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14 June 2019

Kate Dalby
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By email only to: AAT@frc.org.uk

Dear Ms. Dalby

Proposed International Standard on Auditing (UK) 570 (Revised) Going Concern

Thank you for the opportunity to respond to these proposals. Given the public interest in this area following the recent high profile corporate failures, we believe this is an area where there is need for further reform. The current consultation looks largely at the role of auditors in the light of the current scope of audit and responsibilities of management and those charged with governance. In our response to Sir Donald Brydon's Call for Views, we have set out our thoughts on a more holistic package of measures which would recognise that changes are needed to both the role of management and those charged with governance in their stewardship of an audited entity, and then to the auditor's role in providing stakeholders with assurance. We look forward to working with the FRC and its successor body to play our part in this area and we fully support the aim to improve the quality of both reporting and audit work in relation to going concern. However, we have some significant concerns with the specific approach the FRC has taken in the draft standard.

Our key concerns are outlined below.

International consistency

The proposed approach by the FRC in the consultation draft is effectively to rewrite the international standard. This is in direct contradiction to the FRC's previously established approach which was only to supplement auditing standards as issued by the International Auditing and Assurance Standards Board (IAASB). The previous approach made it much easier to identify where there were additional UK requirements or guidance. This approach is helpful for a number of reasons:

- Firstly, it allows group auditors to identify clearly incremental requirements of ISAs (UK) to component auditors in other countries.
- Secondly, it allows audit firms that are members of global networks, which typically use common audit tools worldwide, to identify clearly additional policies and procedures that need to be introduced in the UK. This is particularly useful to those smaller audit firms which have less technical resource to analyse such changes.
- Thirdly, it allows UK auditors to assert confidently compliance with ISAs as issued by the IAASB when acting as component auditors to overseas group auditors. Again, the analysis needed to

support such a statement is harder when the FRC has made numerous changes to the underlying IAASB text, which will have a disproportionate impact on smaller audit firms.

From reviewing the proposed standard, it is extremely difficult to identify the actual differences in the standard from that issued by the IAASB, especially where the FRC has re-ordered or renumbered the existing procedures and guidance.

We also question the scale of the changes and wonder whether they are all necessary, especially the significant amount of moving and minor tailoring of existing procedures and guidance. Fundamentally, we do not believe that this will lead to a change in behaviour and will not be an adequate response to the high-profile corporate failures that have led to criticism of the audit profession. Rather than rewrite the existing ISA (UK), we would recommend that the FRC develops complementary guidance to accompany the standard, such as in a staff guidance note, where the FRC could explain in more detail what specific behavioural change is being envisaged. Where a genuine additional requirement is needed, this should be clearly identified as such.

This is most evident in the numerous changes that made to the standard without any explanation or guidance as to what the change is meant to achieve. For example, we do not believe that changing the word "adequate" to "appropriate" when assessing the going concern disclosures will result in any changes in auditor or audited entity behaviour. Instead, if the FRC believes change is necessary in this area we recommend that further guidance be included to explain how auditors should determine how the disclosures made by the directors are adequate rather than simply substituting one word with another; if this is genuinely intended to be a different standard then guidance for management and those charged with governance of audited entities on the difference would also be needed so that they can be clear what the new standard is to which they are being held.

In summary, we strongly recommend that the FRC revisits the approach taken in the consultation draft and produce an updated version of the standard that includes only supplementary requirements and application material to the IAASB standard.

Timing of the changes and interaction with the Brydon review

We note that the Brydon review has asked a number of questions relating to going concern and we have included in appendix 2 our response to those questions. We are concerned that the FRC is pre-empting whatever recommendations may come out of that review and that any changes made by the FRC could be contradicted by those recommendations. Even if there is alignment in what is proposed, it is unhelpful for the public perception of audit, as well as for directors and auditors, for there to be changes two years running in respect of going concern.

