



Agenda Item 1

The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern

Objective of Agenda Item

To discuss comments received in response to proposed AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* ("AU-C section 570" or the "proposed SAS"), and amendments to other standards (the "Exposure Draft").

Task Force members are:

- Marc Panucci—PwC (Chair)
- Aron Dunn—Allen, Gibbs & Houlik (ARSC)
- Jennifer Haskell—D&T
- Ryan Kaye—E&Y
- Steven Morrison—Morrison, Brown, Argiz & Farra
- Chris Smith—BDO
- Michael Westervelt—CliftonLarson (TIC)

General

In total, 20 comment letters were received in response to the Exposure Draft.¹ Responders were supportive of the Auditing Standards Board's ("ASB") proposal to update AU-C section 570 in light of the impending effective date of the Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2014-15, *Presentation of Financial statements – Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*; using the IAASB's ISA 570 (Revised), *Going Concern* as the base, and written in a framework neutral manner.

¹ To access the comment letters, please follow this link:
<http://www.aicpa.org/Research/ExposureDrafts/AccountingandAuditing/Pages/LoC-on-ED-of-Proposed-SSARS-The-Auditor%27s-Consideration-of-an-Entity%27s-Ability-to-Continue-as-a-Going-Concern.aspx>

Issues for Discussion

I. Applicability of AU-C section 570 to Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement

In issuing the Exposure Draft, the ASB requested feedback on whether in audits of single financial statements and specific elements, accounts, or items of a financial statement (AU-C section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*) the proposed SAS applies. Extant AU-C section 570 is silent regarding the matter; however, the ASB acknowledges that paragraph .01 of AU-C section 805 states that “AU-C sections 200–700 apply to an audit of financial statements and are to be adapted as necessary in the circumstances when applied to audits of other historical financial information.” As a result, there may be confusion regarding whether AU-C section 570 applies to audits of single financial statements and specific elements, accounts, or items of a financial statement. In the Exposure Draft, the ASB included the following questions:

1. Should the standards be amended to indicate that AU-C section 570 is applicable to all audits of single financial statements and specific elements, accounts, or items of a financial statement? If so, how would the auditor apply the requirements of AU-C section 570 (that is, would specific procedures need to be performed), including concluding whether substantial doubt exists about an entity’s ability to continue as a going concern?
2. If commenters believe that AU-C section 570 is not applicable to audits of single financial statements and specific elements, accounts, or items of a financial statement, is the application guidance related to risks and uncertainties sufficient in considering whether appropriate disclosures have been made?

In response to Question No.1, of those responders that commented on the question, the majority agreed that the proposed SAS should not be amended to indicate that AU-C section 570 is applicable to audits single financial statements and specific elements, accounts, or items of a financial statement. Some responders suggested that the applicability of AU-C section 805 is a matter for the auditor’s professional judgment; therefore, implying the standard should remain silent. More responders suggested that the proposed SAS is not applicable to audits conducted under AU-C section 805; therefore, either explicitly suggesting or implying AU-C section 805 should not remain silent on the issue and should make it clear that the proposed SAS does not apply single financial statements and specific elements, accounts, or items of a financial statement. Two responders believe that the proposed SAS should be applicable to an audit of single financial statements (for example, balance sheet). In these responders’ opinion, FASB ASC 205-40 would require the entity to make an evaluation of its ability to continue as a going concern in connection with preparation of a single financial statement in accordance with GAAP.

Based upon the responses, the Task Force believes that the view of the majority should be reflected in the final standard; therefore, the Task Force proposes that AU-C section 805 be amended to reflect AU-C section 570 does not apply to audits of single financial statements and specific elements, accounts, or items of a financial statement. The Task Force does not believe it is explicit in the FASB standard that Subtopic 205-40 applies to a single financial statement and one Task

Force member expressed a view that Subtopic 205-40 would not apply as the FASB standards are written in the context of a full set of financial statements.

