

Tom Seidenstein
IAASB Chair

Filed via the website

Brussels, 1 February 2021

Subject: Accountancy Europe Comment Letter to the IAASB Discussion Paper (DP) on Fraud and Going Concern

Dear Sir, Dear Tom,

Accountancy Europe is pleased to provide you with its comments on the IAASB DP on Fraud and Going Concern.

Recent fraud cases and corporate failures, as well as the potential impact of the ongoing COVID-19 pandemic indicate the need for reconsidering the functioning of today's financial reporting ecosystem. At Accountancy Europe, we have been working on the issues of fraud and going concern and recently issued two publications¹ that include recommendations to strengthen this ecosystem. We therefore welcome that the IAASB has also identified the need to revisit the role of auditing standards in these two areas. We also invite the IAASB to consider recommendations set out in our publications noting that their scope is wider than the audit of financial statements and auditing standards.

Fraud and going concern are complex matters and there is no silver bullet solution for the issues at stake. To address them, we should adopt a holistic approach taking into account the relevant risks and the expectations of stakeholders. Only concerted efforts and commitment of all the key parties can achieve tangible results in the public interest.

There is no one-size-fits-all solution that can be offered by the financial statements audit. The world is constantly changing and so do the business environment, societies and public expectations. Auditors need to be agile to be able to respond to the needs of stakeholders and adapt their work according to evolving circumstances. At the same time stakeholders need to be alert to the facts that certain risks concerning both fraud and going concern cannot be eliminated, no matter how much work the auditor undertakes. Standards can support auditors by establishing a framework that allows for flexibility where necessary. To enhance agility and adaptability and to avoid a "tick the box" behaviour, the auditing framework should continue to be based on principles-based requirements and be reinforced by application material that provide guidance and examples for clarifying the requirements.

We agree with the IAASB that the audit expectation gap should be broken into the three components: the knowledge gap, the performance gap, and the evolution gap.

The knowledge gap seems to be the one where the IAASB can play a crucial role by clarifying key concepts and definitions, as well as what an audit can and cannot do (i.e., inherent limitations) through

¹ Fraud: Recommendations to strengthen the financial reporting ecosystem; available at <https://www.accountancyeurope.eu/publications/fraud-recommendations-to-strengthen-the-financial-reporting-ecosystem/>
Going Concern: Recommendations to strengthen the financial reporting ecosystem; available at <https://www.accountancyeurope.eu/publications/going-concern-recommendations-to-strengthen-the-financial-reporting-ecosystem/>

communication and education directed to all stakeholders. We note that for both fraud and going concern there are certain concepts which are commonly misinterpreted or understood differently by stakeholders.

We expect that the risk-based approach to quality management in audit firms, as described in the new set of quality standards released by the IAASB, as well as the recently revised ISA 315 that includes a more robust and consistent risk identification and assessment, will help narrowing the performance gap. Audit firms will demonstrate even more their commitment to quality.

The auditor's role can be reconsidered and expanded as a response to the evolving expectations and thus responding to the evolution gap. The IAASB should consider and consult on (i) adapting the scope of the audit of financial statements and/or (ii) developing assurance standards for complementary engagements that auditors could undertake alongside the statutory audit.

For the evolution of auditor's role, certain preconditions should be met as explained in our detailed responses below. The primary responsibility for fraud prevention and assessment of the entity's going concern lies with the management and Those Charged with Governance (TCWG) of the entity. Hence, any expansion in the auditor's work will need to be based on increased requirements for the audited entities.

In addition, the value of an audit is closely linked to its timeliness. The same is true for the information provided to the markets by the entities. Therefore, any evolution of reporting and auditing should not be at the expense of providing timely information to the public.

Finally, we believe that any changes to the current functioning of the financial reporting ecosystem, including changes linked to the audit purpose and scope, should be based on the outcome of a cost/benefit analysis and an impact assessment.

For further information on this letter, please contact Harun Saki at harun@accountancyeurope.eu or Noémi Robert at noemi@accountancyeurope.eu.

Sincerely,



Olivier Boutellis-Taft
Chief Executive

ABOUT ACCOUNTANCY EUROPE

Accountancy Europe unites 50 professional organisations from 35 countries that represent close to **1 million** professional accountants, auditors and advisors. They make numbers work for people. Accountancy Europe translates their daily experience to inform the public policy debate in Europe and beyond. Accountancy Europe is in the EU Transparency Register (No 4713568401-18).

ANNEX - REQUEST FOR COMMENTS

Question 1- In regard to the expectation gap (see Section I):

What do you think is the main cause of the expectation gap relating to fraud and going concern in an audit of financial statements?

