

**Auditor Reporting—Summary of Responses Relating to Going Concern (GC)**

The following represents the Task Force's (TF) preliminary views on the way forward based on responses to the Invitation to Comment (ITC) and feedback from the public roundtables. IAASB input on these matters, in the context of the detail that follows in this agenda paper, will be welcome.

- Continue to explore auditor reporting on GC, addressing both the use of the GC assumption and the identification of material uncertainties
- Continue to engage with the International Accounting Standards Board (IASB) and International Financial Reporting Interpretations Committee (IFRIC) on implications of changes to financial reporting standards, and continue to monitor developments of the US Financial Accounting Standards Board (FASB) and encourage efforts towards a common global financial reporting solution in response to calls for a more “holistic” approach to GC
- Consider the wording of auditor statements related to GC to:
  - Ensure the language does not widen the expectation gap by explaining what is meant by “the use of the GC assumption”, placing the statement relating to material uncertainties in context of the auditor’s work effort, and explicitly noting management’s responsibility for assessing the use of the GC assumption and identifying and disclosing material uncertainties
  - Provide flexibility for application due, in part, to differences in management’s responsibilities under different financial reporting frameworks
- Consider revisiting the placement of all elements of GC reporting, including:
  - Whether the description of management’s responsibilities would be better placed with auditor reporting on GC
  - Whether the “clear signal” of the required Emphasis of Matter (EOM) paragraph required by extant ISA 570<sup>1</sup> may be lost if included together with the conclusion on the GC assumption
  - Whether the conclusion on the GC assumption is better placed in the Opinion or Basis for Opinion paragraphs, as it is the basis of accounting used to prepare the financial statements
  - Whether flexibility in the placement of the GC reporting elements should be allowed, to take into account the relative importance of GC reporting to the particular entity
- Consider lack of support for the auditor to include additional information in the auditor’s report about the auditors’ judgments and processes when there are underlying events or conditions but the conclusion is that no material uncertainties exist
- Develop limited amendments to ISA 570 to operationalize auditor reporting on GC (e.g., clarification of terminology or additional application material) for inclusion in the June 2013 exposure draft and consider the need for a longer-term revision of ISA 570 in light of potential changes to management’s responsibilities for GC that may be promulgated by accounting standard setters
- Conduct further outreach to determine the implications of reporting on GC for banking and financial institutions and factor into the standard-setting process

<sup>1</sup> International Standard on Auditing (ISA) 570, *Going Concern*

## Introduction

1. The ITC on auditor reporting identified reporting by the auditor on GC as an important area to enhance the relevance and transparency of the auditor's report on a topic of particular interest to stakeholders in light of the recent global financial crisis.
2. The ITC included the following in its illustrative auditor's report:

### Going Concern

#### *Use of the Going Concern Assumption*

As part of our audit of the financial statements, we have concluded that management's use of the going concern assumption in the preparation of the financial statements is appropriate.

#### *Material Uncertainties Related to Events or Conditions that May Cast Significant Doubt on the Company's Ability to Continue as a Going Concern*

Based on the work we have performed, we have not identified material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern that we believe would need to be disclosed in accordance with IFRSs. Because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company's ability to continue as a going concern.

The responsibilities of management with respect to going concern are described in a separate section of our report.

#### *Management's Responsibilities Relating to Going Concern*

Under IFRSs, management is responsible for making an assessment of the Company's ability to continue as a going concern when preparing the financial statements. 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. Under IFRSs, the Company's financial statements are prepared on a going concern basis, unless management either intends to liquidate the Company or to cease trading, or has no realistic alternative but to do so.

IFRSs also require that, when management is aware of material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern, management disclose those uncertainties in the financial statements.

3. In developing the ITC proposals, the IAASB was cognizant that some stakeholders, in particular investors, would highly value a statement by the auditor about GC. Nevertheless, it also understood that some of the concepts and terminology related to GC, including "going concern assumption" and "material uncertainties", are not widely understood, or at least have potentially different interpretations.
4. The IAASB was also aware that reporting on GC – even in a factual manner in accordance with what is already required by ISAs and International Financial Reporting Standards (IFRSs) (i.e., making explicit what is already implicit) – could potentially result in widening of the expectation gap and be seen as the auditor providing a "piecemeal" audit opinion.

5. The ITC included the following questions in relation to GC:
- *Question 8: What are your views on the value and impediments of the suggested auditor statements related to going concern, which address the appropriateness of management's use of the going concern assumption and whether material uncertainties have been identified? Do you believe these statements provide useful information and are appropriate? Why or why not?*
  - *Question 9: What are your views on the value and impediments of including additional information in the auditor's report about the auditor's judgments and processes to support the auditor's statement that no material uncertainties have been identified?*

### **Focus and Structure of this Paper**

6. This paper summarizes views received on the above ITC questions, which included respondents' comments on both the proposed direction and wording in the illustrative auditor's report, and the respondents' views on broader considerations seen as relevant to the IAASB's decisions about the way forward.
7. The Task Force proposes that the IAASB first discuss and consider views that are in response to the proposals in the illustrative auditor's report (i.e., the wording relating to GC), in order to assess whether to continue to pursue auditor reporting as envisioned in the ITC. This will gauge the degree of support for the value of the suggested improvements, and also the level of concerns or possible impediments for reporting on the GC assumption and related material uncertainties.
8. However, in determining the way forward for auditor reporting on GC, the IAASB will also need to consider views about alternative approaches, including a more holistic approach to dealing with GC that could potentially have a much longer-term horizon. The IAASB will need to assess whether such views can also be taken into consideration as part of the immediate proposals or be factored into forward plans. Lastly, other issues can be addressed, including response to Question 9 of the ITC.
9. Accordingly, this Paper is structured as follows:
- Section I: Summary of Key Messages Relating to the Suggested Auditor Statements Relating to GC
- Section II: Summary of Views Identifying Broader Considerations
- Section III: Summary of Key Messages and Approach Relating to ITC Question 9
10. This paper does not address comments relating to the placement of auditor reporting on GC within the overall structure of auditor's report and related considerations pertaining to consistency versus relevance or national reporting differences. These are covered in general in **Agenda Item 6-C**.

