

**Auditor Reporting—Summary of ED Responses Related to Going Concern (GC)****Overview**

The following are the key themes arising from the responses to the July 2013 Exposure Draft (ED) in relation to the proposed requirements in respect of GC that have been considered by the ISA 570 Drafting Team (DT-570) in preparing the recommendations included in this paper.

*Holistic Approach*

- Although respondents generally supported the IAASB in its attempts to address calls for increased information from auditors about GC, the key message delivered by the respondents was that GC needs to be addressed as part of a holistic approach, together with accounting standard setters, thereby promoting global consistency in reporting.
  - Support for the holistic approach was noted across most stakeholder groups with only preparers of financial statements, academics, and individuals being silent on the subject.
  - While many respondents encouraged the IAASB to pursue a holistic approach, some went so far as suggesting that the IAASB defer its work until improvements related to GC had been developed by accounting standard setters.

*Exception-Based Reporting*

- Many respondents indicated a preference for an exception-based reporting model, that is, including discussion in the auditor's report only in situations where a material uncertainty (MU) related to events or conditions that may cast significant doubt on an entity's ability to continue as a GC had been identified.
  - Respondents commented that users may become desensitized to GC reporting, and important messages may be obscured, if a GC section was included in every auditor's report irrespective of whether GC issues had been identified.
  - Respondents also expressed concern around the assurance that users may take from the auditor singling out GC in the auditor's report.
  - Respondents also questioned the value of making explicit something that is implicit in the preparation of the financial statements and is generally understood to be a premise on which the financial statements are prepared.

*Close Call Situations*

- Respondents commented that the IAASB needs to clarify whether matters related to GC could be determined to be a key audit matter (KAM) in situations where the auditor has spent significant audit effort in determining whether a MU exists, but ultimately determines that a MU does not exist.
- If considered a KAM, respondents further commented that clarity was needed as to whether this would be included in the KAM section, the GC section or be an Emphasis of Matter (EOM) paragraph in the auditor's report.

## Objectives of the CAG Discussion

The following are the objectives of the CAG discussion at its March 2014 meeting:

- Obtain input on the DT's proposal not to go forward with the two statements proposed in the ED in respect of GC, and the DT's alternative proposal to revert to exception-based reporting for MU identified in respect of GC.
- Obtain input on the DT's proposals to include additional wording in all auditor's reports in the Auditor's Responsibilities and Management's Responsibilities sections of the auditor's report about GC (see Appendix 1).

## I. Overall Comments on the Need for a Holistic Approach to Address GC

### A. Feedback from Respondents to the ED

1. Consistent with feedback to the Invitation to Comment (ITC), respondents to the ED continue to stress the importance of, and need for, a holistic approach to be taken to improve reporting on GC, encompassing liaison with the various accounting standard-setting bodies and other auditing standard-setting bodies to facilitate consistency in their respective GC standards with respect to framework, concepts and definitions. The need for an approach that involved modification of the accounting standards to facilitate the proposed improvements to the ISAs was highlighted by 31% of all respondents (some 43<sup>1</sup> out of 138 respondents, including three members of the Monitoring Group/MG). This was the single most consistent response ranging across stakeholder groups.
2. The underlying concern expressed was that auditor reporting on GC may be misinterpreted by users of the financial statements if there is a lack of consistent understanding of the underlying concepts in the accounting framework. It was felt that this may actually widen the expectations gap, especially with respect to potential differences in interpretation. This view was acknowledged by the IAASB in the Explanatory Memorandum (EM) to the ED.
3. In particular, the regulatory and audit oversight community (including three MG representatives) expressed strong views that changes to ISA 570<sup>2</sup> should be made in concert with, or subsequent to, updates to the accounting standards. Based on this concern, 24 respondents,<sup>3</sup> including one MG member, recommended that the accounting standard bodies should complete their GC considerations before changes are made to the auditing standards. IOSCO in particular noted the view that "the resulting outcome of what management is asked to say or not say about its GC assessment as a result of the accounting standard-setters' work in this area should be used by the [IAASB] to determine what the auditor should or should not say about the results of the auditor's work."

<sup>1</sup> *Investors and Analysts:* ABI, EUMEDION, ICGN, IMA; *TCWG:* AICD; *Regulators and Oversight Authorities:* AFRC, BCBS, CPAB, CSA CAC, EBA, EAIG, ESMA, IAIS, IOSCO; *NSS:* ASB, CAASB, CNCC-CSOEC, HKICPA, JICPA, MAASB, NZAuASB; *Accounting Firms:* BDO, DTT, EYG, GTI, KPMG, MAZARS, MSUK, PWC; *Public Sector Organizations:* AGA, NAOS; *Member Bodies and Other Professional Organizations:* ASSIREVI, FEE, FSR, IBRACON, IBR-IRE, ICAA, ICAEW, ICPAK, ICAP, ISCA, KICPA, SMPC

<sup>2</sup> ISA 570, *Going Concern*

<sup>3</sup> *TCWG:* AICD; *Regulators and Oversight Authorities:* AFRC, CSA CAC, IOSCO; *NSS:* ASB, CAASB, CNCC-CSOEC, HKICPA, JICPA, MAASB; *Accounting Firms:* DTT, EYG, GTI, MSUK, PWC; *Public Sector Organizations:* AGA, NAOS; *Member Bodies and Other Professional Organizations:* ASSIREVI, FEE, IBRACON, ICAEW, ICPAK, ICAP, KICPA

4. Respondents urged continued liaison with the International Accounting Standards Board (IASB), with 13 respondents<sup>4</sup> going so far as to say that it would be preferable for the IAASB to defer changes to the ISAs until corresponding changes to accounting standards had been made.
5. Further, to reduce the possibility of misinterpretation, 20 respondents,<sup>5</sup> including one MG member, called for more guidance or clarity around key terms, including: substantial doubt; material uncertainty; the ability to continue as a GC, the GC assumption and the interaction or relationship between the latter two. One respondent<sup>6</sup> also called for guidance with respect to management's responsibilities to be provided by the accounting standard setters. Further, three<sup>7</sup> respondents, suggested a statement with respect to management's responsibilities around GC be added to the auditor's report, two of whom suggested that this be included within the Management's Responsibilities section.
6. Also, a few respondents felt that increased reporting on GC would be better addressed by the accounting standards through requirements for improved or enhanced disclosures by management in the financial statements around its assessment of and conclusions relating to GC, thus alleviating the concern that the auditor would be providing "original information" in the auditor's report. These respondents were largely from the accounting firms,<sup>8</sup> member bodies and other professional organizations.<sup>9</sup> Other respondents that supported this were from the National Standard Setters (NSS) and academics.<sup>10</sup>
7. In addition two<sup>11</sup> respondents explicitly suggested that the time frame of the assessment period for GC be clarified. One of these respondents specifically suggested that the clarification be within the accounting standards.<sup>12</sup>
8. Many respondents<sup>13</sup> expressed a preference for management to be required to make disclosures within the financial statements, with the auditor required to express an opinion on management's disclosures. A few respondents<sup>14</sup> specifically commented on the need to preserve the respective

