mazars

Paris La Defense, 31st May 2021

Accountancy Europe
Hilde Blomme, Deputy Chief Executive Officer
Avenue d'Auderghem, 22-28/8
B-1040 Brussels

Re: Comments on the Publication "Fraud: Recommendations to Strength the Financial Reporting Ecosystem"

Dear Hilde,

Mazars is pleased to submit this letter in response to the invitation to comment on Accountancy Europe's publication "Fraud: Recommendations to Strength the Financial Reporting Ecosystem".

Mazars is an international, integrated and independent partnership, specialising in audit, accountancy, advisory, tax and legal services. As of 1st January 2021, there are over 26,000 professionals, including more than 1,000 partners, in more than 90 countries worldwide, trusted and committed in serving major international groups, entrepreneurial and small businesses, private investors and state-owned entities at every stage of their development.

Mazars is a member of the IFAC Forum of Firms, and thus fully supports, for more than 15 years now, the initiatives of IFAC IAASB, IESBA, Forum of Firms and Transnational Auditors Committee, as well as those of the regulators and institutes in these areas of common concern for public interest, in promoting high quality standards as part of the international roll-out of audit engagements. All Mazars firms and correspondents are committed to support and apply those initiatives.

We are committed to being #MazarsForGood – that is a global citizen devoted to having a positive impact on the world and communities in which we operate. We are dedicated to contributing to society in the best possible way, whether through providing quality services to our clients to help them achieve sustainable growth, enabling our talented people to reach their highest potential, or contributing to the public debate with positive insights for the future.

Should you want to get further information, you can refer to our 2019-2020 Group Transparency report [Group transparency report 2019/2020 - Mazars Group]

We would be pleased to discuss our detailed comments submitted hereafter with you and remain at your disposal, should you require further clarification or additional information.

Yours sincerely,

Jean-Luc Barlet
Mazars Group Chief Compliance Officer
jean-luc.barlet@mazars.fr

mazars

Overall comments

Mazars is supportive of all initiatives taken to enhance audit and assurance quality and the future of the profession, for the benefit of the public interest, and thus we welcome the opportunity to add our views to the debate.

We believe that the topic of fraud is a major topic of public interest and requires the contribution of all stakeholders, especially in a crisis environment such as the one of Covid-19 we are facing for longer than 1 year now.

We believe it is high time to join efforts and forces for an integrated approach among legislators, corporate governance actors, accounting and auditing standard setters. The status quo is not an option, neither for the auditors nor for the other stakeholders.

In September 2020, Mazars CEO, wrote an article on "Preventing corporate fraud: a collective responsibility" [1] and we responded to the IAASB Discussion paper in February 2021 from which we want to highlight some extracts.

We present hereafter our comments on your recommendations.

[1] Preventing corporate fraud: a collective responsibility (linkedin.com)

1. Require companies to have, and publicly report on, a fraud risk management program

We agree with this proposal.

The framework on which the fraud risk management program is based should allow scalability to cater for the needs of companies of various sizes.

2. Pay specific attention to senior management fraud

We believe this could be included as part of the fraud risk management program mentioned in #1 above.

Fighting fraud from within is often more effective because of the role and involvement of the boards and audit committees (AC) in the operations of companies.

An auditor's responsibilities towards fraud have been clearly defined in ISA 240. Specifically, auditors are required to perform procedures to address fraud risk arising from management override of controls. The risk assessment process will be greatly facilitated with the work of the boards and AC.

We note that this may be difficult to implement in small to medium sized entities. It is worthwhile to explore the applicability, scalability or extent of this procedure should it be included as part of the fraud risk management program to be rolled out to all types of entities.

We strongly believe that, as a priority at least in the short term for most-exposed entities and PIE, the following could be done:

- **In terms of Corporate Governance**
    - The evolution of Corporate Governance, to manage and mitigate risks associated with the dominance of certain individuals in the management of companies is a must;
    - Non-financial reporting should be high on the agenda of Corporate Governance, to drive CEOs to be accountable for long term value creation, instead of short-term financial results and share plans for management.
- **In terms of internal control**
    - Introduction of increased internal and external reporting on key controls, increasing the personal responsibility and accountability of management, and board members (via AC oversight re shareholder protection / resilience / sustainability / fraud / cash forecasts);
    - Improving and / or expanding corporate fraud prevention efforts (including robust internal control) to identify issues arising in a timely manner;
    - Management must report on the effectiveness of internal control and then the Board must also report.
- The audit report must cover more extensively the work carried out on internal control and the conclusions of the auditors.

3. Mandate an Audit Committee (AC) in all public interest entities

We agree with this proposal.

In addition, the AC must exercise greater responsibility for the company's internal control, by setting up a risk and internal control dashboard.

- More active involvement and challenging of management by those charged with governance ("TCWG"), especially when there are dominant individuals; and

- For PIE, reporting from the AC / Board to be public on select areas, including the key elements of challenge by the AC or the Board vis à vis Management. Such reporting which is already encouraged in some jurisdictions, could be helpful to enhance robust governance and transparency.

4. Make early warning mechanisms for auditors effective

It may be challenging to establish a standardized set of early warning mechanisms. We recognize that such mechanisms are difficult to design given the desire for a level of autonomy by countries when it comes to national law or regulation. However, having some universal and guiding principles would benefit all members in the financial reporting ecosystem. For example, in France, there is an alert procedure that allows the auditors to require the entities to call for a general shareholders meeting whenever it is necessary. We believe that stakeholder engagement to ensure that investors and other users of financial statements have a thorough understanding of an auditor's responsibility in relation to fraud will go a long way towards addressing these issues.

