ICAEW
REPRESENTATION 67/19

PROPOSED INTERNATIONAL STANDARD ON AUDITING (UK) 570 (REVISED) GOING CONCERN

Issued 17 June 2019

ICAEW welcomes the opportunity to comment on the Proposed International Standard on Auditing (UK) 570 (Revised) Going Concern published by the Financial Reporting Council on 4 March 2019, a copy of which is available from this link.

Audit is under the spotlight in the UK and subject to a number of reviews following high-profile corporate collapses. ICAEW strongly supports reform of UK audit and welcomes the focus of the Financial Reporting Council and others on the key issue of going concern.

Our response highlights five areas of concern with the proposed FRC approach.

1. While the FRC has indicated these changes are only intended to enhance the current approach to going concern, we have concerns about the timing of this work. Sir Donald Brydon is considering whether the current framework is fit for purpose as part of his review. The proposed new regulator, ARGA, has not yet been set up.
2. The causes of recent corporate collapses are complex and it is not yet clear that the failures by auditors to highlight them in advance were due to flaws in auditing standards or an audit delivery gap. We call for the FRC to undertake a root cause analysis on the failures to alert.
3. We have concerns with some of the proposed drafting which we believe may give rise to misinterpretation of the FRC's intentions. Drafting could also be improved to address internal consistency and duplication.
4. We disagree with the proposal for auditors to be required to provide additional going concern disclosures in all cases. This is likely to increase costs and introduce a significant amount of boilerplate in audit reports which risks obscuring, rather than highlighting going concern risks.
5. We do not think the requirements and application material are sufficiently scalable to the audit of small and medium sized entities.

Accordingly, we urge the FRC to review these issues further before finalising its proposals.

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This response of 17 June 2019 has been prepared by the ICAEW Audit and Assurance Faculty. Recognised internationally as a leading authority and source of expertise on audit and assurance issues, the Faculty is responsible for audit and assurance submissions on behalf of ICAEW. The Faculty has around 7,500 members drawn from practising firms and organisations of all sizes in the private and public sectors.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 150,000 chartered accountant members in over 160 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

KEY POINTS

1. Audit is in under the spotlight in the UK and subject to a number of reviews following several high-profile corporate collapses. ICAEW strongly supports reform and welcomes the focus of the Financial Reporting Council (FRC) and others on the key issue of going concern.
2. ICAEW welcomes this opportunity to comment on the FRC's exposure draft of ISA (UK) 570. We have five key concerns with the proposed change, discussed in turn below.

Coordination with major audit inquiries

3. We have concerns about the timing and approach of these proposals. While the FRC has indicated these changes are only intended to enhance the current requirements, on reflection, we believe that the FRC should wait for the results of both Sir Donald Brydon's ongoing review into the quality and effectiveness of audit, as well as the establishment of the proposed new regulator, the Audit, Reporting and Governance Authority (ARGA).
4. While we agree that reform is necessary, waiting, as we suggest, will help ensure that reforms are made in a coordinated and considered fashion. The FRC's proposed changes to the audit of going concern have not been considered by the on-going reviews to date, and are not included in the recommendations within Sir John Kingman's report or the Competition and Markets Authority's (CMA) market study.
5. Sir Donald is considering the current going concern standard in his review. He is seeking views on the following questions:

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

   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 good concern"?
6. We acknowledge that Sir Donald may ultimately agree with the FRC's proposals following his review, however, the proposed implementation of the FRC's changes (accounting periods beginning on or after 15 December 2019) could occur prior to the public delivery of Sir Donald's report and recommendations. The FRC's proposed revisions to the approach and disclosure of going concern assessments arguably prejudge the outcome of Sir Donald's review.
7. The proposed implementation date might also prejudice Sir Donald's conclusions, or result in another significant change in quick succession for auditors, neither of which is in the public interest. Changes in quick succession will create confusion for both auditors and the public and compromise effective implementation.
8. Furthermore, Sir John called for the replacement of the FRC with a new, stronger regulator, ARGA. We acknowledge that the FRC is in a process of transitioning to the new arrangements at present, however, new leadership is not yet in place. It seems logical that ARGA needs to be allowed to develop its own views on going concern. It does not seem appropriate for the FRC to pre-empt ARGA's leadership on this topic.