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<sup>4</sup> NSS; ASB, CAASB, MAASB; *Accounting Firms*: DTT, EYG, GTI, PWC; *Public Sector Organizations*: AGA, NAOS; *Member Bodies and Other Professional Organizations*: ASSIREVI, FEE, ICAEW, ISCA

<sup>5</sup> *Investors and Analysts*: EUMEDION, ICGN; *TCWG*: AICD; *Regulators and Oversight Authorities*: IAIS; NSS: AUASB, CNCC-CSOEC, JICPA, MAASB; *Accounting Firms*: EYG, GTI, KI; *Public Sector Organizations*: AGNZ; *Member Bodies and Other Professional Organizations*: ASSIREVI, CICPA, IBR-IRE, ICAA, ICAG, ICPAI, ICAP, NZICA

<sup>6</sup> *Regulators and Oversight Authorities*: CPAB

<sup>7</sup> NSS: AUASB; *Accounting Firms*: EYG; *Member Bodies and Other Professional Organizations*: ICAN

<sup>8</sup> *Accounting Firms*: BDO, BT, DTT, EYG, GTI, MAZARS, PWC, RS

<sup>9</sup> *Member Bodies and Other Professional Organizations*: ASSIREVI, CPAC, FEE, FSR, IBRACON, IBR-IRE, ICAS, KHT, NZICA

<sup>10</sup> NSS: CNCC-CSOEC, JICPA; *Academics*: MU

<sup>11</sup> WPK & CNCC-CSOEC

<sup>12</sup> Four respondents, CFA, IRBA, AUASB, and FAP, suggested disclosure of timeframe in the auditor's report would be appropriate and 1 respondent, ICGN, suggested that it should not be limited to 12 months.

<sup>13</sup> *Investors and Analysts*: BR; *Regulators and Oversight Authorities*: IRBA, NSS: AUASB, CNCC-CSOEC, MAASB, NBA; *Accounting Firms*: BDO, BT, DTT, EYG; *Member Bodies and Other Professional Organizations*: ASSIREVI, IBR-IRE, ICAA, ICAN, ICAS, ISCA, SAICA; *Academics*: MU

<sup>14</sup> NSS: AUASB, CAASB, IDW; *Accounting Firms*: GTI; *Public Sector Organizations*: AGA; *Member Bodies and Other Professional Organizations*: ASSIREVI

responsibilities of management, TCWG and auditors. In addition, clarifying management's responsibilities was also recommended in order to narrow the expectations gap.

9. A similar concern around auditors speaking on behalf of management and thus blurring the respective responsibilities was also raised by 18% of the respondents<sup>15</sup> in response to the proposed statement with respect to not guaranteeing the entity's ability to continue as a GC. Some respondents<sup>16</sup> also echoed the sentiment made in response to Question 9<sup>17</sup> of the ED, that disclosure around GC should only be included in the financial statements, rather than the auditor's report.

## **B. Developments on the Topic of GC by Other Standard Setters and Regulatory Bodies**

### *IASB*

10. In November 2012, the Interpretations Committee (IFRIC) tentatively agreed that the IASB should consider proposals for narrow scope amendments to IAS 1<sup>18</sup> in respect of the threshold for consideration of MU and the GC basis of accounting and objectives for this disclosure. This initiative was presented to the IASB in November 2013, at which time the IASB elected not to move forward with its GC project.
11. In its meeting in January 2014, many members of the Interpretations Committee expressed concerns about the implications of the IASB's decision not to proceed and asked the staff to report those concerns to the IASB leadership.
12. At a recent meeting between IAASB and IASB leadership and staff, the IASB indicated that it recognizes that it still has to address the question proposed by IFRIC concerning the ambiguity about whether a MU with respect to GC should be assessed on a gross basis (before mitigating actions planned by management) or a net basis (after mitigating actions planned by management). The IASB leadership indicated it would explore whether and, if so, how clarification could be progressed in a timely manner. Except for the prospect of expediency, the IASB did not provide any indication as to the timeframe for its conclusions or the manner in which this may be addressed. During this meeting, IAASB Staff shared an overview of the responses calling for a holistic approach to GC and excerpts of the relevant comment letters in which this was mentioned.

### *European Audit Reforms*

13. In mid-December 2013, revised audit reform proposals were agreed between the European Parliament and the Lithuanian European Union presidency, and approved unanimously by COREPER, the committee of permanent representatives of the member states (referred to as the

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<sup>15</sup> *Regulators and Oversight Authorities:* MAOB, NSS: AUASB, MAASB, NBA; *Accounting Firms:* BDO, BT, CHI, DTT, GTI, MSUK, PWC; *Member Bodies and Other Professional Organizations:* ACCA, CICPA, EFAA, FACPE, FAR, FEE, FSR, IBR-IRE, ICAEW, ICAN, ICPAI, NYSSCPA, PICPA, SMPC

<sup>16</sup> *Accounting Firms:* DTT, MAZARS; *Preparers:* NN; *Member Bodies and Other Professional Organizations:* ICAEW

<sup>17</sup> Question 9: Do respondents agree with the statements included in the illustrative auditor's report relating to: (a) The appropriateness of management's use of the GC basis of accounting in the preparation of the entity's financial statements? (b) Whether the auditor has identified a MU that may cast doubt on the entity's ability to [continue as a going] concern when such an uncertainty has been identified? In this regard, the IAASB is particularly interested in views as to whether such reporting, and the potential implications thereof, will be misunderstood or misinterpreted by the users of the financial statements.

<sup>18</sup> International Accounting Standard (IAS) 1, *Presentation of Financial Statements*

“European Union Compromise Package”). The next steps are a formal vote in the plenary of the European Parliament.<sup>19</sup>

14. The texts of the proposed Regulation (which applies to audits of public-interest entities) and the proposed Directive (which applies to all entities), as endorsed by the European Parliament’s Legal Affairs (JURI) Committee, are now publicly available. Auditor reporting on GC would be required by the proposed Directive. These proposals would require only a statement on any MU related to events or conditions that may cast significant doubt about the entity’s ability to continue as a GC. A statement on the appropriateness of the use of the GC basis of account is not proposed to be required. Consistent with the interpretation by the European Commission staff, this can be interpreted as support for the use of a reporting by exception model, which would be not dissimilar to the current EOM model in extant ISA 570 (see page 69 of the proposed Directive).

*US Financial Accounting Standards Board (FASB) and US Public Company Accounting Oversight Board (PCAOB)*

15. The US Financial Accounting Standards Board (FASB) is separately undertaking a project on GC and it issued an ED for comment in June 2013. The comment period ended in September 2013. At its meeting in November 2013, the FASB decided to continue with the project and anticipated beginning re-deliberations in January 2014 around the initial disclosure threshold and content, management’s plans outside of the ordinary course of business, assessment period, the substantial doubt threshold and the applicability of substantial doubt to non-SEC filers.
16. In a recent speech from Chief Auditor Marty Baumann, the PCAOB acknowledged that it believed that improvements were needed to existing auditing standards in the areas of the auditor’s performance obligations under the standard, the time horizon for looking out and the determination of what the terms “substantial doubt” and “GC” mean. However, in light of the current FASB project in respect of GC, the PCAOB has explained it will delay updates to the GC standard<sup>20</sup> until it has a clearer understanding of FASB’s plans.

