



**HW Fisher
& Company**

CHARTERED
ACCOUNTANTS

14 June 2019

By E-mail to:

AAT@frc.org.uk

For the attention of Kate Dalby

Our Ref: GS/HLJ/MPC/DN

Dear Sirs

**EXPOSURE DRAFT OF PROPOSED INTERNATIONAL STANDARD ON AUDITING (UK)
570 (REVISED): GOING CONCERN**

We write to offer our comments on the proposed changes to the auditing standard on going concern.

While we understand the motivation behind these proposals, we do not believe that they are an appropriate response to the perceived issues, or that the proposed changes will be effective in resolving those issues. As is recognised in the exposure draft, the proposed changes will create additional work for auditors, we do not agree that the changes will result in benefits that would justify this additional work.

Fundamentally audit is about the exercise of judgement. The information on which audit judgements must be made will always be limited and these judgements will always be difficult to make. The real issue with audit is that the complexity and rigidity of the current auditing standards have the result that audit is seen as a process rather than a means to reach these judgements. The temptation is to think that so long as the process has been followed this will be enough for the judgements made to be supported, but often this can result in judgements being made from too narrow a perspective.

In the context of smaller audits the emphasis on process is problematic as the auditing standards have often been drafted from the perspective of larger audits and assume a level of organisation and record-keeping that is not present or necessary in a small entity, so that the requirements can be more difficult, and proportionately costly, to apply. This challenges the economics of the audit of smaller entities and has led to pressure for increasing audit exemptions. Properly defined, audit should be beneficial for entities of all sizes and the pressure for ever-increasing audit exemptions is regrettable.

As suggested above, in the context of the larger firms the danger of seeing audit as a process is that audit judgements may be made without taking a sufficiently wide view of the available evidence. That said, a judgement that was reasonable at the time will sometimes turn out to have been wrong. There is no system of audit regulation that can prevent some judgements turning out, with hindsight, to have been incorrect and this needs to be more widely accepted. Much of the current public discourse suggests that in such circumstances the auditors will always have been at fault. This view is unrealistic and should be challenged. We would not seek to make it easier for audit firms, but rather that they be judged on the actual outcomes of their work.

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This is also an issue for regulators. Regulation is substantially seen as an exercise to establish whether the audit process has been followed. Regulators avoid making their own judgements on audit matters, as these are difficult to make, but effective audit regulation must be based on an assessment of whether specific audit judgements were reasonable at the time they were made. It would be reasonable to criticise a firm for not having obtained sufficient reliable evidence on which to place a particular judgement. But for a regulator to conclude that an audit firm has breached the rules, but then to say that there is no suggestion that the judgements made were incorrect, will not contribute to an improvement in the effectiveness of audit.

The tendency of auditing standards to place too much emphasis on the process of the audit, with insufficient focus on the judgements that are required, starts with the international standards. While the International Standards on Auditing claim to be risk based, they allow insufficient leeway to conclude that in particular circumstances the procedures set out in a particular area may not be necessary. There is perhaps some hope that this could eventually be improved, possibly as a long-term result of the IAASB's current consultation on the audit of less complex entities.

At this stage we agree that the FRC should be working within the requirements of the international standards, addressing this more general problem in the UK alone would not be useful. However it is not beneficial for the FRC to add further routine processes to the area of going concern for application in the UK.

Central to the FRC's current proposals in the Exposure Draft (see 1.5 and 1.6 in the Exposure Draft document) is the idea that management will always perform an assessment of the entity's ability to continue as a going concern (and should be asked to do so if such an assessment has not already been made). While some level of assessment of going concern should always be made, the extent of this assessment need not be substantial (except where a viability statement is required under the Corporate Governance Code). We believe that the FRC has substantially underestimated the resistance that management will (justifiably) have to this in cases where no real going concern issues arise.

Where there are going concern issues, then a detailed assessment (normally including projections) will be required and auditors will have a basis to insist that this is done. But for an entity making stable profits which has substantial reserves, net current assets and is not overly dependent on an overdraft, all that might be required would be a confirmation from management (and those charged with governance if different) that there are no known factors which are expected to have an impact on the position. In such cases management need only respond to questions raised by the auditor without the necessity of producing a formal assessment.

New application paragraph A3-8 suggests only that the preparation of projections might be required. However, the overall impression of the redrafted standard is that there is a process that management must go through, and that the auditors should check. Greater emphasis on the judgements that must be made, and that the depth of the assessment required will vary with circumstances, would make the revised standard more proportionate and scalable.

While we understand the case that can be made for the communication of key audit matters where ISA (UK) 701 currently applies, there is no case for applying this more widely. The case for such requirements can only be based upon the existence of a wide-range of shareholders who do not have direct access to management or the auditors. This will not apply to small entities, particular those which are owner managed. The existing cut off for ISA (UK) 701 is reasonable.

The proposed new requirement in 21-1 that auditors should reach a specific conclusion on going concern may fit in with the wider reporting of key audit matters but we do not see a case for applying this requirement to all audits. External stakeholders will be adequately informed of any issues that arise on the basis of the existing company law requirement for reporting by exception.



More generally, the notion of reporting by exception, which is incorporated within UK legislation, used to be a powerful method of ensuring that a succinct audit report could be given, while ensuring that such matters are reported on where this is necessary. More recent standards have required reports to explicitly state all of the matters which are not being reported upon. Where key audit matters are not being reported, the result is that most audit reports comprise a large narrative that follows a standard boilerplate wording which is mostly unintelligible to most stakeholders (particularly because of the need to state in detail matters on which no comment is actually being made). The solution to this is to add a description of all matters on which reporting by exception applies to the general description of audit held on the FRC's website, to which a single reference can be made, and remove the material from individual audit reports.