In your view, what could be done, by the IAASB and/or others (please specify), to narrow the expectation gap related to fraud and going concern in an audit of financial statements?

General considerations on what could be done

All parties in the financial reporting ecosystem have a role to play in addressing the expectation gap related to fraud and going concern in an audit of financial statements. The efforts of the IAASB should focus on responding to valid and reasonable expectations and proposed changes should take account of the outcome of a cost/benefit analysis. Stakeholders and users of financial statements consist of a very broad and heterogeneous group. As a prerequisite to suggesting any changes, we need to understand what the valid expectations are. The way the IAASB is referring to “the” expectation gap and “the” stakeholders could be seen as simplifying the issues at stake.

The starting point for reducing the expectation gap should be to understand:

- various stakeholders’ expectations
- the role of each party in the financial reporting ecosystem (including audit committees, management, internal audit, accounting and reporting standards-setters, regulators and supervisory authorities) to address these expectations

When these are clear, a forward-looking discussion can commence considering whether it is possible and viable, in order to reduce the expectation gap, to (i) adapt the scope of the audit of financial statements or (ii) reflect on complementary engagements that auditors could undertake alongside the statutory audit. As a principle, additional requirements for entities and enforcing robust corporate governance should be the starting point and the driver for any enhanced role of the auditor.

Some stakeholders seem to expect auditors to detect and communicate all instances of fraud committed within an entity and to make a decisive conclusion about the entity’s ability to continue as going concern. We believe that these are not necessarily reasonable expectations.

There could however be quick wins to consider without changing the standards, such as the development of guidance, the publication of educational papers with examples, etc. In any case, if the IAASB were to substantially change the standards, it should also ensure that the drivers of any changes to the ISAs are evidence-based.

As emphasised by the IAASB, part of the expectation gap is linked to a knowledge gap. There is a certain level of inconsistency in stakeholders’ understanding with regards to what the purpose of the audit actually is. In this regard, the IAASB should clarify the requirements and concepts that are commonly misunderstood by stakeholders. These include:

- the auditor’s responsibility and the inherent limitations for both fraud and going concern
- the relationship between fraud and intentional non-compliance with laws and regulations, including topics like money laundering and corruption
- the meaning and implications of quantitative and qualitative materiality with regards to misstatements due to fraud

We believe that the IAASB has a further role in actively informing stakeholders (i.e., through targeted outreach), especially as to the inherent limitations the auditor faces in an audit of financial statements. Although this information is available in ISAs and other materials issued by the IAASB, the inherent limitations are not necessarily comprehended. Hence, a more proactive stance is needed from the IAASB to ensure it reaches all stakeholders.

We also need to further explore how to address the performance gap, and in particular around the issues below that are recurrent in quality reviews:

- what professional scepticism is and how it should be applied better in an audit
- how to ensure effective two-way communication with audit committees on risks related to fraud and going concern

Less Complex Entities (LCEs)

The current project on LCE should allow the IAASB to consider the specificities of such entities. It is important to remain principles-based and fully scalable given that LCE's control environment is often easy to comprehend, but not easy to test due to the limited segregation of duties and established procedures.

Fraud

Causes of the expectation gap

An audit conducted in accordance with the ISA framework follows a risk-based approach, focuses on material misstatements as opposed to all misstatements and does not provide absolute assurance. Accordingly, auditors identify and assess risks of material misstatement and respond to these risks by designing and performing audit procedures. The combination of reasonable but not absolute assurance and a risk-based approach results in an unavoidable risk that some material misstatements in the financial statements may not be detected.

The auditor's current responsibility is to plan an audit to obtain reasonable assurance that the financial statements are not materially misstated due to fraud or error. There is not a clear distinction between these two categories, i.e., fraud or error: one may lead to the other and, the auditor's responsibility in respect of error or fraud is equal, but the work effort is different. It raises the question if we should be referring to fraud and error in this way.

What could be done

As a prerequisite for the auditor to do and report more on fraud, it is first necessary that management:

- designs and implements internal controls to mitigate fraud risk
- discloses publicly the operating effectiveness of the internal controls designed to mitigate fraud risks

A cost/benefit analysis is important to make sure that those actions are practical for small and medium and/or less complex entities. For PIEs, the cost/benefit analysis should also take account of the public interest with any effect on the timeliness of reporting.

