

**Meeting:** IAASB Consultative Advisory Group  
**Meeting Location:** New York  
**Meeting Date:** April 8–9, 2013

## Agenda Item **B.8**

### Auditor Reporting—Going Concern (GC)

#### Objective of Agenda Item

1. To discuss recommendations relating to auditor reporting on going concern, including the effect on ISA 570.<sup>1</sup>

#### Introduction

2. At its December 2012 meeting, the IAASB agreed to continue exploring auditor reporting on Going Concern (GC). This direction was based on feedback received from respondents to the June 2012 Invitation to Comment (ITC): *Improving the Auditor's Report*, as well as the importance that certain stakeholders (e.g., the European Commission (EC)) attach to having explicit statements in the auditor's report relating to GC.<sup>2</sup>
3. Appendix 5 of **Agenda Item B.1** is an excerpt from the IAASB's December 2012 meeting material and provides an illustration of the diversity of views from respondents to the ITC relating to the IAASB's suggested GC improvements. Feedback from the ITC indicated that clarification to the accounting disclosure requirements relating to GC, in particular material uncertainties (MU), would provide a stronger basis for auditor reporting on GC, which prompted the IAASB's related outreach activities to the International Accounting Standards Board (IASB) in 2012.<sup>3</sup>
4. At its February 2013 meeting, the IAASB received an update about the current developments of the IASB and International Financial Reporting Interpretations Committee (IFRIC) and the United

---

<sup>1</sup> ISA 570, *Going Concern*

<sup>2</sup> Article 22 of the EC's proposed regulation called for the auditor's report to "provide a statement on the situation of the audited entity or, in case of the statutory audit of consolidated financial statements, of the parent undertaking and the group, especially an assessment of the entity's or the parent's undertaking's and group's ability to meet its/ their obligation in the foreseeable future and there continue as a going concern."

Article 23 of EC's proposed regulation called for additional reporting to audit committees to "explain in detail and explicitly state the results of the statutory audit" to:

- "Indicate and explain judgments about material uncertainty that may cast doubt about the entity's ability to continue as a going concern; and
- Provide full details of all guarantees, comfort letters, undertakings of public intervention and other support measures that have been relied upon when making a going concern assessment."

<sup>3</sup> See Agenda Item 6-B of the December 2012 IAASB meeting materials for further discussion of respondents' feedback on the IAASB's ITC suggested improvements related to GC, and Agenda Item 9-C of the September 2012 IAASB meeting materials for a discussion about the IAASB's outreach activities to the IASB.

States (US) Financial Accounting Standards Board (FASB) relating to GC.<sup>4</sup> In light of these developments and the feedback from the ITC, the IAASB asked ISA 700<sup>5</sup> Drafting Team (DT-700) to consider:

- How the work of the accounting standards setters may affect the nature and timing of the IAASB's proposals related to auditor reporting; and
- Whether reporting on GC should be required for all entities or whether a conditional approach, which would involve reporting when the consideration of GC was relatively more important to the audit of an individual entity, would be preferable, and

bring forward recommendations for reporting on GC in the auditor's report for the IAASB's consideration at its April 2013 meeting.

5. This paper discusses DT-700's consideration of the matters above and at:

- Section I: Provides an update on interactions with, and developments of, accounting standard setters;
- Section II: Summarizes DT-700's consideration of an overall approach for developing auditor reporting proposals relating to GC;
- Section III: Sets forth DT-700's recommendation for illustrative wording for auditor reporting on GC;
- Section IV: Addresses flexibility versus consistency regarding the wording and placement of the GC section of the auditor's report; and
- Section V: Discusses other options considered by DT-700 in determining the illustrative wording for the GC section of the auditor's report.

#### **I. Update on Interactions With, and Developments of, Accounting Standard Setters**

6. Since the February 2013 IAASB meeting:

- IASB Staff developed agenda papers for discussion at a March 21, 2013 IASB public meeting. These agenda papers included a recommendation from IFRIC for a proposed narrow-focus amendment to IAS 1<sup>6</sup> aimed at addressing:
  - When an entity should be required to disclose information about MU related to events or circumstances that cast significant doubt upon the entity's ability to continue as a GC, and
  - The objective of disclosures about MU about the entity's ability to continue as a GC and what disclosures should be required.<sup>7</sup>

---

<sup>4</sup> See Supplement to Agenda Item 2-B of the February 2013 IAASB meeting materials for the update on the developments of IASB and FASB, including pending proposals to enhance management's reporting on GC.