**C. Drafting Team Recommendations**

17. Having considered the balance of views from respondents to the July 2013 ED, the status of activities of accounting standard setters (which, as explained in the EM to the ED, was a fundamental premise of the IAASB’s work), and the goal of finalizing the auditor reporting proposals in 2014, DT-570 is of the view that the overarching calls to address issues related to GC on a holistic basis warrants re-consideration of an appropriate way forward.
18. The EM to the ED clearly explained this feedback from the ITC, and highlighted the IAASB’s view of the importance of actions being taken by accounting standard setters to respond to this call, so that the proposed statements in the auditor’s report would be understood by users as intended. It also outlined the possibility that the IAASB’s planned actions would likely be affected by these

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<sup>19</sup> After the formal vote, the proposal will then become legislation and will have to be published in the official journal. The regulation would be expected to come into force 20 days after publication in the official journal, while the directive has to be translated and implemented by each member state at the national level, a process which is generally required to happen within two years. As the Regulation and the Directive are mutually dependent in a number of places, making the Regulation effective from entry into force may be viewed as impractical.

<sup>20</sup> AU 341, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern*

developments. While there was a level of support for both statements in the auditor's report, much of this support was premised on anticipation of complementary actions being taken by accounting standard setters concurrently in a holistic manner. Absent action by the IASB and others, DT-570 is of the view that the IAASB needs to weigh the perceived benefits of these statements with the overarching concerns expressed across all stakeholder groups throughout the project.

19. However, it should be noted that the requirements in extant ISA 570 apply regardless of what the financial reporting framework requires as long as going concern is relevant to the financial statements, with a possible exception noted in extant ISA 570<sup>21</sup> for certain special purpose financial reporting frameworks.
20. The remainder of this paper therefore discusses the various aspects of the IAASB's proposals and DT-570's recommendations as to an appropriate way forward in relation to each of them, in light of specific feedback from the ED. Notwithstanding these recommendations, DT-570 intends to continue to follow the developments of the IASB, FASB, PCAOB to determine the impact of their efforts on the IAASB's work in 2014. Should the IASB progress in the future, DT-570 is of the view that the IAASB could take the opportunity to revisit the appropriateness of these recommendations. It was also acknowledged that the post-implementation review may identify further opportunities in relation to reporting on GC.

## II. Statement on the Appropriateness of Management's Use of the GC Basis of Accounting – Question 9(a) of the ED

The following are excerpts of the proposed GC statement on the appropriateness of management's use of the GC basis of accounting from the Illustrative reports included in the ED:

### **When No MU Has Been Identified**

#### Going Concern

The Company's financial statements have been prepared using the going concern basis of accounting. The use of this 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. As part of our audit of the financial statements, we have concluded that management's use of the going concern basis of accounting in the preparation of the Company's financial statements is appropriate.

### **When a MU Has Been Identified (Whether or Not Adequately Disclosed)**

#### Going Concern Basis of Accounting

The material uncertainty identified above does not indicate that the going concern basis of accounting is inappropriate. The Company's financial statements have been prepared using the going concern basis of accounting. The use of 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. As part of our audit of the financial statements, we have concluded that management's use of the going concern basis of accounting in the preparation of the Company's financial statements is appropriate.

<sup>21</sup> ISA 570, paragraphs 2 and A1

## A. Feedback from Respondents to the ED

21. Of the respondents that answered the question regarding the inclusion of statements related to GC in the auditor's report, 69,<sup>22</sup> including two MG members, expressed some level of support for auditors making an explicit statement about the appropriateness of management's use of the GC basis of accounting. However, as further analysis below indicates, this was not always an unqualified support. 13%<sup>23</sup> of respondents, including two MG members, did not comment specifically on this question.
- Of these 69 respondents, only 17<sup>24</sup> of those expressed support without any qualification.
  - The support of 29<sup>25</sup> respondents, including two MG members, investors and others, was specifically in the context of their expectation that the IAASB's proposal would be part of a holistic approach to GC, i.e., there would be additional guidance provided by the IASB in respect of management's disclosures within financial statements, as noted above.
  - Other qualifications to the support expressed included that the statement was implicit or of little or no value, that the statements confused the roles of management and of the auditor, that such statements could be seen as providing a different level of assurance on GC, and generally that the statements could be misunderstood.
22. Many respondents,<sup>26</sup> largely preparers of financial statements and member bodies and other professional organizations, thought that the statement with respect to the conclusion on the appropriateness of management's use of the GC assumption had limited value, often citing that this was already implicit in the preparation of the financial statements and was essentially boilerplate language.<sup>27</sup>

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<sup>22</sup> *Investors and Analysts:* ABI, BR, CFA, EUMEDION, ICGN, IMA, S&P, SLI; *Regulators and Oversight Authorities:* AFRC, DFSA, EAIG, EBA, ESMA, IAIS, IOSCO, MAOB; *NSS:* AUASB, CNCC-CSOEC, FAP, IDW, MAASB, NBA, NZAuASB, UKFRC; *Accounting Firms:* BDO, CHI, DTT, EYG, KPMG, KI, MAZARS, MSUK, PWC, RSM, SRA; *Public Sector Organizations:* AGO, NAOUK; *Preparers:* Gof100-A; *Member Bodies and Other Professional Organizations:* ACCA, CAI, FACPCE, FEE, FSR, IBR-IRE, ICAA, ICAEW, ICAG, ICAN, ICPAI, ICPAK, ICAP, ICAS, ICAZ, IPAR, IMCP, KICPA, NZICA, SMPC, ZICA; *Academics:* ABurrowes, JRGibson1, JRGibson2, HC, HGortemak, MU; *Individuals and Others:* ANA, CMunarriz, DJuvenal, Flrungu

<sup>23</sup> *Investors and Analysts:* DA, JCiesielski, SAAJ; *Regulators and Oversight Authorities:* BCBS, ICAC, IFIAR; *Preparers:* EI, SH, SO; *Member Bodies and Other Professional Organizations:* CAQ, DNR, ICAI, MIA, WPK; *Academics:* JCarcello, KRuhnke; *Individuals and Others:* CBarnard, CLL, PYoung

<sup>24</sup> *Investors and Analysts:* S&P, SLI; *Regulators and Oversight Authorities:* DFSA, MAOB; *Accounting Firms:* SRA; *Member Bodies and Other Professional Organizations:* ICPAI, IMCP, NZICA; *Academics:* ABurrowes, JRGibson1, JRGibson2, HC, HGortemak; *Individuals and Others:* ANA, CMunarriz, DJuvenal, Flrungu

