Kate Dalby

From: Martyn Eynon Jones <martyneynonjones@gmail.com>
Sent: 10 March 2019 22:12
To: AAT
Subject: Proposed International Standard on Auditing (UK) 570 (Revised)Going Concern - Exposure Draft

(For the attention of Kate Dalby)

The Financial Reporting Council is to be commended for updating its auditing standard on going concern in advance of the creation of a successor body as recommended by the Kingman Review and of the outcome of the Brydon Review.

Paragraph 3 of the introduction to the exposure draft helpfully sets out the background but would have benefitted from more root cause analysis of going concern problems generally that have occurred in the past. I would suggest that besides inadequate auditor scepticism the root causes may have included over optimistic or inadequate "group think " by those making going concern assessments , failure to appreciate contract risks appropriately , business models being challenged by disruptive technology and distribution channels , dividends exceeding cash flow for the financial year and the lack of prudence that may be implicit in various accounting standards such as those on financial instruments and intangibles .

Paragraph 3 specifically identifies a few large companies that have collapsed in the past . However in addition to " rear view mirror " analysis there is a need to consider the robustness of the going concern auditing standard for dealing with the possibility of the next global financial crisis and the possible effects on certain companies of Brexit . I would therefore suggest that the recent speech by Hans Hoogervorst on " Are we ready for the next crisis ? "should be mandatory reading for all members of the Financial Reporting Council and its successor body . There is also a need to factor in these issues in considering the contents of the draft revised ISA (UK) and Bulletin guidance .

Paragraph 1.1 of the explanation of proposed key changes correctly highlights the importance of not viewing ISA570 in isolation to the wider suite of auditing standards . One of these standards is ISA580 on written representations . I would suggest that this standard is far too weak on going concern and generally on producing the right psychological impact on directors .

There needs to be the inclusion in written representations that the directors "have to the best of knowledge and belief supplied the auditors with all the available information and documentation needed for a full assessment of the going concern basis including all relevant risks , events and conditions that relate to the twelve month period ahead and that an unbiased and prudent approach and not over optimistic approach has been adopted in assessing the impact of those risks , events and conditions on the going concern basis ". Where the audited entity is a UK company there also needs to be an expectation that the directors state that they "have to the best of knowledge and belief complied fully with section 501 of the Companies Act 2006 in that they have not knowingly or recklessly provided information to the auditors which is misleading , false or deceptive in a material particular and that they are aware of the legal consequences of not doing so ".

Such statements would make directors think more deeply about their assessment of the going concern basis and more generally about the balance and content of the audited financial statements , improve the quality and realism of the information provided to auditors and make it easier for a more challenging and sceptical approach to be applied not only by auditors but also by the non executive directors . It is right to expect auditors to be more challenging and sceptical but there is a danger of a moral hazard arising if that need is applied to just the auditors and not to the directors and in particular the audit committee who should be expected to review the written representations and the financial statements before they are issued .

An inherent problem related to the going concern assessment is that business and going concern risks can arise with huge velocity exacerbated by the actions of banks , suppliers and credit insurers who can suddenly withdraw their support and market movements largely driven by hedge funds going short or by other investors spooked by profit expectations not being met. It therefore needs to be made clear that an unmodified and unqualified auditors' report is not a guarantee of future viability and that shareholders therefore need to take account of half yearly , quarterly reports and market announcements including profit warnings .

Another problem is that going concern judgements are not infrequently very difficult to make and to assess . One of the difficulties is that a binary model for assessing going concern uncertainty is not the perfect solution as the level of going concern risk is not static and can be at a number of different levels along a spectrum beside material and immaterial uncertainty . The reference in paragraph 1.10 to the need to pay more attention to "the completeness of information and particularly the linkage of the viability statement with the principal risk disclosures " is supported . However it would also be helpful if the Financial Reporting Council could work speedily on developing a more graduated form of going concern reporting . Reference is made in paragraph 1.15 to " key observations arising with respect to that (going concern) evaluation " but this needs building on in terms of further guidance of a graduated nature applicable to such observations .

Turning to your requests for comments , mine are as follows :

1. There is scope to improve the quality of the information provided to auditors by making additions to the written representations made by directors to auditors as explained above .

2. Yes.

3. More emphasis should be given in the draft ISA (UK) on assessing the challenges relating to the business model from disruptive technology and distribution channels and on contract risks , political risks , global economic risks ,credit insurers ,the impact of new accounting standards and the prudence of the dividend policy .

4.The period considered by the directors and the auditors should be the same .

5.Yes but the directors should be expected to supply this information by way of the stronger written representations that they provide to the auditors.

6.Yes but the directors should be required to give stronger written representations .

7.Yes.

8.Yes.

9. More time may be needed to ensure that appropriate changes are made to the written representations expected from the directors .

10.Yes .But these bulletins may need to be superseded by bulletins which take into account economic problems arising from Brexit , a future global economic crisis arising from the growing level of debt and a possible future major collapse of financial markets following the prolonged period of bull markets. The Financial Reporting Council and in due course its successor body should keep these possibilities under review.

11. An exposure draft setting out for directors' updated responsibilities for written representations to auditors and further guidance for audit committee chairs and finance directors on assessing going concern in the light of Brexit may be needed . Brexit related issues that directors may need to consider include the effect of changes in tariffs , disruption to supply chains , reduction in the value of sterling , closure of manufacturing plants in the UK , transfer

of UK businesses to EU member states , non availability of suitable potential employees and a general reduction in consumer and business confidence .

I hope that the above is of assistance.

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