Root cause analysis of high-profile audit failures

9. The extent to which flaws in the going concern standard were responsible for the failure of auditors to anticipate the collapses of BHS, Carillion and Patisserie Valerie are not yet clear. It seems more likely that any failure was caused by a delivery gap in the application of the existing auditing standards. We call for the FRC to undertake a thorough root cause analysis of these failures and properly assess whether ISA (UK) 570 is in fact at fault, or whether other standards or regulations need to be changed.
10. If ISA (UK) 570 is assessed as fit for purpose, but concerns are raised regarding other ISAs (UK) or other areas of financial reporting or corporate governance, efforts should be directed to those areas. If ISA (UK) 570 is not fit for purpose, then the FRC should work with IAASB to

reform the international standard, given the implication of the seriousness of such a failure to global markets.

11. We do not oppose the UK taking a leadership role internationally but we believe that the proposed unilateral change risks undermining international consistency and represents a departure from the existing principle of adopting the ISAs with UK pluses to reflect differences in national legal or regulatory requirements.

Concerns with the drafting

12. We have concerns about the drafting of the proposed changes, which we believe may give rise to misinterpretation of the FRC's intentions. We also believe drafting needs to be revisited to deal with internal consistency and duplication.

Potential misinterpretation of intention

13. On 9 May 2019 FRC staff delivered a helpful webinar for Audit and Assurance Faculty members on the background and intentions of the proposed changes to ISA (UK) 570. The presentation made clear that the intention of the changes is to improve the robustness of the auditor review of management judgments on going concern. However, we have concerns that the draft language of the proposed revisions could be interpreted as a fundamental change in the approach to auditing going concern, which would shift the principal focus from management judgment to auditor judgment.

14. The current ISA (UK) 570 requires auditors to test the management assertion that the company is a going concern. This is a key area of management judgment. Management must consider relevant events, risks and their business model against an inherently uncertain future, and whether based upon their plans and judgments, the company can and should continue to operate. The auditor then reviews this judgment based on evidence, and concludes whether this is appropriate, and whether the evidence suggests that a material uncertainty exists.

15. However, the changes as drafted could be read as reversing the starting point, with auditors undertaking a going concern assessment independently of the operational scenarios considered by management. We noted from your webinar that this is not the intention of the changes, and the text should reflect this.

Inconsistencies and duplication

16. The proposed revisions to the objectives (paragraph 9(a)) seem inconsistent with the risk assessment procedures (paragraph 10-1(b)), approach to evaluating management's assessment (paragraph 12-1(b)), auditor reporting (21-1(b) and (c)) and documentation requirement (26-1(c)(i)). The objectives ask auditors to conclude 'whether a material uncertainty related to going concern exists' while paragraphs 10-1(b) and 12-1(c) require the auditor to determine 'whether or not' a material uncertainty exists. The auditor is also required to report that they have 'not identified a material uncertainty' in paragraph 21-1(b). The difference in the amount of work required between these areas could be significant. This text should be clarified.

17. The revisions to the risk assessment procedures largely replicate the text of ISA (UK) 315, with minimum tailoring to going concern. We believe this increases the length of the auditing literature, while not resulting in radical changes in practice. We urge the FRC to review further these drafting issues to ensure they are clear and updated prior to finalising the standard.

Risk of increasing boilerplate and reducing clarity

18. We disagree with the proposal that in all cases, for all entities, auditors should be required to provide additional going concern disclosures. This is likely to increase costs and introduce a significant level of boilerplate language to audit reports. To mitigate litigation risk, auditors are likely to develop standard wording for different scenarios. We believe this is especially

likely to occur for entities which have limited risk of a material uncertainty regarding going concern.