<sup>25</sup> *Investors and Analysts:* ABI, EUMEDION, ICGN, IMA; *Regulators and Oversight Authorities:* AFRC, EBA, EAIG, ESMA, IAIS, IOSCO; *NSS:* CNCC-CSOEC, MAASB, NZAuASB; *Accounting Firms:* BDO, DTT, EYG, KPMG, MAZARS, MSUK, PWC; *Member Bodies and Other Professional Organizations:* FEE, FSR, IBR-IRE, ICAA, ICAEW, ICPAK, ICAP, KICPA, SMPC

<sup>26</sup> *NSS:* CAASB; *Accounting Firms:* BT, GTI, KPMG; *Public Sector Organizations:* AGC, CIPFA, NAOUK, PAS; *Preparers:* AA, CFOF, Gof100-A, NN, SPL; *Member Bodies and Other Professional Organizations:* CalCPA, CICPA, CCAA, KICPA, NYSSCPA, SAICA; *Academics:* BCEMW

<sup>27</sup> *Investors and Analysts:* ICGN; *Regulators and Oversight Authorities:* CSA CAC, ESMA, IRBA, JSE; *Accounting Firms:* BT, CHI; *Public Sector Organizations:* AGO, CIPFA, ECA, GAO, PAS; *Preparers:* Gof100-A; *Member Bodies and Other Professional Organizations:* FEE

23. A few respondents<sup>28</sup> expressed concern that singling out GC by requiring both the statement on the appropriateness of management’s use of the GC basis of accounting and whether a MU had been identified may:
- Imply a different level of assurance on GC compared to the rest of the financial statements;
  - Imply a greater comfort to users on the entity’s future prospects than is warranted;
  - Give undue prominence over other assertions considered in the audit of the financial statements; or
  - Represent a “piecemeal opinion”.

This comment was made for both the proposed statements under Question 9<sup>29</sup> and under Question 10.<sup>30</sup>

24. On the other hand, one respondent<sup>31</sup> expressed a view that the GC basis of accounting relates to the financial statements as a whole, since it reflects an assertion at the financial statement level that permeates the financial statements, and as such does not represent a “piecemeal opinion.”

## **B. Drafting Team Recommendations**

25. Having considered the comments made by the respondents and the overarching comments about the need for a holistic approach to GC, DT-570 recommends the IAASB move away from the requirement, as initially proposed, for the auditor to include a statement of the appropriateness of the GC basis of accounting in the auditor’s report. In particular, DT-570 found merit in the views that such a statement was of limited value to users and was already implicit in the auditor’s opinion. This is because the auditor is required by ISA 570 to modify the opinion if the auditor concludes that management’s use of the GC basis of accounting in the preparation of the financial statements is not appropriate. DT-570 also noted that, under International Financial Reporting Standards (IFRSs), management is not required to disclose that the financial statements are prepared under the going concern basis of accounting, and that it is relatively rare for the use of such a basis of accounting to be inappropriate – which would lead to boilerplate disclosures in most circumstances.
26. However, DT-570 believes that there is merit to the message the IAASB intended to be conveyed by this statement. Specifically, DT-570 believes it is valuable to seek to educate users of the auditor’s report about the use of the GC 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 therefore believes that a viable alternative to including such language in a GC section in the auditor’s report is to include additional wording in both the Management’s

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<sup>28</sup> *Regulators and Oversight Authorities:* EAIG, *Accounting Firms:* PKF; *Preparers:* CFOF; *Public Sector Organizations:* AGC; *Member Bodies and Other Professional Organizations:* CAI, FEE, IBR-IRE, ICPAI, NYSSCPA; *Individuals and Others:* Flrungu

<sup>29</sup> *Regulators and Oversight Authorities:* CSA CAC; *NSS:* JICPA; *Accounting Firms:* GTI, KPMG, PKF; *Public Sector Organizations:* AGSA; *Preparers:* CFOF; *Member Bodies and Other Professional Organizations:* CAI, CICPA, EFAA, FEE, MIA, NYSSCPA; *Academics:* BCEMW

<sup>30</sup> Question 10 : What are respondent’s views as to whether an explicit statement that neither management nor the auditor can guarantee the entity’s ability to continue as a GC should be required in the auditor’s report whether or not a MU has been identified?

<sup>31</sup> *NSS:* IDW

Responsibilities and Auditor's Responsibilities sections of the auditor's report (see paragraphs 47–50).

**Matter for CAG Consideration**

1. Representatives are asked to share their initial views on whether they agree with DT-570's recommendation to convey the message intended in the ED, with respect to the GC basis of accounting, through descriptions in both the Management's Responsibilities and Auditor's Responsibilities sections of the auditor's report.

**III. Statement Whether the Auditor Has Identified a Material Uncertainty that May Cast Significant Doubt on the Entity's Ability to Continue as a GC – Question 9(b) of the ED**

The following are excerpts of the proposed GC statement about whether the auditor has identified a MU from the Illustrative reports included in the ED:

**When No Material Uncertainty Has Been Identified**

Going Concern

Management has not identified a material uncertainty that may cast doubt on the entity's ability to continue as a going concern, and accordingly none is disclosed in the financial statements. Based on our audit of the financial statements, we also have not identified a material uncertainty. However, neither management nor the auditor can guarantee the Company's ability to continue as a going concern.

**When A MU Has Been Identified and Adequately Disclosed**

Going Concern

*Disclosures about a Material Uncertainty Identified*

We draw attention to Note 6 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. As stated in Note 6, these conditions, along with other matters as set forth in Note 6, indicate the existence of a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

**When a MU Has Been Identified But Is Inadequately Disclosed**

*Inadequate Disclosure about a Material Uncertainty Identified*

As described in the *Basis for Qualified Opinion* section of our report, a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern has been identified. The material uncertainty has not been adequately disclosed in the financial statements. Our opinion is qualified in respect of this matter.

Or

*Inadequate Disclosure about a Material Uncertainty Identified*

As described in the *Basis for Qualified Opinion* section of our report, a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern has been identified. The material uncertainty has not been adequately disclosed in the financial statements. We have expressed an adverse opinion as a result of this matter.

**A. Feedback from Respondents to the ED**

27. Of the respondents that answered question 9(b), 56<sup>32</sup> (including three MG members) in general supported the inclusion of a statement relating to MU in the auditor's report in all cases. However, views were mixed between outright support and support with suggestions for improvement. Some level of support was spread across all groups of respondents, with the exception of the public sector organizations, where the majority of the respondents did not support additions to the audit report in respect of GC in general. Notably, of the 56 that supported the inclusion of the statement relating to MU in all cases, 19<sup>33</sup> (or 34%) of these respondents, including three MG member(s), had conditioned this support on the need for a holistic approach to GC. 31<sup>34</sup> respondents explicitly did not support the proposal. 12%<sup>35</sup> of respondents (including one MG member) did not specifically answer this question.
28. Almost 30% of respondents, including one MG member, were in favor of exception-based reporting on MU related to GC, rather than a standard GC section in every auditor's report.<sup>36</sup> The composition of those in favor came largely from the member bodies and other professional organizations, some from the public sector and accounting firms, with the remainder spread across all other groups except academics and individuals.
29. Views ranged from keeping the reporting as is, i.e., by continuing to use an EOM paragraph, including any "exceptions" in a GC section, or including any identified exceptions as KAM.

