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For the attention of Kate Dalby

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Dear Kate

### **Proposed International Standards on Auditing (UK) 570 (Revised) Going concern.**

Thank you for the opportunity to comment on the Financial Reporting Council's (FRC's) proposed revisions to ISA (UK) 570 on Going concern.

In the light of recent high profile business failures we welcome the focus being paid to going concern by the FRC and others, including the review into the quality and effectiveness of audit by Sir Donald Brydon (the 'Brydon Review') and the reviews into the future regulation of financial reporting by Sir John Kingman (the 'Kingman Review') and the Competition and Market Authority's report on the statutory audit market (the 'CMA Report').

### **Major concerns**

- 1. Need for change** – the FRC quotes the recent high-profile collapses of BHS, Carillion and Patisserie Valerie as a reason for revising the auditing standard on going concern but we question whether these collapses were due to a failure in the auditing standard itself rather than the way it was implemented. We recommend that the FRC first performs a root-cause analysis into these failures rather than rush to try and fix business collapses by changing the auditing standard on going concern.
- 2. Overlap with other reviews** - The auditing profession in the UK is currently undergoing a number of reviews and we are concerned that the FRC is seeking to change the auditing standard on going concern at a time when a new regulator, the Audit, Reporting and Governance Authority (ARGA) is being set up by Kingman to replace the FRC and the Brydon Review into the quality and effectiveness of audit is still underway. The Brydon Review is specifically considering the going concern standard and is seeking views on whether it is fit for purpose and whether there should be greater transparency on events or conditions that may cast significant doubt about going concern. The new regulator ARGA will also be considering auditing standards and will have to develop its own views on going concern. In our view rather than jumping ahead and risk inconsistency with ARGA or Brydon it would be better for the FRC to work with ARGA and Brydon in deciding what, if anything, needs to be done to improve the auditor's work on going concern.
- 3. International consistency** – The FRC and the Auditing profession in the UK have worked very hard over recent years to improve the consistency between UK and International standards to such an extent that additional UK requirements are limited to those required by UK law or regulations. We are concerned that the FRC has chosen to go ahead on its own with this project to update the going concern standard and are not working with the IAASB to improve the

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international standard. We question why the FRC has chosen to update going concern standard in the UK at a time when the IAASB has not considered it necessary to make changes at an International level. Going ahead with these changes would mean that the UK would no longer be consistent with the going concern standard used in other countries in the world and lose one of the main advantages of adopting International standards on auditing.

4. **Fundamental change of responsibility** – we are concerned that the exposure draft represents a fundamental change from the responsibility of the auditor reviewing management's assessment and judgements on going concern to the auditor now reaching their own conclusion on going concern independently of management's assessment. We do not believe that this is the intention of the proposed revisions to the standard but, as drafted, the standard seems to make it the auditor's responsibility to conclude on going concern rather than linking that to management's assessment.
5. **Scalability** – We have concerns about the proposal that, in all cases, auditors will be required to make a statement that a material uncertainty in relation to going concern does not exist, give a conclusion that the use of the going concern basis is appropriate and provide additional going concern disclosures about how the auditor evaluated management's assessment of the entity's ability to continue as a going concern and, where relevant, key observations arising with respect to that evaluation. Whilst we are supportive of the use of Key Audit Matters for listed companies (and those other entities set out in ISA (UK) 701) and the graduated audit report that is being considered in the Brydon Review, we do not believe that these new auditor reporting requirements proposed in the exposure draft are suitable for all entities, particularly for small and medium sized entities, and would be difficult to adapt to the audit of entities like pension schemes that fall outside the normal corporate model and where going concern is often not a primary consideration of the auditor.
6. **Extension of reporting responsibilities** - In our opinion moving from the current UK model which requires auditors to include conclusions relating to going concern and report by exception whether the directors use of the going concern basis is not appropriate or the directors have not disclosed a material uncertainty, to a model that requires auditors to make a positive statement that a material uncertainty in relation to going concern does not exist and give a conclusion that the use of the going concern basis is appropriate, represents an unwarranted increase in auditors responsibilities. In our view, the work effort and cost of auditors giving a positive statement that no material uncertainty exists and the going concern basis is appropriate will significantly increase and result in increased audit costs.

#### **Response to specific requests for comment**

##### **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 going concern?**

NO

Although we support a more consistent and robust process in respect of audit work relating to going concern we question whether ISA (UK) 570 has been appropriately revised.

##### **If you do not consider this to be the case, please set out why?**

We were disappointed that the FRC did not provide a marked-up version of the previous standard which would have allowed a better consideration of the changes being made. A large number of the changes proposed appear to be just copying in text from other standards, particularly from the ISA 315 exposure draft and we do not consider that this repetition is necessary to improve the quality of audit work performed in relation to going concern. As stated above, we are concerned that the emphasis of the standard has moved away from auditors testing management's assertion that the company is a going concern to requiring auditors to form their own view as suggested in the new requirements in paragraph 21-1 of the ISA. We believe the revision inappropriately shifts responsibilities from directors to auditors. This is echoed in the standard's shift in tone in paragraph 7 to indicate that auditors can predict the future to a certain degree and the phrasing leaves open to the

reader to what extent the auditor can predict, which is likely to open auditors to litigation, as well as expand the expectation gap.

