THE MALTA INSTITUTE OF ACCOUNTANTS

24th August 2023

Feedback in respect of the Proposed International Standard on Auditing 570 (Revised 202X) Going Concern and Proposed Conforming and Consequential Amendments To Other ISAs

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**?

The public interest was clearly at the forefront when considering the new requirement of an explicit statement on the auditor's conclusions on the appropriateness of management's use of the going concern basis of accounting and whether a material uncertainty exists.

Questions however do arise with respect to the scalability of the proposals as a whole and the additional work that may be required with respect to these proposals. More concrete examples within the ED-570 may help in clarifying expectations of what is appropriate/sufficient for, for example, less complex entities or other non-listed PIEs (such as banks). This concern is also in our responses below.

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?

Strengthening auditor's judgement and work

The proposed changes promote robust risk assessment procedures at the onset of the audit, mainly by aligning with the requirement to design and perform risk assessment procedures with those in ISA 315R. Furthermore, the inclusion of guidance, for example, in relation to the review of methods, assumptions and data used by management in their assessment also aim to identify and perform appropriate audit procedures (whilst also aligning with the existing ISA 540R). New and strengthened requirements for communication with TCWG will also promote more transparent dialogue to perform a more thorough review of management's assessment. The concept of professional scepticism is being reinforced again in the proposals.

Having said this, we still believe that appropriate judgment was being applied under the extant ISA 570R and therefore more explicitly required procedures will not necessarily promote enhanced judgment.

Transparency

The forming of a specific opinion by the auditor will place more onus. This same onus is not being sought by directors/management and therefore this requirement seems to place more burden on the auditor rather than management in relation to the risk of going concern.

For listed entities, the requirement to disclose the procedures performed by the auditor in the audit report may provide more transparency. This transparency, however, is considered to be more useful in those instances where specific risks (significant) have been identified. We note that similar disclosures are required for listed entities in close-call situations and situations where material

uncertainty has been identified (i.e. a description how the auditor evaluated management's assessment. This will tend to reduce the importance of these disclosures in instances where there is material uncertainty and which therefore may require more disclosure. Further consideration should be given to "close-call" situations for audits of listed entities.

There are also competing arguments as to whether these reporting requirements are more appropriately disclosed in the going concern section or as a KAM. The proposal seems to indicate that such matters should not be included in the KAM section, although the purpose of KAMs is to highlight areas that are of most significance in the audit (and going concern could be one of these areas). Further clarity is being sought in this regard.

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?

It is noted that 'Scalability' sections have been included in various parts of the ED. For instance, scalability examples are given in relation to the nature and extent of the auditor's risk assessment procedures depending on the nature and circumstances of the entity (A13). An extract is included below;

The Entity and its Environment

• *The nature and extent of the auditor's risk assessment procedures to obtain an understanding of the measures used, internally and externally, to assess the entity's financial performance are likely to be more extensive for entities with a complex structure and business activities. Such entities may also have complex borrowing arrangements with lenders, suppliers or group entities. In contrast, for smaller or less complex entities whose business activities are simple with few lines of business and with uncomplicated borrowing arrangements the nature of the auditor's risk assessment procedures is likely to be less extensive.*

The Applicable Financial Reporting Framework

• *When the entity's business activities are affected to a lesser degree by uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, the related disclosures in the entity's financial statements may be straightforward and the applicable financial reporting requirements may be simpler to apply. In such circumstances, the auditor's procedures to obtain an understanding of the basis for management's intended use of the going concern basis of accounting are likely to be less extensive.*

Concerns and questions arise about scalability and the depth of work that may be required to address the new requirements. The above quoted paragraphs indicate that procedures etc "are likely to be less extensive", which we are in agreement with. However, further clarification with concrete examples to set an indication or expectation on the sufficiency of the level of detail, may be helpful. For instance, in the case of an owner-managed business in obtaining an understanding, would inquiry and discussion with the owner-manager suffice?

