

1 **Going concern requirements strengthened (Lecture A691 – 7.04 minutes)**

In September 2019, the Financial Reporting Council (FRC) issued a revised version of ISA (UK) 570 *Going Concern* which becomes effective for audits of financial statements for periods commencing on or after 15 December 2019. Early adoption is permitted.

This revised ISA (UK) has been extensively amended in light of the well-publicised criticisms of the auditing profession. ISA (UK) 570 (Revised September 2019) increases the work which auditors are required to do when auditing the going concern status of an entity.

1.1 **Responsibilities of the auditor**

The previous version of ISA (UK) 570 stated at paragraph 6 that the auditor's responsibilities are to '... obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting ... and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.' This responsibility still applies under the revised ISA (UK) 570 but paragraph 6 has been restructured so it is clearer to understand.

1.2 **Definitions**

ISA (UK) 570 (Revised September 2019) contains defined terms in paragraph 9-2 which defines 'management bias' and a 'material uncertainty related to going concern' as follows:

Management bias – A lack of neutrality by management in the preparation of information.

ISA 570 (Revised September 2019) para 9-2

Material uncertainty related to going concern – An uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern, where the magnitude of its potential impact and likelihood of occurrence is such that appropriate disclosure of the nature and implications of the uncertainty is necessary for:

- (i) *in the case of a fair presentation financial reporting framework, the fair presentation of the financial statements; or*
- (ii) *in the case of a compliance framework, the financial statements not to be misleading.*

1.3 **Extended auditor's responsibilities**

The risk assessment procedures and related activities section of ISA (UK) 570 (Revised September 2019) has been significantly increased. ISA (UK) 570 (Revised September 2019) requires the auditor to obtain an understanding of:

- the entity and its environment;

- the applicable financial reporting framework; and
- the entity's system of internal control.

In addition, if the auditor identifies events or conditions which may cast significant doubt on the entity's ability to continue as a going concern which management has not previously identified or disclosed to the auditor, ISA (UK) 570 (Revised September 2019) requires the auditor to:

- a) request management to perform additional procedures to understand the effect of the events or conditions on management's going concern assessment;
- b) inquire as to why management's going concern assessment failed to identify or disclose the events or conditions; and
- c) perform additional audit procedures relating to the newly identified events or conditions.

1.4 Evaluating management's assessment of going concern

The auditor is still required to obtain sufficient appropriate audit evidence to identify whether events or conditions exist which may cast significant doubt on the entity's ability to continue as a going concern and identify whether, or not, a material uncertainty exists. In addition, the auditor is also still required to obtain sufficient appropriate audit evidence concerning the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

The auditor's responsibilities are extended further as ISA (UK) 570 (Revised September 2019) also requires the auditor to:

- evaluate the method used by management in assessing the entity's ability to continue as a going concern, including determining if:
 - the method selected is appropriate in the context of both the financial reporting framework and the auditor's understanding of the entity;
 - changes from the method used in prior periods are appropriate; and
 - whether the calculations are applied in accordance with the method and are mathematically accurate;
- evaluate the relevance and reliability of the underlying data used to make the assessment;
- evaluate the assumptions on which management's assessment is based which requires the auditor to determine whether there is adequate support for the assumptions underlying management's assessment which includes determining:
 - whether the assumptions are appropriate in the context of the applicable financial reporting framework and, where applicable, changes from the prior period are appropriate; and

- whether the assumptions are consistent with each other and with related assumptions used in other areas of the entity's business activities, based on the auditor's knowledge obtained in the audit;
- evaluating management's plans for future actions in respect of going concern, including evaluating whether the outcome of these plans is likely to improve the situation and whether they are feasible;
- considering whether any additional facts or information have become available since the date on which management made its assessment; and
- requesting written representations from management and, where appropriate, those charged with governance, concerning their plans for future actions and the feasibility of those plans.

The auditor is also required to make greater use of the entity's viability statement where one is produced.

1.5 Reporting

ISA (UK) 570 (Revised September 2019) uses the words 'appropriate' and 'appropriateness' in terms of the disclosures made in the financial statements relating to going concern rather than 'adequate' and 'adequacy'.

Use of the going concern basis is inappropriate

As is currently the case, if the financial statements have been prepared on a going concern basis, but, in the auditor's judgement, this basis is inappropriate, the auditor expresses an adverse opinion.

It is worth noting that where the entity does conclude that the going concern basis is inappropriate and is preparing its financial statements under FRS 102, it would not be appropriate to use the 'break up' basis to prepare the financial statements as this basis is inconsistent with FRS 102. A basis other than the going concern basis would be required and the basis on which the financial statements have been prepared will be disclosed in the financial statements.

Use of the going concern basis is appropriate

Where the auditor concludes that the going concern basis is appropriate, the auditor must include a section in the auditor's report headed up 'Conclusions related to going concern' or other appropriate heading and include:

- where there is no material uncertainty related to going concern (see below), a statement that the auditor has not identified a material uncertainty related to events or conditions which, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern for a period of at least 12 months from the date on which the financial statements are authorised for issue (not 12 months from the balance sheet date);

- a conclusion that management's use of the going concern basis is appropriate;
- where the entity is required to, or voluntarily chooses to, report under the UK Corporate Governance Code, or to explain why they have not, the auditor is required to state that they have nothing material to add or draw attention to in respect of the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements; and
- for public interest entities, other listed entities, entities that are required, and those that voluntarily choose to report on how they have applied the UK Corporate Governance Code, and other entities which are subject to the governance requirements of The Companies (Miscellaneous Reporting) Regulations 2018 (SI 2018/800), an explanation as to how the auditor evaluated management's assessment of the entity's ability to continue as a going concern and, where relevant, key observations arising with respect to that evaluation.

Use of the going concern basis is appropriate but a material uncertainty exists

Where management have made appropriate disclosures in the financial statements, the auditor expresses an unmodified (unqualified) opinion. The auditor's report must include a section headed up 'Material Uncertainty Related to Going Concern' (which is currently the case under ISA (UK) 570 (Revised June 2016)) which:

- draws attention to the relevant note in the financial statements that discloses the material uncertainties;
- states that these events or conditions indicates a material uncertainty exists and that it may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's report is not modified in respect of this matter; and
- for entities which are required, or voluntarily choose to, report on how they have applied the UK Corporate Governance Code, or to explain why they have a not, a statement that the auditor has nothing material to add or draw attention to in respect of the directors' identification in the financial statements of any material uncertainties to the entity's ability to continue to do so over a period of at least 12 months from the date of approval of the financial statements.

Auditors must keep in mind that it is not correct to use an emphasis of matter paragraph where material uncertainties related to going concern have been appropriately/adequately disclosed in the financial statements. Such issues must be included under a Material Uncertainty Related to Going Concern paragraph which acts in a similar way to an emphasis of matter paragraph but is not an emphasis of matter paragraph. The paragraph must cross-reference to the relevant disclosure

note in the financial statements and must confirm that the auditor's opinion is not modified (qualified) in respect of this matter.

It should also be noted that the use of a Material Uncertainty Related to Going Concern paragraph is only used when **adequate** or **appropriate** disclosure has been made in the financial statements. If inadequate/inappropriate disclosure has been made, the auditor's report will be modified (qualified) accordingly.

Appropriate disclosure has not been made in the financial statements

Where the entity has not made appropriate disclosures in the financial statements about a material uncertainty related to going concern, the auditor expresses a qualified opinion or adverse opinion in accordance with ISA (UK) 705 (Revised June 2016) *Modifications to the Opinion in the Independent Auditor's Report* as appropriate.