As emphasised in the DP, the auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations. Nevertheless, it is part of the auditor's role to perform specific procedures to help identify instances of non-compliance with laws and regulations that may have a material effect on the financial statements. In some stakeholders'

view, non-compliance with certain laws and regulations, such as anti-money laundering laws, should be considered as a fraud risk in an audit of financial statements.

The IAASB should explore how to make the distinction clear between the prevention/deterrence of material fraud and detection thereof. As included in a Factsheet we published on *The Auditor's Role in Fighting Financial Crime*², the auditor's role in fraud prevention/deterrence is limited and mainly linked to the procedures put in place to accept a new audit client and to properly understand the entity and its control environment.

Regarding the auditor's role in fraud detection, it is currently linked to the responsibility of obtaining reasonable assurance that the financial statements are free from material misstatement, whether due to fraud or error. The term 'fraud' and the associated auditor's responsibilities in the ISAs refer to fraud as a result of fraudulent financial reporting or misappropriation of assets. The IAASB should explore whether the scope and the limits of these two categories are sufficiently understood by stakeholders.

Going concern

Causes of the expectation gap

We believe that there is a specific expectation gap linked to going concern about where to put the cursor in case of a 'close call' when it is not straightforward whether management's mitigating plans will be sufficient, but on balance, after much work during the audit, it is concluded they are just about sufficient. Another reason for the expectation gap is the different interpretations of going concern and material uncertainty concepts, since accounting frameworks do not always define these in the same way. The difference between corporate governance requirements in various jurisdictions may also create different expectations for international investors.

It is also important to emphasise the two different purposes in making the going concern assessment. The first is about concluding whether the going concern basis of accounting is appropriate for the financial statements in accordance with the period defined in the accounting framework (i.e. prevention aspect). The second is about providing information to stakeholders about the economic and financial viability of the entity, as well as potentially its resilience (i.e., transparency aspect). Although there is an overlap, the auditor's role would be different for each of these purposes. The fact that both are referred to by the same words "going concern" is significant in creating the expectation gap.

What could be done

It is important to acknowledge that evaluating an entity's ability to continue as a going concern has its inherent limitations which cannot be eliminated. This is because no one can predict future events with certainty. Nevertheless, steps can be taken in a helpful way towards making the ecosystem more resilient (see our response to Question 3).

² https://www.accountancyeurope.eu/wp-content/uploads/180112_Technical-paper-Auditors-role-in-the-fight-against-fraud-corruption-and-money-laundering.pdf

Question 2 - This paper sets out the auditor's current requirements in relation to fraud in an audit of financial statements, and some of the issues and challenges that have been raised with respect to this (see Sections II and IV). In your view:

Should the auditor have enhanced or more requirements with regard to fraud in an audit of financial statements? If yes, in what areas?

Is there a need for enhanced procedures only certain entities or in specific circumstances?! If yes:

(i) For what types of entities or in what circumstances

(ii) What enhancements are needed?

(iii) Should these changes be made within the ISAs or outside the scope of an audit (e.g., a different engagement)? Please explain your answer.

Would requiring a “suspicious mindset” contribute to enhanced fraud identification when planning and performing the audit? Why or why not?

(i) Should the IAASB enhance the auditor's considerations around fraud to include a “suspicious mindset”? If yes, for all audits or only in some circumstances?

Do you believe more transparency is needed about the auditor's work in relation to fraud in an audit of financial statements? If yes, what additional information is needed and how should this information be communicated (e.g. in communications with those charged with governance, in the auditor's report, etc.)?

Transparent and timely communication

While ISA 260 and ISA 265 already require timely communication with TCWG, enhancement could be done to encourage auditors to have more purposeful and regular discussions especially with audit committees about fraud risks, and to *promptly* communicate with them where appropriate. For PIEs, these discussions should include topics such as how whistleblowing mechanism works within the entity and the risk of fraud committed by management. The IAASB could consider introducing requirements for more transparency towards TCWG, regarding to which extent the audit was designed to identify fraud.

The implications of fraud committed by management are generally more severe compared to fraud committed by employees. Additionally, it is more difficult to detect management fraud. Therefore, the risk of fraud involving the management of the entity requires a different audit approach and we believe that this difference should be properly addressed in ISA 240.

Furthermore, the IAASB could consider developing a separate assurance standard for the cases where management is required by laws or regulations to make a statement on fraud risk management and/or controls against an acceptable framework and auditors are required to report publicly their conclusion on this statement.

It is important to balance all of the competing objectives when considering changes in relation to the scope of audit and fraud. It is also important that reliable information is available to stakeholders on a timely basis. A conflict may therefore arise, as if more work is undertaken in order to increase reliability, the feasible timing of the audit will likely be affected.