<sup>5</sup> Proposed ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

<sup>6</sup> International Accounting Standard (IAS) 1, *Presentation of Financial Statements*

The proposals considered by the IASB at its March 2013 meeting were substantially the same as those presented by IASB representatives to DT-700 and ISA 701<sup>8</sup> Drafting Team (DT-701) in January 2013.<sup>9</sup> DT-700 and IAASB Staff representatives observed the IASB meeting and noted that the IASB was generally supportive of having a proposed narrow-focus amendment to IAS 1. IASB staff was asked to make changes to the IFRIC proposal with the assistance of a number of IASB members. The IASB plans to reconsider the topic at a further meeting for which the timing is not yet certain.

- Individual jurisdictions, for example in the United Kingdom (UK) and the US, are continuing to pursue their own initiatives aimed at improving reporting on GC. However, public discussions about those initiatives indicate that the resulting requirements and guidance may be different from those being proposed by IASB/IFRIC. For example, the FASB initiative draws heavily on words associated with levels of probability that are already applied in other areas of US Generally Accepted Accounting Principles (US GAAP).
  - DT-700 members had an opportunity to receive an update on, and exchange views about, the developments of the FASB related to GC.<sup>10</sup> Among other matters, DT-700 was briefed on how the FASB's approach compared to the approach being taken by the IASB. The FASB's proposed model differs in certain respects from the proposed narrow-scope amendments to IAS 1 being considered by IASB. It was noted that routine discussions were occurring between the staff of the IASB and the FASB in order to keep each other updated on their respective processes.
7. Given the differences between the details of the models being proposed for the accounting and disclosure requirements related to GC (e.g., among FASB, IASB, and UK Financial Reporting Council), stakeholders may call for greater international conformity in finalizing those proposals, including consistent approaches by auditing standard setters to the extent possible. There is no certainty that these projects will result in wholly uniform approaches or will be finalized within similar timeframes.

## **II. Consideration of an Overall Approach for Developing Auditor Reporting Proposals Relating to GC**

8. Taking into consideration the current initiatives of accounting standards setters and how they may affect the nature and timing of the IAASB's auditor reporting proposals, DT-700 developed three potential approaches for moving forward with respect to auditor reporting on GC. Weighing the potential advantages and disadvantages of each option listed in the table below, DT-700 recommends that the IAASB move forward with Option A.

---

<sup>7</sup> One of the IASB agenda papers addresses the time frame for an assessment of GC and solicits the IASB's views about whether a question should be included in the exposure draft of the proposed limited amendment to IAS 1 about aligning the time frame in IAS 1 with those of national auditing requirements.

<sup>8</sup> Proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

<sup>9</sup> See Agenda Item 2-C and Supplement to Agenda Item 2 of the February 2013 IAASB meeting materials for further discussion.

<sup>10</sup> As previously mentioned above, in January 2013, DT-700/DT-701 members had a similar opportunity to meet IASB staff.