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<sup>32</sup> *Investors and Analysts:* ABI, BR, CFA, EUMEDION, IMA, S&P, SLI; *Regulators and Oversight Authorities:* AFRC, BCBS, DFSA, EBA, EAIG, IAIS, IOSCO, MAOB; *NSS:* FAP, IDW, MAASB, NZAuSB, UKFRC; *Accounting Firms:* BDO, DTT, EYG, KI, MSUK, RSM, SRA; *Public Sector Organizations:* NAOUK; *Preparers:* EI; *Member Bodies and Other Professional Organizations:* ACCA, CAI, CalCPA, FACPCE, FSR, IBR-IRE, ICAN, ICAP, ICAS, ICAZ, ICPAI, ICPAK, IMCP, IPAR, KHT, MIA, WPK, ZICA; *Academics:* ABurrows, JRGibson1, JGibson2, HGortemak, MU, *Individuals and Others:* ANA, CMunarriz, DJuvenal, Flrunqu

<sup>33</sup> *Investors and Analysts:* ABI, EUMEDION, IMA; *Regulators and Oversight Authorities:* AFRC, BCBS, EAIG, EBA, ESMA, IRBA, IAIS, IOSCO; *NSS:* MAASB, NZAuSB; *Accounting Firms:* BDO, DTT, GTI, MSUK; *Member Bodies and Other Professional Organizations:* FSR, IBR-IRE, ICAP

<sup>34</sup> *TCWG:* AICD; *Regulators and Oversight Authorities:* CPAB, CSA CAC, JSE; *NSS:* ASB, CAASB, CNCC-CSOEC, HKICPA, JICPA, *Accounting Firms:* MAZARS; *Public Sector Organizations:* AGA, ACAG, AGC, AGM, AGNZ, CIPFA, ECA, NAOS, PAS; *Preparers:* CFOF, USCC; *Member Bodies and Other Professional Organizations:* ASSIREVI, EFAA, IBRACON, ICAG, ISCA, KACR, PICPA, NYSSCPA, *Academics:* BCEMW

<sup>35</sup> *Investors and Analysts:* DA, JCiesielski, SAAJ; *Regulators and Oversight Authorities:* ICAC, IFIAR; *Preparers:* SPL, SO; *Member Bodies and Other Professional Organizations:* CAQ, DNR, ICAI; *Academics:* HC, JCarcello, KRuhnke; *Individuals and Others:* CBarnard, CLL, PYoung

<sup>36</sup> *Investors and Analysts:* ICGN; *TCWG:* AICD; *Regulators and Oversight Authorities:* CSA CAC, ESMA, IRBA, WB; *NSS:* AUASB, CAASB, HKICPA, NBA; *Accounting Firms:* BT, CHI, CR, GTI, KPMG, PKF, PP, PWC; *Public Sector Organizations:* AGO, AGSA, CFQ, GAO, PAS; *Preparers:* AA, Gof100-A, NN, SH; *Member Bodies and Other Professional Organizations:* AIA, CICPA, CPAA, CPAC, FAR, FEE, IAA, ICAA, ISCA, KICPA, NZICA, SAICA, SMPG

30. A few respondents<sup>37</sup> stated that the inclusion of a GC section irrespective of whether an issue has been identified may desensitize users to GC discussions. Thus, when a GC issue is identified, it may lose its prominence and importance in the auditor's report. In addition, a few further respondents<sup>38</sup> were concerned that the language would become boilerplate over time and would also contribute to the loss of impact of any GC issues.
31. A few respondents<sup>39</sup> suggested a more flexible approach to the inclusion of GC, including a tiered approach to financial reporting disclosure along a continuum of severity, that the inclusion of a section addressing GC should not be mandated and that there should be more flexibility in the wording.

#### *Specific Industry Concerns*

32. Respondents<sup>40</sup> continued to question the usefulness and appropriateness of auditor reporting on GC for specific industries, citing particular challenges in doing so.
- In the public sector, respondents noted that GC generally does not have much relevance to this sector. Reasons cited included:
    - Entities within the public sector are not required to report under a GC framework; and
    - Entities are supported by overarching government bodies with tax raising powers, thus it is the overall health of the tax raising entity that is relevant.
  - In the banking sector, respondents noted that financial institutions, by their nature, were different from other entities, and that the financial health of the entity can change very quickly. The requirement to make GC disclosures in the auditor's report could lead to an unwarranted loss of confidence in the entity. It was suggested that changes with respect to GC, if any, should be done in conjunction with the banking authorities. It was also noted by a MG member (BCBS) that "specific authoritative guidance" for banks could cover issues that may be relevant to the auditor's work on GC.
  - Of other concern from a few respondents was the application of the same standard to a broad range of industries. One respondent specifically called out the retail industry due to the composition of a typical balance sheet.

#### *"Close Call" Situations*

33. In a "close call" situation where uncertainties exist but it is ultimately concluded that no MU exists, eight respondents,<sup>41</sup> 50% of whom represent accounting firms, expressed views around the

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<sup>37</sup> TCWG: AICD; *Regulators and Oversight Authorities*: CSA CAC; *Accounting Firms*: CR, PP; *Public Sector Organizations*: GAO; *Member Bodies and Other Professional Organizations*: CPAA, ICAA

<sup>38</sup> *Investors and Analysts*: ICGN; *Regulators and Oversight Authorities*: CSA CAC, ESMA, IRBA; *NSS*: AUASB, NBA; *Accounting Firms*: BT, CHI, GTI, PWC; *Preparers*: Gof100-A, SH; *Member Bodies and Other Professional Organizations*: CICPA, CPAA

<sup>39</sup> *NSS*: CNCC-CSOEC; *Accounting Firms*: BDO; *Public Sector Organizations*: ACAG, NAOS; *Preparers*: USS; *Member Bodies and Other Professional Organizations*: FSR, KHT

<sup>40</sup> *Regulators and Oversight Authorities*: AFRC, BCBS, CPAB; *NSS*: CAASB, CNCC-CSOEC; *Accounting Firms*: MAZARS; *Public Sector Organizations*: ACAG, AGC, AGM, AGO, CIPFA, ECA, GAO, PAS

<sup>41</sup> *Regulators and Oversight Authorities*: ESMA; *NSS*: CNCC-CSOEC; *Accounting Firms*: EYG, KPMG, PKF, PWC; *Member Bodies and Other Professional Organizations*: FEE, ICAA

interaction between the reporting requirements proposed in ISA 570 (Revised) and those included in proposed ISA 701:<sup>42</sup>

- The majority of these respondents<sup>43</sup> sought clarification whether matters related to GC could be determined to be a KAM in situations where the auditor has spent significant audit effort in determining whether a MU exists, but ultimately determines that a MU does not exist (i.e., when conditions were identified that gave rise to uncertainties (although not determined to be “material”). In such cases, clarification of whether the resulting statements around GC would be included in the GC section, the KAM section, or as an EOM paragraph in the auditor’s report, was requested.<sup>44</sup>
- One respondent<sup>45</sup> thought including discussion in the KAM section may undermine the GC section of the audit report.
- One respondent<sup>46</sup> stated a preference for it to be a KAM, citing the PCAOB’s proposal.
- One respondent<sup>47</sup> stated that additional discussion should be included in the GC section.
- One respondent<sup>48</sup> noted that there were mixed views as to which section this should be included within.

