

ISA 570 (Revised) Going Concern

A summary of the major changes of the impacts for audits of financial statements for periods starting on or after 15 December 2019

Background

In late 2019 the Financial Reporting Council issued revisions to International Standard on Auditing (ISA) (UK) 570 'Going Concern'. The revisions to the standard were prompted by concerns about the quality of audit, following the demise of large companies such as Carillion and BHS. The revisions reinforce the need for "professional scepticism" in this complex area of auditing and increase the work auditors are required to do when assessing whether an entity is a going concern. As a result of the revisions UK auditors will follow significantly stronger requirements than those required by current international standards.

ISA (UK) 570 is effective for audits of financial statements for periods commencing on or after 15 December 2019 and so comes at a time when many entities are grappling with the difficulties of assessing the significant impacts of COVID-19 on business.

Changes

The revised standard requires:

- Greater work on the part of the auditor to challenge management's assessment of going concern, thoroughly test the adequacy of the supporting evidence, evaluate the risk of possible bias in the preparation of management's assessment, and make greater use of the viability statement (where applicable);
- Improved transparency with changes to audit reports to include more positive statements and a new reporting requirement for auditors of public interest entities, listed and large private companies to provide a clear, positive conclusion on whether management's assessment is appropriate, and to set out the work they have done in this respect; and
- A "stand back" requirement for auditors to consider all of the evidence obtained, whether corroborative or contradictory, when the auditor draws their conclusions on going concern.

Going Concern

When preparing financial statements, management must assess whether an entity is a 'going concern'. This assessment will typically involve looking at trading forecasts and projections, cash flow forecasts, liquidity, the availability of finance and any other relevant matters.

Under most financial reporting frameworks management must disclose, where applicable, where financial statements have not been prepared on a going concern basis or the existence of material uncertainties that may cast significant doubt on going concern. The revisions to the auditing standard help focus auditor work towards the identification of possible material uncertainties.

Greater challenge

The revised standard introduces a new term "Management bias" to the lexicon of the ISAs. Management bias is defined as "a lack of neutrality by management in the preparation of information". The introduction of the new term demonstrates one of the objectives of the standard setters when the revisions were made, namely that of ensuring that auditors are appropriately sceptical, fair and challenging when performing their evaluation of management's going concern assessment.

The revised standard makes more prescriptive requirements on the auditor in their work in the evaluation of management's going concern assessment. More work is now prescribed in areas such as:

- The evaluation of methods used by management in their going concern assessment and changes from prior years
- The evaluation of the relevance and reliability of the underlying data used by management
- The evaluation of the assumptions made by management in their assessment

- The evaluation of management’s plans for future actions and consideration of whether these are feasible and likely to improve the going concern situation

Improved transparency

For all companies there is a requirement for the auditor to make a positive statement in their report that they have not identified a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. The audit report will also include a conclusion that management’s use of the going concern basis of accounting in the preparation of the entity’s financial statements is appropriate.

For auditors of public interest entities, listed and large private companies there is a new reporting requirement for to provide a clear, positive conclusion on whether management’s assessment is appropriate, and to set out the work they have done in this respect.

These new reporting requirements will likely necessitate the performance of additional audit work to ensure that auditors can make these statements.

“Stand back” requirement

The new standard includes the require for auditors to evaluate the sufficiency and appropriateness of the audit evidence they have obtained. Commentators have termed this the “stand back” requirement.

In summary the standard requires auditors to consider all of the evidence obtained, whether corroborative or contradictory, when they draw their conclusions on going concern. This requirement is designed to require auditors to evaluate the quantity and quality of their audit evidence while considering carefully both corroborative and contradictory evidence as well as the risk of “management bias”. While this process would have been best practice under the old version of the audit standard, the requirement is now mandated and necessary steps in the process prescribed, therefore increasing the work and documentation obligations placed on auditors.

Conclusions

The new requirements have been in development for some time, but the timing of their introduction is unfortunate as many entities are currently devoting significant amounts of time navigating the uncertain economic environment post COVID-19. Likewise, auditors have devoted much time in current financial reporting processes to assessing going concern risks under the old audit standard, the revisions will increase the time burden.

Despite the unfortunate timing, the new requirements are positive and likely to be welcomed by investors and other users of financial statements as work on going concern and related disclosures will be more comprehensive, balanced and robust.

To prepare for the increased requirements while meeting reporting timeframes, management should liaise with audit teams early in the audit process to set out the detail and evidence behind their going concern assessments. Management should prepare in advance and be ready to provide support and evidence for all material assumptions, judgements and estimates made in their going concern assessments.

Both the ICAEW and FRC have provided useful guidance on preparing Going Concern assessments to Directors and preparers of financial statements at:

<https://www.icaew.com/technical/financial-reporting/uk-gaap/uk-gaap-faqs/coronavirus-going-concern-considerations-a-guide-for-preparers>;

<https://www.frc.org.uk/covid-19-guidance-and-advice> and;

<https://www.frc.org.uk/getattachment/0acd1390-a3dd-4f7b-9737-678348542446/Guidance-on-the-Going-Concern-REVISED-WEB-READY-2016.pdf>

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