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

We note that ED-570 has been aligned with other ISAs e.g. ISA 540R, requiring the auditor to design and perform procedures in an unbiased manner. The requirement throughout to assess events individually and collectively reinforces the importance of 'seeing the wider picture'. The auditor is also "*required to "stand back" and consider all audit evidence obtained, including audit evidence that is consistent or inconsistent with other audit evidence, and regardless of whether it appears to corroborate or contradict the assertions in the financial statements*." Although not explicitly stated, the need to be professionally skeptical is implied through these requirements.**

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 note that the definition of Material Uncertainty was, in essence, already included in the extant ISA 570R, and is not a 'new' definition. However, the repositioning of the definition in a separate section at the beginning of the document enhances clarity and importance of understanding the term. The clarification with respect to the phrase 'may cast significant doubt' is clear, concise and helpful to the reader.

In fact, the Malta Institute of Accountants (MIA) welcomes the definition of the term "material uncertainty (related to going concern)" and in providing clarity for other terminology used in the standard such as the phrase "may cast significant doubt".

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?

It is clear that the requirements relating to risk assessment are being enhanced, clarified, and noted by way of examples and will need to be specifically addressed in all circumstances (again the discussion around scalability becomes important).

Although the enhanced procedures may appear to be reasonable, they however seem to imply a significant change in perceived responsibility. Under the extant ISA, the auditor evaluates management's assessment of the entity's ability to continue as a going concern. The proposals however place an obligation on the auditor to form a view on the existence of events or conditions independently of management. This represents a significant change in auditor's responsibility and therefore the change is not simply limited to strengthening the risk assessment procedures related to going concern.

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 note that updating the requirement from the date of the financial statements (ie, the year-end) to the date of approval of the FS, deviates from the requirement of IAS 1, para 26 (see extract below), which would be the basis on which management would "time" their assessment.

26 In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, the entity may reach a conclusion that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

While noting that we are in agreement that an assessment as at the date of the approval of the FS increases relevance, particularly where the audit does not start immediately after the year-end, we consider that the determination of the time period is within the ambit of the financial reporting standards and not auditing standards. It is also to be noted that this change could create inconsistencies with local financial reporting frameworks. For example, in Malta, Section 3.4 of GAPSME requires that 'where the period considered by management in making its assessment of the entity's ability to continue as a going concern has been limited to a period of less than twelve months from the balance sheet date, that fact shall be disclosed.' Hence, it is advisable that the auditing standard should not mandate the specific period required, as this varies with the applicable financial reporting framework.

In addition, if this change is maintained, some level of push-back from clients may be anticipated given that their assessment may need to be revised further or re-performed/extended. The "flexibility" allowed by the ED-570 is to discuss with management/TCWG and (possibly) obtain additional support (example given in A44: profitable company, no liquidity concerns, no additional events or conditions that may cast significant doubts have been identified beyond the period of assessment).

The IAASB may consider including a clarification that in the latter case unless the auditor is aware from other procedures/cumulative audit knowledge of events or conditions that may/will occur in the period, and after considering subsequent procedures as per ISA 560, the assessment need not be extended for the remaining period (see example below).

Management FY – 1 Jan 202X – 31 Dec 202X
Management's assessment – 1 Jan 202X+1 – 31 Dec 202X+1
Approval of FS – 1 June 202X+1
Additional period that should have been covered by management's assessment – 1 Jun 202X+2 till 31 May 202X+2

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?

The extant ISA 570R (Para 16) requires the auditor to perform additional audit procedures only where events or conditions are identified. The new requirements will require additional work and documentation (at a higher cost) even in those areas where specific risk has not been identified (and therefore this requirement seems to depart from a risk-based approach).

Questions arise with respect to the scalability of the proposals as a whole. As recognised in the ED-570, when performing the audit of less complex entities procedures and processes are likely to be less formal and, hence, the scalability of such evaluation will need to be taken into consideration, particularly in cases where it is clear that no events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern. Comments on our concerns of scalability and proportionality have been included in our response to question 3, above.