### **I. Summary of Key Messages Relating to the Suggested Auditor Statements Relating to GC**

11. Overall, the majority of respondents supported the IAASB's initiative to explore changes that address auditor reporting on GC. While the ITC suggestions to include statements in the auditor's report about the GC assumption and material uncertainties were acknowledged as interrelated, differing views were received on these respective statements. The Appendix provides an illustration of the diversity of views on key matters relating to GC. These are explained in more detail below. A

general caveat in many of the responses on the topic of reporting on GC, including those that were supportive of (or at least not uncomfortable with) the ITC suggested improvements, was the importance of also looking at the issue more holistically – which is discussed in Section II.

*Statement on the Appropriateness of Management's Use of the GC Assumption*

12. A majority of respondents<sup>2</sup> expressed general support for auditors making an explicit statement about the appropriateness of management's use of the GC assumption. This included support from many investor and regulator respondents, as well as from some national standard setters (NSS) and firms. In particular, it was noted that:
  - The statement provides useful and informative information.<sup>3</sup>
  - Transparency and the communicative value of auditor's report are improved, as the statement would essentially make explicit what is already required under the auditing standards.<sup>4</sup>
  - It has the benefit of increasing the robustness of the auditor's challenging of management's assumptions in this area.<sup>5</sup>
13. In contrast, there were many respondents<sup>6</sup> who were not convinced of the value of such reporting. It was noted that the statement would have limited informational value because it only states explicitly what is already implicit. Further, in virtually all circumstances, it would in essence be boilerplate reporting.
14. In particular, a few respondents<sup>7</sup> expressed considerable concern such as the following:
  - The language of that conclusion in the ITC reflects the language of ISA 570 but it is highly "coded";

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<sup>2</sup> *Investors and analysts:* ABI, BR, CalPERS, EUMEDION, GCSPS, HEOS, ICGN, IMA, NAPF, S&P, SAAJ, SLI; *TCWG:* ACGN, IBGC, IIA, OECD; *Regulators and oversight authorities:* AFRC, BCBS, CSIPPC, CSRC, DFSA, EAIG, EBA, HKFRC, IAIS, ICAC, IRBA, JSE, MAOB; *NSS:* ASB, AUASB, CNCC-CSOEC, IDW, MAASB, NBA; *Accounting firms:* BDO, CHI, DTT, EYG, GC, GTI, KI, KPMG, MAZARS, PWC, RSM, SNG, TL; *Public sector organizations:* BC, RD; *Preparers:* Gof100-A, Gof100-UK, MEDEF, USCC; *Member bodies and other professional organizations:* ACCA, ASSIREVI, CAI, CIMA, CNDCEC, EFAA, FACPCE, IBR-IRE, ICAA, ICAEW, ICAN, ICAP, ICAS, ICPAI, ICPAK, ICPAU, IE, IMCP, MICPA, OROC, WPK; *Academics:* UofW; *Individuals and Others:* CBarnard, DJuvenalMRejon, Flrungu, KPastakia, RMahadevan, ROverweg

<sup>3</sup> *Investors and analysts:* ABI, CalPERS, EUMEDION, GCSPS, HEOS, ICGN, SLI; *TCWG:* OECD; *Regulators and oversight authorities:* CSIPPC, DFSA, EAIG, EBA, HKFRC, IAIS, ICAC, JSE; *Accounting firms:* GC, MAZARS; *Preparers:* MEDEF; *Member bodies and other professional organizations:* CIMA, ICAP, IMCP; *Academics:* UofW; *Individuals and others:* DJuvenalMRejon, Flrungu, RMahadevan

<sup>4</sup> *Investors and analysts:* ICGN, NAPF; *Regulators and oversight authorities:* IAIS; *Accounting firms:* DTT, EYG; *Member bodies and other professional organizations:* ICAN; *Individuals and others:* KPastakia

<sup>5</sup> *Regulators and oversight authorities:* EBA

<sup>6</sup> *TCWG:* AICD; *Regulators and oversight authorities:* CSA CAC, CPAB, IOSCO, WB; *NSS:* CAASB, CICPA, FAP, HKICPA, JICPA, NZAuASB, UKFRC; *Accounting firms:* BT, CB, CCW-UK, CH-AU/NZ, MNP; PKF, PKF(UK), PP, SRA, WBLI, WK; *Public sector organizations:* ACAG, AGA, AGC, AGM, AGNZ, AGQ, CIPFA, GAO, NAOS; *Preparers:* BE, CNRL, QCA; *Member bodies and other professional organizations:* BICA, CalCPA, CAQ, CGAC, CPAA, CPRB/SCAG, FAR, FEE, ICAI, ICPAS, KICPA, KWT, NCFPAAROC, NYSSCPA, SMPC, TK, ZICA; *Academics:* AAA, BCEM, JCarcello, KJamalSSunder, PGillis, VMassarygina; *Individuals and others:* JKelly, RRodil

