



Financial Reporting Council

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By email to: AAT@FRC.org.uk

For the attention of Kate Dalby

14 June, 2019

Dear Ms Dalby,

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

PricewaterhouseCoopers LLP (We) welcome the opportunity to respond to the FRC's exposure draft on the proposed International Standard on Auditing (UK) 570 (Revised) Going Concern (ISA (UK) 570).

In giving our views, we are conscious of the other reviews that are being undertaken in the UK. In particular, we note that the Brydon Review on the Quality and Effectiveness of Audit¹ and the BEIS initial consultation on the Kingman recommendations², have both raised questions over the auditor's responsibilities around going concern and viability and how this may differ from stakeholder expectations. Both reviews may lead to further recommendations for reform. We recognise that the FRC's goal is for a more immediate response to what it sees as necessary improvements in audit quality in this area. However, until the outcome of these other reviews is known, we feel very strongly that this is not the right time to seek to change the standard, and by making incremental changes at this point, there is a risk that stakeholders might assume that all issues related to audit in this area have been solved - this could in fact widen the expectation gap.

¹https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/794244/brydon-review-call-for-views.pdf

²https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/784988/independent-review-financial-reporting-council-initial-consultation-recommendations.pdf

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A system-wide approach

Audit operates as part of a inter-connected corporate reporting “ecosystem”. This ecosystem has several different members - preparers, those charged with governance, investors, other users, regulators, as well as auditors. As in any ecosystem, effective functioning of the whole depends on each member operating effectively. We fully recognise the need for auditors to embrace change, but the effectiveness of any changes will depend on the evolution of the roles of all ecosystem members. In the area of going concern, we believe that the system as a whole is not meeting stakeholder expectations. Unless stakeholders have access to the right information to enable them to make more timely and better decisions about their relationship with a company, making incremental changes to the audit process will be ineffective.

Changes to directors’ responsibilities and associated reporting

Reform should begin with new and more specific responsibilities for directors to assess the going concern and viability of a company, with consequent reporting requirements. We are concerned that these areas have not been addressed as part of this consultation. In fact, as we note in our detailed response, there are areas of the revised standard where it is being suggested that the auditor may be asked to go beyond the directors in terms of their assessment and disclosures; we do not support such an approach.

We believe that an improved model could be achieved by replacing the viability statement with a more robust going concern statement where the directors set out their business model and key risks that could threaten that business model - focusing on individual events and conditions rather than making generic statements. We have given more details on this proposal in Appendix 1 to this letter. The auditor’s assurance would mirror this assessment, with reasonable assurance in the first 12 months.

We have also expressed this view in our responses to both the Brydon Review and the BEIS initial consultation on the Kingman recommendations.

The regulator also has a part to play in reform and we note the recommendations from Sir John Kingman in his independent review of the FRC, that the new regulator, the Audit, Regulation and Governance Authority (ARGA), should have increased responsibilities relating to corporate failure, for example, setting up a market intelligence unit³. These responsibilities need to be incorporated as a coherent part of any new regime.

Our views on the key changes in the Exposure Draft are included in Appendix 1 to this letter and our responses to the questions in the Exposure Draft are included in Appendix 2. Whilst we are responding to the FRC’s consultation on the proposed changes, as we note above, we are not endorsing that changes be made at this point and we recommend the FRC consider awaiting the outcome of the other reviews before any proposed changes are finalised.

³https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf



We hope our comments are helpful and if you have any questions or require any further information, please do not hesitate to contact me at hemione.hudson@pwc.com.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Hemione Hudson", written in a cursive style.

Hemione Hudson
Head of Assurance, PricewaterhouseCoopers LLP



Appendix 1 - Our views on the key changes in the Exposure Draft

1. A general point over the enhanced procedures included in the revised standard in both the work effort and reporting, is that by increasing the number of procedures, there is a risk of failing to take into account that individual companies can be vastly different and so a more flexible, principles based approach may be better.

