National Audit Office

The UK's independent public spending watchdog

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Tom Seidenstein
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Dear Tom,

PROPOSED INTERNATIONAL STANDARD ON AUDITING 570 - GOING CONCERN

We welcome the opportunity to comment on your consultation on the exposure draft for a new proposed International Standard on Auditing (ISA) 570 on going concern.

We are supportive of the overall objective of the standard setter in revising ISA 570, to strengthen the auditor's evaluation of management's assessment of going concern where this is an appropriate response to going concern risk and to enhance transparency with respect to the auditor's responsibilities and work related to going concern.

We are also responding to the consultation from the perspective of auditing in the UK public sector, although we are aware that colleagues from other Supreme Audit Institutions face similar challenges and share some of the concerns that are articulated within this response.

Whilst responding to the specific questions in the consultation, we also feel that it is helpful to set out the context in which going concern is considered within the UK public sector. We are also aware that a similar context applies in other jurisdictions.

Going concern in the UK public sector context

The Comptroller and Auditor General (C&AG)'s audit mandate is largely focussed on the audit of UK central government, although the C&AG does have a wider role in setting the Code of Audit Practice applicable within local government in the UK.

UK central government departments and associated bodies classified to central government are required to prepare their financial statements in accordance with International Accounting Standards (IAS) (UK) which have been further adapted by the UK's finance ministry (HM Treasury) within their Government Financial Reporting Manual (FReM) to reflect the UK public sector context. Similar adaptations to IAS (UK) have been made by the standard setters for local government within the UK.

HM Treasury's FReM interprets paragraphs 25 and 26 of *IAS 1 – Presentation of Financial Statements* in relation to going concern as follows:

- "*for non-trading entities, the anticipated continuation of the provision of a service in the future, as evidenced by inclusion of financial provision for that service in published documents, is normally sufficient evidence of going concern. However, a trading entity needs to consider whether it is appropriate to continue to prepare its financial statements on a going concern basis where it is being, or is likely to be, wound up,*

- *Sponsored entities whose statements of financial position show total net liabilities should prepare their financial statements on the going concern basis unless, after discussion with their sponsors, the going concern basis is deemed appropriate, and*
- *Where an entity ceases to exist, it should consider whether or not its services will continue to be provided (using the same assets, by another public sector entity) in determining whether to use the concept of going concern for the final set of financial statements."*

Most public sector entities within the UK are non-trading. The interpretation above therefore means that for these entities, an evaluation of their going concern status is not predicated upon the ability of the entity to continue to trade or whether there is an intention to liquidate the entity but is instead predicated upon whether the services provided by the entity will continue to be provided in the future either by the entity itself or a different entity.

The UK's Financial Reporting Council (FRC) has worked together with the Public Audit Forum (PAF) which is chaired by the UK NAO to issue *Practice Note 10: Audit of financial statements and regularity of public sector bodies in the United Kingdom*. Practice Note 10 provides guidance on how to apply the ISAs (UK) in the public sector context. In relation to ISA (UK) 570 there is extensive guidance on how to apply extant *ISA (UK) 570 – Going Concern*, particular in relation to the continued provision of service adaptation of the financial reporting framework noted above.

Our response is therefore focussed on the perspective of ensuring that auditors within the UK public sector can take a proportionate approach to considering going concern in the context of the financial reporting framework in which the UK public sector is preparing their financial statements. This reflects the view that the risks surrounding going concern are more focussed and limited when the continued provision of service approach is followed. We have therefore focussed our response on the questions within your consultation document which relate to these matters.

We acknowledge that in arriving at this outcome it will be necessary to revise *Practice Note 10: Audit of financial statements and regularity of public sector bodies in the United Kingdom* to reflect the revised standard as we remain broadly supportive of the proposed revisions in the context where the continued provision of service approach does not apply. To achieve this objective, we consider that the proposed standard needs to give greater prominence to considering the requirements of the financial reporting framework in relation to going concern and allowing the auditor to tailor their responses to the risks inherent in the financial reporting framework.

Question 1 - Do you agree that the proposals in ED-570 are responsive to the public interest, considering the qualitative standard-setting characteristics and project objectives that support the public interest as set out in Appendix 1?

We believe that the proposals in ED-570 are responsive to the public interest in the commercial sector context, strengthening the auditor's evaluation of management's assessment of going concern where it is appropriate to do so.

The additional transparency provided by the proposed changes to auditor reporting in paragraph 33 to 37, will also help to ensure that the users of the financial statements have an enhanced understanding and expectation of the work performed by auditors in relation to going concern.