Scalability

We are also concerned that the changes are not scalable and impose unnecessary burdens on smaller non-public interest entities. If changes are not appropriate for the smallest entities and are disproportionate, there is a real danger that those entities will instead choose not to have an audit, which will not achieve the FRC's aim of improving corporate reporting.

Responsibilities of management and those charged with governance

The standard makes a number of changes to the responsibilities of auditors, but there is no mention in the consultation document about what changes are being made (if any) to the guidance available to those who are responsible for preparing and overseeing the preparation of the financial statements and performing their own assessment of going concern. We do not believe that is appropriate to impose requirements for management and those charged with governance in auditing standards and we believe that guidance and standards for directors need to develop in parallel with any changes to ISA (UK) 570.

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We have set out our responses to the feedback questions in the attached appendix 1 together with extracts of our response to the Brydon review in appendix 2.

If you would like to discuss any of our responses in more detail, please do not hesitate to contact Philip Lenton (plenton@deloitte.co.uk) or 020 7007 1772.

Yours faithfully

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Appendix 1 – Responses to consultation questions

Q1. 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, for the reasons set out in our covering letter and elsewhere in this response, we do not believe that the standard has been appropriately revised. As we previously noted, we would strongly recommend that the FRC revisits its proposed approach and revert to its existing practice of only supplementing, not rewriting, IAASB standards.

The FRC in the past has stated its commitment to follow the ISAs as issued by the IAASB and only supplement where necessary. The approach taken in the consultation draft is in direct contradiction to that approach.

One of the inadvertent consequences of the FRC's approach is that it could actually create more confusion. An example is that the numbering in the standard is not consecutive, for example Paragraph A13-1 is immediately followed by A16-1, and paragraph A19-3 by A23. This could lead auditors to believe that they are missing relevant guidance.

There is also an inconsistent approach as to whether to renumber or highlight in grey a paragraph where there has been a UK change. For example, paragraph 6 is not renumbered where there are UK changes, but the whole paragraph is highlighted in grey whereas paragraph 14-1 is renumbered but only the UK changes are highlighted.

Q2. Do you believe that the revisions appropriately address the public interest?

While we appreciate that there is significant public interest in this area given the recent high-profile corporate failures, we are concerned that the revisions to ISA (UK) 570 alone will not achieve the FRC's aims.

Management and those charged with governance of an audited entity (e.g. the directors of a company) are responsible for making a going concern assessment and we consider that further guidance or standards for directors should be issued in parallel with any updated auditing standard. This will provide management and those charged with governance with a clear, unambiguous set of requirements for the preparation and oversight of a going concern assessment so that the directors are aware of all of their responsibilities and do not need to read ISA (UK) 570 to obtain a full list of all of their responsibilities.

In addition, the public interest may not be served by having two sets of changes in quick succession – first the changes proposed by the FRC in ISA (UK) 570 and then subsequently any changes implemented as a result of the Brydon review.

Q3. 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?
b) Obtaining sufficient appropriate audit evidence in relation to the adequacy of management's assessment?

While we agree that the changes may promote a more robust process, we again question the need for such extensive changes to the standard proposed by the FRC.

We note that many of the additions in respect of understanding the entity and its environment have been adapted from or duplicate the material in ISA (UK) 315. We do not believe that this level of detail is necessary to promote a more robust process as the requirements and guidance already apply. Adding this additional guidance will also mean that as ISA 315 is currently being revised by the IAASB, all of that additional material will need to be revisited when the revised ISA is published.

Similarly, in terms of obtaining sufficient appropriate audit evidence, we do not believe that the revisions will make a significant impact as they are mainly rewriting or reordering existing requirements and guidance.

Q4. 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, the requirements on auditors to evaluate the directors' assessment needs to align with whatever accounting standards require. To do otherwise would result in auditors having to develop their own going concern assessment independent of the directors rather than evaluating the directors' own assessment.

Q5. 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, although we believe this was sufficiently clear in the existing standard.

Q6. 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?