Enhanced reporting

2. As we note in our cover letter, we think the current reporting model could be improved by replacing the viability statement with a more robust going concern statement. This would be a clearer, more logical approach than having two separate disclosures. In performing their diligence before writing this more robust going concern statement, the directors could also define the risks that could “break” that business model, and provide commentary over those risks including any mitigating factors. A useful approach to doing this may be to incorporate a reverse stress testing regime, similar to that used in the financial services industry. The current viability statement regime asks directors to define (and explain the rationale for) the period of the assessment, and we have seen a tendency to default to an assessment period of 3-5 years. Under our suggested approach of a more robust going concern statement, we think it would be more meaningful not to define one single viability period (beyond the minimum 12 months required for going concern), but to focus on the circumstances that could cause each of the key risks to materialise, over what time period that could happen and what the associated impact could be.
3. Notwithstanding our comments above about the need for reform of the corporate reporting regime in this area, in its current form, we support more transparency over the assessment of going concern (para 21-1) and viability. Firstly, this should be on the part of the company, with an improved corporate reporting regime over going concern working alongside the proposed additional disclosures by the auditor. This would not only make for more robust, well rounded and useful information for stakeholders, it would reinforce the responsibilities of the directors for preparing accounts which are true and fair.
4. With regard to the requirement that the auditor positively affirm that no material uncertainty has been identified (para 21-1(b)), we believe the directors should also be required to make this statement.
5. In terms of the additional disclosures in the audit report around going concern, the requirement in 21-1(a) is designed to cover much of the same information that would currently be included in a KAM, so there is a risk that situations where there has been more significant effort around going concern that would normally have warranted a KAM, are lost in a section that would (as proposed) be included in all audit reports. A possible solution would be to instead include a mandatory KAM on going concern for all companies issuing an extended audit report (also see our comment in paragraph 11 below) and to use this section for those companies that do not issue an extended audit report.

It is also not clear whether the auditor’s additional disclosures would still be required if a material uncertainty Emphasis of Matter had been included.



Risk assessment

6. We support the proposal for better linkage of risk assessment procedures in respect of going concern with the auditor's understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control to identify events and conditions that may indicate a going concern issue (paras 10-1,10-2). We feel this will align well with the work already being covered by the recent revisions to ISA (UK) 315⁴. However, we question whether, by having such a broad risk assessment and focusing on the procedures, methods and assumptions used by management, insufficient attention is given to the critical task of understanding the key business risks that might call into question the entity's ability to continue as a going concern. Identifying these risks as part of the risk assessment process, would be a valuable exercise for both management and the auditor.
7. We would appreciate more clarity on what level of audit evidence the FRC is expecting to be obtained as part of the risk assessment (paragraph 10-1 specifically mentions "the auditor shall design and perform risk assessment procedures to obtain audit evidence...." that provides an appropriate basis for the identification of material uncertainties). This appears to be a more significant requirement than in the past and is also contradicted by the paragraphs which follow, which only focus on "obtaining an understanding" as part of the risk assessment process. It is not clear what level of evidence would be needed to provide an "appropriate" basis - whether this is intended to be sufficient appropriate audit evidence or something less. If it were expected to be sufficient, appropriate audit evidence, we would be concerned that there is no defined threshold for what is considered to be sufficient for such procedures and therefore there is a risk of inconsistent application.
8. We would appreciate more guidance on how to meet the proposed requirement in paragraph 10-5 that the auditor evaluate whether events or conditions that may cast significant doubt on the entity's ability to continue as a going concern give rise to management bias in the financial statements. In particular, it is not clear whether this refers to:
 - bias with regard to management not disclosing a material uncertainty when one is required; or
 - that once a material uncertainty is disclosed, the other disclosures in the financial statements could be overly optimistic; or
 - that the financial information presented by management is so positively biased it hinders the identification of any material uncertainties.

Evaluation of management's assessment

9. We welcome the additional guidance around work effort when evaluating management's assessment (paras 12-1 - 14-1). However, while we agree with the proposal that management's assessment should be evaluated whether or not events and conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, we caution that the auditor should be allowed to exercise judgment in determining whether a sufficient assessment has been performed by management, taking into account the

⁴[https://www.frc.org.uk/getattachment/0737b946-b24a-441d-a313-54e0a90f9e7d/ISA-\(UK\)-315_Revised-June-2016.pdf](https://www.frc.org.uk/getattachment/0737b946-b24a-441d-a313-54e0a90f9e7d/ISA-(UK)-315_Revised-June-2016.pdf)



size, complexity and “safety” of the company, and in determining what is a sufficient level of audit work on that assessment. We acknowledge that the FRC has included guidance on scalability and applying the standard in a proportionate way, but this is included in the application material (particularly A3-8, A4-1, A4-2, A11-4 and A-12) rather than the requirements so would appear to carry less weight.

The viability statement

10. We welcome the additional guidance on the work effort around the viability statement (para 16-1), however note that having such specific procedures appears to go beyond those required by ISA (UK) 720 “Other information”⁵ and move close to procedures one might deem to be of an audit standard. In our view, the auditor should either be required to audit the viability statement and report on it as part of the audit opinion or continue with the current approach. We feel that what has been suggested could lead to misinterpretation by auditors and could result in misunderstanding externally about an auditor’s responsibilities in this area, increasing the expectation gap.