In the context of the UK public sector where, for most entities, the definition of going concern in the financial reporting framework is predicated upon continuation of provision of service rather than on liquidity, a key concern of the users of the financial statements is to ensure that the auditor's work in relation to going concern is proportionate and focussed on the risks to continuation of service provision. The auditor's mandate generally provides for a separate consideration of matters related to financial sustainability upon which, we report extensively through separate reporting mechanisms.

In this context, we consider that the proposed standard could be more explicit in requiring the auditor to perform both risk assessment procedures and their evaluation of management's assessment of going concern in the context of the definition of going concern provided within the financial reporting framework.

We do not consider that the requirements set out in Paragraphs 12(b) and 12(c) of ED-570 are relevant when the financial reporting framework requires the financial statements to be prepared on a going concern basis predicated upon the continued provision of service.

Furthermore, the requirements for understanding the entity's system of internal control in relation to going concern within paragraphs 12(g) to 12(i) of ED-570 could benefit from the addition of scalability guidance within the application guidance for the circumstances where going concern is simple and therefore management's controls addressing going concern risk are proportionate to that risk. Such application guidance could provide examples of what the auditor must consider when, for example, reviewing management's risk assessment process over going concern risks, where going concern risk is minimal in the context of the financial reporting framework.

We believe that giving greater prominence to the auditor's understanding of the requirements of the applicable financial reporting framework relating to going concern would achieve many of these aims by allowing the auditor to focus on this first. We would therefore be supportive of introducing the material in paragraphs 12(d) and 12(e) in ED-570 as a separate whole paragraph ahead of the current paragraph 12.

Alternatively, an option would be to add public sector application guidance associated with paragraphs 11 to 15 which set out some of the context of the financial reporting frameworks applicable in the public sector and noting that the auditor should tailor their risk assessment procedures required by paragraphs 11 to 15 to reflect the definition of going concern within financial reporting frameworks applied in the public sector context.

Question 2 - Do you believe that the proposals in ED-570, considered collectively, will enhance and strengthen the auditor's judgments and work relating to going concern in an audit of financial statements, including enhancing transparency through communicating and reporting about the auditor's responsibilities and work?

The proposals set out within ED-570 are broadly similar to the change made to ISA (UK) 570 by the UK's FRC in 2019. We have found these changes to be beneficial in strengthening the auditor's evaluation of management's assessment of going concern where it is appropriate to do so. The changes to auditor reporting have also helped to increase understanding amongst users of the financial statements of the auditor's responsibilities and work on going concern. We are therefore supportive that the proposed changes will achieve this aim.

Question 3 - Do you believe the proposed standard is scalable to entities of different sizes and complexities, recognizing that general purpose financial statements are prepared using the going concern basis of accounting and that going concern matters are relevant to all entities?

For the UK public sector, a key consideration of the users of the financial statements is that the auditor's work on going concern is proportionate to the risk inherent in the financial reporting framework. As noted above, this risk is limited for most entities within the UK public sector where the financial statements are prepared on a going concern basis provided that the services provided by the entity will continue into the future. Given that there is significant public interest in this, we have included much of the consideration of scalability in our response to question 1. We believe that additional application guidance is needed for when this is the case and have expanded on this further in our response to question 9 below.

The application guidance provided within ED-570 provides helpful guidance on scalability, which we welcome. We are particularly supportive of the continued inclusion of the example on The Applicable Financial Reporting framework within paragraph A13. However, it would be helpful if this example and many of these others given had greater prominence rather than being included as bullet points within an examples box.

Paragraph 19 of ED-570 requires the auditor to perform some specific procedures in relation to management's assessment of going concern. We consider that some of the required procedures detailed here may not be applicable or indeed achievable where management's assessment of going concern is simple due to the limited risk to the entity. This is particularly relevant in the context of the continued provision of service approach to going concern applied extensively in the UK public sector.

Question 5 - Do you support the definition of Material Uncertainty (Related to Going Concern)? In particular, do you support the application material to the definition clarifying the phrase "may cast significant doubt"?

We are supportive of the proposed definition of Material Uncertainty (Related to Going Concern) as set out with paragraph 10 of ED-570. It is helpful that this definition links to concepts such as the magnitude of potential impact and likelihood of occurrence which are present in *ISA 315 – Identifying and Assessing the Risk of Material Misstatement*. This will help auditors interpret this definition using concepts that are already well understood. We can also see that this definition could drive more consistency in the identification of material uncertainties in relation to going concern by auditors.

The current specific guidance required for the UK public sector context and issued as guidance under the UK auditing standards, is consistent with the application material related to the definition of a material uncertainty on going concern in the ED-570.

Question 6 - Does ED-570 appropriately build on the foundational requirements in ISA 315 (Revised 2019) in addressing risk assessment procedures and related activities, to support a more robust identification by the auditor of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern?