#### *Content of Disclosures about MU*

34. There were mixed views in relation to the amount of detail to be included in the GC statement relating to MU. Those calling for additional detail, namely regulators and oversight authorities,<sup>49</sup> including one MG member, NSS,<sup>50</sup> member bodies,<sup>51</sup> public sector organizations,<sup>52</sup> and individuals and others,<sup>53</sup> thought that more discussion around the following areas would be appropriate.
- Where a MU had been identified, discussion of management’s plans to mitigate it;
  - The auditor’s judgments in concluding that no MU have been identified and details of the uncertainties considered;
  - Where the consideration of whether a MU exists is a “close call” or GC is considered a significant risk or KAM, the work performed by the auditor to reach his/her conclusion;

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<sup>42</sup> Proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

<sup>43</sup> NSS: CNCC-CSOEC; *Accounting Firms*: EYG, KPMG; *Member Bodies and Other Professional Organizations*: FEE, ICAA

<sup>44</sup> A few further respondents called for further clarification of the interaction between these sections but did not express this view specifically in the context of close call situations. These respondents were: *Accounting Firms*: BT, EYG, KPMG, MAZARS; *Member Bodies and Other Professional Organizations*: ICAEW, IBR-IRE, SMPC.

<sup>45</sup> *Accounting Firms*: PWC

<sup>46</sup> *Accounting Firms*: PKF

<sup>47</sup> *Regulators and Oversight Authorities*: ESMA

<sup>48</sup> *Member Bodies and Other Professional Organizations*: ICAA

<sup>49</sup> *Regulators and Oversight Authorities*: EBA, ESMA, IAIS

<sup>50</sup> NSS: AUASB, NZAuASB, UKFRC

<sup>51</sup> *Member Bodies and Other Professional Organizations*: FEE, ICAA, ICAS

<sup>52</sup> *Public Sector Organizations*: AGO, AGNZ

<sup>53</sup> *Individuals and Others*: CMunarriz

- MU identified in prior years that do not continue to be MU; and
  - One respondent from the public sector suggested that earlier disclosure of uncertainties was more useful to users.
35. Contrary to the positions expressed above, other respondents had issues with the additional disclosures, including the following:
- A few respondents<sup>54</sup> stated that it would be factually incorrect or inappropriate to state that management had not identified any MU, given that such were identified and managed by management on a regular basis. Further, management appropriately discloses how such risks are managed. A financial institution identifying liquidity as a financial risk was provided as an example of this.
  - Some respondents<sup>55</sup> made the comment that the two proposed statements relating to GC may become a “self-fulfilling prophecy”; be viewed in a negative way; or that the audit report would be too lengthy.<sup>56</sup>

## **B. Drafting Team Recommendations**

36. DT-570 is proposing to retain the approach in both extant ISA 570 and proposed ISA 570 (Revised) in relation to the need for the auditor to obtain sufficient appropriate audit evidence to determine whether or not a MU related to events or conditions that may cast significant doubt on the entity’s ability to continue as a GC when such events or conditions have been identified.<sup>57</sup> Based on the audit evidence obtained, the auditor is then required to conclude whether a MU exists.<sup>58</sup> If a MU has been identified, the auditor is required to determine whether the financial statements adequately disclose the MU.<sup>59</sup> If adequate disclosures in respect of a MU have not been made in the financial statements, the auditor is required to express a qualified or adverse opinion<sup>60</sup> 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 sectors.<sup>61</sup>
37. To address concerns expressed by the respondents that users will become desensitized to commentary in the auditor’s report, which may result in commentary in respect of GC being

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<sup>54</sup> *Regulators and Oversight Authorities:* IRBA; *Preparers:* CFOF

<sup>55</sup> *Regulators and Oversight Authorities:* CPAB; *Preparers:* EI, SH; *Member Bodies and Other Professional Organizations:* EFAA, ICAP

<sup>56</sup> *Regulators and Oversight Authorities:* IRBA; *Accounting Firms:* PP; *Preparers:* Gof100-A; *Member Bodies and Other Professional Organizations:* FSR; *Academics:* JRGibson1

<sup>57</sup> See paragraph 16 of proposed ISA 570 (Revised).

<sup>58</sup> See paragraph 18 of proposed ISA 570 (Revised).

<sup>59</sup> ISA 570, paragraph 21 requires the auditor to determine whether the financial statements: (a) Adequately disclose the principle events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern and management’s plans to deal with these events and conditions; and (b) Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

<sup>60</sup> See paragraph 23 of ISA 570 (Revised).

<sup>61</sup> ISA 570, paragraphs 2, 4 and A1

obscured when an actual issue related to GC exists, DT-570 recommends that reporting on whether a MU had been identified would only be required on an exception basis (i.e., when a MU had been identified and the auditor has concluded that the MU is appropriately disclosed in the financial statements (i.e., the auditor is able to express an unmodified opinion).

38. In such circumstances, this reporting would include:
- A separate section entitled “Material Uncertainty Relating to Going Concern” included within the auditor’s report, replacing the “Going Concern” section proposed in the ED.
  - Consistent with the ED (and the premise of an extant EOM paragraph), a statement to:
    - Draw attention to the note in the financial statements in which the MU is disclosed; and
    - Explain that these events or conditions indicate the existence of a MU that may cast significant doubt on the entity’s ability to continue as a GC and that the auditor’s opinion is not modified in respect of the matter.
39. This section would be supplemented by new language proposed in the auditor’s and management’s responsibilities sections (see paragraphs 47–50).
40. DT-570 will continue to work with the DT-701 team in respect to when the auditor’s judgments about GC may be determined to be a KAM and how this would be addressed by the proposed standards (including where such information may be placed in the auditor’s report).

**Matter for CAG Consideration**

2. Representatives are asked whether they agree with DT-570’s recommendation to revert to exception-based reporting when a MU has been identified and the auditor determines it is appropriately disclosed in the financial statements, and require such reporting under the heading “Material Uncertainty Relating to Going Concern.”

**IV. Statement with Respect to Guaranteeing an Entity’s Ability to Continue as a GC – Question 10 of the ED**

The following is an excerpt of an additional statement proposed to be included in the auditor’s report when no MU had been identified:

However, neither management nor the auditor can guarantee the Company’s ability to continue as a going concern.

**A. Feedback from Respondents to the ED**

41. Respondents that commented on this statement indicated mixed views about whether it should be included in the auditor’s report, with approximately half of those who responded to the question supporting the inclusion of the proposed guarantee statement. However, as with the responses in

respect of the other GC statements, this was not unqualified support. 12%<sup>62</sup> of respondents did not specifically answer this question.

