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Ms Hilde Blomme
Accountancy Europe
Avenue d'Auderghem, 22-28/8
B-1040 Brussels

Our ref SRA/288

30 April 2021

Dear Ms Blomme

Re: Accountancy Europe, *Fraud and Going Concern - Restoring Public Trust in the Financial Reporting Ecosystem*: Recommendations to Strengthen the Financial Reporting Ecosystem

We appreciate the opportunity to comment on the publication *Fraud and Going Concern - Restoring Public Trust in the Financial Reporting Ecosystem: Recommendations to Strengthen the Financial Reporting Ecosystem* (the "Recommendations") issued by Accountancy Europe.

We recognise the need to reconsider the functioning of today's financial reporting ecosystem, as well as the increasing demand for a longer-term, future-oriented view across a wider range of aspects of a company's performance, including non-financial information elements, their impacts and their interdependency with financial reporting. We are supportive of Accountancy Europe's objective, in issuing the Recommendations, to consider the key roles and responsibilities of different parties within this ecosystem together with proposals as to how these could be further developed.

Accordingly, we welcome Accountancy Europe's timely and thoughtful exploration of the issues set out in the Recommendations in respect of the critical areas of fraud and going concern. We are committed to open and constructive dialogue to ensure that improvements are made to the financial reporting ecosystem, including that audits continue to be fit for purpose and to evolve, as appropriate, to reflect changes in the business environment, including increasing globalisation and complexity, technology advances, and resulting changes to stakeholder needs.

We also welcome Accountancy Europe's recognition of other recent initiatives in this area, and we note, amongst others, the IAASB Discussion Paper - *Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statements Audit* (the "IAASB DP") and the Independent Review into the Quality and Effectiveness of Audit in the UK (the "Brydon Review").

We highlight that we formally responded to the IAASB DP and we attach our response as an appendix to this letter. We note that there is significant commonality between many of the Recommendations set out by Accountancy Europe and the areas explored by IAASB and therefore we believe our response to the IAASB DP would be helpful and informative to Accountancy Europe in understanding our views.

We also set out certain overarching comments on the Recommendations, as well as how “assurance” may be provided in the areas of fraud and going concern, below.

Going Concern

We highlight in our response to the IAASB DP that we believe that ‘going concern’ is a fundamental assumption underlying the basis of preparation of financial statements. We consider that the role and responsibilities of management and auditors with respect to the going concern assessment continue to be appropriate to the preparation and audit, respectively, of financial statements.

In particular, we believe that the going concern assessment should continue to be a binary ‘pass/fail’ model. We have concerns that proposals to change the concept of ‘going concern’ or to broaden the responsibilities of management and auditors in the context of financial statements preparation/audit, such as the introduction of graduated reporting, may confuse users of financial statements and may undermine the overall conclusion as to whether the entity is, or is not, considered to be a going concern.

We recognise that there is demand from stakeholders for better information as to whether the company itself is “resilient/viable” in the longer-term. Accordingly, we believe that it is important to explore the corporate reporting model to evaluate how to supplement the traditional focus on historical records of financial performance with more forward-looking information, both financial and non-financial, to provide greater insight into how an enterprise creates value over the short, medium and longer term. We believe there is a role for the auditor (outside of the financial statement audit) related to this information as there is a clear market trend towards the need for wider assurance over elements other than the financial statements themselves, including corporate reporting of, and assurance over, ultimate business “resilience” or “viability”.

In our response to the IAASB DP we highlight that we use the term ‘assurance’ in a broader sense and that, in our view, solutions would not necessarily fall within the scope of the financial statement audit, which as a concept/ scope, we do not believe needs to be broadened in itself. The ISAs themselves note the limitations of an audit in this area, including the fact that information becomes less reliable the further into the future to which it relates, as well as the fact that the auditor cannot make predictions about the future. Instead, an audit focuses on the performance of risk-based assessment and the identification of events or conditions that may cast doubt on the entity’s ability to continue as a going concern, with additional procedures required if such events or conditions are identified.