<sup>7</sup> *NSS:* CAASB, UKFRC; *Member bodies and other professional organizations:* FEE, NYSSCPA; *Academics:* AAA

- Many readers of financial statements and related audit reports will be unaware that there are very few circumstances where it is inappropriate under accounting standards for this statement to be made; and
  - Making this statement may lead investors and other users of financial statements to conclude that an auditor is asserting that an entity is viable when this is not, in fact, the case.
15. In this regard, there is an extremely high threshold for departing from the GC basis of accounting. In light of this, the point has been strongly made that there is relatively little value in this conclusion; it will often remain true even when the entity is experiencing significant financial or economic distress, including when the directors and auditors have reported that there are material uncertainties. Further, a natural reading of the text might imply that it is reasonable to assume the entity is solvent and will be able to meet its liabilities as they fall due when this may not be the case.
16. A few respondents,<sup>8</sup> who generally supported the suggested statement, nevertheless acknowledged that the proposals may not work in all jurisdictions. It was recommended that any required statement be sufficiently flexible to accommodate other reporting models besides IFRSs, in particular when management may not have an explicit responsibility to make an assessment about GC – and in such situations, it was not seen as appropriate for the auditors to make a statement about the appropriateness of the use of the GC assumption.
17. Further, irrespective of whether the respondents were generally supportive, many acknowledged and emphasized the need for, or importance of, a more holistic approach to addressing GC in financial reporting. These views are further described in Section II of this paper.

*Statement Whether Any Material Uncertainties Have Been Identified*

18. From an overall perspective, responses were mixed regarding a statement by the auditor about whether any material uncertainties were identified. Some respondents were of the clear view that the proposal makes sense, whereas others expressed concern (some strongly) with the proposals. Several respondents put forward suggestions for refinement in the proposals, or alternative treatment within other areas of the new auditor reporting model.
19. From those respondents who supported this proposal,<sup>9</sup> it was noted in particular that the statement would be helpful and informative to such users. Most of these respondents did not articulate specifically the nature of the added value that would be derived, except noting that, in light of the global financial crisis, investors would welcome some assurance that the auditor is satisfied, and has robustly challenged management and directors on whether they have exercised due care in undertaking their GC assessment, and that the assumptions are reasonable.<sup>10</sup>

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<sup>8</sup> *Regulators and oversight authorities:* IAIS, NSS: CAASB, JICPA; *Accounting firms:* BDO, DTT, EYG, MNP, PKF, PKF(UK), PWC; *Preparers:* USCC; *Member bodies and other professional organizations:* ASSIREVI, DNR, NYSSCPA; *Academics:* UofW

<sup>9</sup> *Investors and analysts:* ABI, BR, CalPERS, EUMEDION, GCSPS, HEOS, ICGN, IMA, NAPF, SLI; *TCWG:* ACGA, IBGC, IIA; *Regulators and oversight authorities:* BCBS, CSIPPC, HKFRC, IAIS, ICAC; *NSS:* CNCC-CSOEC, NBA; *Accounting firms:* DTT, EYG, KPMG, MAZARS; *Member bodies and other professional organizations:* ACCA, CIMA, FACPCE, ICAEW, ICAN, ICAP, ICAS, IMCP, MICPA, WPK; *Academics:* UofW; *Individuals and others:* CBarnard, RMahadevan

<sup>10</sup> *Investors and analysts:* IMA; *Regulators and oversight authorities:* EBA

20. In contrast, many more respondents were of a view that it was not appropriate for the auditor to make such a statement. The following was noted:
- Management and those charged with governance (TCWG) should be the original source of information, a point strongly echoed in responses about auditor commentary (AC). As such, a statement by auditors would go beyond what is currently required of management.<sup>11</sup> The roles and responsibilities of management, TCWG and the auditor should be preserved.<sup>12</sup> Accordingly, the auditor should not be required to report on material uncertainties (or the GC assumption) unless management has done so.
  - Impediments would likely include higher litigation risks for auditors.<sup>13</sup>
  - It adds more standardized information to the auditor's report that is likely to "cloud" the auditor's opinion or can be perceived as an "audit qualification".<sup>14</sup>
21. It was also noted that the proposal has the potential to decrease the value of the current reporting model – "which provides meaningful information in extreme circumstances, usually around going concern issues" – and may undermine the importance of the signal / red flag that the EOM model achieves.<sup>15</sup> The general sense was that the present ISA 570 already achieves what the ITC is trying to accomplish.
22. In relation to impediments, it was anticipated that there will likely be an indirect increase in audit costs as auditors seek to reduce the expanded audit risk, such as an inappropriate statement on GC immediately preceding a bankruptcy or other business failure.<sup>16</sup>
23. In addition, consistent with comments on the inclusion of a statement regarding the GC assumption, there were concerns over risks of user misinterpretation of terms such as "GC" and "material uncertainties."<sup>17</sup> This concern exists despite the fact that some auditors are prepared to make the