However, one Task Force member believes the approach may be interpreted to be ISA minus. This is because, in the basis for conclusion for issuing ISA 800 and 805, the IAASB's position was not as definite, and instead it explained that the auditor's responsibilities in describing his or her responsibilities as it relates to going concern may need to be adapted depending on the relevance of the going concern basis of accounting. Other Task Force members believe it is more important the standard be clear related to the applicability of AU-C section 570 to audits conducted in accordance with AU-C section 805.

Proposed amendments to AU-C section 805 are not reflected as the Task Force first wanted to see if the ASB agrees based on the divergent views. If the ASB believes it should be left to auditor judgment then the Task Force believes guidance is needed on how AU-C section 570 should be applied to audits of single financial statements and specific elements, accounts, or items of a financial statement. The Task Force has briefly discussed this in the past but could not come up with consensus on how to apply AU-C section 570 to audits of single financial statements and specific elements, accounts, or items of a financial statement. The Task Force acknowledges some guidance exists in A7 of AU-C section 805 but believes that guidance may often inappropriately have the auditor conclude that an audit of a single financial statement and specific elements, accounts, or items of a financial statement is not practicable. It should be noted that if it is determined that AU-C section 805 does not apply edits to A12 would also be needed.

Another option raised by one responder (Laura Lindal) was for the auditor to decide if AU-C section 570 procedures would be applied and if not report that in an other matter paragraph and restrict the use of the report. The Task Force does not believe this is an appropriate option as it could lead the auditor or management to not perform AU-C section 570 procedures when there might be reason to believe there is substantial doubt about an entity's ability to continue as a going concern. One responder (BDO) suggested if the ASB decides AU-C section 570 does not apply to audits conducted in accordance with AU-C section 805, then the audit report should state it does not apply. If this is decided, this might naturally occur as the ASB continues to deliberate broader changes to the auditor's report.

In response to Question No. 2, of those responders that commented on the question, the majority agreed that the auditor should consider ASC 275, *Risks and Uncertainties*, and ASC 275 and 450 *Contingencies*. However, one responder (KPMG) noted that the risks and uncertainties guidance set out in GAAP would not be applicable for governmental entities and suggested including application guidance that other financial reporting frameworks may have other considerations. Another responder (D&T) disagreed with the ASB's conclusion to include a consideration of ASC 275 and 450 because in their view, calling out specific accounting requirements is not necessary as it is implicit in the auditor's opinion that the financial statements are presented fairly in accordance with the applicable financial reporting framework.

On balance, responders were supportive of the ASB's position with respect to the guidance related to ASC 275 and 450 to audits of single financial statements and specific elements, accounts, or items of a financial statement. The Task Force agrees that the requirements in ASC 275 and 450

would be implicit but also believe using this as an example will help auditors focus on these disclosures. Therefore, the Task Force does not recommend any amendments in regards to this issue except for the issue with respect to governmental entities (see paragraph A24 of amendments to AU-C section 800 and paragraph A12 of amendments to AU-C section 805).

Expected ASB Action

Does the ASB agree with the Task Force recommendation that AU-C section 570 does not apply to audits in accordance with AU-C 805? If so, does the ASB agree with making this explicit in AU-C section 805? If the ASB believes it is up to auditor judgment on whether AU-C section 570 applies, does the ASB have recommendations related to guidance on how to apply AU-C section 570 to AU-C section 805?

Does the ASB agree with the modifications suggested by the Task Force to reflect considerations of other financial reporting frameworks and retain the auditor's consideration of risk and uncertainties and contingencies?