Suspicious mindset

We cannot envisage starting all audits from a point of distrust of management. We agree it is important for the auditor to apply professional scepticism at all steps of the risk-based audit process, as well as to consider more external factors and sources of information (media, analysts, etc.). However, starting an audit while questioning management's integrity or assuming that any information provided by the management could be false would not be practicable.

It should be clear that the auditor's responsibility is an obligation of means, not an obligation of result (detecting fraud). To this end, audit firms should be encouraged to develop training and real-life examples of committed frauds to increase the auditors' awareness and scepticism. We invite the IAASB to reinforce the importance of such aspects more clearly rather than introducing new concepts and additional requirements.

Use of forensic experts

Forensic audit significantly differs from a financial statement audit in terms of its scope and methodology. Forensic experts generally investigate suspected or known fraud with a targeted approach. Consequently, they need to modify their approach when they are used by auditors in the risk identification process of an audit.

There is no recognised definition of a forensic expert. Forensic experts to be involved in financial statements audit should have an understanding of the audit and its objectives. Experts with this profile are scarce and involving them may increase the cost of audit considerably.

Some forensic-type procedures are already incorporated in detailed testing and analytical procedures that are performed by auditors as a result of their risk assessment. The effectiveness of these procedures could be enhanced by more extensive training of auditors about forensic techniques.

Current ISA 240 and other ISAs do not stop auditors from using forensic experts. In fact, these experts are already involved in many audit engagements. We do not think these experts should always be used though, there should always be some sort of a trigger, i.e., an indication of fraud, to involve forensic specialists.

There is also a risk of widening the expectation gap as having these experts do not guarantee that the audit will identify every instance of fraud. A potential revision to ISA 240 may clarify the fact that involving forensic experts will not be a silver bullet but might be useful depending on the circumstances of the audit engagement, and especially in:

- brainstorming discussions during the planning phase of the audit engagement to cover e.g. potential weaknesses in internal control, any history of fraud in the entity's business environment; and/or
- designing specific procedures to address fraud risks, and reviewing the results of these procedures; and/or
- cases when there is high risk of fraud based on to the audit team's assessment

Use of Technology

Auditors already use computer-assisted audit techniques such as data analytics to identify anomalies and patterns of unusual transactions that might indicate a fraud risk. This enables auditors to target their work effort more effectively on areas with higher risk.

While more extensive use of data and advanced technologies presents an opportunity for identifying and better addressing fraud risks, there are some challenges such as the ones highlighted in the key takeaways from IAASB's roundtable series.

With increased dependence on technology, auditors should continue improving their skills in using the tools available. Technologies could particularly help auditors in performing mechanical audit procedures that require limited application of professional judgement. This would allow the auditor to invest more in testing critical areas.

Importance of corporate culture

An appropriate, effective and adequate corporate governance system is the first line of defence to deter and prevent fraud. Entities need to establish internal controls as part of their corporate governance structure and their board(s) are responsible for overseeing this. Tone at the top, promoting ethical behaviour and monitoring of management's financial incentives are important elements that can reinforce this particular aspect of the control environment.

When designed and implemented properly, internal controls enable auditors to adopt a more effective and efficient approach by relying on the controls operating effectively (having tested them) and focusing on the areas where there are deficiencies.

Third-party fraud

The DP explains that third-party fraud is often committed in collusion with employees within the entity. There are also purely third-party fraud issues, e.g., cybersecurity issues which may not necessarily involve intended collusion. In our view, third-party fraud with employee collusion should not be considered as third-party fraud, but as an employee fraud with an external accomplice.

Engagement quality review

We agree with the measures proposed in the DP and believe that the new set of standards on quality management should facilitate their application. We refer in particular to the general requirement as included in paragraph 25 (b) and related application material (paragraphs A34 and A35) of the ISQM 2 and to ISA 220 (Revised) and its application material (paragraphs A 36, A 54 and A 92) which include explicit references to fraud and going concern.

Question 3 - This paper sets out the auditor's current requirements in relation to going concern in an audit of financial statements, and some of the issues and challenges that have been raised with respect to this (see Sections III and IV).

In your view:

Should the auditor have enhanced or more requirements with regard to going concern in an audit of financial statements? If yes, in what areas?

Is there a need for enhanced procedures only for certain entities or in specific circumstances? 1
If yes:

(i) For what types of entities or in what circumstances?

(ii) What enhancements are needed?

(iii) Should these changes be made within the ISAs or outside the scope of an audit (e.g., a different engagement)? Please explain your answer.