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<sup>11</sup> *Regulators and oversight authorities:* CSA CAC, DFSA, EBA, HKFRC, MAOB; *NSS:* AUASB, CAASB, HKICPA, IDW, JICPA, MAASB, NZAuASB, UKFRC; *Accounting firms:* BDO, CB, CH-AU/NZ, DTT, EYG, KI, KPMG, PWC, TL, WK; *Public sector organizations:* ACAG, NAOS; *Preparers:* CNRL, MEDEF, USCC; *Member bodies and other professional organizations:* ASSIREVI, BICA, CalCPA, CAQ, CGAC, CPRB/SCAG, FEE, FSR, IBR-IRE, ICAS, ICASL, ICPAS, ICPAU, MICPA, NCFPAAROC, NYSSCPA, OROC, ZICA; *Academics:* PGillis; *Individuals and others:* Flrungu

<sup>12</sup> *Regulators and oversight authorities:* AFRC, EAIG, IRBA, IOSCO; *NSS:* ASB, AUASB, CAASB, CICPA, NZAuASB; *Public sector organizations:* ACAG, AGC, GAO; *Member bodies and other professional organizations:* FACPCE, FAR, ICAI, ICPAS, IE; *Academics:* UofW

<sup>13</sup> *Regulators and oversight authorities:* CPAB, CSA CAC, CSRC; *NSS:* CAASB, FAP, NBA, NZAuASB, UKFRC; *Accounting firms:* CB, CCW-UK, RSM; *Preparers:* CNRL, QCA; *Member bodies and other professional organizations:* CNDCEC, CPRB/SCAG, EFAA, FAR, ICAI, ICPAS, KICPA, NYSSCPA, OROC; *Academics:* AAA; *Individuals and others:* ROverweg

<sup>14</sup> *TCWG:* AICD; *Accounting firms:* GTI, MNP, PP; *Public sector organizations:* ACAG, AGQ; *Member bodies and other professional organizations:* KWT, NYSSCPA, TK

<sup>15</sup> *NSS:* CAASB, NZAuASB, UKFRC; *Accounting firms:* BDO, BT, CB; *Preparers:* USCC; *Member bodies and other professional organizations:* CAI, CAQ, ICAA, ICAEW, ICPAS

<sup>16</sup> *Accounting firms:* CB; *Academics:* AAA

<sup>17</sup> *Investors and analysts:* BR, EUMEDION, ICGN; *TCWG:* ACGA; *Regulators and oversight authorities:* AFRC, CPAB; *NSS:* CAASB, UKFRC; *Accounting firms:* GTI, KPMG; *Public sector organizations:* AGQ; *Member bodies and other professional organizations:* CAI, ICAI, TK

suggested statements because they reflect work performed.<sup>18</sup> Many respondents<sup>19</sup> suggested the need for clarification of this and related terminology by accounting standard setters.

#### *Possible Refinements to the ITC Proposals*

24. Notwithstanding the general concerns, some suggestions were put forward as possible refinements to the ITC proposals.

#### Reporting Based on Management's Perspective

25. In relation to preserving the roles and responsibilities of auditors and management, a respondent<sup>20</sup> suggested that a statement that no material uncertainties have been identified should be presented from the perspective of management, with the auditor commenting on this statement based on the results of the audit. This was illustrated as follows:

Under IFRSs, management is responsible for making an assessment of the Company's ability to continue as a going concern when preparing the financial statements. In assessing whether the going concern basis 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. Under IFRSs, the Company's financial statements are prepared on a going concern basis, unless management either intends to liquidate the Company or to cease trading, or has no realistic alternative but to do so.

IFRSs also require that, when management is aware of material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern, management disclose those uncertainties in the financial statements. Management has not identified any such material uncertainties and as such has not disclosed material uncertainties in the financial statements. Based on the work we have performed, we concur with management's conclusion that disclosures are not necessary in accordance with IFRSs. Because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company's ability to continue as a going concern.

#### Tiered Approach

26. A few respondents<sup>21</sup> suggested a tiered approach to financial reporting disclosure along a continuum of severity. For example:
- No GC issue: only brief disclosures;
  - Potential GC issue: more extensive disclosures; and
  - Clear GC issue: significantly more details to be provided.

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<sup>18</sup> NSS: CAASB

<sup>19</sup> *Investors and analysts*: BR, EUMEDION, ICGN, SAAJ; *TCWG*: ACGA; *Regulators and oversight authorities*: AFRC, CPAB, CSRC, EAIG, EBA, HKFRC, IAIS, IRBA; *NSS*: ASB, AUASB, CAASB, CICPA, HKICPA, MAASB, NZAuASB, UKFRC; *Accounting firms*: DTT, EYG, GTI, KPMG, MNP; *Public sector organizations*: ACAG, AGC, AGQ, GAO; *Member bodies and other professional organizations*: ASSIREVI, CAI, FACPCE, FAR, FEE, IBR-IRE, ICAEW, ICAI, ICPAS, IE, KICPA, TK; *Academics*: UoW

<sup>20</sup> *Accounting firms*: KPMG

<sup>21</sup> *Accounting firms*: BDO, KPMG; *Member bodies and other professional organizations*: FEE

Based on this approach, there would be less of a need, or possibly no need, for a specific statement by the auditors about whether or not material uncertainties have been identified. Rather, the auditor's report could refer to management's disclosure by way of an EOM paragraph, which would reference the footnote disclosures and mirror the substance of the severity of the conditions. (This of course would require enhancement to the accounting standards, a common theme in a significant number of responses – as further discussed below).