<p style="text-align: center;"><b>Option A</b></p> <p style="text-align: center;">Continue to Pursue Improvements in Auditor Reporting on GC Using the Premise of Extant ISA 570<sup>11</sup></p>	<p style="text-align: center;"><b>Option B</b></p> <p style="text-align: center;">Exclude GC from the Scope of the Auditor Reporting Project and Await the Finalization of Accounting Standards before Addressing the Issues Relating to Reporting in an ISA 570 Revision Project</p>	<p style="text-align: center;"><b>Option C</b></p> <p style="text-align: center;">Proceed with Auditor Reporting on GC, and Attempt to Predict Likely Changes to Accounting Standards and Factor In Potential Improvements to Auditor Reporting that Could Result from Them</p>
<p><i>Advantages</i></p> <ul style="list-style-type: none"> <li>• ISA 570 is based on extant accounting and financial reporting requirements and guidance with which auditors are already familiar.</li> <li>• As signalled in the auditor reporting project proposal, this option limits amendments in ISA 570 to only those necessary to underpin auditor reporting requirements related to GC.</li> <li>• To complement this option, the IAASB could establish an ISA 570 Working Group to continue monitoring the activities of accounting standard setters with respect to GC, and further explore the need for a broader project to revise ISA 570 based on their finalized accounting standards (effectively realizing the advantages to be derived from Options B and C).</li> </ul> <p><i>Disadvantage</i></p> <ul style="list-style-type: none"> <li>• Some respondents to the ITC may be concerned that clarifications in the concepts and requirements in accounting and financial reporting disclosures related to GC may be necessary in order to facilitate meaningful and understandable GC auditor reporting (i.e., a holistic approach).</li> </ul>	<p><i>Advantage</i></p> <ul style="list-style-type: none"> <li>• Option would be responsive to certain respondents to the ITC who emphasized the need for a holistic solution on GC, but not others, in particular investors and analysts, and regulators, who encouraged the IAASB to pursue having explicit statements about GC in the auditor’s report.</li> </ul> <p><i>Disadvantage</i></p> <ul style="list-style-type: none"> <li>• Having an exposure draft of proposed ISA 700 (Revised) that did not address GC could be viewed as presenting an incomplete perspective on how auditors’ reports will look in the future, and is likely to be negatively received by certain stakeholders, including the EC.</li> </ul>	<p><i>Advantage</i></p> <ul style="list-style-type: none"> <li>• Option would take into account concerns that a holistic approach to GC is needed and could result in a stronger audit work effort relating to GC on which to base auditor reporting.</li> </ul> <p><i>Disadvantage</i></p> <ul style="list-style-type: none"> <li>• This option would involve more substantive amendments to ISA 570 to address when disclosures about MU are expected to be provided, the timeframe for evaluating GC, and management disclosure matters. Implementing the option could be difficult in light of the different approaches being explored by accounting standard setters.</li> <li>• The IAASB would need to spend a significant amount of time deliberating revisions to ISA 570, without having the benefit of the finalized accounting standards. Doing so would be in effect pre-judging the outcome of accounting standard-setters’ deliberations and subsequent consultations, and would be difficult to explain. This would seem at best a confusing and over-engineered approach and at worst it would be viewed as presumptuous.</li> </ul>

<sup>11</sup> ISA 570, *Going Concern*

9. DT-700 is of the view that Option A is the most effective and appropriate course of action for the IAASB to take with respect to GC. Accordingly, the remainder of this paper is drafted on the basis of DT-700's recommendation to have the IAASB pursue Option A so as to stay on track for the timely issuance of auditor reporting proposals that address GC (principally through limited amendments to ISA 570), which will be discussed at the June 2013 IAASB meeting.

**Matter for CAG Consideration**

1. Representatives are requested to comment on which of the three options they would support. If Option A is not supported, Representatives are asked to provide rationale why Options B or C, or a further alternative, would be preferred.

**III. DT-700's Recommendation for Illustrative Wording Relating to Auditor Reporting on GC**

*When a Material Uncertainty (MU) Is Not Identified*

10. In considering revised illustrative wording relating to auditor reporting on GC, DT-700 reaffirmed the IAASB's position that these words should be based on the auditor's work effort required under extant ISA 570. Accordingly, DT-700 concluded that it is:
- Important to have a GC section in auditors' reports of all entities, and for all audits (i.e., a universal requirement, not conditional on the existence of a MU or when GC was relatively more important to the audit of an individual entity).
  - Useful to focus on making what was otherwise implicit in management's presentation of the financial statements explicit (i.e., the financial statements are prepared using the GC assumption, and no MU have been disclosed).
11. DT-700 acknowledged that, under both International Financial Reporting Standards (IFRSs) and other national accounting standards such as US GAAP, management does not have an explicit requirement to state that financial statements are prepared using the GC assumption. The IAASB had previously attempted to address this concern by including a framework-specific description of management's responsibilities relating to GC in the auditor's report under the heading Management's Responsibilities Relating to Going Concern; however, respondents to the ITC suggested that such material should be presented with the auditor's statements on GC to give them appropriate context.<sup>12</sup>
12. Accordingly, DT-700 determined that it was necessary to redraft the GC section to be included in the auditor's report when the auditor determines that the use of the GC assumption is appropriate

