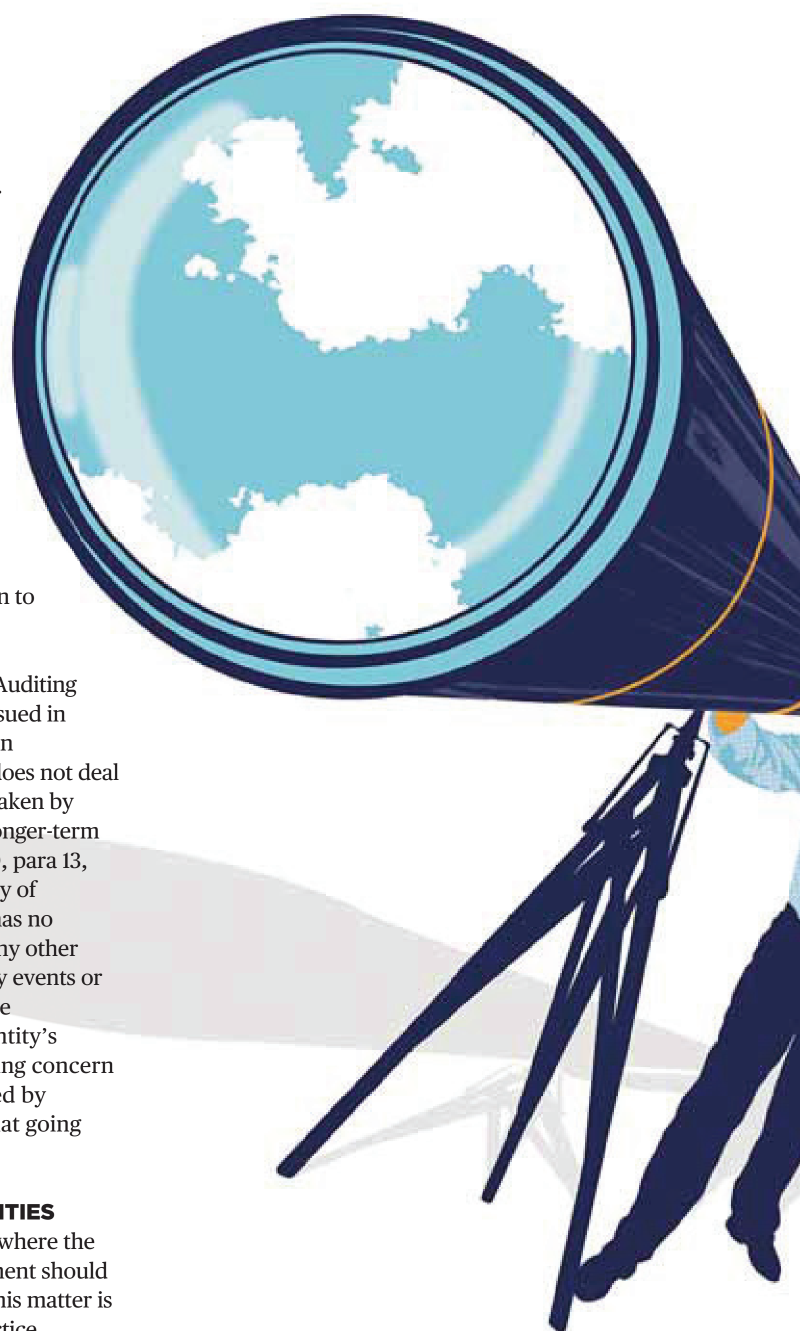
TAKING THE LONG VIEW

What do auditors need to know about longer-term viability statements? **James Roberts** provides some answers



The first thing that many auditors need to know is that the requirement for a longer-term viability statement in the annual report (AR) is not something that will affect them or their audit clients. It is one of the changes that was introduced when the UK Corporate Governance Code was revised in 2014. The Code applies only to companies with a premium listing of equity shares in the UK (regardless of where they are incorporated) and those that chose to report on how they have applied the Code or explain why they have not.

However, directors of affected companies will soon be including in their 2015 AR and accounts their first longer-term viability statements, and their auditors will be affected. The revised Code introduced the requirement that, for accounting periods beginning on or after 1 October 2014, directors state in their company's AR that they have a reasonable expectation that the company will be able to continue in operation and to meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.