#### Further Clarifications

27. In relation to the understandability of auditor reporting on GC and concerns about the expectations gap, various suggestions were also received on how to improve the proposals, including:
- Placing all information about GC together in the auditor's report, rather than including management's responsibilities elsewhere, to improve clarity.<sup>22</sup> This would include reference to the period covered by the assessment.
  - Not placing GC reporting near the front of the report, as it gives it undue emphasis in circumstances where there is no issue.<sup>23</sup>
  - Strengthening/making more specific the caveat wording, to indicate that future events or conditions may change the assumptions upon which the statement is based on, and may therefore also affect the entity's ability to continue as a GC.<sup>24</sup>
  - Re-characterizing the wording of "we have not identified" (and for the GC assumption "we conclude") and placing reporting on GC in the context of the auditor's responsibilities e.g., "we have obtained sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern assumption and whether a material uncertainty exists related to events or conditions....going concern."<sup>25</sup>

#### Auditor Commentary

28. A few respondents<sup>26</sup> suggested making discussion about GC a mandated matter in AC. To promote consistency and provide emphasis, the auditor would either make the statement if the conclusion is "clean" or provide more insights into the issue if the conclusion is "modified".
29. In addition, a suggestion was made<sup>27</sup> to require a GC paragraph as AC when it is *more likely than not* that the auditor is aware of conditions and events that it is *reasonably foreseeable* that an entity may not be able to meet its obligations as they become due. However, this suggestion would require substantive change to the accounting and auditing standards. Similar suggestions, including recommendations for a more holistic approach, are discussed in Section II.

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<sup>22</sup> *Regulators and oversight authorities:* IAIS; *Accounting firms:* KPMG, PWC; *Member bodies and other professional organizations:* WPK

<sup>23</sup> *NSS:* CAASB

<sup>24</sup> *Member Bodies and Other Professional Organizations:* IBR-IRE

<sup>25</sup> *NSS:* CAASB

<sup>26</sup> *NSS:* CICPA, JICPA; *Accounting firms:* GTI, PWC; *Public sector organizations:* ACAG; *Member bodies and other professional organizations:* EFAA, FEE, SMPC

<sup>27</sup> *Investors and analysts:* CalPERS

### Matter for IAASB Consideration

1. Based on the feedback received (and notwithstanding suggestions for a more holistic approach), does the IAASB believe that the Task Force should continue to explore how best to propose auditor reporting on GC, addressing both the use of the going concern assumption and the identification of material uncertainties?

## II. Summary of Views Identifying Broader Considerations

30. Many respondents suggested alternative approaches, including a more holistic approach, to dealing with GC. In general, a range of holistic options was noted, from those that have a medium-term horizon and a moderate level of difficulty that can be directly influenced by IAASB, to those that have a much longer-term horizon and greater level of difficulty and a further distance from the remit of the IAASB. Respondents' suggestions have been categorized as follows:
  - Clarifying and enhancing definitions and concepts relating to GC such as "material uncertainties" and "significant doubt";
  - Furthering international convergence of financial reporting frameworks; and
  - Enhancing financial reporting frameworks.

### *Clarifying and Enhancing Definitions and Concepts Relating to GC such as "Material Uncertainties" and "Significant Doubt"*

31. Many respondents<sup>28</sup> agreed with the view in the ITC that interaction with the IASB to further clarify terms such as "significant doubt" and "material uncertainty" would be necessary.
32. In particular, there appears to be a lack of clarity about the meaning of certain terminology used in current financial reporting, such as whether a conclusion on the "appropriateness of the use of the GC assumption" is the same as the "ability to continue as a GC."
33. In addition, the concepts of "material uncertainty" and "significant doubt" are not well-understood by users, and can be subject to differing interpretations by both preparers and auditors. Moreover, there appears to be an expectations gap between what users think auditors should warn of in respect of GC, and what auditors are required to do under ISA 570.
34. Because of the lack of clarity about the meaning of certain terminology, introducing a requirement for the auditor to include affirmative statements about GC in the auditor's report could result in misunderstanding or confusion by users. For example, users may misinterpret a statement about the appropriateness of management's use of the GC assumption as conveying more than simply a conclusion on the basis of accounting used to prepare the financial statements. For these reasons, a holistic approach that includes a comprehensive re-assessment of the requirements for reporting on GC by both preparers and auditors, including clarifications to terminology, would lead to significant enhancements to the usefulness of GC information for users. At the same time, such an

<sup>28</sup> *Investors and analysts:* BR, EUMEDION, ICGN, SAAJ; *TCWG:* ACGA; *Regulators and oversight authorities:* AFRC, CPAB, CSRC, EAIG, EBA, HKFRC, IAIS, IRBA; *NSS:* ASB, AUASB, CAASB, CICPA, HKICPA, MAASB, NZAuASB, UKFRC; *Accounting firms:* DTT, EYG, GTI, KPMG, MNP; *Public sector organizations:* ACAG, AGC, AGQ, GAO; *Member bodies and other professional organizations:* ASSIREVI, CAI, FACPCE, FAR, FEE, IBR-IRE, ICAEW, ICAI, ICPAS, IE, KICPA, TK; *Academics:* UofW

approach would help mitigate the risk that auditor reporting could be misinterpreted by users or result in widening the current expectations gap.

