CHAPTER 1

Enhanced requirements proposed for going concern assessment

This article aims to:

- Provide an overview of the proposed revisions to the auditing standard on going concern (ISA 570).

Introduction

Going concern is a fundamental principle in the preparation of financial statements. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded in a manner that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

In assessing whether the going concern assumption is appropriate, management assesses all available information about the future for at least, but not limited to, 12 months from the reporting date. The International Accounting Standard (IAS) 1, *Presentation of Financial Statements* also prescribes certain disclosures related to going concern[1].

Additionally, as per the International Standard on Auditing (ISA) 570 (Revised)[2], *Going Concern*, auditors are required to obtain sufficient appropriate audit evidence regarding, and conclude on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements. Based on this audit evidence, the auditors are required to conclude whether a material uncertainty exists about an entity's ability to continue as a going concern.

New development

Corporate failures across the globe and economic uncertainties have emphasised the need for a more robust standard and enhanced transparency about the auditor's responsibilities and work related to going concern. Accordingly, in April 2023, the International Auditing and Assurance Standards Board (IAASB) issued an exposure draft of ISA 570 (Revised 202X) (ED-570) which proposes greater transparency with regard to going concern. The ED-570[3] augments the risk assessment procedures, draws on a wider range of information (including external or third-party information) to obtain sufficient and appropriate audit evidence, enhances the use of professional skepticism and requires more transparency and communication.

In this article, we will provide an abstract of the key revisions proposed in ED-570.

1. These disclosures mainly pertain to cases where events or conditions have been identified which may cast a significant doubt on an entity's ability to continue as a going concern. In such a case, the management may conclude that (a) there are no material uncertainties on an entity's ability to continue as a going concern (close call) or (b) there are material uncertainties on an entity's ability to continue as a going concern (material uncertainty).
2. ISA 570 was last revised in January 2015.
3. The comment period for ED-570 ended on 24 August 2023.

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Key revisions proposed in ISA 570

The key revisions to ISA 570 are given below:

Risk identification and assessment

The ED-570 prescribes a vigorous approach for performing risk assessment procedures that go beyond inquiry and discussion. These procedures would build on the foundational requirements in ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment,* and enable auditors to perform risk assessment from a going concern lens. This includes understanding the entity and its environment, the applicable financial reporting framework and the entity's system of internal control. Where fraud risks have been identified, ED-570 requires the auditors to consider and address these in accordance with ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements.*

Such risk assessment procedures would facilitate timely identification of events or conditions that may cast a significant doubt on an entity's ability to continue as a going concern (events or conditions).

Management's going concern assessment

Timeline over which management's going concern assessment is being made

One of the significant changes proposed in ISA 570 is a change in the commencement date of the period of managements' going concern assessment. Management is now required to perform a going concern assessment for a minimum period of 12 months from the ***date of approval of the financial statements.*** The current ISA 570 requires the management to perform a going concern assessment for a minimum period of 12 months from the date of financial statements.

Some jurisdictions globally[4] have already adopted such a commencement date, accordingly, this change would aid to align the global practice and thus abet comparability and consistency among jurisdictions. It would also benefit users of financial statements, as management's going concern assessment would be based on more current information, and from a date when management and Those Charged With Governance (TCWG) have taken responsibility for the financial statements.

4. These include the United Kingdom, Australia and New Zealand

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Extension of management assessment and consequences of management unwillingness

Where management's going concern assessment is for a period which is lesser than 12 months, the auditor would need to request the management to extend such assessment to at least 12 months. In case the management is unwilling to extend its assessment, ED-570 has stipulated certain revised procedures. It has been proposed that the auditor would need to discuss with management or TCWG (when appropriate) regarding the rationale for such unwillingness.

Where management or TCWG are able to provide additional information to support the appropriateness of their use of the going concern basis of accounting[5], the auditor should document the significant judgements related to the appropriateness of the period used by management in its going concern assessment.

However, where the auditor is unable to obtain sufficient appropriate audit evidence that supports the management's use of the going concern basis of accounting due to management's limited going concern assessment, the auditor would need to assess the impact on the audit. This impact could be a change in the risk assessment and planned audit procedures and/or could have implications on the audit report- in terms of a qualification or a disclaimer of opinion.

Evaluating management's assessment of going concern

The ED-570 has augmented the requirement for a robust evaluation of management's going concern assessment, including reviewing and appropriately challenging the method, assumptions and data used by the management to make its going concern assessment[6]. The ED-570 also prescribes additional procedures to be undertaken on management's revised assessment when necessary, if events or conditions exist that the management has not previously identified or disclosed.

In verifying the management's going concern assessment, the auditor should assess the management's plan for future actions[7]. It should be evaluated if the management's plan for future action includes financial support from third parties, related parties or from the entity's owner-manager. In such a case, the **intent and ability** of these parties to maintain and provide the necessary financial support should be evaluated. The auditor may also consider obtaining a **written confirmation** from such parties to obtain sufficient audit evidence.

Where the finance providers refuse to provide such a confirmation, and alternative strategies and sources of finance are not available, then it should be evaluated whether a material uncertainty exists.

Transparency about going concern in the auditor's report

Stakeholders demanded greater transparency of the auditors' work with regard to going concern assessment of an entity[8]. The ED-570 has now addressed this, thereby proposing another significant amendment to ISA 570.

The ED-570 now requires the auditors' report of **all entities** to include an explicit statement (or a section) on going concern. This section would include more information about the nature and extent of the auditor's work as well as the results and any significant findings of the auditor. The heading of this section would be 'Going Concern' where no material uncertainty exists or 'Material Uncertainty related to Going Concern' where material uncertainty exists. Further requirements pertaining to this section, when the auditor's report is not modified in relation to going concern is given in Table 1 on the next page.