II. Special Purpose Frameworks

Paragraph 3 of the proposed SAS states in part that: "Special purpose financial statements may or may not be prepared in accordance with a financial reporting framework for which the going concern basis of accounting is applicable (for example, the going concern basis of accounting is not applicable for financial statements prepared on the cash basis of accounting,...". Several responders questioned why AU-C section 570 would not be applicable to the cash basis of accounting and one responder (TIC) questioned why AU-C section 570 would not be applicable to the tax basis of accounting. TIC cited an AICPA non authoritative accounting guidance in which it states that the going concern is relevant to cash and tax basis of accounting. In addition, one responder (US HHS) expressed concern with the interpretation that going concern might not be applicable to special purpose frameworks. They stated that if an auditor of a non-Federal entity reports a substantial doubt about the entities ability to continue as a going concern in either of the preceding two audit reports the non-federal entity does not qualify as a low-risk auditee; therefore, impacts the number of programs the auditor is required to test. US HHS also stated many of these financial statements are prepared under an other comprehensive basis of accounting. As a result, US HHS did not support the change in the proposed SAS.

Based on divergent views, including at the Task Force, the Task Force believes that there are two options to address the issue of whether AU-C section 570 applies in audits of special purpose frameworks:

1) Revert to Extant AU-C section 570—reverting to the existing scope of the standard which states in part in paragraph .01 of AU-C section 570; "This section applies to all audits of financial statements, regardless of whether the financial statements are prepared in accordance with a general purpose or a special purpose framework." This approach represents no change to the existing model and would be responsive to US HHS concerns. However, the Task Force recognizes that under this approach confusion may continue and there will be diversity in the execution of the

standard as the standards are not clear what the work effort is when going concern is not the basis of accounting.

2) Retain the Model Proposed in the Exposure Draft with Additional Application Guidance— Under this model, the Task Force discussed that auditor would have to apply his or her professional judgment whether AU-C section 570 applies. If so, the Task Force recognizes that a key aspect for consideration would be the degree to which the special purpose financial statements contain GAAP-like disclosures. This issue is already addressed in paragraph 17 of AU-C section 570 which states, in part, “In an audit of special purpose financial statements when the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, the auditor should evaluate whether the financial statements include informative disclosures similar to those required by GAAP...” Guidance similar to this could be added to AU-C section 570 in assisting the auditor in whether AU-C section 570 applies to audits of special purpose financial statements. If the ASB has definitive views related to the special frameworks referred to in AU-C section 800 (cash basis, tax basis, regulatory basis, and contractual basis) a statement could be made whether AU-C section 570 applies or not. This guidance might help auditors determine whether AU-C section 570 applies to special purpose financial statements but there is a risk without sufficient guidance there will be inconsistent decisions of whether to apply AU-C section 570, and as a result, this approach may not be responsive to the concerns expressed by the US HHS. If concerns of US HHS are not addressed additional outreach might be needed.

Changes to the proposed SAS have not been reflected as the Task Force first wanted direction from the ASB if there is a preferred approach.

Expected ASB Action

What are the ASB’s views about the options presented by the Task Force? Should the AU-C section 800 revert to extant model that states the AU-C section applies in audits of special purpose frameworks or retain the model presented in the Exposure Draft that AU-C section 570 with additional application guidance? If retaining the existing model, does the ASB have definitive views if AU-C section 570 should or should not be applied to specific special purpose frameworks mentioned in AU-C section 800?

III. Interim Financial Information

In issuing the Exposure Draft, the ASB decided to require performing review procedures to address the situations when the applicable financial reporting framework includes requirements for management to evaluate the entity’s ability to continue as a going concern for a reasonable period of time in preparing interim financial information. The proposed amendments to AU-C section 930 reflected a new requirement for the auditor to include an emphasis-of-matter paragraph in the auditor’s report when certain conditions or events exist related to substantial doubt about an entity’s ability to continue as a going concern. This decision was based on the ASB’s desire to achieve consistency in auditor reporting in both the annual audit and interim financial information.

One responder (D&T) expressed the view that it is not clear from the conforming amendments to AU-C section 930, what the work effort may be as it relates to the consideration of going concern when certain conditions or events exist related to substantial doubt about an entity's ability to continue as a going concern, given that the auditor is required by paragraph 16 of AU-C section 930 to perform "interim review procedures," and that the nature and extent of these interim review procedures are a "matter of the auditor's professional judgment."

