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Dear Harun,

Grant Thornton International Ltd appreciates the opportunity to provide input into Accountancy Europe's recommendations to strengthen the financial reporting ecosystem specifically related to fraud and going concern.

Fraud

In addition to comments related to the specific recommendations we have the following overall comments:

1) We believe that before implementing any additional recommendations an analysis should be performed of recent frauds, assessing whether the implementation of any of the suggested recommendations would have prevented or detected the fraud. Although the implementation of these recommendations may prevent or detect a fraud the cost of doing so may be disproportionate to the benefits.

2) The focus of the recommendations is currently on Public Interest Entities (PIEs), we believe that any recommendations should have broader application as fraud is not only relevant to PIEs. Although the motivations and how fraud may be perpetrated may be different there is still the risk of fraud. For example, rather than being motivated to inflate revenue, as is common in many PIEs, to meet investor expectations, a SME may be motivated to reduce recorded revenue to reduce their tax burden.

Comments on specific recommendations

1) Require companies to have and publicly report on a fraud risk management system

This report could be included within management's report, where applicable. However, caution should be exercised such that these reports are specific to the entity and are not just rote in nature. In addition, it is unclear from the recommendations what expectations there would be on the auditor with respect to this information, that is, is the auditor expected to provide some level of assurance on this information.

2) Pay specific attention to senior management fraud

We support additional guidance provided to Audit Committees on how to be an effective oversight body. This guidance may include:

- Questions an audit committee may ask of senior management related to fraud risks

- Maintaining independence in fact and perception from senior management
- Experience requirements needed on the board to fulfill responsibilities
- Working effectively with external auditors
- Overseeing an effective internal audit function and its procedures related to fraud risk

3) **Mandate an audit committee in all public interest entities**

We agree that for appropriate governance an audit committee should be required for all public interest entities. However, as mentioned before, fraud is not unique to public interest entities, and there should be consideration as to what may be required to provide the necessary governance for non-PIEs.

4) **Make early warning mechanism for auditors effective**

If the auditor has identified or suspects a fraud, ISA 240.43 currently requires the auditor to determine whether there is a responsibility to report the occurrence or suspicion to a party outside the entity. We agree that it should be clear through local legislation who this is to be reported to, taking into account both the legal responsibilities of the auditor and confidentiality requirements.

5) **Clarify auditing standards for a common understanding of the auditor's role**

It is unclear in the recommendation what is meant by "clarify" the standard. The standard clearly outlines the responsibilities of the auditor and states that the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Although the standard clearly sets out the responsibilities there is an education process to make clients and other stakeholders aware of the respective responsibilities with respect to fraud.

That being said, areas where additional guidance may be helpful include:

- The degree to which a fraud risk factor(s) may indicate that there is a risk of material misstatement related to fraud requiring the auditor to develop a response
- Auditor's responsibility when a non-material fraud is detected. For example, there has been misappropriation of cash detected that is not material to the financial statements
- Guidance on how to identify the relevant characteristics of fraudulent journal entries. ISA 240.A43 provides example characteristics however there is no guidance when each of these may be relevant. As a result, in some cases the selection of journal entries to test has become a rote exercise as auditors will test journal entries for all identifying characteristics listed versus determining which characteristics are relevant given the facts and circumstances of the entity
- The application of professional skepticism. Throughout the ISA there are references to exercising "enhanced" professional skepticism. Clarity and guidance are needed on what is expected when the auditor exercises "enhanced" professional skepticism

6) **Auditors' access to knowledge and awareness about fraud**

We support information sharing to provide relevant information to auditors. However, given that each fraud is unique caution needs to be used in how this information is used as for each engagement the auditor needs to; identify the fraud risk factors, determine whether there is a risk of material misstatement due to fraud and develop an appropriate response to the identified fraud risk. In addition, although increasing the auditors' access to knowledge and awareness about fraud may increase the likelihood that they may identify fraud it does not mean that all frauds will be detected.

7) **Auditors to clearly communicate their work and conclusions about fraud**

We believe the standards currently provide sufficient communication requirements related to fraud. For example, ISA 240.40 requires the auditor to communicate if they have identified a fraud or has obtained information that a fraud may exist. In addition, ISA 240.41 and .42 include other requirements if fraud is suspected involving management and any other matters related to fraud.

We caution requiring auditors to communicate the specific audit procedures performed to address common fraud schemes, providing this information may provide a means for those that perpetrate the fraud to circumvent audit procedures performed by the auditor.

If a requirement is implemented requiring the auditor to report publicly their conclusion on management's statement on fraud risk, we urge caution in managing the expectation gap this may introduce. Accordingly, any such required auditor communications should include an explicit statement about the inherent limitations of even the best audit's ability to detect a well-orchestrated fraud. In addition, if auditors are required to publicly report their conclusion, management should first be required to communicate its own conclusion regarding fraud risk management.