---

<sup>12</sup> The ITC included the following wording: "Under IFRSs, management is responsible for making an assessment of the Company's ability to continue as a going concern when preparing the financial statements. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. Under IFRSs, the Company's financial statements are prepared on a going concern basis, unless management either intends to liquidate the Company or to cease trading, or has no realistic alternative but to do so.

IFRSs also require that, when management is aware of material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern, management disclose those uncertainties in the financial statements."

and when the auditor has not identified any MU, incorporating some of the relevant material from the description of management's responsibilities, as follows:

### **Going Concern**

The going concern assumption is a basis of accounting that presumes that an entity will be able to realize its assets and discharge its liabilities in the normal course of business. The going concern basis of accounting is appropriate unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so. The financial statements have been prepared using the going concern basis of accounting, taking into account available information about the future, which is at least, but not limited to, twelve months from the end of the reporting period. As part of our audit of the financial statements, we have concluded that the management's use of the going concern assumption basis of accounting in the preparation of the Company's financial statements is appropriate.

The financial statements do not include disclosures of any material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern that are required to be disclosed if identified. Based on the work we have performed, we have not identified material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern that we believe would need to be disclosed in the financial statements in accordance with IFRSs. Because not all future events or conditions can be predicted identified, this statement is not a guarantee as to the Company's ability to continue as a going concern.

This wording has been included in the illustrative auditors' reports included in **Agenda Item B.5**.

13. DT-700 developed the revised wording by summarizing concepts from paragraphs 2–5 of extant ISA 570 to provide more context to the auditor's statements that were included in GC section of the ITC illustrative auditor's report. It is possible that, as part of a broader ISA 570 project, further alignment to the evolving accounting standards could be made, thereby resulting in an amendment to this description.
14. DT-700 was also of a view that the sub-headings used in the ITC to distinguish between the statements related to the GC assumption and the identification of MU should be removed. This is due to DT-700's view that a subheading would be more useful in circumstances when the auditor identifies a MU in order to highlight in the auditor's report the existence of the MU (see paragraph 16 below).

#### *When a Material Uncertainty (MU) Is Identified*

15. Appendix 2 to the ITC provided an illustration of how GC reporting would be changed when a MU exists that is adequately disclosed in the financial statements, based on the extant ISA 570 requirement to include an Emphasis of Matter (EOM) paragraph in such circumstances. Swayed by the strong steer provided by respondents to the ITC, DT-700 determined that it would continue to be necessary for the auditor's report to prominently signal an issue relating to MU when such circumstances occur. DT-700 also noted that ongoing liaising with DT-701 would be necessary, insofar as DT-701 is considering whether the concept of EOM paragraphs should be retained.
16. DT-700 therefore determined that, when a MU exists and is adequately disclosed in the financial statements, and the auditor has concluded that the use of the GC assumption is appropriate, the

GC section of the auditor's report would be as follows (shown in marked from what was included in Appendix 2 of the ITC):

### Going Concern

~~Disclosures about Material Uncertainties Identified~~ ~~Material Uncertainties Related to Events or Conditions that May Cast Significant Doubt on the Company's Ability to Continue as a Going Concern~~

Without qualifying our opinion, we draw attention to Note X in the financial statements, which indicates that the Company incurred a net loss of ZZZ during the year ended December 31, 20X1 and, as of that date, the Company's current liabilities exceeded its total assets by YYY. These conditions, along with other matters set forth in Note X, indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern. ~~Because not all future events or conditions can be predicted, this statement is not a guarantee that the Company will or will not be able to continue as a going concern.~~ [Same wording as in Appendix 2 to the ITC, except for deletion of the last sentence]