While the proposals further support the appropriate exercise of professional scepticism, we note that this concept is already embedded in a number of the existing auditing standards. We are not convinced that simply adding more requirements and guidance to this standard will lead to an increase in professional scepticism nor are we convinced that the proposed changes would have led to a different outcome in the case of recent high-profile corporate failures.

Rather than revise the standard itself, we believe that the goal of raising professional scepticism in this area would be better served by producing separate guidance. This could give examples of particular going concern issues and include specific guidance on ways to challenge management's assessment and exercise professional scepticism in those scenarios. The FRC has recently been producing more staff guidance notes and we believe this would be a topic well suited to those guidance notes. For example, the situation where a company is up for sale and the current directors' ability or willingness to perform a going concern assessment beyond a sale is a difficult issue. Auditors often grapple with this, forcing directors to change their own behaviour. Parallel guidance for directors and auditors on how such a situation could be approached could lead to a step change in clarity and reliability of corporate reporting in this area.

Q7. 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 do not believe that it is necessary for auditors of all entities to include an explanation of how the auditor evaluated management's assessment of going concern. We believe that this would simply result in more boilerplate in audit reports as auditors would develop standard wording to explain their approach. The likely effect of this requirement might also make it more difficult to identify where there are genuine going concern issues.

Given that it is management's responsibility to prepare the going concern assessment, we believe that it would be better to focus on getting improved disclosures from management as to how they were satisfied in respect of going concern.

However, if the FRC does retain such a requirement, we believe that it should only apply to entities that are required to report on key audit matters. Even in this situation, there would need to be guidance on how to distinguish clearly those situations where going concern is a key audit matter, such as where it was a close call, as otherwise it could imply going concern is a key audit matter in all cases, which would again dilute the impact.

We also question the need to include key observations where going concern is not a key audit matter, but if the FRC does impose such a requirement, we believe it would be helpful to give guidance on what types of matters might be key observations.

For those entities that comply with the UK Corporate Governance Code, we do not believe that the requirement in paragraph 21-1(d) is necessary. There should be no situations where the auditor has anything material to add, as by definition this would imply that the disclosures were inadequate and consequentially the auditor would modify their opinion on the financial statements. The only situation whether the auditor should need to draw attention to a matter is where there is a material uncertainty.

Similarly, in respect of the requirement in paragraph 24-1 relating to the viability statement, we again question the need to state whether there is anything material to add as to do so would suggest that the auditor’s opinion relating to the other information should already have been qualified. We again suggest that it would be helpful if guidance was given as to what matters the FRC considers the auditor might want to draw attention; it may also be helpful if this is replaced by a requirement for the auditor to include key observations. Such observations could be as simple as drawing attention to disclosures by the directors, but would also allow the auditor to provide more colour where appropriate.

Q8. 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, as set out in our covering letter this is one of our key concerns. We do not believe that the changes are scalable and believe they impose unnecessary burdens on smaller non-public interest entities. For example, as set out in our response to Q7, we do not believe that it is necessary for all audit reports to provide an explanation of how the auditor evaluated management's assessment of going concern as we think ultimately that will lead to more boilerplate in audit reports.

Q9. Do you agree with the proposed effective date (aligned to the effective date of ISA (UK) 540 (Revised December 2018)?

Yes, subject to our comments about the interaction with the recommendations of the Brydon review and the need to issue guidance to directors on a timely basis.

Q10. 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, we support the withdrawal of Bulletins 2008/1 and 2008/10.

Q11. What mechanisms should the FRC employ to ensure there is widespread awareness of the Director’s responsibilities in respect of going concern?

The key mechanism is to promote the guidance that the FRC has prepared for directors of companies that follow the UK Corporate Governance Code and the guidance for other entities.

We have set out our concerns that it is not appropriate for directors' responsibilities to be introduced in the ISA (UK) and that the guidance for directors needs to be updated at the same time or sooner, which is likely to entail a separate consultation giving directors an opportunity to provide input on their responsibilities.

