

Our ref PRM/AFE/00100000

14 June 2019

FAO: Kate Dalby
Financial Reporting Council

Dear Sirs

Proposed International Standard on Auditing (UK) 570 (revised)

Kreston Reeves LLP appreciates the opportunity to respond to the Exposure Draft published by yourselves in March of this year, proposing revisions to ISA(UK) 570 *Going Concern*. We acknowledge that is a high-profile topic at present, and the FRC's moves to revise and improve this Standard are most welcome at this time.

Kreston Reeves LLP is a firm of Chartered Accountants that is amongst the top 25 largest firms in the United Kingdom. Based in London and the South East, we predominantly operate in the SME market providing audit and other accountancy services. Our client portfolio does though extend to include AIM-listed companies. We are a member firm of Kreston International, a global network of independent accounting firms. We are also a member of the Association of Practising Accountants and the Forum of Firms.

Many of the issues confronting the auditing profession today seem to derive from high-profile business failures and concerns regarding audit quality and public interest entities. Issues around going concern and viability contribute to the expectation gap that has featured in public commentary on recent high profile corporate failings.

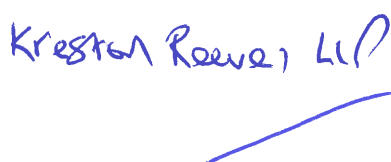
Going concern however is an issue that affects all entities regardless of size, and it is a common issue that we experience in the audit of our client base. We consider it vital therefore that the study takes into account the views of mid-tier firms such as ourselves. Our detailed responses to the questions raised in the Exposure Draft are contained in Appendix 1.

Key points

The majority of audits are undertaken in respect of SMEs, many of whom will have less sophisticated systems available to them when assessing issues of going concern. The standard needs to be proportionate so as to avoid adversely impacting on the cost of audit for SMEs in such circumstances. Conversely, Public Interest Entities will have more sophisticated systems and be better placed to assess going concern over a longer future period and the economic benefits of this to relevant stakeholders makes such an exercise valuable.

If you have any questions on the contents of this letter then please contact Peter Manser at the address shown.

Yours faithfully



Appendix 1

Proposed International Standard on Auditing (UK) 570 (Revised) Exposure Draft

Responses 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.

We are of the opinion that the proposed revisions to ISA(UK) 570 help to provide greater clarity on the work auditors are required to undertake in the area of going concern. We expect that going forward that this will result in a more consistent and robust process. Despite this businesses will continue to fail, and the reporting process will not always be able to provide adequate warning. Improvements to the audit process cannot provide a guarantee that there will not continue to be high-profile business failure and suggestions that the auditor failed to provide adequate warning.

Question 2

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

Any revisions that seek to strengthen the audit process in the key area of going concern are in the public interest.

What we would like to see are corresponding improvements to the financial reporting framework that requires management to disclose greater information on their going concern assessment process in all situations. At present if the going concern basis of accounting is being adopted, management are only required to disclose any material uncertainties that exist which impact upon their assessment. A requirement that all entities provide disclosure in their financial statements on their going concern status, whether there are uncertainties about their future viability or not, we believe would enhance financial reporting, and provide a clearer link between the financial statements and the auditor's report.

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.

Although we would expect that the majority of auditors already undertake a comprehensive risk assessment in respect of going concern, we envisage that the proposed revisions will provide a timely reminder to auditors of the importance of going concern issues and result in more robust work being performed in this area.

A more robust audit process in itself though is unlikely to result in the quality of evidence available to auditors improving. Unless the FRC, or its successor organisation, can compel management to improve the quality of their going concern assessment process and the disclosure they include in the financial statements, auditors may be unable to obtain higher quality evidence than at present.

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?

We consider it impractical for the auditor to be required to consider a longer period that the directors are required to consider when making their assessment of going concern. By definition the evidence available to the auditors will be limited if not already prepared by the directors for their own purposes.

