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CP ISA570 Sub 4

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Dear Matthew,

Preliminary informal staff feedback

We provide below, our preliminary views on the Consultation Paper: Exposure draft of the IAASB's Proposed ISA 570 (Revised) Going Concern (ED-570). The below comments are CPA Australia staff views which may change as we finalise our submission to the IAASB on the ED-570.

We commend the IAASB's commitment to contribute to narrowing the auditor expectation gap through ED-570. We note that, as articulated in the 2020 IAASB Discussion Paper on going concern, each participant of the financial reporting ecosystem plays a unique and essential role that contributes towards high-quality financial reporting. Therefore, it will take efforts from all participants of the financial reporting ecosystem to bring about meaningful change and improve financial reporting transparency around going concern. Ensuring the entity remains a going concern is primarily the entity's responsibility and all participants of the financial reporting ecosystem including auditors need to be working together to achieve this.

- An auditor's opinion in respect of going concern is expressed in accordance with an applicable financial reporting framework. Currently, the auditor's conclusion on the company's status as a going concern is made with reference to the relevant disclosures in the financial statements. Without changes to the current financial reporting requirements for more explicit requirements around management's going concern assessment and accompanying disclosures in the financial statements, we believe the IAASB's efforts could bring about an imbalance that may result in unintended consequences including further widening the expectation gap affecting the audit profession.
- The language and the tone used between accounting and auditing standards when addressing going concern are also problematic. Current phrasing in IAS 1 *Presentation of Financial Statements* (IAS 1) gives the perception that, as a starting point, "An entity shall prepare financial statements on a going concern basis **unless** management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so." Therefore, for a company that is assessed as very low risk of not being a going concern, management may reach a conclusion that the going concern basis of accounting is appropriate without any detailed assessment. Furthermore, there is no specific requirement for management to include a statement that the financial statements have been prepared on a going concern basis. ED-570 proposes an implied secondary opinion by the auditor on the entity's going concern status without the corresponding specific disclosures in the financial statements. This has the potential to further widen the expectation gap.
- We encourage the IAASB to continue its discussions with the International Accounting Standards Board (IASB) on the matters raised above to ensure that a holistic approach is taken that meets the expectations of stakeholders and that is in the wider public interest. Therefore, we recommend enhancement to transparency in the auditor's report should only be

pursued if there are adequate improvements to the applicable financial reporting framework on management's going concern assessment and related disclosures.

- If the IAASB is to go ahead with the proposed transparency disclosures in the auditor's report without the corresponding enhancement to the reporting requirements, we strongly encourage the IAASB to implement an education and awareness program for the wider public regarding the responsibilities of different parties in relation to going concern, to manage the potential widening of the expectation gap.
- Currently, in our view, the requirements in AASB 101/IAS 1 paragraphs 25-26 do not adequately address disclosure of management's going concern assessment. Whilst advocacy efforts with the IASB continue for an internationally consistent solution, we recommend the Australian Accounting Standards Board (AASB) develops disclosures similar to those developed by the New Zealand Accounting Standards Board, to complement the requirements in IAS 1. We suggest the AUASB communicate this suggestion to the AASB and engage with them in progressing the development of appropriate financial reporting requirements.
- We are of the view that the definition of material uncertainty (related to going concern) can be improved with further clarity and distinction between 'material uncertainty' and 'significant doubt'. We suggest the wording from the application material in paragraph A5 be included in paragraph 10. This will help explain the concept that, material uncertainty is the result of unresolved events or conditions that, individually or collectively, may cast significant doubt. We are also of the view that the definition of material uncertainty should not include the disclosure requirements. We also note that this term is not defined in the accounting standards. Therefore, imposing the proposed definition of accounting terms within auditing standards can be problematic. There is a risk that management may disagree with the auditor on what should be deemed as 'material uncertainty'.
- We support the proposals in the ED-570 to enhance the risk identification and assessment requirements, so that they are consistent with those set out in ISA 315 *Identifying and Assessing the Risks of Material Misstatement* (ISA 315). The feedback we have received indicates that these are the steps that are already being included in the current audit process. We believe the clarifications proposed in the ED-570 through alignment to ISA 315 will further promote consistency in practice.
- Broadly, we are also supportive of the proposed additional requirements in the ED-570 to enhance the auditor's evaluation of management's going concern assessment. However, we disagree with the proposal 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. If there is no events or conditions have been identified and the risk of going concern is assessed as low or insignificant, there is little value in further evaluating management assessment of going concern. The costs incurred will be disproportionate to the benefits (if any) when the risk of going concern is insignificant.
- We are also of the view that further guidance and clarity on work efforts depending on management's assessment of going concern would be helpful. There is a lack of clarity around how the work efforts for the proposed additional requirements in the ED-570 could be scaled for smaller entities, or for entities that are in different going concern risk scenarios. As an extension to that, some clarity may be needed around the application of the ED-570 on the work effort requirements for evaluating events or conditions that may cast significant doubt, compared to situations where material uncertainty exists. Scalability should not only consider whether the same requirements can be applied to entities of differing sizes, but there also needs to be an assessment of whether additional requirements will add value if applied in certain situations.
- We consider the example scenarios and related work efforts as illustrated in the IFRS Foundation educational material on Going Concern – a focus on disclosure to be very useful. We recommend the IAASB include similar example scenarios for going concern from an auditor's perspective, to clearly illustrate the step-up or step-down of work efforts that are proportionate to the size and going concern risks relevant to the entity.
- We are also supportive of the extension period of the auditor's evaluation of the going concern assessment to at least 12 months from the date of approval of the financial statements. The proposed extension period will be more aligned with the current New Zealand requirement.
- In many audits, going concern would likely not be an issue. Therefore, a blanket disclosure about going concern in the auditor's report is likely to undermine its information value and may cause unintended consequences, including readers not

noting disclosures that signal a concern with the going concern assessment. We are of the view that exception-based reporting is more appropriate, that is the inclusion of going concern disclosures in the auditor’s report only when an issue related to going concern has been identified.

- The ED-570 proposes the same heading, ‘Going Concern’ for both the ‘clean’ and ‘close-call’ situations. If the IAASB is to proceed with the inclusion of the blanket disclosure for all audit reports containing an unmodified opinion when no material uncertainly exists (‘clean’ audit report), we recommend that the IAASB revise the heading to better distinguish a ‘clean’ audit report from a ‘close-call’ audit report.
- Other minor areas that we have identified for clarification include:
    - The location of disclosure in the audit report for a ‘close-call’ situation. We suggest the IAASB include further clarification and specific examples to illustrate the appropriate use of the Key Audit Matter (KAM) and Emphasis of Matter (EOM) paragraphs in the audit report.
    - The ED-570 uses the terminology ‘material uncertainty’ whereas IAS 1 refers to ‘material uncertainties’. We recommend the IAASB considers aligning the terminology with IAS 1.
    - Paragraph 10 of the ED-570 refers to ‘appropriate disclosure of the nature and implications of the uncertainty’. We recommend the IAASB clarify the location of the ‘appropriate disclosure’ that is being referred to in paragraph 10, i.e., is it in the disclosures in the financial statements, or the disclosures in the auditor’s report.