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FOR SMES

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Submitted electronically to www.iaasb.org

Brussels, 24 August 2023

Dear Tom,

Response to the International Audit and Assurance Standards Board (IAASB)'s Proposed *International Standard on Auditing 570 (Revised 202X) Going Concern and Proposed Conforming and Consequential Amendments to Other ISAs*

EFAA for SMEs appreciates the opportunity to provide our comments to the IAASB's Proposed International Standard on Auditing 570 (Revised 202X) Going Concern and Proposed Conforming and Consequential Amendments to Other ISAs (ED-570) Our response has been prepared with input from our Assurance Expert Group.

The European Federation of Accountants and Auditors for SMEs (EFAA for SMEs) represents accountants and auditors providing professional services primarily to SMEs both within the European Union and Europe as a whole. Constituents are mainly small practitioners (SMPs), including a significant number of sole practitioners. EFAA's members, therefore, are SMEs themselves, and provide a range of professional services (e.g., audit, accounting, bookkeeping, tax, and business advice) to SMEs. EFAA currently represents 15 national accounting, auditing, and tax advisor organisations with more than 380,000 individual members.

GENERAL COMMENTS

EFAA for SMEs is concerned to ensure that policy, regulation, and professional standards are scalable and proportionate to the capacities of SMPs and their SMEs clients and tailored to the needs and characteristics of SMPs and SMEs.

We greatly appreciate the careful consideration the IAASB has paid to ensure that the proposals are scalable. Nevertheless, we do have some concerns. It is vital that we close, or at least narrow, the expectation gap between public perception and respective responsibilities of management and the auditor. All participants in the financial reporting supply chain have a role to play in helping ensure high-quality financial reporting. We believe some of the proposed revisions will not only prove ineffective in reducing the expectation gap in relation to going concern but rather they might even widen the gap. We are especially concerned that the articulation of the proposed requirements including the auditor's report implies it is the auditor's responsibility to identify events or conditions that cast significant doubt on the ability of an entity to continue as a going concern.

The proposals may also create additional unnecessary work and auditor's report disclosure for all audits, even those where there are minimal risks around going concern or material uncertainties. We wonder whether a more risk-based approach should be applied whereby such additional work and disclosures need only be undertaken if the facts and circumstances lead the auditor, applying their professional judgment, to deem them necessary. The smallest entities that are subject to audits may also struggle to provide some of the information the revisions envision the auditor to have access to as part of their consideration of the appropriateness of management's assessment of going concern, especially where management does not believe there are going concern related issues. We elaborate on these concerns and others in our responses to the questions in the ED below.

OVERALL QUESTIONS

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 generally agree.

We recognize the motivation for the revisions is the incidence of corporate failures and addressing this is in the public interest. We also recognize the significant challenges in defining the public interest and we appreciate that the proposed revisions attempt to manage the expectations of the users of financial statements with improved disclosure of risks in relation to going concern. That said, we believe some of the fundamental issues concerning public interest surrounding going concern relate to the expectation gap between the users' understanding and the actual responsibilities of the auditor. Many believe that auditors are providing assurance on an entity's going concern. This arises from a misunderstanding around the respective responsibilities of management and the auditor in relation to going concern. The revision of ISA 570 presents an opportunity for the IAASB to narrow this gap.

We agree that it is in the public interest to reduce the potential for companies failing soon after the release of financial statements where no going concern issues were identified with some form of "early warning" in the shape of better disclosure of relevant information. We question, however, whether the proposed revisions to the auditor's procedures will prove effective in reducing the likelihood of such failures since they are aimed at improving disclosures and auditor reporting rather than addressing the root causes, namely deficiencies in the corporate reporting ecosystem including the expectation gap. We wonder whether it is useful to have more explanatory commentary in auditor's reports to help mitigate the expectation gap and clarify the intent of audit procedures and what is not possible.

We also note that the proposed language of paragraphs 11 and 33(a)(ii) seems to imply the auditor has a direct responsibility for the identification of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. This may exacerbate the expectation gap and so be contrary to the public interest.

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?

Yes, to some extent.

We believe the proposals will enhance transparency but will have less of an impact on strengthening the auditor's judgments and work in relation to going concern. Reviewing management's assessment of going concern, by its very nature forward looking, demands significant judgment. There are numerous factors that can impact the company's position that are outside of the knowledge and control of management and the auditor at the point in time the financial statements are prepared, and the auditor's report signed. Many things, like extreme weather events, are impossible to predict in advance or address in this standard.