Do you believe more transparency is needed:

(i) About the auditor's work in relation to going concern in an audit of financial statements? If yes, what additional information is needed and how should this information be communicated (e.g., in communications with those charged with governance, in the auditor's report, etc.)?

(ii) About going concern, outside of the auditor's work relating to going concern? If yes, what further information should be provided, where should this information be provided, and what action is required to put this into effect?

As already indicated, prevention of corporate failure is a priority for management and TCWG. Their timely disclosure of going concern assumptions is therefore key. There is also an important expectation towards TCWG to oversee management's assessment and challenge it in cooperation with internal audit, where appropriate.

As the primary responsibility for assessing whether an entity is a going concern lies with management, more detailed and considered disclosures should be required from management to explain why the entity is a going concern according to their assessment³. The appropriateness of preparing the financial statements on a going concern basis comes down to the reliability and relevance of the evidence regarding the assumptions made by management. We acknowledge that this is not in the remit of the IAASB's standard setting area and that part of the problem lies in the accounting standards, which present, for many right reasons, a low hurdle for an entity to be classified as a going concern.

If such disclosures were to be required, it would be feasible to further extend the auditor's role regarding these statements. In this regard, auditing standards should proactively support the widening role of auditors on going concern. This should enhance auditors':

- risk assessment adaptability and agility in selecting the most appropriate risk assessment procedures and considerations for given circumstances

³ We understand that some requirements of disclosures already exist and not only related to the material uncertainty. We refer to the following recent communication from the IFRS Foundation:
<https://www.ifrs.org/news-and-events/2021/01/ifrs-foundation-publishes-edu-material-to-support-companies-in-applying-going-concern-requirements/>

"[...] The topic of going concern has been identified as a potential agenda item to be covered in the IASB's upcoming agenda consultation, for which it will be publishing a request for information in March 2021. In the meantime, it is important to remember what currently applicable IFRS Standards require in relation to going concern assessments—disclosures about not only material uncertainties but also significant judgements."

- work effort in considering more matters and wider context in the evaluation of entities' assessment of going concern, including consideration of relevant contradictory evidence that challenges management assessment

When performing the risk assessment for the planning of the audit, according to ISA 315 (Revised), auditors have to collect relevant information . During this assessment, auditors should give greater consideration to relevant 'external red flags' in their evaluation of going concern, for example based on information included in analyst reports and relevant developments in the environment in which the company operates

Broadening of auditors' work effort will require that auditors keep enhancing their skills and competences. This relates especially to cash flows, liquidity, financing, (worst case) scenario analysis and (reverse) stress testing in the context of evaluating the management's going concern assessment. Moreover, for some areas of work, audit teams might need to use experts, for example, a restructuring expert in case the entity needs to undergo restructuring to survive. In such circumstances, cooperation and intensive communication with TCWG are necessary.

Additionally, any decision as to whether the extension of auditor's role could be part of the statutory audit, or of a separate engagement would need further consideration on how the challenges to achieve this can be overcome. Nevertheless, there needs to be serious consideration of the greater public interest here, as undertaking significantly more work on going concern, such as in-depth working capital reviews, etc. could have a significant impact to the current reporting timetable of many entities.

The current circumstances with the COVID-19 crisis could provide a testing ground for both reporting and auditing issues related to going concern. The IAASB could consider analysing the developments after the 2020 year-end reporting period and monitor how going concern is dealt with by entities and their auditors.

Assessment for longer than 12 months

Some stakeholders suggest that entities should include more details in their annual report on the going concern assumptions and on the key business risks that impact the business viability in a longer term, i.e. from 12 months - as currently required - to 24 months or more (depending on the industry or the financing of the entity). Such timeframe would require changes in the accounting standards and could be more useful to stakeholders. In any case, the period of the auditor's assessment should be consistent with the period of assessment by management.

Nevertheless, it is important to note that the further into the future management or the auditor look, the less reliable the assumptions and estimates will be. Also, today's fast pace of change seems to make this even worse than in the past. The issue may be more about the fact that stakeholders now need broader information, including environmental, social and governance information in order to assess the entity's resilience.

Concept of resilience

Considering the stakeholders' need for broader information and the fact that large PIEs become more systemic and of greater public interest, sustainability reporting and its link to the resilience of an entity could be an area that the IAASB should monitor and consider developing separate assurance standards in the future on.

Question 4 - Are there any other matters the IAASB should consider as it progresses its work on fraud and going concern in an audit of financial statements?

Nothing more to report