42. Further, if the proposals in the ED were to be adopted:

- 31 respondents<sup>63</sup> suggested that this statement should be included in all cases, regardless of whether a MU had been identified;
- Five respondents<sup>64</sup> suggested it should only be included when a MU had been identified, largely part of a view that attention should not be drawn to GC when a MU had not been identified; and
- Two respondents<sup>65</sup> suggested it should only be included when no MU had been identified, stating that inclusion was irrelevant and redundant when a MU had been identified.

43. A concern around auditors speaking on behalf of management and thus blurring the respective responsibilities was also raised by 18% of the respondents<sup>66</sup> in response to the proposed statement with respect to not guaranteeing the entity's ability to continue as a GC. A few respondents<sup>67</sup> also echoed the sentiment, made in response to Question 9, that disclosures around GC should only be included in the financial statements and not in the auditor's report.

44. Similarly, many respondents<sup>68</sup> were of the view that the statement in respect of not being able to guarantee the ability of the entity to continue as a GC was unnecessary or redundant, largely because the basis on which the financial statements were prepared was inherently understood and that the language was boilerplate and of less value. A few respondents<sup>69</sup> also went on to say that the statement appeared overly negative or defensive and that it detracted from the discussion of GC in the auditor's report.

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<sup>62</sup> *Investors and Analysts:* ABI, DA, JCiesielski, SAAJ; *Regulators and Oversight Authorities:* ICAC; *Accounting Firms:* CR, PP, SRA; *Preparers:* SO; *Member Bodies and Other Professional Organizations:* CICPA, ICAI; *Academics:* BCEMW, JCarcello, KRuhnke; *Individuals and Others:* CBarnard, CLL, PYoung

<sup>63</sup> *NSS:* AUASB, IDW, JICPA, NZAuASB, UKFRC; *Accounting Firms:* DTT, KPMG, KI, PWC; *Public Sector Organizations:* PAS; *Preparers:* EI, SH; *Member Bodies and Other Professional Organizations:* CICPA, FACPCE, FSR, IBRACON, ICAA, ICAG, ICAN, ICAS, ICPAK, IMCP, IPAR, ISCA, KACR, KICPA, NZICA, WPK; *Academics:* JRGibson2, MU; *Individuals and Others:* CMunarriz

<sup>64</sup> *TCWG:* AICD; *Regulators and Oversight Authorities:* CSA CAC; *Accounting Firms:* PKF; *Public Sector Organizations:* ACAG; *Member Bodies and Other Professional Organizations:* CPAA

<sup>65</sup> *NSS:* CAASB; *Member Bodies and Other Professional Organizations:* ZICA

<sup>66</sup> *Regulators and Oversight Authorities:* MAOB; *NSS:* AUASB, MAASB, NBA; *Accounting Firms:* BDO, BT, CHI, DTT, GTI, MSUK, PWC; *Member Bodies and Other Professional Organizations:* ACCA, CICPA, EFAA, FACPE, FAR, FEE, FSR, IBR-IRE, ICAEW, ICAN, ICPAI, NYSSCPA, PICPA, SMPC

<sup>67</sup> *Accounting Firms:* DTT, MAZARS; *Preparers:* NN; *Member Bodies and Other Professional Organizations:* ICAEW

<sup>68</sup> *Investors and Analysts:* ICGN; *Regulators and Oversight Authorities:* EAIG, *NSS:* HKICPA; *Accounting Firms:* BT, PP, RSM; *Public Sector Organizations:* AGA, AGO, ECA; *Preparers:* CFOF, Gof100A, SPL; *Member Bodies and Other Professional Organizations:* AIA, CalCPA, DNR, FACPCE, NYSSCPA

<sup>69</sup> *Investors and Analysts:* EUMEDION, IMA; *Regulators and Oversight Authorities:* EBA, ESMA, IAIS, IRBA; *Accounting Firms:* BDO; *Member Bodies and Other Professional Organizations:* NYSSCPA, SAICA

## **B. Drafting Team Recommendations**

45. DT-570 notes the mixed views in relation to firstly whether the statement was appropriate to include in the auditor's report and, if so, whether such a statement should be made regardless of whether a MU had been identified. DT-570 also notes the recommendation to no longer require reporting on the appropriateness of management's use of the GC basis of accounting or reporting when no MU had been identified, an only requiring exception-based reporting when a MU has been identified makes the statement less relevant than originally intended.
46. However, DT-570 believes that there is merit to the message the IAASB intended to be conveyed by this statement is therefore of the view that including such a statement in the auditor's report, as it is fundamental to the premise of the auditor's work in accordance with ISA 570, is useful. DT-570 is therefore proposing that reference to the fact that the auditor cannot guarantee an entity's ability to continue as a GC be made in the Auditor's Responsibilities section of the auditor's report (see paragraphs 47–50).

### **Matter for CAG Consideration**

3. Representatives are asked whether they agree with DT-570's recommendations to convey the message intended in the ED with respect to the inclusion of the "guarantee" statement in the Auditor's Responsibilities section of the auditor's report.

## **V. Other Areas Considered by the Drafting Team**

### **A. Enhancements to the Descriptions of the Responsibilities of the Auditor and Management**

47. Based on the feedback as discussed, certain respondents proposed alternative wording for the statements proposed under Question 9 and under Question 10 of the ED, as well as alternative approaches to including such information in the auditor's report, to address the concerns they had identified. DT-570 has considered these recommendations. Some of these suggestions focused on addressing calls for greater transparency about the respective responsibilities for GC.

#### *Drafting Team Recommendation*

48. Recognizing the IAASB began its efforts in relation to enhanced reporting on GC in response to calls to focus on the auditor's responsibilities in this important area, DT-570 is of the view that additional language in both the Auditor's Responsibilities and Management's Responsibilities sections of the auditor's report could be useful to draw attention to the auditor's work in relation to GC. This language would be included in all auditor's reports (irrespective of whether a MU was identified or not). The aim of these statements is to:
  - Highlight management's responsibilities for GC, in particular the responsibility for the determination of the appropriateness of the GC basis of accounting in preparing the financial statements, and provide background information about when that basis of accounting is appropriate.
  - Highlight the auditor's responsibility in accordance with proposed ISA 570 (Revised) to conclude, based on the audit evidence obtained, whether there is a MU about the entity's ability to continue as a GC.

- Acknowledge that the absence of any reference to MU in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a GC.
49. These changes would necessitate changes to the requirements in proposed ISA 700,<sup>70</sup> which would be further considered by the IAASB at its June 2014 meeting at the same time that changes to proposed ISA 570 (Revised) are considered.
50. DT-570 has explored, on an initial basis, what the proposed wording might entail, taking into account the illustrative wording in the ED. This initial thinking in Appendices 1 and 2 of this paper, but is subject to further change.

**Matter for CAG Consideration**

4. Representatives are asked to provide feedback on DT-570's recommendation as to whether it may be appropriate to include wording related to GC in the Management's Responsibilities and Auditor's Responsibilities sections of the auditor's report.