~~Use of the Going Concern Assumption~~

~~The going concern assumption is a basis of accounting that presumes that an entity will be able to realize its assets and discharge its liabilities in the normal course of business. The going concern basis of accounting is appropriate unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so. The financial statements have been prepared using the going concern basis of accounting, taking into account available information about the future, which is at least, but not limited to, twelve months from the end of the reporting period. As part of our audit of the financial statements, we have concluded that the management's use of the going concern assumption basis of accounting in the preparation of the Company's financial statements is appropriate.~~ [Same wording as the 1st paragraph in revised illustrative wording in paragraph 12 above]

17. In summary, DT-700 determined that, when a MU exists that is adequately disclosed in the financial statements, it would be necessary for the auditor to:
- Position the paragraph identifying the MU first in the GC section (i.e., the order of the GC statements in the example in paragraph 12 above should be reversed).
  - Include an appropriate sub-heading above the paragraph relating to identified MUs in line with extant ISA 706.<sup>13</sup> For purposes of the revised illustration to be included in proposed ISA 570,<sup>14</sup> DT-700 determined that the use of the sub-heading "Disclosures about Material Uncertainties Identified", in lieu of "Emphasis of Matter", would be more meaningful.
  - Include a sub-heading above the conclusion on the appropriateness of the use of the GC assumption in order to distinguish this conclusion from the separate paragraph related to MU.

<sup>13</sup> Paragraph 7(b) of ISA 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, requires the auditor to use the heading "Emphasis of Matter," or other appropriate heading.

<sup>14</sup> See paragraph A21 of ISA 570.

#### **IV. Flexibility Versus Consistency Regarding the Wording and Placement of the GC Section of the Auditor’s Report**

18. Acknowledging that, in some jurisdictions, law or regulation requires auditors to report on matters relating to GC, and the IAASB has decided not to mandate the ordering of the required elements in the auditor’s report, the question remains as to how much flexibility should be allowed with respect to the placement of the paragraphs within the GC section of the auditor’s report. For example, it is necessary for the IAASB to consider whether the suggested placement in the example wording included in paragraph 16 above of the auditor’s discussion related to “Disclosures about Material Uncertainties Identified” should be mandated.
19. GC is a topic for which law, regulation, or national auditing standards may permit auditors to combine their reporting on other reporting responsibilities (ORR) with the new ISA reporting requirement related to GC in the auditor’s report. In circumstances where ORR exists with respect to GC, it is conceivable that law, regulation, or national auditing standards might prescribe or promote best practice in the particular jurisdiction to influence the content or layout of the auditor’s report. It will be necessary for the IAASB to conclude on the level of prescriptiveness that will be necessary in drafting the requirements related to reporting on GC as part of an audit in accordance with ISAs.

#### **Matters for CAG Consideration**

2. Do Representatives agree with DT-700’s recommendation for the illustrative wording to be included in the GC section of the auditor’s report discussed in Section III of this paper?
3. Recognizing that other reporting responsibilities (ORR) may exist in certain jurisdiction with respect to GC, what level of flexibility should be allowed for tailoring the content and layout of the GC section in the auditor’s report?

#### **V. Other Options Considered by DT-700 Related to Illustrative Wording on GC**

20. DT-700 believes that the revised illustrative wording in presented in paragraphs 12 and 16 of this paper is most responsive to the diversity of views from respondents to the ITC. However, in arriving at that conclusion, DT-700 considered other options explained below.

##### *Option 1: Retain the Wording in the GC Section Featured in the ITC (Amended to Relocate the Description of Management’s Responsibilities Related to GC)*

21. Because the ITC wording relating to GC was supported by the majority of investors and analysts, and regulators and oversight bodies, DT-700 considered retaining the wording of the illustrative auditor’s report in the ITC, with one amendment to reposition the description of management’s responsibilities relating to GC in the same section as the auditor’s statements relating to GC.
22. DT-700 determined that this option was less preferable, based on the various concerns raised by respondents to the ITC about the proposed wording related to GC.<sup>15</sup> Instead, DT-700 determined

---

<sup>15</sup> See paragraphs 12–23 and 45–48 of Agenda Item 6-B of the December 2012 IAASB meeting materials for further discussion of respondents’ views on the ITC suggested improvements related to GC.

that it would be more preferable to point out what is implicit in management's decision to prepare the financial statements under the GC assumption when no MU exists, and none are disclosed.

