

Going Concern—Issues and Drafting Team Recommendations

Summary of the IAASB’s Discussions at Its March 2014 Meeting

The Board tentatively agreed with DT-570’s recommendations set out in Agenda Item 4-C¹ to revert to exception-based reporting on going concern matters, and to include additional responsibilities in the management’s responsibilities and auditor’s responsibilities sections of the auditor’s report, based on the additional statements originally proposed in the Exposure Draft (ED).

- Disappointment was expressed by some Board members at what appears to be taking a step back by reverting to exception-based reporting, but the challenge of moving forward with the auditing standard on going concern, absent changes to accounting standards, was recognized. Similar views were expressed by some IAASB Consultative Advisory Group (CAG) Representatives.
- The Board generally supported statements describing both management’s and the auditor’s responsibilities with respect to management’s use of the going concern basis of accounting, and also the auditor’s responsibilities with respect to the ability of an entity to continue as a going concern. The Board largely agreed that such statements would have educational value to users, but concern was also expressed about the addition of what could be seen as more “boilerplate” language.
- The Board expressed mixed views on the inclusion of a statement in the auditor’s responsibilities section of the auditor’s report that the auditor cannot guarantee the entity’s ability to continue as a going concern. Members noted that if the Drafting Team were to proceed with the inclusion of such a statement, alternative wording should be explored to avoid use of the word “guarantee”.
- The Board encouraged the Drafting Team to consider in its future going concern deliberations the outcome of the upcoming planned International Financial Reporting Interpretations Committee (IFRIC) discussions in respect of reinforcement and application of existing disclosures around going concern judgments.
- The Board also encouraged the Drafting Team to consider actions that can be taken to drive behavioral changes in the way that both management and auditors approach the consideration and assessment of going concern.
- The Board encouraged the Drafting Team to further deliberate, in conjunction with the ISA 701² Drafting Team, the interaction between KAM and going concern “close call” situations.³

¹ Agenda item 4-C is available on the IAASB’s website at http://www.ifac.org/sites/default/files/meetings/files/20140317-IAASB-Agenda_Item_4C-Auditor_Reporting-Going_Concern-final.pdf

² Proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

³ The draft of proposed ISA 701 to be considered by the IAASB at this meeting makes reference to the fact that issues related to going concern may be determined to be KAM and how this may be addressed in the auditor’s report (see paragraphs A34–A35 of **Agenda Item 4-B**). Because of the proposal to revert to exception-based reporting, any such discussion would be included in the KAM section of the report, rather than in a separate Going Concern section or as an Emphasis of Matter (EOM) paragraph.

Objectives of the IAASB Discussion

The following are the objectives of the IAASB discussion at its June 2014 meeting:

- Obtain input on DT-570's proposals to enhance the auditor's consideration of disclosures made by management related to events and conditions that may give rise to material uncertainties about an entity's ability to continue as a going concern.
- Obtain input on DT-570's proposed additional wording to be included in relation to going concern in all auditor's reports in the Management's Responsibilities and Auditor's Responsibilities sections of the auditor's report.
- Discuss a revised draft of ISA 570 in light of the IAASB's decision to revert to exception-based reporting.

I. Enhancing Disclosures Related to Events and Conditions that May Give Rise to Material Uncertainties about an Entity's Ability to Continue as a Going Concern

A. Background and Relevant Accounting Developments

1. The IAASB acknowledged that it initially considered auditor reporting on going concern to respond to calls from investors and others for more "early warnings" in relation to going concern. While DT-570 is of the view that disclosures relating to going concern are firstly the responsibility of management and those charged with governance (TCWG), in light of the Board's encouragement at the previous meeting to consider what, if anything, could be done to enhance management's disclosures relating to going concern, DT-570 considered how the requirements in ISA 570 could be strengthened to achieve such improved disclosures, in light of:
 - The existing requirement in ISA 570 to communicate with TCWG about the adequacy of disclosures in the financial statement related to going concern when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern (see paragraph 26 of **Agenda Item 3-B**); and
 - The requirement(s) in proposed ISA 700 (Revised) to evaluate the financial statements in view of the requirements of the applicable financial reporting framework in all cases including, when the financial statements are prepared in accordance with a fair presentation framework, the auditor is required to evaluate whether the financial statements achieve fair presentation.⁴
2. DT-570 also considered the continuing developments of other standard-setting bodies. Notably, since the March 2014 IAASB meeting, the IFRS Interpretations Committee (IFRIC) made public its Tentative Agenda Decision⁵ in respect of disclosures required in relation to material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. This Agenda Decision observes a situation where management, after considering

