INSTITUT DER WIRTSCHAFTSPRÜFER

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**Re.: Accountancy Europe's Views & Ideas Paper entitled "Going Concern: Recommendations to strengthen the financial ecosystem"**

Dear Julia

The IDW is pleased to have the opportunity to comment on Accountancy Europe's Views & Ideas Paper entitled "Going Concern: Recommendations to strengthen the financial ecosystem".

We fully agree that recent corporate failures as well as the potential impact of the ongoing COVID-19 pandemic indicate a need to reconsider the way in which the entire financial reporting ecosystem currently functions. Indeed, each aspect thereof demands careful consideration, as do the interactions between the individual players within this system.

In the wake of the Wirecard case, the IDW published an IDW Position Paper: "Further development of corporate governance and controls as first lessons from the Wirecard case" to which we refer in discussing ACE's paper and suggestions:

https://www.idw.de/blob/124612/cfbb7df12ed31cd1be579bda4aa78431/down-positionspapier-wirecard-englisch-data.pdf.

In the context of going concern, this position paper proposes that management should be required to make an explicit statement in the financial statements that it is not aware of any facts or circumstances that stand in the way of the continued existence of the entity. The Supervisory Board (or Audit Committee) should then be responsible for examining management's declaration and then itself confirm publicly that it has complied with its duty to examine this statement

GESCHÄFTSFÜHRENDER VORSTAND:
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and that it concurs with management's assumption that the entity will continue its activities. The IDW further suggests specific clarification that the entity's risk management system must also cover IT risks, such that management's statement on the continuation of the entity's activities mentioned above would also include measures against possible IT risks that could threaten the entity's existence.

The IDW also suggests that the auditor include an explicit statement on the declaration on the continuation of the entity's activities as proposed above in the auditor's report in stating that no risks have come to the auditor's knowledge in the course of performing assurance procedures on the risk early warning system and the management report and audit procedures on the financial statements that could endanger the existence of the entity and that it is therefore permissible to assume that the entity will continue as a going concern.

We would like to make a few general comments before commenting specifically on the Paper's recommendations and ideas.

***General comments***

**Expectations must be realistic as business failure is part of a free market economy**

We also agree that it is important for the Paper to point out that no amount of improvement can eliminate corporate failure, given that risk is a feature of the free-market economy. There is often an unrealistic public expectation that "proper" entity governance, including the involvement of an independent auditor should be able to counter business failure in the immediate 12-month period after financial statements have been audited. The sudden emergence of the Covid-19 virus and the impact of various measures aimed at containing the spread of disease have clearly demonstrated how fragile many businesses are.

**Recommendations should not be limited to public interest entities (PIEs)**

Whilst we generally support Accountancy Europe's initiative, we are concerned that the recommendations discussed in the Paper are limited primarily to those entities defined in EU legislation as public interest entities (PIEs) and this segment of the audit market. In view of the ongoing Covid-19 pandemic and its likely impact on entities of all sizes, we believe this focus is misplaced. Depending on the business sector, many smaller entities' businesses may be even more at risk of failure during or in the aftermath of the pandemic than larger established PIEs, so the SME sector is highly systemically relevant in most jurisdictions. We would therefore welcome serious consideration of recommendations tailored to this sector.

Indeed, it is especially important to note that the primary responsibility of management and those charged with governance relating to going concern assessment as noted on page 5 of the Paper holds true for all entities, irrespective of their size, complexity or level of public interest. It is therefore imperative that the respective responsibilities and roles of management and those charged with governance relating to going concern are sufficiently clear – including within the applicable laws and regulation.

Indeed, several of the Paper's suggestions made with PIEs in mind may be equally applicable to non-PIEs. For example, we consider that enhanced reporting (driven by appropriate changes to the applicable financial reporting frameworks) together with a requirement for management to make a specific statement on going concern would be helpful and appropriate for all entities.