We also recommend that the FRC works with other bodies to promote awareness of directors' responsibilities to carry out a robust going concern (and, where applicable, viability) assessment and the likely auditor challenge. This should include both the professional accounting bodies of which many CFOs are members (including ICAEW, ICAS, ACCA, CAI and CIMA) as well as other bodies which may provide a route to directors (for example the IoD, CBI and, if changes affect SMEs, the Federation of Small Businesses).

Other comments not covered by the questions above

Letters of support

We believe it would be helpful if the FRC gave more guidance on when directors might be able to rely on letters of support from parent undertakings – in particular assessing the legal enforceability of such letters and also emphasise the need to understand the business rationale for the parent entity to provide that support. This is an area where auditors typically do apply professional scepticism, but we believe that directors relying on such letters do not apply the same level of challenge as auditors. Many, for example, are unware of the current position following the judgement in Re Simon Carves Ltd sub nom Carillion Construction Ltd v Hussain and others [2013] EWHC 685.[1]

Impact of when a company is up for sale or significant changes are planned in a business

There is limited guidance for directors, and indeed auditors, on the approach to take when a company is up for sale or significant changes are planned in a business. This can be particularly difficult when the entity is dependent on financial support from the parent, but also in situations where a company is either a major customer of or supplier to its parent.

Interim reviews

The guidance for auditors in ISRE (UK and Ireland) 2410 and directors in the various FRC going concern materials may also need to be revisited depending on the scale of the changes made by the FRC to the ISA. In particular, it may be helpful to give guidance on what the triggers would be for the directors to perform a detailed review of going concern during an interim.

[1] https://www.bailii.org/ew/cases/EWHC/Ch/2013/685.html

Appendix 2 – Related questions in the response to the Brydon review

Q15: Is the current regulatory framework relating to going concern fit for purpose (including company law and accounting standards)?

15.1 We think it could be improved. There are three questions to consider here, which we set out below.

15.2 Firstly, is the current corporate reporting framework operating as designed, with the vast majority of audited entities and audit firms applying the law and accounting standards appropriately? This is the framework which requires the going concern basis to be adopted unless an entity's management (a) intends to cease trading or enter liquidation within twelve months or (b) have no realistic alternative to cease trading or enter liquidation within twelve months, requiring disclosure of any material uncertainties which give rise to significant doubt as to the entity's ability to continue as a going concern.

15.3 We believe that the current framework is operating as designed, although there are examples where a material uncertainty was not disclosed that should, based on the evidence available at the time, have been. This is a failure by management and those charged with governance – and is unlikely to be improved by moving the bar. Whilst there have been some high profile failures, these are comparatively rare.

15.4 Secondly, is the current audit framework operating as designed, with the vast majority of audit reports correctly calling out if there is a material uncertainty (or qualifying if there is an uncertainty which directors refuse to disclose)? Again, we believe this to be the case – with again, a few high profile failures.

15.5 In our recent response to the FRC on its implementation of the 2016 Audit Reforms we argued that whilst the test in both accounting and auditing standards – that the audited entity is solvent now and likely to be for twelve months, with any material uncertainties to be disclosed – is the right one, there is a big challenge in that directors are not legally obliged to have controls over the inputs to the forecasts, and the forecasting process itself, that they use. Auditors, as a result, whilst forming their own view, often find themselves "auditing in quality" into management's own assessment process. We think that, for at least the more significant audited entities, directors should be required to put such controls in place to support their assessment, and then auditors be required to test those controls, calling out any failures.

15.6 The harder, third question, is whether this going concern test meets the interests of stakeholders, even if it were operated perfectly. Inevitably, the use of hindsight is an issue – it is often argued that because entities become insolvent with a clean audit report and no disclosure of an uncertainty, the regime has failed. Whilst this may sometimes be the case, it will not always be so – events may have occurred that could not reasonably have been foreseen at all, or were only foreseen as remote, by management, those charged with governance or the auditors.