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

NO

We do not believe that the recent high-profile business failures are due to flaws in the auditing standard on going concern. We have not seen any root cause analysis performed on these failures and the FRC has been quick to focus on the going concern standard when there is little evidence to suggest that it was the standard itself that was at fault rather than the application of the standard by the auditors.

We recommend that the FRC should first perform a root cause analysis on these business failures before deciding on which standards it has to “fix” because it may find that it has missed its target. In doing so, we recommend that the FRC or its successor ARGAs, should work closely with the IAASB so that there is a coordinated response to audit work related to going concern.

**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?**

NO

As noted above, in updating this standard the FRC has replicated many of the requirements in ISA (UK) 315. Whilst repeating the requirements might promote a more robust process, we do not think this is necessary when auditors already have to follow the requirements in ISA (UK) 315.

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

NO

Although there is more emphasis in the revised ISA on risk assessment because of the inclusion of elements of ISA (UK) 315 the procedures in this standard are not significantly different to the procedures in the current ISA and we do not consider they would promote a more robust process for obtaining audit evidence in relation to the adequacy of management’s assessment of going concern.

**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?**

NO

In our opinion, it is not practical or necessary for auditors to consider future periods longer than those considered by directors. As noted above this is further evidence of more emphasis being placed on the auditor’s assessment rather than that of the directors and, in our opinion, if the FRC wants the assessment of going concern to consider a longer period than 12 months from sign off then they should recommend that the directors perform this assessment first and have this reviewed by auditors.

**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?**

YES

The revisions are clear but as noted above we believe that the revisions made by the FRC are shifting the emphasis of the auditor’s work from considering the directors assessment of going concern to

forming their own view on going concern and we are concerned that this change in emphasis is fundamentally flawed because the auditor will have to make their own assessment of going concern.

**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?**

YES

We consider that the proposed changes in relation to going concern support the overarching requirement in ISA (UK) 200 for auditors to maintain professional scepticism.

**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

We are supportive of the graduated audit opinion recommended by the Brydon Review and for the use of key audit matters for listed entities and those others set out in ISA (UK) 701 but are concerned with the FRC extending its proposals to all entities irrespective of whether there are going concern issues. In our opinion moving from the current UK model which requires auditors to include conclusions relating to going concern and report by exception where the directors use of the going concern basis is not appropriate or the directors have not disclosed a material uncertainty, to a model that requires auditors of all entities to make a positive statement that a material uncertainty in relation to going concern does not exist and give a conclusion that the use of the going concern basis is appropriate, represents an unwarranted increase in auditors responsibilities. In our view, the work effort and cost of auditors giving a positive statement that no material uncertainty exists and the going concern basis is appropriate will increase significantly with no commensurate benefit.

We believe that the proposals will result in the use of standard boiler-plate language and whilst this might cover different scenarios it will add little value to users of financial statements and could have the impact of diluting the impact of the current requirements where auditors can communicate their concerns about the directors use of the going concern basis in a material uncertainty paragraph. We are concerned that the red flag of a material uncertainty paragraph may be lost in increased disclosure in all entities, whether or not the auditor has reservations about going concern.

**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?**

NO

We consider that the reporting requirements in the exposure draft represent a significant extension of the work effort required by auditors and we do not believe that this is scalable to audits of smaller and/or less complex entities. Management of these type of entities do not generally produce extensive papers supporting their adoption of the going concern basis and it is unlikely that their auditors will be able to rely on detailed forecasts when forming their views on going concern. Even where the going concern risk is low these proposals will require the auditors of smaller entities to perform an extensive going concern review often with little information available to them. The end result will inevitably be boilerplate wording that will comply with the standard but add little to the user's understanding.

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

NO

We believe that the FRC should wait for the results of the Brydon Review and work with the new regulator ARGA if any changes to the going concern auditing standard are required.

**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?**

YES

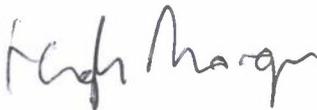
These Bulletins are out of date and we agree with the FRC proposal that they should be withdrawn.

**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 believe it is appropriate for the FRC to impose requirements on directors through auditing standards and recommend that the FRC should issue specific requirements covering what directors should produce to support their adoption of the going concern basis. If directors were required to produce cash flow forecasts and document their assumptions this would help improve the attention that directors pay to going concern and would provide auditors with sufficient information to be able to challenge management's use of the going concern basis. This would require changes to company law or accounting standards but, in our view, it is appropriate to impose this on directors as they are responsible for the preparation of the financial statements and the use of the going concern basis.

If you have any questions about this response or would like any further clarification, please contact me either by telephone on 020 3849 5931 or by email [hugh.morgan@rsmuk.com](mailto:hugh.morgan@rsmuk.com).

Yours sincerely

A handwritten signature in black ink that reads "Hugh Morgan". The signature is written in a cursive style with a large initial "H" and "M".

Hugh Morgan  
Technical Director  
RSM UK Audit LLP