⁴ See **Agenda Item 2-B**, proposed ISA 700 (Revised), *Forming an Opinion and Reporting on the Financial Statements*, paragraphs 13–14.

⁵ Discussion with International Accounting Standards Board (IASB) staff indicates that an Agenda Decision is used when the IASB decides not to progress further with a standard and is essentially an explanation of how an existing requirement should be applied. Agenda decisions are publicly exposed. The comment period for this Agenda Decision ends June 9, 2014.

all relevant information, including the feasibility and effectiveness of any planned mitigation, concludes that there are no material uncertainties relating to going concern. In such a situation, the Agenda Decision highlights paragraph 122⁶ of IAS 1,⁷ noting it “would apply to the judgments made in concluding that no material uncertainties remain related to events or conditions that may cast doubt upon the entity’s ability to continue as a going concern.” The Agenda Decision was made public in the March 2014.

3. Finally, at its May 7, 2014 meeting, the US Financial Accounting Standards Board (FASB) continued its re-deliberations in respect of disclosures relating to uncertainties about an entity’s going concern presumption. The FASB opted to pursue a “single-threshold approach” that would require disclosures when substantial doubt⁸ exists about an entity’s ability to continue as a going concern. The FASB determined that management’s assessment of an entity’s ability to continue as a going concern should be based on relevant conditions or events known or reasonably knowable at the date the financial statements are issued; and that the look-forward period should be one year from the date the financial statements are issued. Further, it was determined that the standard will apply to both public and non-public entities.

B. Drafting Team Recommendations

4. DT-570 is of the view that the clarification of paragraph 122 of IAS 1 can be applied to “close call” situations as discussed in the Agenda Decision, where management has ultimately determined that any identified material uncertainty has been sufficiently mitigated. In such situations, it is likely that significant judgments will be made in determining and assessing the mitigating factors and therefore the accounting literature, as interpreted, would require disclosures of such judgments by management in its financial statements. DT-570 believes this Agenda Decision provides a useful “hook” to further require auditors to consider disclosures related to going concern as part of the overall work effort related to going concern in accordance with proposed ISA 570 (Revised).
5. DT-570 therefore believes a new requirement in ISA 570 could be included to strengthen the auditor’s consideration of disclosures made by management related to going concern. The proposed wording in relation to the requirements (and related application material) is included in paragraph 20 of **Agenda Item 3-B**, with related application material in paragraphs A21–A26.

Matter for IAASB Consideration

1. The IAASB is asked whether it agrees with DT-570’s recommendation to include a new requirement (and related application material) in proposed ISA 570 (Revised) to address the auditor’s work effort in relation to disclosures about going concern and, if so, how the proposed requirement and application material has been articulated.

⁶ Paragraph 122 of IAS 1 states, “An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 125), that management has made in the process of applying the entity’s accounting policies and that have the most significant effect on the amounts recognised in the financial statements.”

⁷ International Accounting Standard (IAS) 1, *Presentation of Financial Statements*

⁸ The term “substantial doubt” should be defined as akin to the term “probable” as it is used in Accounting Standards Codification ASC 450, on contingencies.