15.7 We suggest that some improvements could be made to the current reporting model, which could then be subjected to audit by the auditor:

15.7.1 One enhancement to the required disclosures could be a disclosure by the directors of their historical forecasting accuracy. This would drive them to improve the forecasting process and inform users as to how reliable management's estimates might be.

15.7.2 Another would be to require disclosure of going concern risks prior to mitigation, and then the mitigation put in place by management and those charged with governance. By disclosing these sorts of risks pre-mitigation, users of financial statements could be more informed about the quality of directors' judgements and the risks. This would require a change of attitude by everyone in the financial reporting supply chain – preparers would need to be willing to disclose these matters, auditors would then be able to qualify if they were not disclosed, and users would need to take mature decisions based on the information.

15.7.3 In addition, management could be required to implement controls over assessment of the adoption of the going concern basis of accounting and the existence or otherwise of material uncertainties, and the auditor could report on the effectiveness of these controls. This may give some comfort that, provided the directors continue to operate the controls as designed, future shocks and uncertainties would be identified and disclosed.

15.8 Finally, we note that a deeper level of comfort is delivered when a working capital statement is included in a prospectus or class 1 circular which is normally subject to scrutiny by reporting accountants. The phrasing of the test differs slightly between the Listing Rules for an IPO, a class 1 transaction and in the AIM Rules, but each implies a similar level of comfort. To explore this, we consider the test in the Prospectus Directive Regulation which requires a "Statement by the issuer that, in its opinion, the working capital is sufficient for the issuer's present requirements or, if not, how it proposes to provide the additional working capital needed".

15.9 The practical effects of this are explored in Recommendations issued by the European Securities and Markets Authority[2]. For example:

15.9.1 ESMA do not allow there to be any assumptions, sensitivities, risk factors or caveats. Paragraph 121 of the ESMA Recommendations is clear that the statement cannot be unqualified if there is a need for any refinancing, negotiation of or new credit terms/facilities, decrease in discretionary capital expenditure, revised strategy or acquisition program or asset sales.

15.9.2 The test in a working capital statement requires that bank facilities be committed for at least twelve months from the date of the statement. Requiring this standard for going concern would require many companies to put in place funding for a longer period (for example, renewing overdraft facilities for eighteen months rather than twelve), which will have an economic cost as banks will charge more.

15.9.3 Likewise, if even a modest cost-cutting exercise or asset sale is required, this would lead to a qualification. Investors currently would expect this not to be disclosed as a material going concern uncertainty as long as it was only a remote prospect that these plans would fail. In the working capital statement model, the entity would either need to have already secured facilities to cover the shortfall that even a remote prospect of failure came to pass, or else accept a qualification.

15.10 The effect of such a test, which would either increase the number of going concern uncertainties disclosed, or require significant new financing, would necessarily cost more. It would be for investors to decide if these costs outweigh the risks that they would address.

Q16: Should there be greater transparency regarding identified "events or conditions that may cast significant doubt on the entity's ability to continue as a going concern"?

16.1 We believe the existing framework requires sufficient detail of such matters where they are material uncertainties that give rise to such doubts.

16.2 The broader question is whether such events or conditions should be disclosed when they are not material because there is a mitigating action in place. We explore this in paragraph 15.6 above.

Q17: Should directors make a statement about the sustainability of the entity's business model beyond that already provided in the viability statement?

17.1 Yes, a new statement would be a useful thing, clarifying the directors' views on the future of the entity's business model and associated risks over the longer term.

17.2 Neither the UK Corporate Governance Code nor the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting indicate that the viability statement is about the sustainability of the entity's business model. They do link the viability statement to the current position and the principal risks, and principal risks are defined as those which might threaten the company's business model, future performance, solvency or liquidity and reputation. To support this, para 4 of Appendix B states the following: "The statement should be based on a robust assessment of

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[2] See paragraphs 107-126 of the *ESMA update of the CESR recommendations: The consistent implementation of Commission Regulation (EC) No 809/2004 implementing the Prospectus Directive* available at https://www.esma.europa.eu/sites/default/files/library/2015/11/11_81.pdf

those risks that would threaten the business model, future performance, solvency or liquidity of the company, including its resilience to the threats to its viability posed by those risks in severe but plausible scenarios".