#### The IAASB's Ongoing Coordination with the IASB

35. In regard to the above, the IAASB has acknowledged that it may be necessary to provide additional guidance in the ISAs regarding GC and, in particular, material uncertainties. The IAASB believes that, in developing and finalizing such guidance, it would be highly desirable to coordinate closely with the IASB, given that the guidance on GC in the ISAs is closely interrelated with that in IFRSs.
36. In considering how to clearly convey the outcome of the auditor's work on GC in the auditor's report, the IAASB has identified several areas where it believes further guidance may be beneficial:
- Are the criteria (or "threshold") for management's use of the GC assumption the same as those for deeming the entity as being able to continue as a GC?
  - How should the term "significant doubt" be interpreted in relation to the concept of material uncertainty?
  - What is management expected to disclose in relation to a material uncertainty?

In July 2012, IAASB Chairman Arnold Schilder wrote to IASB Chairman Hans Hoogervorst to request that IFRIC consider clarifying the guidance related to GC in IFRSs as a matter of urgency. IAASB representatives and staff subsequently met with senior IASB staff via teleconference to discuss the issues outlined above. With input from the IAASB representatives, IASB staff developed a paper summarizing the issues for purpose of the IASB's outreach to NSS, securities regulators and the larger audit firms to obtain an assessment of diversity in practice in relation to the application of the requirements of IFRSs regarding GC. IASB staff has summarized the issues and results of their outreach in four agenda papers on this topic, which was considered at the November 13–14, 2012 IFRIC meeting.<sup>29</sup>

#### *Furthering International Convergence of Financial Reporting Frameworks*

37. Comments on the need for a more holistic approach to corporate reporting were particularly noted in the context of GC,<sup>30</sup> in part due to differences in management's responsibilities under different financial reporting frameworks. It was noted that not all financial reporting frameworks require management to disclose material uncertainties or address management's responsibilities relating to GC.
38. On November 7, 2012, the US FASB tentatively decided to require management to assess a company's ability to continue as a GC and the need for disclosure when certain levels of uncertainty exist.<sup>31</sup> This would be a change because the current US requirement to explicitly

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<sup>29</sup> See the IASB Staff Agenda Paper 12 available at: [www.ifrs.org/Meetings/Pages/IFRSInterNov012.aspx](http://www.ifrs.org/Meetings/Pages/IFRSInterNov012.aspx).

<sup>30</sup> *Investors and analysts:* ICGN; *Regulators and oversight authorities:* AFRC, CSRC, DFSA, EAIG, EBA, HKFRC, IAIS, IRBA, MAOB; *NSS:* ASB, AUASB, CAASB, CICPA, CNCC-CSOEC, HKICPA, IDW, MAASB, NZAuASB; *Accounting firms:* BDO, CH-AU/NZ, DTT, EYG, KI, KPMG, PKF, PKF(UK), PWC, TL, WK; *Public sector organizations:* ACAG, AGC, GAO, NAOS; *Preparers:* MEDEF; *Member bodies and other professional organizations:* ASSIREVI, BICA, CAQ, FACPCE, FAR, FEE, FSR, ICAEW, ICAI, ICAS, ICASL, ICPAS, ICPAU, IE, IBR-IRE, MICPA, NFPCPAOROC, OROC; *Academics:* BMendick, PGillis, UofW; *Individuals and Others:* Flrungu

<sup>31</sup> See US FASB November 7, 2012 [Board Meeting Minutes](#).

assess a company's ability to continue as a GC rests primarily with auditors. Per the FASB's tentative decision, management would start providing disclosures in its financial statements about an entity's financial difficulties when existing events or conditions indicate it is near *more likely than not* that the entity may be unable to meet its obligations *in the ordinary course of business*, within a *reasonable period of time* from the balance sheet date. The FASB expects to issue an Exposure Draft on this topic in the first quarter of 2013.

39. Many respondents<sup>32</sup> urged the IAASB collaborate with the appropriate accounting standard setters (e.g., the IASB and the US FASB) to ensure that explicit requirements are imposed upon management to assess and disclose (i) whether or not the GC basis is appropriate and (ii) whether or not material uncertainties related to GC have been identified as a jurisdictional condition to implementing mandatory auditor reporting requirements in this area.

#### *Enhancing Financial Reporting Frameworks*

40. A few respondents<sup>33</sup> were of the view that the solution to the issue of GC will have less to do with refining the current accounting and auditing standards and more through a fundamental revisiting of the focus and context of relevant information in financial reporting. For example, it was noted that a holistic approach that includes a comprehensive reassessment of the requirements for reporting on GC by both preparers and auditors, including clarifications to terminology, would lead to significant enhancements to the usefulness of GC information for users. At the same time, such an approach would help mitigate the risk that auditor reporting could be misinterpreted by users or result in widening the current expectations gap. It was also noted that there has been a recent focus in a number of jurisdictions on how corporate reporting could be enhanced in this area, such as the UK's Sharman Inquiry which issued its recommendations earlier this year, the Financial Stability Board's initiatives in relation to banks, and the FASB's project on risk disclosures.