5. For example, management's assessment does not cover a period of at least 12 months from the date of approval of the financial statements, however, the entity has profitable operations and no liquidity concerns, and management or TCWG have not identified any events or conditions that may cast significant doubt on the entity's ability to continue as going concern beyond the period of assessment they have chosen.

6. In making such assessment, ISA 540, *Auditing Accounting Estimates and Related Disclosures* should be referred to.

7. When events or conditions are identified, the auditor's conclusion as to whether a material uncertainty exists is dependent on the auditor's evaluation of management's plans for future actions.

8. Additionally, stakeholders had commented that there was lack of clarity with respect to the use of Key Audit Matters (KAM), material uncertainty and emphasis of matter paragraph in the auditor's report.

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Table 1: Explicit statement on going concern in the auditor's report when the auditor's report is not modified in relation to going concern

Particulars	Disclosure requirement in audit reports of	
	Listed entity	Unlisted entity
Going concern section		
Explicit statement on going concern State that the auditor: • Concluded that the going concern basis of accounting is appropriate • Based on the audit evidence obtained, has not identified a material uncertainty	Disclosures required	Disclosures required
Events or conditions identified but no material uncertainty exists (including close call) If events and conditions have been identified but no material uncertainty exists, auditor to make: • A reference to the related disclosures in the financial statements, if any • A description of how the auditor evaluated management's assessment of the entity's ability to continue as a going concern	Disclosures required	Not required (Disclosures may be made on a voluntary basis)
Material uncertainty related to going concern section		
Material uncertainty exists but going concern basis of accounting is appropriate Auditor to state that: • A material uncertainty exists, but going concern basis of accounting is appropriate • Auditor's opinion is not modified • Include a reference to the related disclosures in the financial statements	Disclosures required	Disclosures required
Additional disclosures on material uncertainty A description of how the auditor evaluated management's assessment of the entity's ability to continue as a going concern	Disclosures required	Not required (Disclosures may be made on a voluntary basis)

(Source: KPMG in India's analysis, 2023 read with Proposed International Standard on Auditing 570 (Revised 202X), *Going Concern* and Proposed Conforming and Consequential Amendments to Other ISAs issued by the IAASB in April 2023)

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Where there are inadequate disclosures about a material uncertainty, the auditor is required to express a qualified or adverse opinion (in accordance with ISA 701, *Modifications to the Independent Auditor's Report*). In such a case, the material uncertainty section of the audit report would give reference to the qualification.

Further, in case of a disclaimer of opinion, the going concern or the material uncertainty section would not be required to be inserted in the audit report (which is consistent with the current practice).

Enhanced communication

The ED-570 requires better communication between the auditor and TCWG and with third parties. This is further explained below:

Communication with TCWG: The ED-570 has emphasised on the need for an effective and timely two-way communication between the auditor and TCWG throughout the audit. As a new requirement, the auditors would need to obtain an understanding of how TCWG exercise oversight over management's assessment of going concern. Additionally, they would need to understand from TCWG on what they consider to be identified events and conditions. The auditor would also need to communicate to TCWG when they come across events and conditions and on other matters, such as:

- Adequacy of the disclosures that describe significant judgments made by management and the mitigating factors in management's plans,
- The basis for the auditor's conclusions and an overview of the audit procedures performed, and
- When applicable, management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern.

Communication with external parties: The ED-570 has inserted a new requirement to communicate with appropriate external parties when law, regulation or relevant ethical requirements require or establish responsibilities permitting the auditor to report to an appropriate authority outside the entity.

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Other amendments

Other amendments to ISA 570 include:

- **Clarifying terminology:** The ED-570 has defined certain terms, such as 'Material Uncertainty (Related to Going Concern)', thus minimising the likelihood of varying interpretations and has also clarified the concept of the term 'may cast significant doubt'.
- **Professional skepticism:** The ED-570 has emphasised the need to exercise professional skepticism when performing procedures related to going concern to prevent possible management and auditor bias.
- **Technology:** The ED-570 through its examples of automated tools and techniques reflects the auditor's use of technology to perform the auditor's work related to going concern.

Next steps

The proposed changes to ISA 570 would help to provide greater clarity, as well as enhance the overall approach to auditing the going concern assessment by more closely aligning it with foundational standards. Some of the key considerations for management and members of the audit committee include:

- The amendments have been proposed to ISA 570, however, considering that the Standards on Auditing (SA) issued in India are closely aligned with ISAs, we expect similar amendments to be issued in the SA.
- ED-570 requires management to perform a going concern assessment for a minimum period of 12 months from the date of approval of the financial statements, this would require management to prepare comprehensive business and financial plans for an extended period. The absence of such evaluation and plans or alternative strategies could impact the planned audit procedures, including the auditor's report. ED-570 also clarifies that the auditor would base their assessment based on the evaluation conducted by the management.
- The audit committee would need to be vigilant while they assess the management's going concern assessment, and have a robust oversight over this process. They would also need to actively engage with the auditors to discuss their concerns and expectations of the audit at the beginning of the audit and understand the auditor's observations and issues on a timely basis throughout the course of the audit.
- There is increased stakeholder focus on the risks of climate change, environmental damage and societal issues, which have a close relationship with longer term aspects of 'going concern' considerations. As a result, there would be greater demand for reporting by companies that address their impacts and initiatives in relation to these overarching global concerns as a core feature impacting their market value.

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