We consider that ED-570 appropriately builds upon the foundational requirements in ISA 315 (Revised 2019) to support a robust identification by the auditor of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. The structural link from paragraphs 11 to 15 to the structure in ISA 315 should help firms to build these requirements into their methodologies and software.

Question 8 - Do you support the enhanced approach in ED-570 that requires the auditor to design and perform audit procedures to evaluate management's assessment of going concern in all circumstances and irrespective of whether events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern?

We agree with the principle that the auditor should always design and perform audit procedures to evaluate management's assessment of going concern, irrespective of whether events or conditions have been identified that may cast significant doubt on the ability of the entity to continue as a going concern.

In circumstances where going concern risk is limited or restricted to when events or conditions occur, such as where the continued provision of service approach is applied in the UK public sector, the procedures performed by the auditor should reflect this limited risk. We consider that paragraph A31 in the application guidance provides sufficient guidance to adopt a more proportionate approach in these circumstances. However, it would be helpful to include an example of a simpler scenario which did not refer to reviewing cash flow forecasts, as this is not as relevant in the public sector context where the continued provision of service approach applies.

Question 9 - Does ED-570 appropriately incorporate the concepts introduced from ISA 540 (Revised) for the auditor's evaluation of the method, assumptions, and data used in management's assessment of going concern?

Paragraph 19 of ED-570 seeks to incorporate concepts introduced in ISA 540 (Revised) into the auditor's evaluation of going concern. We are supportive of this approach for most financial reporting frameworks where going concern is assessed based upon liquidity and other associated measures. In this context, using the framework in ISA 540 (Revised) to evaluate and review management's forecasts and models is sensible and applies a methodology with which auditor's should already be familiar. It also allows auditors to more explicitly consider consistency of assumptions applied in the going concern assessment with assumptions made elsewhere by management in the preparation of the financial statements.

In the context of the UK public sector, where the definition of going concern is largely predicated upon continued provision of service, we consider that the biggest driver of material uncertainty on going concern will not be liquidity but will instead be government policy change. In such circumstances, we do not consider that it will be necessary for management to prepare detailed forecasts, models or estimates to support their assessment of going concern.

The retention of paragraph A30 in ED-570 is key in this context, in highlighting that where management has not prepared a detailed forecast and going concern is simple, then there is no need for the auditor to either to request management to do so or to construct one themselves as it may be possible to evaluate management's assessment of going concern purely on the basis of a simple assessment. We are supportive of the retention of this paragraph within the application guidance.

We also welcome the scalability content included within paragraph A38 of ED-570. However, this paragraph does not currently provide guidance on the circumstances where management does not provide a forecast, model or calculation to support their going concern assessment. In such circumstances and where the going concern assessment can be simple, we consider that it is possible for the auditor to conclude on going concern without performing the procedures required by paragraph 19aii and 19bii of ED-570.

Question 10 - Do you support the enhanced requirements and application material, as part of evaluating management's plans for future actions, for the auditor to evaluate whether management has the intent and ability to carry out specific courses of action, as well as to evaluate the intent and ability of third parties or related parties, including the entity's owner-manager, to maintain or provide the necessary financial support?

We welcome the enhanced requirements and application material, as part of evaluating management's plans for future actions, for the auditor to evaluate the intent and ability of third parties or related parties to maintain or provide necessary financial support. These requirements will address a risk which may have previously existed of auditors seeking to rely on a letter of support provided by a third party without adequately considering whether that third party were able to provide this support.

We consider that there are some particular UK specific considerations in how these requirements are applied to support provided by UK government entities to companies and other entities, given that the UK's constitutional requirements limits the ability of UK government bodies to provide such support without the consent of the UK Parliament. However, we believe that these nuances may be considered separately within the UK's national implementation of the standard.

Question 13 - Do you support the requirements and application material that facilitate enhanced transparency about the auditor's responsibilities and work relating to going concern, and do they provide useful information for intended users of the audited financial statements? Do the proposals enable greater consistency and comparability across auditor's reports globally?

The requirements and application material included in paragraphs 33 to 37 of ED-570 are broadly consistent with the reporting requirements on going concern introduced in the UK under the revised ISA (UK) 570 in 2019. Experience in the UK context has shown that they have been helpful for the users of the financial statements in providing an enhanced understanding of the auditor's responsibilities and an understanding of the work performed by the auditor to consider going concern. We are therefore supportive of these proposals as they should help to facilitate greater consistency and comparability across auditor's reports globally.