#### *Related Considerations Pertaining to Applicability of Proposals*

41. In addition to the above, several respondents noted additional considerations pertaining to the applicability of the ITC proposals.
42. A few respondents<sup>34</sup> indicated that the concept of GC, as a whole, may not have much relevance to public sector organizations in light of the funding model, though this may not be the case for entities that receive donor funding. This was because, in the public sector, GC determinations are usually primarily dependent on continuing government appropriation and therefore GC is not a primary consideration in the preparation of many public sector financial statements. In addition, many lower-tier public bodies are directly supported by government funding. In these cases, the GC assessment equates directly to a view of the overall solvency and revenue generation capacity of higher levels of government, having regard to the totality of governments' commitments for all of their dependent entities. This in turn is dependent upon the overall financial health of the tax-paying

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<sup>32</sup> *Regulators and oversight authorities:* AFRC, BCBS, CSRC, EAIG, EBA, IAIS, IRBA, ; *NSS:* AUASB, CNCC-CSOEC, HKICPA; *Accounting firms:* BDO, DTT, EYG, KPMG, GTI; *Public sector organizations:* AGC, AGQ; *Member bodies and other professional organizations:* ASSIREVI, CAQ, FAR, FEE, ICPAS, ICPAU; *Academics:* UofW

<sup>33</sup> *NSS:* CAASB, CNCC-CSOEC; *Accounting firms:* BDO, EYG, KPMG, GTI, PKF, PWC; *Member bodies and other professional organizations:* ACCA, ASSIREVI, CAQ, FEE, ICAEW, MICPA

<sup>34</sup> *Accounting firms:* MNP; *Regulators and oversight authorities:* IRBA; *Public sector organizations:* ACAG, AGC, AGM, AGQ, CIPFA, RD

citizenry and the corporate sector. In practice, the preparers of most public sector financial statements may not be carrying out any particularly sophisticated assessment of their financial position as their main concern will be whether the government plans to continue funding the entity.

43. However, International Public Sector Accounting Standards (IPSASs) require management to make an assessment of GC and provide a basis for the public sector auditor's work under ISA 570. As explained in paragraph A1 of the ISA 570, management's use of the GC assumption is also relevant to public sector entities. Certain public sector entities ordinarily do not become legally insolvent or bankrupt because these governments have wide-ranging powers to levy rates, fees or taxes and so are able to adjust their revenues to meet their obligations. However, discussion with the Financial Audit Subcommittee of the International Organization of Supreme Audit Institutions (INTOSAI) noted that auditor reporting on GC may provide more of a signal about a public sector organization's fiscal responsibility, in that it may be helpful to highlight when public sector organizations require additional funding.
44. A few respondents<sup>35</sup> suggested that, due to the nature of the banking and insurance industries, there may need to be a specific GC framework and guidance for these industries. This was because of the view that financial health of a financial institution can change in a very short time. Banks are clearly different from other entities, in that confidence in a bank's solvency (or indeed even its national currency) is what sustains the business model – any fear about the future viability and solvency of a bank can give rise to a run on the bank and immediate liquidity concerns. For banking organizations, disclosures regarding liquidity concerns may have significant implications. Therefore, these respondents were of the view that any requirement to disclose GC uncertainties needs to be carefully considered in conjunction with banking regulators, given the wider systemic contagion risks that can ensue.

#### **Matters for IAASB Consideration**

2. Does the IAASB believe that the recommendations by respondents to explore a more holistic approach to GC should impact the IAASB work on GC as to providing clarity and transparency for the exposure draft planned for June 2013? What is the IAASB's view as to how the timing of the IAASB's work should take into account IFRIC or IASB's deliberations and development of additional accounting guidance?
3. In relation to improving ISA 570 and IFRSs, should ISA 570 be considered for revision to provide more clarity, transparency and flexibility of the application based on the relevant financial reporting framework? Should certain limited amendments be made to ISA 570 for purposes of the exposure draft planned for June 2013? What is the IAASB's view as to whether a longer-term revision is appropriate?
4. Does the IAASB believe that further outreach is needed to determine the implications of reporting on GC for banking and financial institutions?

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<sup>35</sup> *Regulators and oversight authorities: BCBS, EBA, IAIS; Accounting firms: KPMG, PWC*

### III. Summary of Key Messages and Approach Relating to ITC Question 9

45. Question 9 of the ITC solicited views whether auditors should include additional information in the auditor's report about the auditor's judgments and processes to support the auditor's statement that no material uncertainties have been identified. Respondents that supported this suggestion were primarily from the investor and analyst community.<sup>36</sup> In particular, they indicated that the statement would be helpful and informative, but did not articulate specifically the nature of the added value that would be derived.
46. However, a majority of respondents<sup>37</sup> were of a view that it was not appropriate for the auditor to include additional information about the auditor's judgments in concluding that no material uncertainties have been identified. The following was noted:
- It is not appropriate for the auditor to make such a statement, noting, that such a statement by auditors would go beyond what is currently required of management.<sup>38</sup> While investors and analysts would find this information useful, others reiterated the view expressed more generally in relation to AC that it is not appropriate to include the auditor's subjective views or provide original information about the entity.
  - A few respondents<sup>39</sup> expressed a view that such a statement would likely widen the expectations gap, "cloud" the auditor's report, increase litigation risks and may become "boilerplate".
47. One respondent<sup>40</sup> suggested that, if significant events arise or conditions exist that impact the assessment of GC, there might be financial statement effects (such as asset impairment, etc.). The events, conditions, financial statement effects and environmental factors and matters could be included in the AC section, in the same way as any other matter worthy of specific comment.