The period to be covered by the assessment is a decision for the directors. It should be significantly more than 12 months from the date of approval of the financial statements. It is anticipated that periods chosen will be between three and five years. But this depends on the nature and circumstances of the business, and the budgeting, forecasting and risk management processes it undertakes, which coincides with the company's longer-term strategic plans.

The longer-term viability statement is separate and additional to the going concern consideration that directors need to confirm in annual and half-yearly reports, to the extent that it is appropriate that the company adopts the going concern basis in preparing those.

Auditors' work in relation to the going concern basis of accounting is set out in the International Standard on Auditing (ISA) 570 *Going Concern*, issued in October 2009 and revised in September 2014. This ISA does not deal with the work to be undertaken by auditors in respect of the longer-term viability statement. ISA 570, para 13, says that, other than inquiry of management, the auditor has no responsibility to perform any other audit procedures to identify events or conditions that might cause significant doubt on the entity's ability to continue as a going concern beyond the period assessed by management in making that going concern statement.

AUDITOR RESPONSIBILITIES

The Code does not specify where the longer-term viability statement should be located within the AR; this matter is left to the directors. In practice, however, we expect it to be included either in the strategic report (along with the disclosure of principal risks and uncertainties) or in the corporate

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governance statement (with the disclosures in respect of risk management and internal control).

ISA 720, *The Auditor's Responsibilities Relating to Other Information*, deals with other information in the AR, which is outside the audited financial statements themselves, and ISA 720B deals specifically with information in the directors' report. That standard requires the auditors to read other information in the AR to identify any that is incorrect or inconsistent (or that is otherwise misleading) with the knowledge that they have acquired, as auditor, in the course of performing the audit. The Listing Rules will also soon include reference to the longer-term viability statement as being a matter specified for review by auditors in terms of compliance with the Code.

It is clear, therefore, that the auditor should read the longer-term viability statement in the context of the above requirements: consider it for consistency and also appropriateness in light of the knowledge they have from their performance of their other work as auditors.

PRACTICAL CONSIDERATIONS

The process required for company directors to put themselves into a position to make a longer-term viability statement is inevitably interlinked with their consideration of the company's principal risks and uncertainties.

Directors are required by Code provision C.2.1 to have performed a robust assessment of their principal risks, including those that threaten the business model, the future performance of the business and its solvency or liquidity. Auditors will consider these risks and uncertainties in their review of other information in the AR, and to satisfy themselves that there are no matters that give rise to concerns with the director's statement that the AR and accounts as a whole, are fair, balanced and understandable.

Auditors are required to report by exception if the statement is not consistent with the knowledge they have acquired in the course of their audit.

The directors will also need to undertake an analysis of budgets and forecasts, and a robust challenge of the assumptions that underlie them. Auditors will have knowledge of these matters through their work to confirm the going concern basis of accounting is appropriate.

Auditors will also wish to understand:

- the process for selecting the period on which the directors choose to report, its relationship to management's normal forecasting processes and its relationship to any business cycle which the company is subject to (and thus might be consistent with its peer group), and consider whether the disclosure explains why the directors consider the chosen period to be appropriate, not just state what it is;
- the process through which the company comes to its conclusion on the longer-term viability statement, and be familiar with any systems and controls around it, though they are under no obligation to examine these; and
- what material assumptions and judgements have been made in preparing the information supporting the longer-term viability statement.

As a matter of good practice auditors will want to communicate with those charged with governance on any matters arising in respect of their consideration of the longer-term viability statement.

SPOTTING INCONSISTENCIES

If, in considering the matters above, auditors become aware of material misstatements or inconsistencies with other information in the AR, which management are unwilling to change, they should communicate these to those charged with governance. They may also suggest that the company consults third parties and, having considered this, they may have to modify their audit report or withhold it until the matters can be resolved.

In extremis, auditors may have to withdraw from the engagement, bearing in mind that the circumstances surrounding such resignation will need to be reported, and bearing in mind that they have the right to be heard at the annual general meeting in respect of matters that affect them as auditors.

James Roberts
is a BDO partner and chairman of the Audit & Assurance Faculty