The material uncertainty regime

11. Another important area for potential reform is the material uncertainty regime, whereby auditors must highlight material uncertainties regarding going concern in their auditor reports. The bar for reporting a material uncertainty is high, and consequently, such reporting can become a self-fulfilling prophecy, leading to a company’s demise. We suggest that auditors need another route to highlight potential issues relevant to the going concern assessment which may not (yet) be material uncertainties. The inclusion of a mandatory Key Audit Matter (KAM) on going concern in all public interest audit reports would provide a means of reporting such issues, and we would suggest that there could be an expectation (rebuttable) that the auditors of all reasonably complex companies would have a number of disclosable points to report in such a KAM. As we note in paragraph 5 above, this may be what the FRC is aiming to achieve in its proposed increased disclosures in the audit report over the audit procedures and outcomes relating to going concern, which will be particularly important for companies that are not required to include KAMs in their audit reports as it will mean there is still a way for them to highlight potential issues (although, as per our response to question 7 in Appendix 2, caution would need to be exercised so this did not become a disproportionate burden to small, less complex entities). If this is the FRC’s intention, more guidance on how to highlight specific concerns within the auditor’s disclosures would be helpful.

⁵ [https://www.frc.org.uk/getattachment/11b5e047-a2d7-4674-8281-cc57ec3d5e66/ISA-\(UK\)-720_Revised-June-2016.pdf](https://www.frc.org.uk/getattachment/11b5e047-a2d7-4674-8281-cc57ec3d5e66/ISA-(UK)-720_Revised-June-2016.pdf)



Appendix 2 - Our responses to the questions in the exposure draft

Question	Response
<p>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?</p>	<p>The expansion of the detail behind each of the requirements is helpful as is the addition of more application material. This will most likely help to produce a more consistent approach. As noted above, however, there is a danger that by making the procedures so prescriptive (particularly where they are included in the requirements as opposed to the application material) and largely about examining management's processes rather than their judgements, the auditor may not focus on the key business risks that might call into question the entity's ability to continue as a going concern.</p> <p>We welcome the "stand back" requirement (para 18-1) to consider all audit evidence obtained, corroborative and contradictory, but we wonder if this should also be a requirement at the risk assessment stage when considering whether the most key risks have been identified.</p>
<p>2. Do you believe that the revisions appropriately address the public interest?</p>	<p>There is a well documented expectation gap between what the public expects and what an audit is required to do in the area of going concern. So while more robust procedures and more transparency will help, we do not believe they will fully address the public interest because the public expects more than the current audit model provides. We hope that this will be addressed by the Brydon Review. We note also that ARGAs will have an important role in promoting stakeholder understanding of auditor responsibilities.</p>
<p>3. Will the revisions promote a more robust process for:</p> <p>a) Obtaining an understanding of the entity and its environment, the applicable financial reporting framework and internal control relevant to going concern?</p> <p>b) Obtaining sufficient appropriate audit evidence in relation to the adequacy of management's assessment</p>	<p>See response to Q1.</p>
<p>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</p>	<p>At the moment, there is nothing to prevent a company (and the auditor) performing an assessment beyond 12 months. However, as this is the minimum period stated in IAS1, it is regularly used as the benchmark.</p> <p>The question seems to suggest that an extended period would only be for the auditor's evaluation of going concern and we feel</p>