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?

The MIA welcomes the more robust evaluation of management's assessment, including evaluating the method, assumptions and data used by management – although for small audit engagements, the auditor should always be given the opportunity to scale down these procedures depending on the identified risks.

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 are in support of the enhanced requirements and application material, although these procedures should already be best practice under the extant ISA. However, in instances where owner managers are involved, although written support may be more easily obtained, the difficulty remains in assessing an <u>individual's ability</u> to continue to provide the support. An example is given in A54:

Example:

The continuance of a smaller or less complex entity in financial difficulty may be dependent on the owner-manager subordinating a loan to the entity in favor of banks or other creditors, or the owner-manager supporting a loan for the entity by providing a guarantee with the owner-manager's personal assets as collateral. In such circumstances, the auditor may obtain appropriate documentary evidence of the subordination of the owner-manager's loan or of the guarantee. ***Where an entity is dependent on additional support from the owner-manager, the auditor evaluates the owner-manager's ability to meet the obligation under the support arrangement.*** *In addition, the auditor may request written confirmation of the terms and conditions attaching to such support and the owner-manager's intention or understanding.*

Hence, while the MIA welcomes the new requirements when management's plans for future actions include financial support by third parties or related parties, including the entity's owner-manager, more clarity, possibly supported by examples, should be provided when the auditor is required to evaluate the intent and ability of those parties to maintain or provide the necessary financial support. It is very difficult to evaluate the intention of others and more clarified application material needs to be provided in this area.

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 twoway communication with TCWG about matters related to going concern?

The enhanced requirements and application material strengthen the requirement for communication with management and TCWG from the initial stages of the audit and is to be maintained throughout the audit process. These are already in line with current best practice.

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?

As such, the requirement to report to another authority etc, does not emanate from the ISA itself, but from the laws and regulations of the respective jurisdiction. In our view, the inclusion of this "requirement" in ED-570 serves the purpose of a reminder to the auditor to consider other legal, regulatory, ethical etc requirements, and we have no objection to its inclusion.

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?

Including an explicit statement in the Audit Report without an equivalent statement made by the directors with respect to their assessment of the going concern basis, may imply a shift in perceived/assumed responsibility that may create additional legal exposure for auditors. Therefore, we do not feel that it is necessary to have an explicit statement on going concern for all entities (non-listed companies) where there is no material uncertainty.

We also take cognisance of the importance, that if the proposals are approved in their current form, including an explicit statement on Going Concern in the audit report should not come across as a guarantee to the users of the financial statements on such matter. Therefore, we propose that under the 'Auditor's responsibilities for the audit of the financial statements' section it is clarified that, in line with the wording in the ED-ISA 570 para 7, *"the absence of any reference to a material uncertainty about the entity's ability to continue as a going concern in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern."*

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?

The enhanced requirements promote transparency about the auditor's responsibilities and work performed relating to going concern, particularly for listed entities where the auditor is now required to detail procedures performed in respect the evaluation of management's assessment (similar to a KAM). However, as already mentioned above, the proposed ED-570 is not making a distinction between the requirements imposed on the auditor where there is a material uncertainty and "close-call" situations (work performed by the auditor will need to be disclosed in both cases). In "close-call" situations the conclusion that there is no material uncertainty is already included in the FS disclosures (prepared by the client) which have been audited and on which the auditor is opining.

Also refer to concern raised on "guarantee" mentioned in Q13, above.

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.

Sections 33 – 37 address the different possible scenarios, however, our comments on certain scenarios (eg "close call" situations) are included above (Q 13 & 14).

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. Request for General Comments

Further to the matters noted above, will ISA for LCE reflect and provide further examples and guidance in relation to scalability of procedures etc for less complex entities?

17. 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.

Not applicable

(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.

This should be a sufficient timeframe.