

Ms. Sherry Hazel
Audit and Attest Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

6 February 2012

Proposed Statement on Auditing Standards, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern (Redrafted)*

Dear Ms. Hazel:

Ernst & Young LLP ("Ernst & Young") is pleased to submit this comment letter to the Auditing Standards Board (ASB) in response to the ASB's request for comment regarding the above-referenced proposed Statement on Auditing Standards (proposed SAS).

We support the issuance of this proposed SAS. We agree with the ASB's strategy to move forward with the clarity redraft of SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, so that it's consistent with the format of the other clarified SASs that were issued as SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*. We also agree with the ASB's decisions to:

- ▶ Include the requirement in paragraph 18 of the proposed SAS for the auditor to obtain written representations from management concerning the entity's ability to continue as a going concern (see our "comment for consideration" related to this paragraph of the proposed SAS asking the ASB to re-consider when in the process it is appropriate for the auditor to obtain these representations)
- ▶ Incorporate existing Interpretation No. 1, "Eliminating the Going-Concern Explanatory Paragraph From a Reissued Report" of AU section 342 into paragraph 20 of the proposed SAS

We also support the ASB's intent to converge the proposed SAS with International Standards on Auditing (ISA) 570, *Going Concern*, pending the Financial Accounting Standards Board's (FASB) anticipated development of accounting guidance addressing going concern. We urge the ASB to consider any new accounting guidance, as well as current practice issues related to evaluating and reporting going concern issues, as part of its subsequent redrafting of this proposed SAS.

Attached below is our response to each of the ASB's questions for respondents as well as comments related to the proposed SAS for your consideration. We would be pleased to discuss any of our comments with members of the ASB or its staff.

Sincerely,

Ernst + Young LLP

Responses to guide for respondents

Question 1: Are the objectives of the auditor appropriate?

Yes. We believe the objectives of the auditor are appropriate.

Question 2: Are the differences between the proposed SAS and SAS No. 59 identified in the supplement to the exposure draft, and other language changes, appropriate?

We believe the differences between the proposed SAS and SAS No. 59 are appropriate.

Question 3: Have considerations for audits of smaller, less complex entities and governmental entities been dealt with appropriately?

Paragraph 16 of Governmental Accounting Standards Board (GASB) Statement number 56, "Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards" issued in March of 2009 and effective upon issuance states (*emphasis added*):

Going Concern Considerations

16. Continuation of a legally separate governmental entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. Information that may significantly contradict the going concern assumption would relate to a governmental entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of governmental operations, restructuring of debt, submission to the oversight of a separate fiscal assistance authority or financial review board, or similar actions. *Financial statement preparers have a responsibility to evaluate whether there is substantial doubt about a government's ability to continue as a going concern for 12 months beyond the financial statement date. Moreover, if there is information that is currently known to the government that may raise substantial doubt shortly thereafter (for example, within an additional three months), it also should be considered.*

The proposed SAS requires the auditor to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited. Because the GASB Statement cited above exists today for governmental entities, and is inconsistent with the auditor's responsibilities in the proposed SAS, we ask the ASB to consider whether there are auditing issues caused by this inconsistency that could be addressed in the proposed standard or as an interpretation to the standard once it is issued.

Comments for consideration

- ▶ Paragraph 3 of the proposed SAS states that "The auditor's responsibility is to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited (hereinafter referred to as a reasonable period of time)." We ask the ASB to consider whether this content should be moved from the introduction section of the proposed SAS to a requirement paragraph (for example, paragraph 7), to position this important topic as a requirement.

- ▶ Paragraph 7 of extant AU 341 states (*emphasis added*):

If, after considering the identified conditions and events in the aggregate, the auditor believes there is substantial doubt about the ability of the entity to continue as a going concern for a reasonable period of time, he should consider management's plans for dealing with the adverse effects of the conditions and events. The auditor should obtain information about the plans *and consider whether it is likely the adverse effects will be mitigated for a reasonable period of time* and that such plans can be effectively implemented.

We believe that the extant requirement for the auditor to consider whether it is likely that the adverse effects will be mitigated for a reasonable period of time should be included in the proposed SAS. We believe this is an important consideration in evaluating the effects of management's plans and in our conclusion as to whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. Therefore, we suggest the following revision to paragraph 9 of the proposed SAS:

If, after considering the identified conditions and events in the aggregate, the auditor believes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should obtain information about management's plans that are intended to mitigate the adverse effects of such conditions and events. The auditor should

- a. identify those elements of management's plans that are particularly significant to overcoming the adverse effects of the conditions and events and plan and perform procedures to obtain audit evidence about them including, when applicable, considering the adequacy of support regarding the ability to obtain additional financing or the planned disposal of assets; ~~and~~
 - b. assess whether it is likely that the adverse effects will be mitigated by management's plans for a reasonable period of time; and
 - c. assess whether it is likely that such plans can be effectively implemented.
- ▶ Paragraph 18 of the proposed SAS states (*emphasis added*):

If conditions or events have been identified *that indicate there could be substantial doubt* about the entity's ability to continue as a going concern, the auditor should obtain written representations from management

- a. regarding its plans that are intended to mitigate the adverse effects of conditions and events that indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and the likelihood that those plans can be effectively implemented, and
- b. that the financial statements disclose all of the matters of which management is aware that are relevant to the entity's ability to continue as a going concern, including principal conditions and events, and management's plans

While we agree with the requirement for the auditor to obtain written representations, we believe written representations should be required once the auditor has concluded that they *believe there is substantial doubt about the entity's ability to continue as a going concern for a*

reasonable period of time (consistent with paragraph 9 and 11 of the proposed SAS), not when conditions or events have been identified that indicate there *could* be substantial doubt.

Paragraph 9 of the proposed SAS requires the auditor to obtain information about management's plans when the auditor *believes there is a substantial doubt* about the entity's ability to continue as a going concern. Further, paragraph 11 of the proposed SAS requires the auditor to consider the possible effects on the financial statements and the adequacy of the related disclosures, *when the auditor concludes there is substantial doubt* about the entity's ability to continue as a going concern. Therefore, the proposed SAS requires the auditor to obtain representations from management regarding management's plans and the adequacy of the financial statement disclosures when the auditor has identified conditions or events that indicate *there could be substantial doubt about the entity's ability to continue as a going concern*, but doesn't require the auditor to obtain information about management's plans or evaluate the adequacy of disclosures at this point in the auditor's process. The auditor could be requesting management representations regarding information they had not discussed with the client as part of the audit (because the auditor never got to the point in the process where they believed there was substantial doubt about the entity's ability to continue as a going concern).

We suggest that the ASB revise paragraph 18 of the proposed SAS to require the auditor to obtain written representations from management *when the auditor believes there is substantial doubt* about the entity's ability to continue as a going concern for a reasonable period of time.

- ▶ We suggest the following revision to paragraph A10 of the proposed SAS to clarify the intent of the application guidance:

A10. The auditor may perform procedures, *in addition to those required by paragraph 19*, that the auditor deems necessary in the circumstances *when determining whether to eliminate the going-concern emphasis-of-matter paragraph that appeared in the original report*.