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<sup>36</sup> *Investors and analysts:* ABI, BR, CalPERS, GCSPS, HEOS, NAPF, SLI; *Regulators and oversight authorities:* HKFRC, JSE; *NSS:* NBA; *Public sector organizations:* NAOS; *Preparers:* PAIB; *Member bodies and other professional organizations:* ICAN, ICAP, ICAS; *Academics:* HC, JCarcello, UofW; *Individuals and others:* Flrungu, KPastakia, RRodil, ROverweg, SGiang,

<sup>37</sup> *Investors and analysts:* EUMEDION, ICGN, IMA, SAAJ; *TCWG:* AICD, IIA, OECD; *Regulators and oversight authorities:* CSA CAC, CPAB, CSIPPC, CSRC, DFSA, IAIS, IOSCO, IRBA, WB; *NSS:* AUASB, CAASB, CICPA, CNCC-CSOEC, FAP, HKICPA, IDW, JICPA, MAASB, NZAuASB, UKFRC; *Accounting firms:* BDO, BT, CCW-UK, CHI, DTT, EYG, GC, GTI, KI, KPMG, MAZARS, MNP, PKF, PKF(UK), PP, PWC, RSM, SNG, SRA, TL, WBLLI, WK; *Public sector organizations:* ACAG, AGA, AGC, AGNZ, AGQ, BC, CIPFA; *Preparers:* BE, Gof100-UK, QCA, USCC; *Member bodies and other professional organizations:* ACCA, ASSIREVI, CAI, CalCPA, CGAC, CNDCEC, CCAA, DNR, EFAA, FAR, FEE, FSR, IBR-IRE, ICAEW, ICPAI, ICPAK, ICPAS, ICPAU, IMCP, KICPA, KWT, MICPA, NYSSCPA, SMPC, WPK; *Academics:* AAA, BCEM, VMassarygina; *Individuals and others:* RMahadevan

<sup>38</sup> *Investors and analysts:* EUMEDION, ICGN, IMA; *TCWG:* AICD, IIA, OECD; *Regulators and oversight authorities:* CSIPPC, CSRC, IAIS, WB; *NSS:* AUASB, CAASB, FAP, HKICPA, IDW, JICPA, MAASB, NZAuASB, UKFRC; *Accounting firms:* BDO, BT, CCW-UK, CHI, DTT, EYG, GTI, KI, KPMG, MNP, PKF, PKF(UK), PP, PWC, RSM, SNG, TL, WK; *Public sector organizations:* ACAG, AGA, AGC, AGNZ, AGQ, CIPFA; *Preparers:* Gof100-UK, MEDEF, QCA, USCC; *Member bodies and other professional organizations:* ACCA, ASSIREVI, CAI, CalCPA, CGAC, CNDCEC, EFAA, IBR-IRE, ICPAK, ICPAS, ICPAU, IMCP, KICPA, KWT, MICPA, NASBA, SMPC, WPK; *Academics:* AAA, BCEM, VMassarygina; *Individuals and others:* RMahadevan

<sup>39</sup> *Regulators and oversight authorities:* CPAB, CSA CAC, CSRC; *NSS:* CAASB, FAP, NBA, NZAuASB, UKFRC; *Accounting firms:* CCW-UK, RSM; *Preparers:* QCA; *Member bodies and other professional organizations:* CNDCEC, CPRB/SCAG, EFAA, FAR, ICAI, ICPAS, KICPA, NYSSCPA; *Academics:* AAA; *Individuals and others:* ROverweg

<sup>40</sup> *Public sector organizations:* ACAG

Another respondent<sup>41</sup> suggested that, with expanded disclosures by management, the auditor may be able to reference these disclosures in AC without providing original information about the entity.

48. The Task Force also notes that ISA 570 requires the auditor to communicate with TCWG events or conditions identified that may cast significant doubt on the entity's ability to continue as a GC. Such communication includes whether the events or conditions constitute a material uncertainty; whether the use of the GC assumption is appropriate in the preparation of the financial statements; and the adequacy of related disclosures in the financial statements. Depending on the IAASB's views about the objective and focus of AC (see **Agenda Item 6-A**), the auditor's work on GC may be among those matters considered for inclusion in AC.

**Matter for IAASB Consideration**

5. Considering the lack of support, what are IAASB's views as to whether the Task Force should pursue reporting by auditors on their judgments and processes when events or conditions have been identified that may cast significant doubt on an entity's ability to continue as a GC but the conclusion is that no material uncertainties exist?

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<sup>41</sup> *Accounting firms: EYG*

## Appendix

### Illustration of Support for Reporting on GC

**Note:** The following table is intended to depict the level of support for reporting on GC. It is intended to provide a directional steer on key issues and has been focused on those stakeholders that are primary participants in the financial reporting supply chain. The views of other respondents (academics, public sector organizations, member bodies and other professional organizations, and individuals and others) are included in the main paper.

Green indicates support for the concept, yellow indicates mixed views (including balancing support and lack of support from individual respondents within the category), and red indicates an overall lack of support for the concept. Blank boxes indicate no respondents fell into that particular category. Support for Reporting on GC category is intended to be an overall summary.

	Investors and Analysts	Regulators and Oversight Bodies	National Standard Setters	Accounting Firms – Forum of Firms	Accounting Firms – Regional and Smaller Firms	TCWG	Preparers
<b>Support for Reporting on GC</b>							
<b>Reporting on the Appropriateness of Management’s Use of the Going Concern Assumption</b>							
<b>Support for Statement on Whether Material Uncertainties Have Been Identified</b>							
<b>Support for AC on GC</b>							
<b>Need for More Holistic Approach/Improvements to Financial Reporting<sup>42</sup></b>							

<sup>42</sup> **Note:** The ITC did not explicitly ask for respondents’ views regarding a more holistic approach to GC; rather, respondents from these stakeholder groups expressly suggested this as a potential approach that could be undertaken to enable auditor reporting on GC.