Comments on ideas to be explored

1) **More extensive use of forensic experts by auditors**

   We do not believe that a forensic expert should be required on all PIE audit engagements. We believe that the involvement of a forensic expert may be an appropriate response to identified and assessed risk of material misstatement due to fraud.

   The use of a forensic specialist may not be an appropriate response to an identified fraud risk. In addition, this may put firms that don't have forensic specialists at a competitive disadvantage.

2) **More extensive use of data and technology by auditors**

   There has been an increasing use of technology not only by clients but also by auditors. Although the increased use of technology brings about opportunities it also brings with it risks. For example, there may be vast amounts of data and reports that can be produced, and it may be challenging for the auditor to sift through the information to determine what is relevant. In addition, increase use of technology brings with it other IT related risks such as Cyber risks.

   Any recommendations related to the use of data and technology by auditors should align with the direction of the IAASB Audit Evidence Taskforce.

Going Concern

In addition to comments related to specific recommendations we have the following overall comments:

1) Similar to our comment on fraud we do not believe the recommendations should be focused on PIEs. Going concern is an issue that impacts all entities. In some instances, there is greater going concern risk in SMEs than in PIEs.

2) Although the recommendation may result in some improvement, caution needs to be exercised in increasing the expectation gap in the auditor's responsibility related to going concern. It needs to be clear that management needs to perform their assessment of going concern first prior to the auditor performing their responsibilities. The recommendations proposed will not eliminate corporate failure nor will they enable the auditor to detect pending corporate failures.

3) We recommend that Accountancy Europe work closely with the IAASB, as the IAASB is working on a similar initiative to make sure there is consistency messaging regarding responsibilities of management and the auditor.

Comments on specific recommendations

1) **Broaden companies' work effort**

We agree that financial reporting standard setters, such as the IASB, should address management's work efforts in preparing their going concern analysis. We believe that COVID-19 has demonstrated that more guidance is needed, in particularly, when dealing with subjective assumptions.

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

The ISAs currently require the auditor to obtain an understanding of internal control to identify and assess risks of material misstatement. Recommending the auditor to consider internal control over financial reporting as whole will significantly expand the scope and cost of an audit engagement. Therefore, if a decision is made to move forward with this recommendation, we believe it should be limited to PIEs as to not overburden the non-PIEs.

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

Although we understand the rationale for this recommendation it is not clear if such increase in disclosure would have a significant impact, in fact it may have a negative impact if a corporate failure occurs in light of all the additional disclosures.

Determining whether there is a material uncertainty is a matter of professional judgement, in addition the ISAs do not include a definition of material uncertainty. There should be consideration as to whether or not, as a first step, providing a more clear definition of "material uncertainty," along with additional guidance would be sufficient.

4) Change in mindset, transparency and communication

We agree that there should be transparency in disclosure by the auditor and management with respect to going-concern related disclosures. This transparency is not only relevant for PIEs but is also relevant for non-PIEs.

5) Mandate audit committee in each PIE

Yes. See comments in fraud section.

6) Clarify and harmonize the period for going concern assessment

We agree that if it is not possible to harmonize the period for the going concern assessment to improve clarity the notes to the financial statements should specify the period management's going concern assessment covers.

7) Broaden auditor's area of consideration and work effort

We believe that ISA 570 and ISA 315 already address the need for the auditor to identify and assess risks of material misstatement which would include the entity's ongoing use of the going concern assumption.

ISA 570 requires the auditor to evaluate management's assessment of the entity's ability to continue as a going concern. The nature of this evaluation is dependent on the quality of management's assessment. Expanding auditing procedures cannot be a substitute for management performing an inadequate assessment.

8) Make early warning mechanisms for auditors effective

We agree that there should be greater clarity and harmonization with respect to whom the auditors are required to communicate with if they become aware of information that may jeopardize the continuing function of a PIE.

Comments on ideas to be explored

1) Assessing companies' longer-term viability and resilience

Although there may be some benefit to assessing longer-term viability and resilience of a company, this assessment must first be performed by management. Similar to the existing requirement, the auditor would evaluate the reasonableness of management's assessment.

However, it needs to be recognized that this may be challenging depending on the situation. For example, the pandemic demonstrated that identifying reasonable assumptions for even 12 months was a challenge due to constant change and that in many cases management's assessment of going concern was changing daily. The longer the period of the assessment the greater estimation uncertainty there is in the assessment.

2) Interconnecting financial and nonfinancial information

We agree this is an area needs to be explored as non-financial information will increasingly be considered material to the users of the financial statements. It will be important that assurance is able to be provided on the non-financial information.

Thank you again for the opportunity to respond to the draft recommendations. If you would like to discuss any of our comments please contact Katherine Schamerhorn (Katherine.Schamerhorn@gti.gt.com).

Best regards,

R. Trent Gazzaway

Trent Gazzaway
Global Leader – Service Line Capabilities and Quality