**B. Other Suggestions Noted in the Responses to the ED**

51. Five respondents<sup>71</sup> suggested education of the users of the financial statements as a means to overcome user misunderstanding of the auditor's report, four of whom made the comment specifically in response to the question on GC and one who spoke in general terms. DT-570 and Staff intend to give further thought to how best to do so as part of consideration of an overall "roll-out plan" for 2015 in support of the new and revised auditor reporting standards and what they may look like.
52. Four respondents suggested that a representation from management should be obtained to enable the auditor to make the proposed statements in the auditor's report.
53. A few respondents spoke to legal implications of the statements, including potential conflict with existing laws and political implications in various jurisdictions and whether such statements would or would not help in respect of auditor litigation.
54. Four respondents suggested consideration of the threshold used in respect of GC, four respondents expressed issues with wording within the proposed ISA, three respondents thought the GC disclosures would affect the cost of performing an audit and six respondents suggested consideration of the discussion in the Sharman Report.

**C. Enhancing Disclosures Related to GC**

55. DT-570 acknowledges that the IAASB initially considered auditor reporting on GC to respond to calls from investors and other for more "early warnings" in relation to GC. While DT-570 is of the view that disclosures relating to GC are firstly the responsibility of management and those charged with governance, DT-570 believes there may be a role for auditors to play in considering those disclosures.

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<sup>70</sup> Proposed ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

<sup>71</sup> ACCA, DA, DJuvenal, ICAEW, JSE

56. Specifically, paragraph 26 of proposed ISA 570 (Revised) requires the following:

Unless all those charged with governance are involved in managing the entity, the auditor shall communicate with those charged with governance events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern. Such communication with those charged with governance shall include the following:

- (a) Whether the events or conditions constitute a material uncertainty;
- (b) Whether management's use of the going concern basis of accounting is appropriate in the preparation of the financial statements; and
- (c) The adequacy of related disclosures in the financial statements.

57. DT-570 is of the view that the discussion of the adequacy of related disclosures with TCWG could be seen as not only requiring discussion of disclosures relating to any MU that had been identified, but also in relation to the auditor's consideration of whether the financial statements adequately disclose any events or conditions that may cast significant doubt on the entity's ability to continue as a GC. US auditing standards for private companies specifically establish a requirement for auditors to consider the need for additional disclosures in circumstances where the auditor concludes that a MU does not exist due to management's plans to mitigate certain events or conditions.<sup>72</sup>

58. DT-570 also noted that the auditor is required by proposed ISA 700 (Revised)<sup>73</sup> to evaluate whether, in view of the requirements of the applicable financial reporting framework, among other things, whether:

- The information presented in the financial statements is relevant, reliable, comparable, and understandable;
- The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and
- In the case of a fair presentation framework, whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.

59. Accordingly, DT-570 is of the view that there may be opportunities within the application material in either proposed ISA 570 (Revised) or proposed ISA 700 (Revised) to explain more about what disclosures in the financial statements related to GC are intended to achieve and matters the auditor may consider in evaluating their adequacy. DT-570 intends to give this further consideration

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<sup>72</sup> AUC-570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, paragraph 13, states: "When the auditor concludes, primarily because of the auditor's consideration of management's plans, that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time has been alleviated, the auditor should consider the need for, and evaluate the adequacy of, disclosure of the principal conditions or events that initially caused the auditor to believe there was substantial doubt. The auditor's consideration of disclosure should include the possible effects of such conditions or events, and any mitigating factors, including management's plans."

<sup>73</sup> Proposed ISA 700 (Revised), paragraphs 13–14. Additional application material to support these requirements is being proposed as part of the Disclosures project ([see Agenda Items H and H.1](#)).

as it develops revisions to proposed ISA 570 (Revised) for discussion at the June 2014 IAASB meeting.

## Draft – Extract from the Auditor’s Report when No Material Uncertainty Identified<sup>74</sup>

### Responsibilities of [Management and Those Charged with Governance or other appropriate terms] for the Financial Statements (paras. 32–34 of proposed ISA 700 (Revised))

Management is responsible for the preparation and fair presentation of these financial statements, in accordance with IFRSs,<sup>75</sup> and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. **Management is also responsible for determining the appropriateness of the use of going concern basis of accounting in the preparation of these financial statements. The use of this 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.**

[Those charged with governance] are responsible for overseeing the Company’s financial reporting process.

### Auditor’s Responsibilities for the Audit of the Financial Statements (paras. 35–40 of proposed ISA 700 (Revised))

The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

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<sup>74</sup> The draft wording presented in this appendix, highlighted in green, is for illustrative purposes only to demonstrate the extent of additional text to the Auditor’s Responsibilities and Management Responsibilities sections. The recommended wording is still in the process of being considered by DT-570.

<sup>75</sup> Where management’s responsibility is to prepare financial statements that give a true and fair view, this may read: “Management is responsible for the preparation of financial statements that give a true and fair view in accordance with IFRSs, and for such ...”

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Obtain sufficient appropriate audit evidence and conclude regarding the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether 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. If we determine that a material uncertainty exists, we are required to discuss this in our auditor's report. However, the auditor cannot guarantee an entity's ability to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We are required to communicate with [*those charged with governance*] regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We are also required to provide [*those charged with governance*] with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

## Appendix 2

### Draft – Extract from the Auditor’s Report when a Material Uncertainty Identified<sup>76</sup>

#### **Material Uncertainty Relating to Going Concern**

We draw attention to Note 6 in the financial statement, 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 liabilities exceeded its total assets by YYY. As stated in Note 6, these conditions, along with other matters as set forth in Note 6, indicate the existence of a material uncertainty that may cast doubt on the Company’s ability to continue as a going concern. Our opinion is not modified in respect of this matter.

#### **Responsibilities of [Management and Those Charged with Governance or other appropriate terms] for the Financial Statements** (paras. 32–34)

Management is responsible for the preparation and fair presentation of these financial statements, in accordance with IFRSs,<sup>77</sup> and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. **Management is also responsible for determining the appropriateness of the use of going concern basis of accounting in the preparation of these financial statements. The use of this 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.**

[Those charged with governance] are responsible for overseeing the Company’s financial reporting process.

#### **Auditor’s Responsibilities for the Audit of the Financial Statements** (paras. 35–40)

The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as

<sup>76</sup> The draft wording presented in this appendix, highlighted in green, is for illustrative purposes only to demonstrate the extent of additional text to the Auditor’s Responsibilities and Management Responsibilities sections. The recommended wording is still in the process of being considered by DT-570.

<sup>77</sup> Where management’s responsibility is to prepare financial statements that give a true and fair view, this may read: “Management is responsible for the preparation of financial statements that give a true and fair view in accordance with IFRSs, and for such ...”

fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Obtain sufficient appropriate audit evidence and conclude regarding the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether there is a material uncertainty about the entity's ability to continue as a going concern. If we determine that a material uncertainty exists, we are required to discuss this in our auditor's report. However, the auditor cannot guarantee an entity's ability to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We are required to communicate with [*those charged with governance*] regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We are also required to provide [*those charged with governance*] with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.