In general, there is an urgent need for our profession to take a proactive stance and be clear about the audit and its capabilities and limitations in regard to going concern. Non-auditors need to be better informed in order to for them to understand the practical implications of inherent limitations of an audit. Currently, some of the public's expectations as to the auditor's role in relation to going concern issues may simply not be reasonable.

***Comments on the recommendations***

**Broaden companies' work effort**

**Mandate going concern disclosure even if no uncertainties**

The IDW agrees that financial reporting standards need to address companies' work effort in preparing their going concern forecasts more thoroughly.

We would also strongly encourage financial reporting standard setters such as the IASB to revisit the level of transparency that should be required of companies in regard to reporting on going concern, material uncertainties and close calls, beyond the current IFRS interpretation. In our view, irrespective of whether there are any material uncertainties impacting an entities potential to continue as going concern, a specific statement in the financial statements by management outlining its views on going concern should be considered. We suggest the potential benefits of transparency of risks would outweigh the work effort, since currently non-PIEs may be reluctant to address detailed information as to the risks they face, and the expected work effort would introduce rigor in requiring management of non-PIEs to face up to and address potential risks to their businesses; at the same time this should be proportionate to the complexity and size of the business. Improving the transparency regarding the fundamental issue of going concern would be beneficial to all parties involved with businesses in all sectors and sizes.

We believe that all companies should be required to provide disclosures detailing management's judgements concerning those risks that could impact the company's strategy and business model and, where applicable, for PIEs this should extend to the disclosure of judgements made in considering the various scenarios used to test the business's potential resilience.

As explained in our general comments, the IDW suggests that management should make an explicit statement in the financial statements on going concern – and this be subject to oversight within the company and audit.

International auditing standards deal far more thoroughly with this issue than financial reporting standards, resulting in specific reporting requirements for auditors. Useful and transparent reporting on issues relevant to going concern nevertheless must remain a responsibility of management (i.e., in compliance with robust reporting standards), with the auditor opining on management's assertions, and potentially detailing the auditor's approach in arriving at that opinion.

It is important that management make two assertions: 1. Whether the use of the going concern basis of accounting is appropriate and 2. Whether there is a material uncertainty.

On the basis of companies' disclosure of this information, we also support the suggestion that auditors should be required to provide:

- a statement on their consideration of management's going concern assumption, even where neither a material uncertainty nor issues with management's assessment have been identified, and
- conclusions as to whether the following are appropriate
    - management's use of the going concern basis of accounting, and
    - management's statement that no material uncertainty has been identified.

However, we are not convinced that the suggestion concerning "gradual reporting" would prove practicable, as we believe that providing transparent information in sufficient detail would be superior, since this should allow the reader to draw their own conclusions aligned to their individual risk appetite.

**Mandate disclosure on companies' risk management systems on going concern and expand the auditor's involvement**

We agree that disclosures on companies' risk management systems on going concern coupled with appropriate involvement of the auditor is a sensible suggestion for PIEs. Given the complexity of most PIEs and desire not to overburden non-PIEs we agree that in this case it would be appropriate to limit such a requirement to PIEs. In this context, robust risk management systems and procedures for the identification of going concern issues should include sensitivity analyses, as appropriate.

However, in addition, we also suggest requiring disclosure of detailed information concerning the entity's business model and sustainable development potential (i.e., expanded in this case non-financial information) in the management report. This would be helpful to stakeholders, and as such should also be subject to auditor's procedures to ensure its veracity.

**Change in mindset, transparency and communication:**

We believe it is important for standard setters', management of companies' and auditors' mindsets move towards transparency in going concern-related disclosures for all entities.

It should become the norm to disclose pertinent information related to the health of the business instead of the current regime whereby only entities already in difficulty are required to make specific disclosures, which are naturally associated with the fear that any disclosure will trigger negative implications of e.g., a self-fulfilling prophecy.

Auditors have long been concerned that they may find themselves in the untenable situation whereby they are required to highlight going concern uncertainties in a special section of the auditor's report, which the reporting entity may either not have reported with appropriate degree of transparency or may not have reported at all.