17.3 The main criticisms of the current viability statement largely relate to whether the company's future prospects can be reasonably assessed beyond the 3-5 year period most companies have selected for the viability statement outlook period – for example by considering longer term risks to the business model such as climate risk.

17.4 A minority of companies comment on the sustainability of the entity's business model in the viability statement. A more usual approach is to see it as about availability of financing in the mid-term. Some companies do split this out – a statement of 3-5 years based on the entity's medium-term financial strategy and related forecasts, coupled with an outlook statement of longer term sustainability of the business model – for example, so as to consider risks whose financial effect may be further out but which need to be taken into account now, such as climate change.

17.5 Ultimately, we believe that there should be a statement based on funding over the medium-term, and then a statement that the board believes that the company's strategy and business model supports the development of sustainable value over the long term. This statement should include sufficient detail to explain why this is the case, which could involve aspects such as vision for the market in the longer term, its approach to current principal and emerging risks and its sustainability (e.g. ability for a company to be agile and innovative). The assessment should consider a wide range of macro risks in addition to financial and operational matters, including commercial factors, technology and environmental factors. This statement would make a more explicit connection between the principal risk disclosures and viability, with more challenge to risk disclosures which do not adequately address the sustainability of the business model. This linkage would lead to a really compelling discussion of the prospects and viability of the business.

17.6 It might also be beneficial for users if preparers were required to discuss alternative business models considered and rejected in favour of the applied business model. This might better inform users on the risk appetite of the directors. There might then be less perceived 'shock and radical change' when new executives join and alter the strategy.

17.7 Such a statement would be subject to the existing safe harbour for directors, recognising that as anyone looks further into the future, they lose degrees of certainty – for example, in its existing Guidance, the FRC states that "*Reasonable expectation does not mean certainty. It does mean that the assessment can be justified. The longer the period considered, the more the degree of certainty can be expected to reduce.*" What is important is that the directors make such statements, whether covering the short term (going concern), medium term (viability) and long term (sustainability) that they do so having taken reasonable steps. In that context it might be beneficial to users if the directors were required to outline the steps they have taken in making these statements.

Q18: Should such a statement be subject to assurance?

18.1 We support the provision of enhanced assurance over viability, risk and strategy disclosures.

18.2 Ultimately it is not practical to expect an auditor to provide assurance on, or otherwise "underwrite", the future sustainability of the business model itself. However, with careful scoping an auditor could provide a level of assurance regarding the directors' due diligence / controls / forecasts over making the statement. The auditor would need a form of 'safe harbour' akin to that of the directors – recognising again that even if their work is done to a high standard, there can be no certainty that they will identify all failures of management, nor that they will be guaranteeing the long-term viability of the business.

Q19: Who might be capable of giving such assurance?

19.1 To give meaningful, carefully scoped, assurance in this area, the assurance provider needs a detailed understanding of the financial reporting practices of the entity and its future prospects, together with processes to prepare forecasts.

19.2 At the moment, the auditor is ideally placed to provide such assurance as it already has this knowledge – maybe not to the same depth as management, but deeper than any other external party, and there are many natural crossovers with the knowledge and expertise needed to audit the financial statements. The auditor may need to call on specialists (whether within their firm or not) to assist, but the core disciplines of looking at controls over financial forecasts are traditional audit skills.

19.3 Such a service could be provided by another service provider, including another audit firm, but the time (and therefore cost) required to provide that assurance would likely be significantly higher than if the auditor was used, reflecting the breadth of the areas which would need to be looked at, including understanding of risks, testing of controls and processes and the reliability of external data sources.