19. We do not believe boilerplate will add value to users of financial statements, and may make them more opaque. Reporting by exception ensures that critical disclosures are highlighted due to their rarity. When disclosures are long and contain significant boilerplate, users are less likely to understand them; this could inadvertently obscure risks relating to going concern from users rather than highlight them.

Scalability concerns

20. We do not think the requirements and application material are sufficiently scalable to the audit of small and medium sized entities. The increased rigidity in the standard will impose a process on small audits, which is not justifiable in cases where it is clear there is no going concern risk.
21. The result is likely to increase prompts in audit methodologies, but reduce the application of professional judgment on going concern by auditors. The disclosure requirements will also be substantial for small and medium sized practitioners. This will increase work requirements and the costs of these audits without corresponding benefits.

ANSWERS TO SPECIFIC QUESTIONS

Question 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?

22. It is difficult to argue that the standard is not more consistent and robust, given the replication of text from other auditing standards directly into the standard. However, we believe the drafting issues we highlighted in our key points should be clarified prior to finalising the standard.
23. On 9 May 2019 FRC staff delivered a helpful webinar to Audit and Assurance Faculty members on the background and intentions of the proposed changes to ISA (UK) 570. The presentation made it clear that the intention of the changes is to improve the robustness of the auditor review of management judgments on going concern. However, we have concerns that the language of the proposed revisions could be interpreted as a fundamental change in the approach to auditing going concern, which would shift the principal focus from management judgment to auditor judgment.
24. The current ISA (UK) 570 requires auditors to test the management assertion that the company is a going concern. This is a key area of management judgment. Management must consider relevant events, risks and their business model against an inherently uncertain future, and whether based upon their plans and judgments, the company can and should continue to operate. The auditor then reviews this judgment based upon evidence, and concludes whether this is appropriate, and whether the evidence suggests that a material uncertainty exists.
25. However, the changes as drafted could be read as reversing the starting point, with auditors undertaking a going concern assessment independently of the operational scenarios considered by management. The drafting could be read as requiring auditors to first obtain evidence and conclude on whether a material uncertainty exists, and then determine based upon that whether management's judgment is appropriate. The lack of clarity could be read as reversing the roles, with auditors undertaking a going concern assessment independently of the operational scenarios considered by management.
26. This approach would be problematic; it would place responsibility for identifying relevant events and circumstances on the auditor, when this is the role of management and directors.

We note from your webinar that this is not the intention of the changes, and call for the drafting to be updated to reflect this.

27. Likewise, we believe the drafting changes in paragraph 7 should be reviewed; we recommend retaining the existing language in this paragraph. However, if 'with certainty' is to be added, we recommend that the FRC provide further explanation as to the level of certainty to which the auditor is expected to predict. Otherwise, users of the financial statements are left to judge for themselves the extent to which the auditor has predicted the future. This may open auditors to litigation, as well as expand the expectation gap.
28. We also have concerns with the replication of ISA (UK) 315 in the going concern standard. We believe this is problematic for two reasons. Firstly, replicating ISA (UK) 315 is unlikely to improve the auditor's approach. Auditors are already required to adhere to ISA (UK) 315, therefore, embedding it in ISA (UK) 570 should not cause radical changes in practice.
29. Secondly, across the ISAs, a general principle of not simply repeating standards, without significant tailoring, seems to be best practice. In this case, the proposed revisions are largely duplication, rather than providing significantly new considerations relating to going concern. We believe it more appropriate to simply cross reference to the requirements, rather than replicate the text.

