

13 June 2019

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For the attention of Kate Dalby
Financial Reporting Council
125 London Wall
London
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Dear Sirs

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

We are pleased to respond to your consultation on proposed revisions to ISA 570 (UK) Going Concern. We have responded to the questions posed in the consultation paper in turn below, but also have some overall observations.

The assessment of whether an entity is a going concern is a key factor in assessing the truth and fairness of the financial statements. It is an art, rather than a science, not least because the future in the modern world is very difficult to predict, particularly the outcome of political decisions affecting the ultimate viability of businesses.

The issue of the exposure draft clearly comes against a background of recent high profile corporate failures and associated concern about the quality of audit. Going concern is a difficult area of the audit which requires the exercise of significant judgement about what will happen to a business over a period of at least twelve months from the date of approval of the financial statements. In the absence of a crystal ball, the auditor will need to form a judgement about management's assessment of whether the business is a going concern and design suitable audit procedures to obtain sufficient appropriate audit evidence.

This is an area where we would agree the exercise of professional scepticism is vital, but nevertheless auditors (and management) are only human and revising the auditing standard to require a more positive opinion on going concern, as is proposed, will not in and of itself eliminate the risk either of corporate failure or of incorrect judgements being made either by management or by the auditors. The burden should be placed on management, through appropriate accounting standards or legislation, to determine whether the business is a going concern or whether there are uncertainties in this respect, and what the resulting impact is on the accounting or disclosures in the financial statements. It should then be down to the auditor to form an opinion on whether these judgements are appropriate.

We are also concerned that the proposals to require a tailored, positive opinion on going concern for all audits of all entities of whatever size is disproportionate given that the audit of a small owner managed business poses little to no systemic risk whatsoever. It will add significantly to the costs

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of an audit for such a business for little benefit and there is a risk such an opinion could be misread by at least some users of a small or even micro entity's audited financial statements, such as customers, as a statement that the business is unlikely to fail and therefore seek to rely on that opinion even if suitable caveats are included in the audit report. It will therefore create additional risks, including in respect of liability, for the auditors of such entities, again with little benefit to the stakeholders in such a business or to the wider economy. In our view, this type of opinion should be restricted to PIEs.

We believe that in the event the proposals are put in place investors, bankers and other stakeholders such as suppliers will need to be educated in the meaning of the new requirements – both so that there is understanding that the positive opinion is not a guarantee the business will not fail, and to ensure the opinion does not become a self-fulfilling prophecy.

Finally, we are concerned that the revisions made to ISA 570 for accounting periods beginning on or after 17 June 2016 – specifically the requirement to include a conclusion in respect of going concern in the audit report - have not been in place for long enough to enable a full evaluation of whether this has led to an improvement in auditing this area, or not. In our opinion it has placed additional emphasis on the requirement to properly consider the issue of whether the business is a going concern and whether there are material uncertainties in this respect.

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 supportive of strengthening the objective of the Standard to make it explicit that the auditor is required to obtain sufficient appropriate audit evidence about whether a material uncertainty exists in respect of going concern. In our view this was already implicit in the Standard but it is useful to make it explicit.

We agree that the revisions should be effective in promoting a more robust audit process in respect of going concern, but have concerns about the proportionality and scalability of the proposed Standard as applied to the audit of owner-managed businesses, particularly smaller entities. In some cases the procedures undertaken by the management of a smaller entity may be very informal and the requirement for more robust procedures to be undertaken on informal information may be difficult to apply in practice.

We agree with the proposed 'stand back' requirement to consider all audit evidence obtained, whether confirmatory or contradictory, when evaluating going concern. Whilst ideally this should already have been taking place, the inclusion of an explicit requirement will help to focus the audit team on ensuring the evidence obtained has been properly evaluated before the audit is concluded.

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

This depends on what the public interest is considered to be.

