

Head of audit
ABC LLP

29 June 2020

Dear Sir/ Madam

FRC's review of firms' going concern policies and procedures

I am writing to give feedback on our review of firms' audit policies and procedures in relation to going concern (GC), in light of the Covid-19 (C-19) situation. This covered the seven largest UK audit firms, as at May 2020.

This follows the guidance for companies, and bulletin for auditors, issued by the FRC on 26 March 2020, and subsequently expanded to cover additional matters:

[https://www.frc.org.uk/news/march-2020-\(1\)/frc-guidance-for-companies-and-auditors-during-cov](https://www.frc.org.uk/news/march-2020-(1)/frc-guidance-for-companies-and-auditors-during-cov)

While the Board of the relevant entity is responsible for the going concern assessment, auditors are required to audit it in accordance with ISA (UK) 570, and firms need to ensure there are appropriate policies and procedures in place for this.

Our review covered requirements related to audited financial statements, rather than interim review procedures. We have not yet reviewed any completed audits to see how the policies and procedures were applied in practice. We plan to do this next, and to report on it later in the year.

Some of our key findings and messages are also relevant to audit more broadly in the current circumstances, as well as to those audit firms that were not included within the scope of our review.

Key findings

- All the firms we reviewed enhanced their audit policies and procedures relating to going concern from the end of March 2020, when the consequences of Covid-19 began to increase the risk of material uncertainties relating to going concern for many companies. In particular, this included a significant increase in required consultations at most firms, increased guidance and more regular communications with audit teams. Some firms have described this as "emergency measures".
- The focus of the firms has been on improving the consistency of execution in the audit of going concern, largely through providing additional central support in light of the increased uncertainty in the going concern assessments. We consider this to have been an appropriate response by the firms, and one that needs to be proportionate to the particular circumstances of individual entities, which will vary considerably in terms of the impact on business and financial resilience.
- Increased central oversight was necessary because, when the UK lockdown commenced, a number of audits were in an advanced stage of completion (including December 2019 year ends). The potential benefits included:

8th Floor, 125 London Wall, London EC2Y 5AS Tel: +44 (0)20 7492 2300 Fax: +44 (0)20 7492 2301 www.frc.org.uk

The Financial Reporting Council Limited is a company limited by guarantee. Registered in England number 2486368. Registered office: as above.

Please see our privacy page at <https://www.frc.org.uk/about-the-frc/procedures-and-policies/privacy-the-frc> if you would like to know more about how the FRC processes personal data or if you would like to stop receiving FRC news, events, outreach or research related communications.

- Sharing up-to-date information about Covid-19;
 - Providing additional support to audit teams, given the high degree of uncertainty and level of judgement in assessing the going concern assumptions and adequacy of the related disclosures;
 - Upskilling audit teams on how to approach the assessment of going concern, in the context of the heightened risks;
 - Increasing the level of challenge to audited entities about their assumptions, stress testing and disclosures in the financial statements;
 - Drawing conclusions, including setting out the rationale for why there is a material uncertainty, or not.
- As far as we can tell on the basis of our review, the additional measures implemented by the firms have been consistent with the requirements of ISA (UK) 570 and the additional guidance issued in March 2020 by the FRC. Some firms have also used this as an opportunity to incorporate into their guidance certain aspects of revised ISA (UK) 570 (which comes into effect for December 2020 year ends).
 - The additional policies and procedures have been similar across the firms, with the intention of giving increased attention to responding to the heightened risks arising from Covid-19.

We set out in the appendix key messages to the firms, along with good practices we identified as part of our review.

Yours sincerely

David Rule
FRC Executive Director of Supervision

Appendix

Key messages

1) Continue to perform an appropriate level of consultations on going concern and Covid-19 matters

Background

All firms have enhanced their consultation requirements on going concern assessments since the end of March 2020. This provides support to audit teams in ensuring that there has been a sufficiently robust approach, particularly when considering a material uncertainty in relation to going concern.

Findings

Most of the firms have introduced a mandatory consultation policy in relation to going concern.

The firms have the following range of consultation procedures:

- Technical panel (comprising senior audit partners)
- Central technical review (usually a mix of audit partners and directors/managers in a central team)
- Reviews by a second or third partner (not a technical expert, but a peer)

Any consultation decisions need to take into account the technical knowledge and experience of the central team, or technical panel, and the audit team's entity specific knowledge of their specific circumstances.

Good practice

- Review by technical panels: These are used more frequently than others by two of the firms. They involve a more in-depth review process than other consultations.
- Review by central technical team: Most of the firms' consultations are performed by a central technical team, especially for listed entities. This has the benefit of their experience in reviewing a wide range of GC assessments.
- Going concern consultation documentation: Most firms require completion of a consultation document or work paper. This ensures that the key judgements and discussion points are recorded. Some firms have more comprehensive memoranda than others. Best practice is to include the completed documents in a central database.

2) Continue to provide regular communications to audit teams on Covid-19 matters

Background

Since March 2020 the extent of regular communications on Covid-19 has increased across the firms.

Findings

The types of communications have been fairly consistent across the firms, with regular bulletins and partner and staff briefings.

Good practice

Dedicated website and FAQs: All firms have developed dedicated websites and FAQs on going concern and other Covid-19 related matters to keep audit teams up to date with developments.

3) Continue to develop policies regarding the auditor's report and focus on going concern disclosures

Background

The Covid-19 situation is more likely to result in reference to going concern in the auditor's report, either related to Key Audit Matters (KAMs) or a material uncertainty (MU). Where there is an MU, audit teams need to carefully consider the adequacy of the disclosures in the financial statements, including those required by IAS 1.