*Option 2: Address the GC Assumption Only and Remain Silent on the Identification of MU Unless a MU is Identified by Management and Disclosed in the Financial Statements*

23. Concerns were raised by many respondents to the ITC, in particular auditors, and member bodies and other professional organizations, who indicated that:
- The term MU as described in the underlying accounting standards was unclear; and
  - The statement "... we have not identified MU..." in the auditor's report could lead to misunderstanding among investors and other users, and could potentially be misleading as to the auditor's work effort relating to GC (e.g., investors and other users may conclude that the auditor is asserting on the viability of an entity).
24. To mitigate these concerns, DT-700 explored an option to limit auditor reporting on GC to a conclusion on the appropriateness of the use of the GC assumption. This option would exclude all references to MU (i.e., the ITC wording would be amended to exclude the paragraph in management's responsibilities about MU, and separate sub-section on MU).
25. DT-700 members noted that this option could potentially accommodate anticipated clarifications to be made in IFRSs about GC/MU by signalling that the auditor reporting requirements related to GC/MU would be revised when the accounting standards relating to GC have been finalized. DT-700 considered illustrative wording to reflect the changes described at paragraph 23 above, but concluded that it would not be responsive to those that believed that the statement on the GC assumption would be of limited value on its own.

*Option 3: Address MU Identification Only and Exclude the Conclusion about the Appropriateness of the Use of the GC Assumption as the Basis for the Preparation of the Financial Statements*

26. Weighing the EC's call for more explicit auditor reporting on GC against the concerns raised by certain respondents to the ITC about having a statement in the auditor's report that addresses management's use of the GC assumption in the preparation of the financial statements, DT-700 considered an option to:
- Focus the auditor's report on the identification of MU (i.e., amend the ITC wording to remove management's responsibilities for the GC assumption and the separate sub-section on the GC assumption); and
  - Be silent about the appropriateness of the use of the GC assumption in the preparation of the financial statements.
27. DT-700 considered illustrative wording to reflect the changes described in paragraph 26. However, DT-700 opted against pursuing this option because a number of DT-700 members were of a view that, if the phrase "use of the going concern assumption" was clarified in the auditor's report (as is suggested in DT-700's recommendation in paragraph 12 above), it would more valuable to have statements in the auditor's report about both the use of the GC assumption and MU.

*Option 4: Explore the Implications of Reporting on GC in the Auditor’s Report on an Conditional Basis (i.e., Only When MU or GC Issues Are Present)*

28. Certain respondents to the ITC indicated that requiring statements about the appropriateness of the use of the GC assumption and the identification of MU in the auditor’s report would be providing irrelevant and largely standardized disclosures because, at any given time, the majority of entities are not facing financial distress.
29. As a result, rather than requiring reporting in all circumstances, DT-700 considered whether certain parameters could be established to help the auditor determine when to include statements about the appropriateness of the use of the GC assumption or the identification of MU in the auditor’s reports.
30. DT-700 considered whether auditor reporting about GC should be included in the auditor’s report only when the auditor concludes, based on the procedures performed, that a MU exists related to events or conditions that may cast significant doubt on the entity’s ability to continue as a GC (i.e., a “status quo” inclusion of an EOM paragraph when a MU is identified as required by ISA 570). However, DT-700 determined that the “status quo” would not be responsive to stakeholders, in particular investors and regulators, and that some form of incremental auditor reporting on GC should be required.
31. DT-700 also considered whether the auditor should include additional information to describe the significant auditor judgments made to support a conclusion that no MU exists, when certain events or conditions nevertheless exist casting significant doubt on the entity’s ability to continue as a GC (i.e., “a near miss”). However, in light of the lack of support from the majority of respondents to the ITC, DT-700 opted against pursuing this option further, but acknowledged that auditors may consider further discussing GC as a key audit matter in accordance with new proposed ISA 701.

**Matters for CAG Consideration**

4. If Respondents do not support the approach taken in Section III of this paper, which of the other options considered by DT-700 (described in paragraphs 21–31 of this paper) would be preferred and why?