

## FRC- ISA (UK) 570 (REVISED) GOING CONCERN - EXPOSURE DRAFT REQUEST FOR COMMENTS

*Comments by Vinita Mithani FCA, Lecturer in Accounting at Middlesex University*

Comments are invited in writing on all aspects of the Exposure Draft of ISA (UK) 570. In particular, comments are sought in relation to questions 1–10 below:

**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?**

- 1.1 *In most respects there is now a lot more specific guidance on the procedures to be carried out and the focus that is required, especially in the "Application and Other Explanatory Material" section.*
- 1.2 *Independent assessment of risks*  
*However, the main document is not explicit enough about the need for the auditor to start by actively performing an independent assessment of risks relating to going concern, before evaluating management's assessment. Perhaps this could be specifically spelt out in Paragraph 10.*
- 1.3 *External sources of evidence when identifying risks*  
*Additionally, even if the auditor is clear about the above, the risk remains that when trying to gain an understanding of the entity and its environment, the auditor predominantly considers documents prepared by the entity itself, which could paint a much more optimistic picture of the industry forces and the entity's position. Again, it would be useful to clarify this within Paragraph 10-2 and also A3-2, and perhaps even provide some useful examples of external sources of evidence.*
- 1.4 *External sources of evidence when evaluating management assessment*  
*The need to use external sources of evidence as far as possible also needs to be highlighted as part of the guidance for evaluating management's own assessment of going concern (Paragraphs A8-3 to A8-8).*
- 1.5 *Possible use of external industry expert*  
*In relation to the above points, guidance should refer to the need for the auditor to consider using the services of an independent industry expert as otherwise, the risk of being led down a certain path by management, becomes much higher.*
- 1.6 *Pervasiveness of confirmatory bias on the part of the auditor*  
*Confirmatory bias is a significant risk for the auditor, not only because of the superior knowledge held by management, but also because of the auditor-client relationship, and so the more clearly guidance is drafted to try and prevent this, the better.*
- 1.7 *Management bias assumption*  
*One must also be aware of the academic research demonstrating the natural human tendency for optimism; this, alongside the well-documented implications for management's remuneration and career of their financial representations, means that the auditor should really consider management bias as a given, rather than being alert to signs of such bias. This will provide a more compelling argument for professional scepticism to be integral to every aspect of the auditor's work.*
- 1.8 *Excessive management bias*  
*And perhaps the indicators that the auditor needs to be additionally alert to should be those of excessive management bias which would then require altogether different professional decisions to be made by the auditor in respect of the audit engagement.*

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

*2.1 Yes, to a large extent, but please see points made above in relation to Question 1.*

**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?**

*3.1 Yes, to a large extent, but please see points 1.2, 1.3, 1.5 and 1.6 above.*

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

*3.2 Yes, to a large extent, but please see points 1.4, 1.5, 1.6 and 1.7 above.*

**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?**

*4.1 Unfortunately, because of the uncertain times that we live in, the reliability of longer forecasts becomes increasingly questionable, and therefore difficult for the auditor to form an opinion on. More importantly perhaps, there needs to be greater demand from the auditor for management to carry out rigorous sensitivity analysis on the 12 months forecasts.*

**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?**

*5.1 Yes, however, as explained in paragraph 1.2 above, it is not sufficiently clear in the main document that the auditor needs to assess the likelihood of such events at the outset before it considers management's own identification of them.*

**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?**

*6.1 There is certainly a move in the right direction but the need to seek evidence from outside the organisation is not emphasised, and therefore risks remain as explained above in paragraphs 1.3, 1.4, 1.5 and 1.6.*

*6.2 Also, please see point 1.7 above about the assumption of management bias, and its impact on ensuring professional scepticism throughout.*

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**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?**

- 7.1 *Yes, this requirement certainly overcomes the issue of a lack of visibility in terms of what procedures have actually been carried out in relation to such a significant audit issue. The reporting requirement would hopefully, in turn, ensure that procedures are carried out much more rigorously.*
- 7.2 *Additionally, it is possible that upon reading the auditor's explanation, others within the industry, e.g. suppliers, competitors or experts, who may not have been consulted by the auditor, may come forward to highlight issues not picked up by the auditor, although this is not the ideal order of events – see my suggestions in paragraphs 1.3, 1.4 and 1.5, regarding looking externally as part of the audit process.*
- 7.3 *The other issue to be aware of is that the auditors' statements on how going concern assessment was evaluated can fast become vague and general, similar to the state of affairs with many other disclosures within the financial statements, and therefore the regulator will need to keep a close eye on these.*

**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?**

- 8.1 *Yes, especially as such tailoring/scaling has been successfully exercised for decades by auditors of smaller entities.*

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

- 9.1 *Yes, auditors should have sufficient time to update their internal audit manuals and programmes, and also to complete necessary staff training in time for the audits of financial statements for periods commencing on or after 15 December 2019.*

**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?**

- 10.1 *Bulletins 2008/01 and 2008/10 were designed to give very specific additional guidance following the 2008 financial crisis. While some of that guidance was generic and would appear to be encompassed in the proposed ISA (UK) 570 (Revised), some was very specific and detailed and went beyond the guidance within the proposed ISA (UK) 570 (Revised); one example would be the risk factors listed in the appendix of both bulletins; these are a lot more closely aligned to the very specific issues faced at the time, in particular with regards to fair values and impairments, but also regarding external finance.*
- 10.2 *Perhaps the proposed ISA (UK) 570 (Revised) could have an additional separate appendix giving detailed guidance more pertinent to such difficult economic times...as we may indeed experience those again in the future.*

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

- 11.1 *Finance Directors (FDs) in particular would be tasked with making such assessments, and most FDs would generally be members of one or more Accountancy Bodies, namely the ICAEW, ACCA, ICAS etc. The FRC would need to cooperate with these bodies to get the message across to its members through newsletters, conferences etc. but the FRC would need to ensure there is a cohesive communication strategy in this respect.*
- 11.2 *The FRC could also engage directly with FDs to ensure such awareness. Letters addressed specifically to FDs of listed companies may be most effective.*

*Vinita Mithani's background*

*Vinita is a Fellow Chartered Accountant (Fellow Member of the Institute of Chartered Accountants in England & Wales - ICAEW). She has over 20 years' combined experience in statutory audit and also as an internal finance professional within business. She is now a lecturer in Accounting and Finance at Middlesex University, London.*

*In the last twelve months, Vinita has published opinion articles on auditor independence in *Economia Online*, ICAEW's online magazine. She has also given oral and written evidence, and acted as advisor to the BEIS (Business, Energy and Industrial Strategy) Parliamentary Select Committee on its future of audit inquiry.*

*Comments submitted on 13 June 2019*

Responses should be sent to **AAT@frc.org.uk** and marked for the attention of **Kate Dalby**. Responses should be received by **5pm on Friday 14 June 2019**.