Our detailed responses to the questions on which specific comment is requested are set out in an Appendix to this letter.

Our overall conclusion is that the FRC should not proceed with these proposals.

Yours faithfully

Michael Comeau
Technical Principal



APPENDIX

RESPONSES TO SPECIFIC QUESTIONS RAISED

1. *Has ISA (UK) 570 been appropriately revised to promote a more consistent and robust process in respect of the auditor's responsibilities in the audit of financial statements relating to going concern? If you do not consider this to be the case, please set out why?*

No. The proposals set out a more detailed and, arguably, robust process, but we do not agree that this is appropriate as we do not think that a process is what is needed. Instead what is needed is to improve the quality of the judgements made in relation to going concern. If anything a more rigid box ticking approach is likely to be detrimental to the quality of those judgements. The quality of judgements made would be improved by an increased focus on the objectives of the auditors' work through the adoption of more principles based standards. Until these can be made available, a better engagement from regulators in the judgements made rather than the process by which they were reached would help.

2. *Do you believe that the revisions appropriately address the public interest?*

No, as above, we believe that the public interest will be better served by an improvement in the quality of the judgements made, and that auditors should be held to account for the quality of their judgements rather than for whether they have followed a process.

The public interest is not served by a belief that such judgements will always turn out, with hindsight, to have been correct. No amount of process could ever ensure this. Regulators could usefully probe harder into the extent to which the judgements made were reasonable at the time they were made, if the following of a process were not used as a proxy for the exercise of judgement.

3. *Will the revisions promote a more robust process for:*
 - a) *Obtaining an understanding of the entity and its environment, the applicable financial reporting framework and internal control relevant to going concern?*

The existing standard already requires this understanding, the more rigid requirements of these proposals will be harder to apply for entities with less formal procedures. We agree that any business must have some form of internal controls but many businesses do not have internal controls in a form that makes the verification of their operation the most effective audit approach.

- b) *Obtaining sufficient appropriate audit evidence in relation to the adequacy of management's assessment?*

As set out in our covering letter, while we agree that some level of assessment of the entity's going concern status should always be made, we do not see virtue in making a formal detailed assessment a routine requirement.

4. *In making an assessment of going concern, the directors are required to consider a period of at least 12 months. In evaluating the directors' assessment should the auditor be required to consider a longer period, and if so what should it be?*

An assessment of going concern should include any factors expected to have an influence on going concern at any point in the future, but the period for which formal projections are required will be a matter of judgement depending on the circumstances. In practice the further into the future any such projections extend the less reliable they will be. It will be expected that periods which are nearer in time can be the subject of more detailed projections than those extending further into the future. Part of the judgement to be made concerns the reliance that can be placed on the various projections made. The dangers of setting a requirement to consider a fixed period are that this may be taken as a licence to ignore anything beyond that period, but also that detailed projections will be made beyond the period in which they can be made with any accuracy.



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5. *Is it sufficiently clear from the revisions to the standard that the auditor is required to first identify whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern before considering whether there are factors which may mitigate those events or conditions?*

This approach is clear in the proposed drafting, but was already clear in the existing standard.

6. *Do the proposals sufficiently support the appropriate exercise of professional scepticism throughout the risk assessment procedures, evaluation of management's assessment and evaluation of audit evidence obtained?*

As above, the need to exercise professional scepticism is clear in the proposed draft, but this is already clear in the existing standard, supplemented by additional materials on professional scepticism which are in issue. We do not believe that the proposed changes are necessary.

7. *Do you agree with the proposals for auditors of all entities to provide an explanation of how the auditor evaluated management's assessment of going concern (including key observations) and to conclude on going concern in the auditor's report?*

No, other than in the context of the communication of key audit matters where ISA (UK) 701 currently applies, we do not believe that this explanation would serve any purpose. The drafting of such explanations would add costs to the audit process which would not be justified. Of course where there are going concern issues the existing disclosures should continue.

The focus should be on the existing requirements for the directors to justify their adoption of the going concern basis in the financial statements.

8. *Are the requirements and application material sufficiently scalable, including the ability to apply ISA (UK) 570 (Revised) to the audits of entities with a wide range of sizes, complexities and circumstances?*

As set out in the responses above, the proposed changes would impact disproportionately on smaller entities, however the issue is not primarily one of scalability. The key point is that additional requirements should apply only when there is a going concern issue.

9. *Do you agree with the proposed effective date (aligned to the effective date of ISA (UK) 540 (Revised December 2018))?*

We do not believe that these changes should be made.

10. *Do you agree with the withdrawal of Bulletins 2008/1 and 2008/10 as set out in paragraph 1.20? Is there guidance in these Bulletins which has not been included in the revised standard which remains useful and should be included?*

Some of the guidance in Bulletin 2008/10 remains useful, and could still be regarded as a source of guidance, albeit that if it has not been updated care would be needed with its use, but it would be better not to expand the standard itself.

11. *What mechanisms should the FRC employ to ensure there is widespread awareness of the Director's responsibilities in respect of going concern?*

We do not support the expansion of the directors' existing responsibilities as suggested in this draft. However, those existing responsibilities should be stressed. The FRC could usefully set these out in a brief guidance note for directors which could be passed on to them by their auditors where needed.