We recognise that following recent high profile corporate failures there is concern about whether auditors are doing enough in respect of going concern, and whether sufficient professional scepticism is being applied, which may in some cases be justified. We also appreciate that ensuring that the audits of PIEs are – and are perceived to be – of high quality is vital. However, whilst it is equally vital that the audit of smaller entities is robust, some of the proposals, particularly

in respect of the auditor's opinion on going concern, appear to us to be disproportionate to smaller entities where there is little to no systemic risk. We are not convinced that imposing the same requirements on these entities as on large PIEs, as a result of corporate failures of some large PIEs and other large entities, is either justified or desirable.

- 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.**

The revisions are likely to place additional emphasis on the need to fully understand the business and the risks that it may not be a going concern, and also the need to properly challenge management's assessment and obtain evidence as to whether that assessment is appropriate. However, this additional emphasis could be achieved without the need for a positive opinion, which for the reasons explained above we do not believe is required for the audits of non-PIEs.

- 4. In making an assessment of going concern, the directors are required to consider a period of at least twelve months. In evaluating the directors' assessment should the auditor be required to consider a longer period, and if so what should it be?**

No, we do not believe it should be mandatory for the auditor to consider a longer period than twelve months from the date of approval of the financial statements. In some cases it may be relevant for the auditor to consider a longer period, particularly where there are indications of a material uncertainty in relation to going concern, but we believe it would be disproportionate to apply this to all audits regardless of whether a material uncertainty exists or not and regardless of the degree of systemic risk. In respect of external factors such as changes in the political or technological environment the degree of uncertainty can be so great that it is simply not possible for an assessment of a longer period than twelve months to be made.

- 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?**

Yes, we believe this is clear from the revisions, although we believe it was already implicit in the previous version of the Standard. A clear definition of what 'significant' means would potentially be useful.

- 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?**

Yes, although the need for the exercise of professional scepticism throughout the process was in our view already implicit in the Standard. As the audit of going concern is necessarily forward looking it should always have been an area where the exercise of professional scepticism is particularly important.

- 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?**

As should be clear from the remainder of our responses, we do not believe that auditors of all entities should provide either a tailored explanation of how they have evaluated management's assessment of going concern, or a positive conclusion in respect of going concern. For the reasons explained above we do not believe this is either necessary or desirable for non-PIEs and particularly smaller privately owned businesses where there is little to no systemic risk. It should be down to management to provide an explanation in the notes to the financial statements, and/ or the strategic report, as to why they believe the business to be a going concern.

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?

As should be clear from our responses, we have serious concerns that some of the proposed changes are disproportionate and will be difficult to apply in practice to the audits of at least some smaller entities.

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

Given that the FRC will need to analyse the comments received and then proceed to a final Standard, we believe that this date is too early. Audit firms will need time to understand the changes and provide necessary guidance and training. There will also be a need for communication with audited entities so that they understand the impact of the change and the additional work it is highly likely to require.

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 the Bulletins should be withdrawn as they are out of date. Guidance should however be updated when a review is conducted by the FRC (or ARGA, when it replaces the FRC) and the review identifies lessons that need to be learnt. The regulator should also provide guidance on what good practice looks like rather than simply highlighting bad practice.

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

There needs to be clear outreach to corporate boards so that directors are aware of their responsibilities in respect of going concern. Appropriate guidance material should also be published which sets out exactly what directors are expected to do. However, this needs to be combined with an environment where appropriate sanctions can be applied to all directors of an entity in the event of a corporate failure where the directors can be shown to be at fault, not just those directors that are members of a professional body.

It can be very difficult with smaller listed companies or private companies to ensure that stakeholders engage with the issues. The FRC could potentially engage with the monitoring bodies to ensure that they liaise with members and also encourage the monitoring bodies to provide their own guidance material as appropriate.

We hope that our comments are helpful to you. If you have any questions on any of this, then please contact either Martin Muirhead or Tessa Park.

Yours faithfully



KINGSTON SMITH LLP