Question 2

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

30. If the failure to report in advance of high-profile corporate collapses was due to fundamental flaws in the going concern standard, then we would agree that it is appropriate to revise the standard in the public interest.
31. However, it seems less likely that they were due to flaws in ISA (UK) 570 than a delivery gap in the application of the existing auditing standards. We call for the FRC to undertake a thorough root cause analysis of these failures and properly assess whether ISA (UK) 570 is in fact at fault, or if other standards or regulations need to be changed.
32. If ISA (UK) 570 is assessed as fit for purpose, but concerns are raised regarding other ISAs (UK) or other areas of financial reporting or corporate governance, efforts should be directed to those other areas. If ISA (UK) 570 is not fit for purpose, then the FRC should work with IAASB to reform the international standard, given the implication of the seriousness of such failures for the global markets.
33. We do not oppose the UK taking a leadership role internationally but, we believe that the proposed unilateral change risks undermining international consistency and represents a departure from the existing principle of adopting the ISAs with UK pluses to reflect differences in national legal or regulatory requirements.

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

34. In our view, as the requirements are largely a duplication of ISA (UK) 315, we do not believe they will promote a more robust process for obtaining an understanding of the entity and its environment, the applicable financial reporting framework and internal control relevant to going concern. The fundamental principles of ISA (UK) 315 already apply to auditors.
35. Likewise, we do not believe the revisions will promote a more robust process for obtaining sufficient appropriate audit evidence in relation to the adequacy of management's

assessment. The procedures are not significantly different to the procedures in the current standard that auditors would perform if they identified a going concern risk. This would only create a more robust process where the auditor's risk assessment has incorrectly failed to identify events or conditions impacting going concern.

Question 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?

36. We do not believe that in this context it is possible or desirable for auditors to be asked to consider future periods not considered by directors, who are ultimately responsible for the business and its operations. Auditors may not be able to obtain sufficient information and, as set out above, any requirement for them to consider a longer period gives the impression that the overriding responsibility rests with the auditor and not the directors.
37. If the FRC believes that directors should be assessing a longer period, then financial reporting, corporate governance legal or other requirements should be changed. Requiring longer reviews by auditors, but not directors, would put the emphasis and responsibility on auditors to determine if a company is a going concern, rather than the directors of the company.
38. If a consensus view is that directors should look at a longer period than 12 months from the date of the financial statements, we agree that auditors should also look at this. However, 12 months seems sensible as it takes the reader at a minimum through to the next period end.

Question 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?

39. Yes, in our view the order is clear in the revisions. We reiterate our concern expressed in the key points and in response to Question 1, above, that the revisions could potentially be viewed as changing the requirements from the audit of a management assertion – that the entity is a going concern – to one where auditors independently judge whether the entity is a going concern. This would change the emphasis from the directors' judgment to the auditor's judgment. We note from your webinar that this is not the intention of the changes, and call for the FRC to clarify the text prior to finalisation.

Question 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?

40. Auditors are already required to maintain professional scepticism throughout the entire audit, including when assessing going concern, in line with ISA (UK) 200. The proposed changes do not change the standard itself, with additions limited to the application guidance. We note that professional scepticism is a behavioural aspect of auditing, which the addition of guidance materials will not necessarily impact. Failure to exercise professional scepticism is a delivery gap issue.

Question 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?

41. We disagree with the proposal that in all cases, for all entities, auditors should be required to provide additional going concern disclosures and to conclude on going concern in the auditor's report. We believe to require this is very likely to introduce significant boilerplate language to audit reports, particularly where auditors believe they have nothing important to convey. To mitigate litigation risk, auditors are likely to develop standard wording for different scenarios. We believe this is especially likely to occur for entities which have limited risk of a material uncertainty regarding going concern.
42. We do not believe boilerplate language will add value to users and may make financial statements more opaque. Reporting by exception ensures that critical disclosures are highlighted due to their rarity. When disclosures are long and contain significant boilerplate, users are less likely to understand them; this could inadvertently obscure, not highlight risks to going concern from users.
43. There may be value in requiring disclosures where it is a close call as to whether a material risk exists. However, a close call may be an indication that it is a material uncertainty in nature. We believe it would be helpful to move away from a binary position in these cases and that it may in some cases be more appropriate to include a Key Audit Matter on going concern for close calls or, going forward, possibly to include this as part of a graduated audit opinion.
44. Sir Donald's review is considering the benefits of graduated audit opinions. We question how mandatory reporting for all entities in all cases on going concern would interact with graduated opinions should Sir Donald recommend these. We believe the FRC should wait for his recommendations before enacting this change.