One responder (E&Y) suggested including additional guidance with respect predecessor-successor auditor situations.

The Task Force does not believe a change should be made in clarifying the work effort as this was discussed with the ASB before, and it was concluded it should be auditor judgment and that since auditor is not concluding in an interim review related to going concern it is not appropriate to require audit procedures. Similar additional guidance was not provided with respect to a predecessor-successor auditor situation as this would involve auditor judgment depending upon the circumstances, and it is difficult to provide prescribed procedures related to an interim review.

Expected ASB Action

The Task Force seeks the ASB to confirm that the work effort related to consideration of going concern should be left up to auditor judgment.

IV. Considerations for Governmental Entities

Some responders suggested that the proposed SAS should better address the impact on governmental entities and suggested additional application guidance to address governmental considerations. The Task Force accepted many of these recommendations. See changes to paragraphs A7a, A8a, A25, A30a, and A30b.

In addition in several places public sector entities was changed to governmental entities based upon recommendation of responders.

Expected ASB Action

Does the ASB agree with the additional application guidance and editorial changes to address governmental considerations?

V. Inquiry Beyond Evaluation Period

Paragraph 17 of the proposed SAS states that: "The auditor should inquire of management regarding its knowledge of conditions or events beyond the period of management's evaluation that raise substantial doubt about the entity's ability to continue as a going concern." Several responders raised the issue that this requirement could be interpreted as going beyond what is required by FASB. The Task Force recommends edits to paragraph 17 to remove the notion as to whether there is substantial doubt. Also, the Task Force recommends edits to the application guidance, including adding paragraph A22a, to make it clear the auditor is not asking management

to extend its evaluation and depending upon the financial reporting framework what is the responsibility of the auditor if conditions or events exists (i.e. is it part of the substantial doubt evaluation or consideration of other disclosures).

Expected ASB Action

Does the ASB agree with the changes in paragraph 17 and the application guidance?

VI. Third-Party Confirmations

One responder (GT) suggested elevating paragraph A27 of the Proposed SAS which provides application guidance to situations in which management's assumptions include continued support by third parties (for example, subordination of loans, additional funding or guarantees) to a requirement. The Task Force considered this comment and concluded that this circumstance would also be valid if such support originated from an owner-manager, however the form of audit evidence in this case may be in the form of a written confirmation from the owner-manager or a management representation.

The Task Force also discussed the implications for the auditor in the event that the requested written confirmation (or representation) is not received. Does this automatically result in the auditor's conclusion that there is substantial doubt about the entity's ability to continue as a going concern? Or, if the written confirmation is not received, can this be overcome by performing other procedures? The Task Force concluded that if the written confirmation (or representation) is essential to arrive at the conclusion whether there is substantial doubt and the written confirmation is not received, then the auditor would conclude that there is substantial doubt and a going concern emphasis-of-matter paragraph would be necessary. If the written confirmation (or representation) is not essential, then it is based upon auditor judgment based upon the totality of the audit evidence of whether there is substantial doubt if the written confirmation (or representation) is not received.

The Task Force accepted the recommendation to elevate paragraph A27 to a new requirement, but the task force also recommends application material to 1) provide guidance when the written confirmation is essential in arriving at the conclusion whether there is substantial doubt, 2) provide guidance when the written confirmation is not considered essential to arrive at the conclusion whether there is substantial doubt, 3) clarify the written confirmation relates to the willingness of support but not necessarily the ability to support, and 4) provide illustrative language in the application material of a letter of support.

Expected ASB Action

Does the ASB agree with elevating paragraph A27 to a requirement and the relevant application guidance?

Items Presented

Agenda Item 1 – Issues Paper

Agenda Item 1A – Proposed SAS (marked from Exposure Draft)

Agenda Item 1B – Comment Letter Analysis (for reference only)

Mr. Panucci will refer to the Issues Paper (Item 1) and the proposed SAS (Item 1A) in leading the discussion.