Question 14 - Do you support the requirements and application material that facilitate further enhanced transparency about the auditor's responsibilities and work relating to going concern? Should this be extended to also apply to audits of financial statements of entities other than listed entities?

The additional requirements and application material included in paragraphs 33 to 37 of ED-570 for listed entities are broadly consistent with the reporting requirements on going concern introduced in the UK under the revised ISA (UK) 570 in 2019. Experience in the UK context has shown that they have been helpful for the users of the financial statements of listed entities in providing an enhanced understanding of the auditor's responsibilities and an understanding of the work performed by the auditor to consider going concern.

We would also consider that there are large entities of public interest which are not listed where these requirements may be beneficial. It may therefore be helpful to add application guidance material to encourage the auditor to include these disclosures within their auditor's report for other entities where this may be beneficial to the users of the financial statements.

Question 15 - Is it clear that ED-570 addresses all implications for the auditor's report relating to the auditor's required conclusions and related communications about going concern (i.e., auditor reporting is in accordance with ED-570 and not in accordance with ISA 701 or any other ISA)?

We consider that ED-570 adequately addresses most of the implications for the auditor's report relating to going concern.

We are also pleased to note the introduction of paragraph A85 within the application guidance in ED -570 which provides clear guidance that the auditor may decide to include an emphasis of matter to highlight the basis of preparation of accounting in the circumstances where the financial statements have been prepared by a management on a basis other than going concern, but the auditor has determined that this basis of accounting is appropriate. This is an area where there has previously been divergence of practice in reporting, so this clarification is helpful in this context.

It would however be helpful if paragraph A85 could be further expanded to provide guidance on how to modify or not the Going concern section of the auditor's report in the circumstance described above where the financial statements have been prepared by a management on a basis other than going concern, but the auditor has determined that this basis of accounting is appropriate.

Question 16 - Are there any other matters you would like to raise in relation to ED-570?

Financial Sustainability in the public sector

Paragraph A66 has been included within ED-570 as relevant guidance for the public sector context. Given the financial reporting framework used in the UK public sector and other jurisdictions, we do not find this paragraph helpful as it may cause confusion between separate auditor responsibilities for going concern in the audit of the financial statements and for considering matters related to financial sustainability which are considered elsewhere within the audit mandate.

The assessment of going concern for most entities within the UK public sector is simple and based upon the continued provision of services and not financial sustainability. Consequently, the level of disclosure within public sector financial statements in the UK reflects this and is less extensive than you might expect for equivalent organisations (for example listed entities and public interest entities) operating in the private sector. We therefore do not consider this either to be helpful or applicable in the UK public sector context.

Furthermore, given that the definition of going concern given in the financial reporting framework for most UK public sector entities is not linked in any way to financial sustainability, we feel that it is unhelpful to include a reference to financial sustainability within the going concern standard where it is not directly relevant. There is a risk that this reference may lead to excess work and reporting of financial sustainability issues within the context of going concern where within the UK public sector the auditor has a separate statutory responsibility to report on financial sustainability matters.

General purpose financial statements where going concern is not a relevant concept.

The C&AG is appointed as auditor for a small number of general-purpose financial statements which are effectively funds or which relate to specific activity performed by government rather than a specific entity. The financial reporting framework for these financial statements is silent as to whether the concept of going concern applies to them or indeed whether they should be prepared on a going concern basis.

Given the context of these financial statements, the concept of going concern can seem abstract, irrelevant, and not helpful to the users of the financial statements and in practice, the only consideration of going concern is being undertaken by the auditor.

We therefore consider that it would be helpful to add a clarification to ED-570 that where a set of financial statements are prepared for a general purpose but do not relate specifically to the activities of an entity, then the work to be performed by an auditor to address going concern, does not need to apply all the elements of ISA 570.

Question 17 – General Comment / Effective Date

The consultation document notes that the IAASB believe that an appropriate effective date for the standard would be 18 months after the approval of the final standard. We agree that this is a sensible timeframe and would consider 18 months to be the minimum necessary period to successfully implement the standard within the UK public sector. Given the significance of the application guidance provided to the UK public sector through the UK's Financial Reporting Council, a significant adoption period should be factored in to allow for the necessary activity which will include:

- UK Financial Reporting Council to embed the changes in the standard within ISA (UK) 570, with a full public consultation process.
- UK Public Audit Forum to amend and issue a revised Practice Note 10 to reflect the final changes to ISA (UK) 570
- Consequential amendments to local auditing codes for specific sub-sectors to be made following the Practice Note 10 revised.
- Audit firms to implement the changes made to the guidance within their methodologies and roll-out training to staff.

We hope that you find this response helpful. We would be more than happy to arrange a further conversation on any of the detail within this response.

Yours sincerely

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