Question 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?

45. We do not think the requirements and application material are sufficiently scalable to the audit of small and medium sized entities. The proposals will impose a process on small audits which is not justifiable in cases where it is clear there is no going concern risk.
46. The proposals imply that even if an auditor identifies there is little or no risk to going concern, for example, in a client with significant cash balances and a stable client base, that the auditor must still complete a full going concern assessment.
47. The result is likely to increase prompts in audit methodologies, but reduce the application of professional judgment to going concern by auditors. The disclosure requirements will also be substantial for small and medium sized practitioners. This will increase work requirements and the costs of these audits.
48. Management of small and medium sized companies rarely produce thorough assessments of going concern. For less complex companies, this will be additional process with limited benefit, while for more complex small and medium sized companies this is likely to be beneficial. In both cases the audit processes are likely to increase costs on companies, as the standard may be interpreted as introducing new backdoor requirements on management for additional evidence of management assessment required for review by auditors.
49. Scalability will also be impacted by the inconsistent language on 'whether or not' highlighted in our response to Question 1, above. This could represent a significant increase in work requirements for audits of all sizes, and the standard is not clear that this could be scaled for small or medium audits.

Question 9

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

50. We believe that the FRC should wait for the results of both Sir Donald Brydon's ongoing review into the quality and effectiveness of audit, as well as the establishment of the proposed new regulator, the Audit, Reporting and Governance Authority (ARGA).
51. While we agree that reform is necessary, these changes are all likely to affect the nature and extent of the auditors work on going concern and they should be made in a coordinated and considered fashion. The FRC's proposed changes to the audit of going concern have not been considered by the on-going reviews to date, and are not included in the recommendations within Sir John Kingman's report or the Competition and Markets Authority's (CMA) market study.
52. Sir Donald is considering the current going concern standard in his review. He is seeking views on the following questions:

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

    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 good concern"?
53. We acknowledge that Sir Donald may well ultimately agree with the FRC's proposals following his review, however, the proposed implementation of the FRC's changes (accounting periods beginning on or after 15 December 2019) could occur prior to the public delivery of Sir Donald's report and recommendations. The FRC's proposed revisions to the approach and disclosure of going concern assessments arguably prejudge the answers to Sir Donald's questions.
54. The pace of implementation could prejudice Sir Donald's ability to conclude, or result in another significant change in quick succession for auditors, neither of which is in the public interest.
55. Furthermore, Sir John called for the replacement of the FRC with a new, stronger regulator, ARGA. We acknowledge that the FRC is in a process of transitioning to the new arrangements at present, however, new leadership is not yet in place. It seems logical that ARGA needs to be allowed to develop its own views on going concern. It does not seem appropriate for the FRC to pre-empt ARGA's leadership on this topic.
56. If the FRC does wait, there is a risk of ARGA approving further changes to the standard, as a result of new leadership views or the result of Sir Donald's review.
57. We also note, that given the duplication of significant portions of ISA 315, it would be best to align the implementation date with ISA 315 changes, rather than ISA 540.

Question 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?

58. Yes, we agree with the withdrawal of these bulletins as we believe they are out of date.

Question 11

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

59. We believe the FRC should use any and all mechanisms available to it to improve awareness of directors' responsibilities, including its powers to regulate, issue guidance, and/or raise awareness in other ways.
60. Directors' responsibilities regarding going concern are more onerous than those imposed on auditors. There is currently no defined 'going concern process' for directors in the UK to follow. There is a danger that the FRC will create confusion over directors' responsibilities on going concern through backdoor requirements for auditors.
61. If the FRC wants to impose requirements on directors, it should address the requirements to companies directly, and be clear about what assessments and documents should be produced by directors to assess going concern, such as cash flow reviews. It is not appropriate to impose requirements on directors through auditing standards.