II. Management’s Responsibilities and Auditor Responsibilities Relating to Going Concern

A. Drafting Team Recommendations

6. In light of the support from the IAASB to explore the inclusion of additional statements in the “Management’s Responsibilities” and “Auditor’s Responsibilities” sections of the auditor’s report in respect of going concern, DT-570 continued to pursue drafting additional wording with respect to both of these responsibilities.
7. In drafting the additional wording, DT-570 sought to educate users of the auditor’s report about the use of the going concern basis of accounting in the preparation of the financial statements, when the use of this basis is appropriate, and that management is responsible for this determination. DT-570 also sought to educate the users on the extent of the auditor’s work effort in relation to the identification of a material uncertainty and the ability of the entity to continue as a going concern. DT-570 believes this is a viable alternative to including such language in a “Going Concern” section in the auditor’s report, with corresponding changes to the requirements in proposed ISA 700 (Revised).
8. DT-570 believes that the concepts of management’s and the auditor’s responsibilities with respect to going concern should be included in all auditor’s reports for all entities. The inclusion of such additional wording will provide users with additional transparency and clarification of those responsibilities that pertain to management and those that pertain to the auditor. Further, the additional wording will emphasize that those responsibilities exist in all cases irrespective of whether a material uncertainty has been identified.
9. In respect of the statement that neither management nor the auditor can guarantee the entity’s ability to continue as a going concern, DT-570 considered the mixed views of the Board – firstly, in relation to whether it was appropriate to include such a statement in the auditor’s report and, if so, whether the statement should be made regardless of whether a material uncertainty had been identified; and secondly in relation to the perceived defensive tone of the statement. DT-570 also considered that, in light of its recommendation to no longer require reporting on the appropriateness of management’s use of the going concern basis of accounting or reporting when no material uncertainty had been identified, the statement is also less relevant than originally intended.
10. Notwithstanding concerns from the IAASB, CAG and others about the tone and appropriateness of including a “guarantee statement”, DT-570 is of the view that it is useful, in describing the auditor’s required work effort with respect to going concern, to provide further context about the basis on which this work is performed. DT-570 has therefore revisited the language proposed in the ED and, based on the IAASB’s counsel, has sought to more factually explain the limitations of the auditor’s work (drawing reference to material already included in ISA 570).
11. The proposed statements for inclusion in the *Management’s Responsibilities* section and the *Auditor’s Responsibilities* section are included in the illustrative auditor’s report in **Agenda Item 2-D**. The requirements relating to these proposed statements about management’s responsibilities and the auditor’s responsibilities are included in paragraphs 33(b) and 37(b)(iv) of **Agenda Item 2-B**, respectively. Application material in paragraph A49 of Agenda Item 2-B explains that the wording used in the illustrative report provides illustrations of how the requirement to describe

management's responsibilities would be applied when IFRSs is the applicable financial reporting framework. If an applicable financial reporting framework other than IFRSs is used, the wording may need to be adapted to reflect the application of the other financial reporting framework in the circumstances.

Matter for IAASB Consideration

2. The IAASB is asked for its feedback on the proposed illustrative wording and the proposed requirements addressing the descriptions of the respective responsibilities for going concern.

III. Nature of Other Changes Proposed to ISA 570

A. Drafting Team Recommendations

12. In addition to revisions arising from the matters described in this paper, in light of the decision to revert to exception-based reporting for going concern, DT-570 revisited proposed ISA 570 (Revised) as included in the ED and considered the effect of this decision on the requirements therein relating to the inclusion of a Going Concern section within the auditor's report. In particular, DT-570 considered whether streamlining of the proposed requirements and application material was needed.
13. DT-570 evaluated the various decisions made by the auditor in accordance with the work effort included in proposed ISA 570, and was of the view that it may be useful to highlight those decisions, and the implications of them, in a decision flowchart, included as an Appendix to this paper.

Auditor's Approach to Material Uncertainties under Extant ISA 570 Retained

14. As agreed with the IAASB at its March 2014 meeting, DT-570 is proposing to retain the exception-based model in relation to the need for the auditor to obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern when such events or conditions have been identified. Based on the audit evidence obtained, the auditor is then required to conclude whether a material uncertainty exists.
15. Consistent with extant ISA 570 and the draft of ISA 570 (Revised) included in the ED, if a material uncertainty exists, the auditor is required to determine whether the financial statements adequately disclose the material uncertainty. If adequate disclosures in respect of a material uncertainty have not been made in the financial statements, the auditor is required to express a qualified or adverse opinion and explain the circumstances in the Basis for Qualified (or Adverse) Opinion section of the auditor's report. These requirements would continue to apply for audits in both the public and private sector.