Such concerns could be eased considerably by robust requirements for all entities – not just PIEs – to report going-concern related information.

**Mandate an audit committee in each public interest entity**

We fully support this suggestion and agree that EU legislation should be amended to preclude exceptions to the requirement for PIEs to have an audit committee.

Beyond this suggestion in the Paper, we believe that certain prescribed competency levels should be mandatory for audit committees of PIEs, and that the name of the individual who holds the required experience and competency should be disclosed.

Indeed, well-functioning corporate governance must consider the respective roles of management and the supervisory board or non-executive directors, not just an audit committee. All need to be sufficiently qualified to play their respective roles appropriately.

**Clarify and harmonize the period for going concern assessment**

We agree that harmonization of the period of going concern assessment is desirable, as it is currently confusing for users of the financial statements that in some jurisdictions, the assessment is made covering at least 12 months from the balance sheet date, whereas in others it covers 12 months from the date of approval of the financial statements or date of the auditor’s report.

Potentially a period from the balance sheet date is more practical for entities as the date of approval of the financial statements may not be clear. Any harmonization needs to take place through accounting requirements – the auditor cannot be required to apply a longer period than management, since the auditor is required to assess management’s work not perform an independent assessment.

In our opinion, mandating disclosure in the notes might be helpful, although it cannot solve the issue of incomparability.

**Broaden auditors’ area of consideration and work effort**

Whilst we note the suggestions made in the Paper, we believe that in performing an audit in compliance with ISAs auditors already select the most appropriate risk assessment procedures in the individual audit engagement circumstances, and they do not disregard contradictory evidence or red flags, but instead take a sufficiently wide context.

Provided the entity’s management presents more detailed information to the auditor (i.e., in accordance with suitably amended financial reporting standards), the auditor could, as suggested, broaden some aspects of audit work. However, assessing the entity’s ability to continue as a going concern must remain the full responsibility of management. Auditors should test the veracity of management’s assessment, but audit procedures cannot be a substitute for this if management does not deliver a well-founded assessment.

**Make early warning mechanisms for auditors effective**

We agree that improved coordination and clarification of the responsibilities of all parties in the ecosystem is needed. In this regard we refer to the IDW’s

Position Paper mentioned above, in which we outline a number of suggestions in this context. However, the total extent to which improvements might be helpful in early recognition or even in averting business failure is currently being explored.

***Specific comments on the ideas***

**Assessing companies' longer-term viability and resilience**

Longer term prognoses, scenario analyses and longer-term viability assessments that take account of multiple factors are generally helpful in gauging business resilience, as the current Covid-19 pandemic has clearly demonstrated.

However, any such assessments must be performed by management in the first instance, with the auditor required to consider their assessment. There need to be clear criteria for such an assessment, otherwise auditors will be unable to obtain assurance in relation to such assessments.

It needs to be clear that the further into the future assessments try to go the less reliable they are likely to be, but these can provide a valuable tool for management in governing the business as well as a variety of other stakeholders in deciding on their potential engagement with the business.

**Interconnecting financial and non-financial information**

It is important that any non-financial information is capable of being assured. This presupposes:

- the existence of suitable criteria for the preparation of non-financial information and its interconnection with financial information,
- management has the systems and processes (internal control) in place to gather the information needed as evidence to support its assertions in the non-financial information it reports and any disclosures on interconnectivity, and
- management is required to support those assertions and disclosures with such evidence.

The IDW firmly believes that non-financial information is now useful to investors and other stakeholders and that this needs to be suitable for comparison purposes. Furthermore, mandatory assurance is needed to ensure that those who seek to rely on such information can have comfort in the reliability of this information.

Please let us know, should you have any questions, as we would be pleased to discuss this with you further.

Yours truly,

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| Melanie Sack | Gillian Waldbauer |
| Executive Director | Head of International Affairs |

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