<p>consider a longer period, and if so what should it be?</p>	<p>strongly that it would first need to be an extended period for the directors' assessment.</p> <p>We support encouraging the directors to extend the "look forward" period in their assessment to make it less of a rigid cliff-edge and therefore result in better quality of conclusions in cases where there could be a material change shortly after the 12 month period. This would then better inform the auditor's assessment over the 12 month going concern period.</p> <p>In the event that our recommendation of a combined going concern/viability regime, as detailed in our cover letter, is introduced, the extension of the "look forward" period would be naturally incorporated.</p>
<p>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?</p>	<p>We question why the distinction is only being suggested for the auditor - it should also be required as part of management's identification process.</p> <p>We are also not clear as to why a distinction is necessary. In the existing standard, when management's assessment was only evaluated by the auditor if events or conditions had been identified that indicated a possible material uncertainty, clear identification of these events and conditions before considering any mitigating factors was important. However, that distinction seems less important in the revised standard as it is proposed in the revised standard that all assessments have to be evaluated.</p> <p>It is also not clear whether making this distinction could make a difference to how an auditor reports. For example, if there was a condition that indicates a possible material uncertainty, AND mitigating factors, would that mean it was no longer reportable?</p>
<p>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?</p>	<p>We welcome the emphasis on maintaining professional scepticism in the revised standard and think the requirement to "stand back" and consider all evidence whether corroborative or contradictory in para 18-1 is a valuable addition. However, professional scepticism is ultimately a mindset and so, although it certainly helps, it is difficult for wording in a standard to completely drive behaviours.</p> <p>As a general point, we would support more collaborative work between ARGA and the profession to drive pride in audit, including the core value of scepticism.</p>
<p>7. Do you agree with the proposals for auditors of all entities to provide an explanation of how the auditor evaluated management's</p>	<p>As we note in our cover letter, reform should begin with increased responsibilities of the directors to assess going concern and enhance their disclosures. This should be applied to all entities. In terms of the additional disclosures by the auditors, we think it is important to have this requirement not just for PIEs, as defined by the EU, but also a broader subset of</p>



<p>assessment of going concern (including key observations) and to conclude on going concern in the auditor's report?</p>	<p>entities where there is a significant public interest (for example those using public funding). However, if it were to be applied to all entities, especially smaller, less complex entities and those that have a strong cash position, it may become a disproportionate burden and cost and the disclosure could quickly become a boilerplate,</p>
<p>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?</p>	<p>The application material on scalability is helpful and we recommend that, when they are supervising audit firms, the FRC remains true to its spirit and perhaps even identifies audits where "too much" is being done.</p>
<p>9. Do you agree with the proposed effective date (aligned to the effective date of ISA (UK) 540 (Revised December 2018)?</p>	<p>As noted in our cover letter, while we understand that the FRC is trying to immediately address issues, we believe it would be more appropriate to wait until after the Brydon Review has been completed, to finalise amendments to this standard.</p>
<p>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?</p>	<p>Yes, although Bulletin 2008/10⁶ includes some useful examples of company disclosures that it may be useful to keep if there is a logical place to put them.</p>
<p>11. What mechanisms should the FRC employ to ensure there is widespread awareness of the Director's responsibilities in respect of going concern?</p>	<p>This question appears to broaden the scope of the consultation beyond the role of auditors; as explained in the cover letter, we agree with this approach as we think that companies and directors must also play their part in solving the issues relating to going concern reporting.</p> <p>The FRC has already issued Guidance in relation to going concern, both for companies that apply the UK Corporate Governance Code (as part of the 2014 Guidance on risk management, internal control and other financial and business reporting⁷) and for those that do not (in the 2016 Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks⁸).</p>

⁶<https://www.frc.org.uk/getattachment/00c2636d-af9e-41fe-9dc6-80be1b6775b5/Bulletin-2008-10-Going-Concern-Issues-During-Dec-2008.pdf>

⁷<https://www.frc.org.uk/getattachment/d672c107-b1fb-4051-84b0-f5b83a1b93f6/Guidance-on-Risk-Management-Internal-Control-and-Related-Reporting.pdf>

⁸<https://www.frc.org.uk/getattachment/62ae3969-fe26-4def-8d25-e2acd821e7b1/Guidance-on-the-Going-Concern-REVISED-WEB-READY-2016.pdf>



	<p>Both pieces of Guidance would need to be revisited to take account of changes from the current consultation process (and indeed the wider governance reform agenda), and we are aware that this is happening in the case of the 2014 Guidance noted above companies.</p> <p>Our sense is that the Guidance for non-Code companies in particular would benefit from further promotion by the FRC, once it is updated. This contains, for instance, content relating to going concern for subsidiary companies that would be helpful to many of their directors.</p> <p>The connection between the responsibilities of directors in relation to going concern and their other legal duties under, for instance, section 172 of the Companies Act⁹ and insolvency law could also be better drawn out. With the ongoing discussions in both of these areas as part of the governance reform debate there is an opportunity to highlight the significance of the underlying judgements that directors make in relation to going concern, which we suggest may need to be reframed as a more fundamental judgment about the future of the company - the current regulatory framework requires directors to consider if the going concern basis of accounting is an appropriate basis on which to prepare the financial statements - and consequently it is often regarded as an accounting policy decision. We believe that framing it in this way undermines the fundamental importance of the judgement which is probably the most critical judgement that the directors make each year in preparing and approving the accounts.</p>
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⁹<https://www.legislation.gov.uk/ukpga/2006/46/section/172>