We do have sympathy though with the view that a period of 12 months from the date of the approval of the financial statements is too short a period when considering going concern issues. However any move to extend this period would require changes to the underlying financial reporting framework that the preparers of financial statements are subject to, and not just the auditing standards.

For some entities extending the going concern assessment period may not be an issue. Many of our client though would struggle to produce quality forecasts and budgets for a period in excess of 12 months. This could lead to unnecessary conflict between client and auditor. From our experience we appreciate that it can already difficult to obtain audit evidence that covers the entire assessment period. Organisations are used to producing budgets and forecasts that cover 12 months from the balance sheet date, but not the entire assessment period. We feel that more can be done to make directors aware of their responsibilities in respect of going concern, which we have addressed in our response to Question 11.

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?

The need to first undertake a thorough risk assessment is clear from the revised standard. We are of the opinion though that the revised standard could be clearer when detailing at what point in the process the auditor should consider any mitigating factors. An additional paragraph, to follow paragraph 10-2, that provides clear guidance to the auditor on how any mitigating factors should be considered as part of the risk assessment process would be beneficial.

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?

The revised standard clearly reminds auditors at paragraph 12D-3 of the importance of maintaining professional scepticism throughout the course of the audit.

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?

We agree that it is important for there to be greater transparency as to the work auditors undertake when considering going concern, and also the inherent limitations that exist in an area where there is often uncertainty, in order to help address the expectation gap which may exist. We welcome the proposal for the audit report to provide an explanation of how the auditor evaluated management's assessment of going concern, although we fear that it is likely that standard 'boilerplate' text will often be used by auditors that will prove to be of limited benefit to the users of the financial statements.

It would be beneficial for the FRC (or its successor) to provide guidance to auditors in the form of examples of how the revised audit report will look as a result of this proposal. This should not be restricted to public interest entities, but should include an examples relevant to SMEs also.

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?

Going concern is an issue that affects all entities regardless of their size, legal nature or complexity as evidenced by our own client base. It is of extreme importance to us that the requirements are sufficiently scalable to be able to address the circumstances of all audit engagements.

We acknowledge the additional requirements in the proposed standard for entities required to adopt the UK Corporate Governance Code, but these are unlikely to be of significance to our client base. Other than this it appears to use that the same requirements are in place for all audit engagements. Given the importance of going concern we consider this to be appropriate.

We also note the references to 'Considerations Specific to Smaller Entities' contained within the Application and Other Explanatory Material. We find this guidance to be helpful in providing an indication of the nature of the audit evidence required to satisfy the requirements of the Standard.

As noted in our response to Question 7 what we would also find useful are examples of the revised audit report wording, to provide an indication of how this might differ for entities with different circumstances.

Question 9

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

We agree with the proposed effective date as being appropriate for the mandatory application of the revised standard.

Given the importance that going concern plays in the audit of financial statements we would suggest that early adoption of the revised standard is strongly encouraged by the FRC, and not simply permitted.

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?

We agree that Bulletins 2008/1 and 2008/10 should be withdrawn, and that the revised ISA(UK) 570 adequately reflects the guidance for auditors set out therein.

Question 11

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

In our response we have suggested that changes are made to UK GAAP in order to improve the disclosure of going concern issues within financial statements. In doing so we would suggest that the FRC or its successor organisation also revisits and updates its guidance to directors in respect of going concern, and in doing further stresses the directors' responsibilities in this area.

In addition audited financial statements are required to include details of the directors' responsibilities for the financial statements, with the wording of this disclosure usually based upon guidance issued by the Auditing Practices Board in Bulletin 2010/2. We would suggest that the FRC reissue this guidance, updating it to better highlight the directors' responsibilities in respect of going concern. This would help to make it clear to both directors and the users of financial statements that responsibility for assessing going concern issues is primarily the directors'.

It is commonplace for unaudited financial statements to also include details of the directors' responsibilities for their preparation. We would suggest that the FRC encourages more small companies and LLPs to do so to aid greater awareness of directors' responsibilities in respect of going concern.