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

We reckon a common understanding of the auditor's role towards fraud in an audit is only a starting point. This is because the public has no insight into the materiality thresholds applied in an audit. What is appropriately deemed non-material by the auditors may, if known, be considered material by the users of financial statement. Beyond simply being knowledgeable of the role of the auditors, this lack of knowledge regarding materiality creates a knowledge gap, or expectation gap as more commonly known

To narrow the expectation gap, the role of the auditor is key, the role of management and TCWG is crucial. As mentioned in the paper by the International Auditing and Assurance Standards Board (IAASB) chair "we [the auditors] cannot narrow the expectation gap alone".

A reminder of the primary responsibilities of the role-players, including the differences between management, governance (TCWG, boards, AC), and the auditor, through public / stakeholder engagement, is necessary but not sufficient.

We believe it is high time to join efforts and forces for an integrated approach among legislators, corporate governance actors, accounting and auditing standard setters.

The fraud topic requires auditor professional judgement and professional skepticism in an evolving environment. To allow for the need for auditors to adapt and be agile, we suggest that the standard setters keep the principles-based approach of the standards and avoid a "tick-the-box approach" or create a "one size fits all" approach as it will impede adaptation and weaken professional skepticism.

It would be relevant to make sure that scalability is considered at an early stage.

In addition to the above, the following could be done for all entities on the topic of fraud:

- More education, pedagogy throughout the audit process, in the auditor's report and during Shareholders' meetings. Focus by regulators and standards setters on developing educational material that can be presented to AC and other stakeholders to give more explanations, insights about the role of the auditor and main concepts around audit (risk-based approach, materiality, KAM etc.);
- The standard setters and national legislators may consider defining internationally established best practices for good corporate governance, such as compulsory AC with independent members for entities with certain characteristics (PIE; size etc.). Also, the senior member of the supervisory board and AC need to have appropriate qualifications and knowledge in the area of financial statements, and the relevant industry to be able to challenge management independently and properly. Defining expectations on the financial qualifications ("financial expert") should be considered;
- There is a short-term action which consists in reaffirming and better communicating our current limited liability for fraud. In particular, there could be a reinforcement of the understanding of the concept of materiality through public/stakeholder engagement;

- In the medium/longer term, auditors could be given more resources, to enable them to go further in identifying the risks of fraud;
- Make it compulsory to enrich the training course for auditors on risk management, fraud investigations, CSR and IT security;
- More guidance from standard setters around the application of professional skepticism and unpredictability in audits could facilitate better audit fraud procedures;
- The cyber risk review must become mandatory in the auditors' mission.

6. Improve auditors' access to knowledge and awareness about fraud

It is beneficial to auditors if a platform is established and maintained for the purpose of sharing case studies and experience on discovered fraud.

While such platform may be set up by an alliance among firms, inputs from regulators and/or investors could be valuable as well. Auditors may be able to gain useful insights and thus make meaningful changes to their risk assessment process.

7. Auditors to clearly communicate their work and conclusions about fraud

We share the same view. As mentioned in #2 above, in the short term, it should be made a requirement for auditors to report on the work carried out on internal control and the conclusions of the auditors.

8. Ideas to be explored

a. More extensive use of forensic experts by auditors

We believe the current requirements in relation to professional skepticism together with the additional procedures proposed are sufficient for the purpose of fraud identification. Mandatory use of forensic experts in a PIE audit may introduce an element of distrust between the auditor and the audited entity. The use of experts can be helpful under certain facts or circumstances but should not be systematic and should be risk-based. The application of professional skepticism provides the appropriate balance in the relationship with the audited entity regarding the objectives of the auditing standards.

b. More extensive use of data and technology by auditors

We share the same view on the use of data and technology by auditors. This could be part of #6 above. In addition to case studies and experience sharing, the platform could provide analyses of publicly available and selected internal data so as to raise the governance bodies and auditors' awareness of fraudulent schemes. The platform could also develop industry metrics or business trends to aid audit firms in planning and performing risk assessment.

On the other hand, standard setters and national legislators should consider giving more guidance on how to use technology and data analytics to address fraud.

9. Other recommendations

- Further guidance regarding the risk of management override and how to address it through the implementation of unpredictability and journal entries testing and other tests would be beneficial.
- The articulation between ISA 240/ISA 550 and the recently revised standards ISA 315 and ISA 540 could be improved.
- Further guidance, including examples, on
  - Fraud use cases / accounting schemes.
  - Enhanced risk resulting from the increasing extent of electronic audit evidence and highly automated entity processes
- Transparency in financial reporting

- In terms of the auditor's report:
    - To enhance the description about what the relevant parties' responsibilities are in relation to fraud, including possibly an explanation around the concept of materiality and how it impacts the auditor's work in relation to fraud. Consideration could also be given to including in the auditing standards disclosure of the materiality level or ranges in the audit report.
    - A transparent discussion between the management and those charged with governance to assist the auditor in understanding how much challenge is done by governance. Reference to this procedure could be made, but the details should not be disclosed in the auditor's report.
- In terms of management and governance procedures:
    - Enhanced disclosures related to management's approach to identifying and mitigating fraud, including risks coming from collusion of senior management, could be beneficial.
    - Enhanced disclosure of how management and governance manage the risk of third-party fraud that involve collusion with employees at the company could be beneficial.

- Collaboration between standard setters and national legislators on the following areas.
    - To give a benchmark, even though restricted in some countries, of how many entities have included Fraud as a KAM during Covid-19.
    - Greater consistency between countries on the different governance fraud prevention mechanisms could be considered, recognizing that it will be dependent on the legal national frameworks.