Findings

All firms either require, expect or have a rebuttable presumption for a going concern and/or Covid-19 related KAM.

One firm requires a rebuttable presumption for an MU, whereby audit teams need to explain the reasons for those situations where there is no MU for going concern, taking into account the particular circumstances of the entity.

Good practice

- Rebuttable presumptions – As explained above, some firms have this for KAMs and/or MU. This helps ensure that the audit team appropriately consider the risks relating to going concern, although it is important that the audit approach is proportionate to the particular risks of the individual entity.
- Examples of auditor's reports and disclosures on material uncertainty: Most firms publish examples of these (across the market) regularly for audit teams, to encourage consideration of GC disclosures.
- Avoiding boilerplate disclosures: All firms are encouraging audit teams to ensure that boilerplate disclosures are not used in the financial statements.

4) Continue to perform central risk assessment procedures of entities with higher Covid-19 risks

Background

Central risk assessment procedures can lead to several types of action, such as further partner support, more engagement of specialists or additional consultation procedures.

Findings

The central risk assessment procedures generally include consideration of Covid-19 related risks.

Good practice

Review of Covid-19 risks: We have identified elements of good practice in most firms. For example, one firm performed an additional exercise to identify the sectors and audits with the highest risks related to Covid-19. For those audits identified, the firm considered whether sufficient resources had been allocated and whether they were subject to sufficient central review.

5) Increase the extent of guidance on how to assess economic scenario-related assumptions

Background

For some companies, assumptions about the period of lockdown and the speed of economic recovery are key to going concern assessments currently. Depending on the strength of the balance sheet and availability of cash resources and other facilities, these assumptions may be critical in determining whether there is a material uncertainty.

Findings

None of the audit firms issued “anchor scenarios” on these types of assumptions. Appropriately, the audit firms recognised that assumptions should differ depending on the circumstances of individual entities, for example the sectors and geographical regions they operate in. One firm provided more guidance than others on assumed periods of trading.

Good practice

- Published economic data: The four largest firms publish a range of economic assumptions, with input from internal economists. One of these firms has developed a tool to assist in the consideration of these assumptions.
- Guidance on government funding schemes: Most firms have issued guidance on government schemes, including the Covid Corporate Financing Facility (CCFF).

6) Increase the extent of guidance on reverse stress and scenario testing and related disclosures

Background

ICAEW guidance states that “a reverse stress test is a stress test that starts from the opposite end – with the identification of a pre-defined outcome. This might be the point at which an entity can be considered as failing, or the entity’s business model becomes unviable. Severe, but plausible, scenarios that might result in this outcome are then explored”. The guidance issued to companies by the FRC in March 2020 stated “Many companies already use scenario and stress testing in developing their statements and this should continue as far as practicable. The use of reverse stress testing, to identify future scenarios that could lead to corporate failures, is also good practice”.

Findings

The firms have issued some guidance in relation to reverse stress testing and/or severe but plausible considerations, although the extent to which this is required, and the nature of the guidance, varies by firm.

Good practice

Audit procedures on stress testing: Some firms incorporate this into their work programs or consultation memos.

7) Increase the level of detail in Covid-19 specific work programs on going concern

Background

The firms updated their going concern work programs or papers (WP) at the end of March 2020 onwards, generally by supplementing them with additional WPs, templates, practice aids or checklists. The firms informed us that a supplemental approach was necessary, given many audits were either in progress or nearly completed at the time of the changes and also that

the updates relating to the revised ISA (UK) 570 do not come into effect until the end of 2020 (and updated work programs would need to be issued during 2020 for this).

Findings

The level of detail on going concern was often at a high level in the supplementary work programs.

Good practice

- Risk based work program: The existing GC work program for one firm generates a risk score which requires input from specialists when above a certain risk score.
- Mandated workpaper: Most firms require the GC or Covid-19 workpapers to be completed and signed off by the audit partner and Engagement Quality Control Reviewer (EQCR).
- Prepared by entity questionnaire: One firm requires the entity to complete a questionnaire regarding their going concern assessments, including what they have considered in their assessment. This helps the audit team plan their audit approach and discuss any concerns with management about their approach at an early stage.
- Presumed significant risk: One firm expects a significant risk on Covid-19 or going concern. Another firm requires audit teams to rebut if going concern is not a significant risk. In both cases, the audit approach needs to be tailored to the specific risks of the particular entity.

8) Increase the use of specialists and in-flight teams

Background

Internal specialists (such as economists and transactions advisory) can contribute their expertise in assessing the cash flow assumptions in going concern assessments. In-flight teams can review and challenge the audit work on a real time basis.

Findings

The decision to use specialists is generally the decision of the audit team. The extent of additional in-flight reviews (specifically for going concern and Covid-19 matters) has been limited.

Good practice

- Use of specialists and in-flight review: One firm requires the use of transaction advisory specialists and in-flight reviews for all high-risk audits (including Public Interest Entities/ listed entities). Another firm has a large coverage of in-flight reviews for going concern.
- Involvement in developing guidance: Most firms use transaction services and/or advisory specialists to help develop the guidance provided to audit teams.

9) Start to monitor the number of delayed audit reports

Background

The Covid-19 situation has caused a delay in signing of auditor's reports, for a combination of reasons, including delays caused by entities, the level of uncertainty around going concern, or a backlog of consultations at some audit firms.

Findings

While the firms have informed us that there have been delays to audit reports (especially for non-listed entities) they have not been able to provide details of the number of delayed audit reports. The firms should monitor this.