Some auditors are criticized for failing to challenge what management are asserting. However, where the nature of an assertion and its assessment are forward looking, there needs to be a recognition of the difficulty in making a challenge. We wonder whether, in the interests of fostering realistic expectations, it would be useful for the standard to further stress the inherent difficulties in this area and explain the complexity of judgements in relation to going concern. This might be done by way of some illustrative examples.

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?

Yes, to a large extent.

We welcome the fact that this question is being asked (it ought to be a standard question for all projects) and the significant effort made to consider scalability. The application material and the examples given to illustrate differences will be useful for SMPs. However, we are concerned that regulators may interpret such application material as requirements in so doing leaving SMPs exposed to being challenged where none is warranted. Accordingly, it is vital to stress that examples are purely illustrative and are not exhaustive and other conditions may also be relevant for different treatment in SMEs.

While we greatly appreciate the attempts to make the standard scalable, there may still be issues as to relevance. Audit procedures in relation to going concern often rely on the quality of information that management can provide, and for the smallest entities that do not have formal forward reporting or cash flow projections, the availability of the information management can produce will be a barrier.

We note that for smaller entities, the date of the audit may be significantly later than for larger entities in some jurisdictions, which could create practical challenges in view of the proposed new requirement to commence the twelve-month period from date of approval of financial statements.

We suggest that consideration of scalability should not only consider whether the same requirements can be applied to entities of differing sizes but include an assessment as to whether additional requirements will add value if applied in certain situations. The present proposals may result in *significant extra audit work for SME accountants and SMPs who will need to request additional information from their SME clients, but the available information may add very limited if any value to some audits. A risk-based assessment would be more appropriate to adopt as a principle in the revisions. For very small entities, requiring the annual production of the information that the proposals outline risks encouraging a checklist approach. This will add little if any value to the audit but could potentially give the impression the auditor had made broader detailed considerations using such information, which will rarely actually be the case. If an entity is highly unlikely to have going concern issues based upon a review of different factors, such as the level of reserves and intention to utilize, such review and scrutiny of additional information is unnecessary to support the auditor's conclusion. In any case, it is vital to stress that the quality of audits performed by SMPs is of comparable quality and rigor as that of larger audit firms.*

4) Do the requirements and application material of ED-570 appropriately reinforce the auditor's application of professional skepticism in relation to going concern?

Yes.

We believe that the requirements and application material reinforce the requirement to exercise professional skepticism. However, as mentioned above the forward-looking nature of going concern assessments and the accompanying inherent uncertainties are different to other aspects of audit work. Since there can be limited scope and ability to practically challenge management an initial focus on corroboration, in the absence of information to the contrary, may be more appropriate.

SPECIFIC QUESTIONS

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 generally support the proposals.

We suggest, however, that the challenges in defining material uncertainties related to going concern are explored in the explanatory memorandum and / or application material to ED 570. In the absence of such discussion, the wording of paragraph 10 may imply material uncertainties are readily identifiable, which is often not the case in practice.

We also suggest that the phrasing of the actual definition be simplified and made more readily understood and translatable by use of shorter sentences.

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?

Yes, to some extent.

We express above our concern at the proposed language of paragraphs 11 and 33(a)(ii) since it implies the auditor has a direct responsibility for the identification of events or conditions that may cast *significant doubt on the entity's ability to continue as a going concern. We believe, to be compatible with ISA 315 (Revised 2019) the auditor should be required to perform procedures to identify the risk(s) of material misstatement associated with going concern issues. The responsibility to perform an identification of all such events and conditions is the responsibility assigned to management as part of its preparation of financial statements.*

We agree with the principles of the foundational requirements. However, some of the areas flagged in paragraph 12 may be less relevant for smaller entities, so could create a challenge for SMPs. While the examples of scalability given in paragraph A13 are welcome, they fail to recognize that in many private owned entities owners are managers, and there are few staff, so they do not necessarily have the capability or need to develop formal, complex strategies, objectives and forecasts, budgeting, and cash flow information that the proposals envision. As such these SMEs look to their principal advisers, often SMPs, for help. This presents the risk of auditing their own work. The lack of formal forward-looking procedures in many SMEs does not necessarily give rise to going concern issues. For many SMEs the detailed considerations listed, in the absence of proportionality, would add little value and may even be misleading if the information available is imprecise or of poor quality.

7) Do you support the change in the commencement date of the twelve-month period of management's assessment of going concern, from the date of the financial statements (in extant ISA 570 (Revised)) to the date of approval of the financial statements (as proposed in paragraph 21 of ED-570)?

When responding consider the flexibility provided in paragraphs 22 and A43–A44 of ED-570 in circumstances where management is unwilling to make or extend its assessment.

If you are not supportive of the proposal(s), what alternative(s) would you suggest (please describe why you believe such alternative(s) would be more appropriate and practicable)?