Separate Section with Required Heading to Highlight a Material Uncertainty Related to Going Concern

16. In situations where a material uncertainty has been appropriately identified and disclosed, DT-570 is recommending that a separate section entitled "Material Uncertainty Related to Going Concern" be included within the auditor's report, replacing the "Going Concern" section proposed in the ED and that, consistent with the ED (and the premise of the extant Emphasis of Matter (EOM)

paragraph), a statement would be required to draw attention to the note in the financial statements in which the material uncertainty is disclosed and to explain the events or conditions that gave rise to the existence of that material uncertainty.

17. DT-570 also considered, when a material uncertainty exists, whether any flexibility should be allowed in terms of the heading to be used in the auditor's report and concluded that the same heading should be used in all auditor's report unless law or regulation prescribe a different heading. DT-570 is of the view that a required heading will lead to consistency in reporting and will more clearly flag going concern issues for users of the auditor's report when they exist.
18. DT-570 also considered whether this separate section should be required in cases where the auditor's opinion is modified due to inadequate disclosures relating to the material uncertainty. DT-570 is of the view that the section entitled "Material Uncertainty Related to Going Concern" should still be included in the auditor's report when the opinion is modified, notwithstanding that this may be viewed as somewhat duplicative. DT-570 believes that this will give the appropriate prominence and emphasis to the material uncertainty relating to going concern through inclusion in both the Basis for Qualified/Adverse Opinion section as well as the separate section "Material Uncertainty Related to Going Concern".

Other Changes to the Form and Content of Proposed ISA 570 (Revised)

19. When there are implications for the auditor's report in relation to going concern, the extant ISAs require communication with TCWG about the form and content of the auditor's report, including:
 - ISA 705⁹ – When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with TCWG the circumstances that led to the expected modification and the proposed wording of the modification.
 - ISA 706¹⁰ – If the auditor expects to include an EOM paragraph or an Other Matter (OM) paragraph in the auditor's report, the auditor shall communicate with TCWG regarding this expectation and the wording of this paragraph.
20. The requirement relating to communicating with TCWG about modifications to the auditor's opinion has been retained in proposed ISA 705 (Revised). The requirement in ISA 706 would have previously addressed the requirement in extant ISA 570 to include an EOM paragraph in the auditor's report when a material uncertainty exists. However, since such exception-based reporting is no longer considered to be an EOM paragraph, a minor revision is needed to paragraph 26 of **Agenda Item 3-B** to continue to require such communication. The DT also considered responses to the ED that suggested changes to ISA 570 as exposed. Recognizing the limited scope of the project, a number of minor edits were incorporated into the proposed standard in response to these suggestions, but no substantive changes were deemed to be necessary.
21. Finally, as a result of the above changes to ISA 570 as exposed, DT-570 considered the appropriateness of its organization and format. DT-570 is of the view that the proposed "Auditor Conclusions and Reporting" section of the standard would be better split into two separate sections, entitled "Auditor Conclusions" and "Implications for the Auditor's Report". Further, certain paragraphs within those sections have been re-ordered to provide a more logical flow.

⁹ Proposed ISA 705, *Modifications to the Opinion in the Independent Auditor's Report*

¹⁰ Proposed ISA 706 (Revised), *Emphasis of Matter and Other Matters Paragraphs in the Independent Auditor's Report*

Matters for IAASB Consideration

3. The IAASB is asked for its feedback on the decision flowchart included in the Appendix, including whether such material could usefully be included in the final ISA 570 (Revised) or other implementation support materials.
4. The IAASB is asked for its feedback on the matters described in this section and the revised draft of proposed ISA 570 presented as **Agenda Item 3-B**.

Appendix

Events or Conditions Identified that May Cast Significant Doubt on the Entity’s Ability to Continue as a Going Concern – Decision Flowchart

