of the audit	
Reporting duties	

Worked answers

MODULE 2 | 2.6.3 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Question 1 - Yarrabee Freight

Weigh them together: (a), (b), (d) and (g) at once would make the risk high.

	Warning sign?	Why
(a)	Yes: financial	Net current liabilities
(b)	Yes: operating	Loss of a key customer worth over a third of revenue
(c)	Yes: operating	Loss of key managers, with no replacements
(d)	Yes: financial	Suppliers moving to cash terms signal a loss of trust in its credit
(e)	Not on its own	A normal commitment, though it adds to fixed costs if revenue falls
(f)	Yes: other	A change in government policy expected to hurt the business
(g)	Yes: other	An uninsured catastrophe
(h)	No	Possibly mitigating, but profit isn't cash: test whether it is turning into cash

Question 2 - The two categories

	Category	The auditor's procedures
(a), (b)	Direct	Recalculate the tax, check rates, thresholds and lodgements, and test the liability, to obtain sufficient appropriate evidence of compliance
(c)	Direct	Evidence of compliance runs through the whole audit: every recognition, measurement and disclosure requirement
(d), (e), (f)	Other	Ask management and those charged with governance about compliance; inspect correspondence with the heavy vehicle, safety and environmental regulators; stay alert for fines, incidents or notices during other work. Breaches could still bring penalties or provisions, or threaten the licence to operate

Question 3 - Voltana's lapsed licences (suggested)

Stage	Response
The first conversation	Raise it promptly with management and, given its seriousness, with those charged with governance (go straight to them if management may be involved)
Understanding what happened	Which workers and installations, since when; match installers on rebate claims to the licence register; was it known or deliberate? Consider legal advice
Effect on the financial statements	The rebate receivable (claims that may be invalid); repayments, penalties or re-inspection costs as provisions or contingent liabilities; disclosures
Effect on the rest of the audit	Reassess fraud risk and management's integrity; report the control deficiency; obtain written representations on known non-compliance
Reporting duties	Tell those charged with governance; consider the auditor's report; with legal advice, weigh reporting to an appropriate authority (such as the electrical safety regulator) under the Code; notify ASIC only for a significant contravention of the Corporations Act