We support the change in principle.

While we support the change, we are concerned that this change may create an inconsistency with financial reporting standards applicable in some jurisdictions. If such an inconsistency is widespread, we suggest leaving flexibility to allow a change in the commencement date if deemed appropriate based on assessed risks.

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 support the approach in principle.

We believe that this may create challenges in some entities. Many clients of SMPs are not able, nor do they need, to complete detailed forecasting, so management's assessment is less formal than the proposed changes envision. This is especially true in smaller owner-managed businesses which monitor going concern without using formal forecasts or management reporting typically found in larger *entities. There may also be resistance to producing such information as its relevance to going concern is not well understood or accepted, or where management is confident that there are no going concern issues to warrant expending the time and resources to do so. This may present challenges for SMPs when making this evaluation.*

Furthermore, there is little value in evaluating management's assessment of going concern if the risk of going concern is assessed as low or insignificant. A risk-based approach seems to be more appropriate since this would avoid directing effort and attention to areas that do not add value and away from areas where the assessed risk may justify further work.

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?

We have no comments.

We wonder whether the approach is over-engineered for SMEs.

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 support in general the proposals.

We believe it is not completely clear what procedures are expected to be carried out to evaluate the intent and ability of management, third parties and related parties to provide financial support. Assessing the intent of both management and third parties is challenging and subjective so its inclusion may create practical challenges. Such an evaluation might only be able to give negative assurance in that there is nothing to suggest there is an inability or clearly no intent to support.

11) Will the enhanced requirements and application material to communicate with TCWG encourage early transparent dialogue among the auditor, management and TCWG, and result in enhanced two-way communication with TCWG about matters related to going concern?

Yes.

12) Do you support the new requirement and application material for the auditor to report to an appropriate authority outside of the entity where law, regulation or relevant ethical requirements require or establish responsibilities for such reporting?

We support the new requirements and application material.

13) This question relates to the implications for the auditor's report for audits of financial statements of all entities, i.e., to communicate in a separate section in the auditor's report, under the heading "Going Concern" or "Material Uncertainty Related to Going Concern", explicit statements about the

auditor's conclusions on the appropriateness of management's use of the going concern basis of accounting and on whether a material uncertainty has been identified.

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?

We support the proposal in principle.

We believe the requirement in Paragraph 33 (a) to have this commentary in auditor's reports for financial statements where there are no material uncertainties or going concern issues may be problematic. We suggest the requirement be limited to specific cases where, in the judgement of the auditor, such a disclosure may be helpful based upon the facts and circumstances present.

We suggest the potential impact on the proposed ISA for Audits of Financial Statements of Less Complex Entities standard (ISA for LCEs) be considered if the proposal is approved. We understand the IAASB will only consider potential consequential amendments once the changes to ISA 570 (Revised 202X) have been finalized. Stakeholders would likely expect changes to be considered as this could potentially create a barrier to the implementation of the ISA for LCEs standard in some jurisdictions as regulators may view this as a factor in any decision on adoption.

14) This question relates to the additional implications for the auditor's report for audits of financial statements of listed entities, i.e., to also describe how the auditor evaluated management's assessment of going concern when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern (both when no material uncertainty exists or when a material uncertainty exists).

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?

We generally support the proposals.

We do not believe this should be extended to audits of financial statements of entities other than listed entities. When an SMP auditor believes it is helpful to include additional descriptions of their work related to specific, significant matters in certain circumstances (KAM) then they may do so. However, this should not be a requirement.

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)?

This includes when a material uncertainty related to going concern exists or when, for audits of financial statements of listed entities, events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained, the auditor concludes that no material uncertainty exists.

We have no further comments.

16) Are there any other matters you would like to raise in relation to ED-570? If so, please clearly indicate the requirement(s) or application material, or the theme or topic, to which your comment(s) relate.

We have no further comments.

REQUESTS FOR GENERAL COMMENTS

The IAASB is also seeking comments on the matters set out below:

(a) Translations—Recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-570.

As mentioned above we note that there are instances of long sentences within the proposed revisions that will create a challenge when translating to other languages.

(b) Effective Date—Given the need for national due process and translation, as applicable, and the need to coordinate effective dates with the fraud project, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning approximately 18 months after approval of the final standard. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA.

We suggest the IAASB set an effective date of at least 24 months following approval of the final standard to allow sufficient time for the standard to be translated and for implementation support activities, the development of non-authoritative guidance material and delivery of education and training, completed.

CONCLUDING COMMENTS

We trust that the above is clear but if you have any questions please do not hesitate to contact us.

Yours faithfully,

Salvador Marin	Paul Thompson
President	Technical Director