As we suggest in our response to the IAASB, we recommend the exploration of a “combined approach” to meet stakeholder information needs. This approach would

include a formal going concern assessment performed by management as part of the preparation of financial statements, for a period that is at least but not limited to 12 months from the date *of authorisation* [emphasis added] of the financial statements (i.e. beyond the existing requirement that requires a minimum 12 months from the reporting date), focused on information that is relevant to the going concern assessment, in the current context of going concern as a basis of preparation of financial statements. Auditors would evaluate this assessment as part of their financial statement audit. Further information could also be provided by management, e.g. in the front section of the annual report, about potential events/ conditions and related risks beyond the period of management's assessment of going concern, looking at the longer-term, including business plans and management's possible responses to these risks.

In our response to the IAASB DP we recommend that assurance be provided over management's processes/ controls to develop this additional information, including making assumptions and judgements, and the auditor could also possibly provide commentary on assumptions and judgements in a long-form report. This could be performed as a separate engagement, either as part of an integrated audit with separate reporting over an entity's system of internal control including in respect of this area, or as a separate assurance engagement over management's processes and controls to prepare this information, performed in accordance with the ISAE 3000 (Revised) suite of standards. A separate assurance engagement of this nature may be optimal as it would allow greater flexibility as an entity's processes and controls in this area evolve, is arguably better suited to address information relating to the longer term, and it is able to adapt as suitable criteria are developed (the pace of which may also vary across different jurisdictions). It would also enable assurance solutions to develop and evolve in line with stakeholder demand.

Fraud

There are inherent limitations to the ability of an audit, that is nevertheless carefully planned and properly executed, to detect material fraud. This unavoidable risk is due, in part, to the fact that most audit evidence is persuasive rather than conclusive, in order to support reasonable assurance. Additionally, as Accountancy Europe also recognises, some frauds are highly sophisticated, carefully organised, may be perpetrated by senior management, and may involve collusion, making them particularly challenging to detect.

We believe there may be a fundamental lack of understanding by users of financial statements about the inherent limitations of an audit as described above, in particular, because these limitations interact with the fact that an audit is a risk-based, and not an absolute, assurance engagement, and is rooted in the concepts of materiality and reasonable assurance. We also believe there is also a lack of understanding as to what 'fraud' in an audit of financial statements actually means. This includes the fact that there is an interaction between the concept of fraud and that of breaches of laws and regulations, which have some degree of overlap (especially in the case of intentional violations) but with breaches of laws and regulations encompassing a significantly broader scope, including operational and reputational matters such as in

respect of environmental or health and safety legislation. We think users of financial statements may believe “fraud” encompasses such matters beyond those that are directly connected to the financial statements themselves, however, as auditors, our focus is on risks of material misstatement of the financial statements due to fraud.

In our response to the IAASB, we have made several suggestions regarding potential enhancements to ISA 240 The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements, including potential enhancements to considerations regarding when to involve forensic specialists, and introducing a “standback” requirement to evaluate the audit evidence obtained and consider whether the fraud risk assessment and the nature, timing and extent of our procedures to address fraud risks remain appropriate. However, we believe that, overall, the ISAs are fit for purpose regarding the role and responsibilities of the auditor with respect to the detection of material fraud and we do not consider that these should be changed more broadly, or the concept of an ‘audit’ changed fundamentally in this area. Management and those charged with governance are responsible for the control environment and policies and processes to prevent and detect fraud at an entity, including setting the right ‘tone’ regarding business conduct.

We support Accountancy Europe’s proposals for the establishment, and public reporting by entities, of a fraud risk management program that includes procedures regarding fraud risk assessment, internal controls and responses to incidents/ allegations of fraud. We believe, as Accountancy Europe also acknowledges, that this solution would need to be focused on the internal control system holistically, as it relates to the preparation of the financial statements. Furthermore, in respect of anti-fraud processes and controls, we consider that such a solution would need to be directed to corporate reporting-related fraud, which needs to be clearly defined, as opposed to ‘fraud’ in the broader sense, such as fraud relating to operational/ reputational matters.

In our view, it is critical that a suitable and well-defined framework, similar to the COSO Framework that is used in an audit of Internal Control Over Financial Reporting (ICOFR), against which to measure/evaluate an entity’s processes and controls, be developed, with emphasis on the appropriate involvement/ oversight of those charged with governance, and which ideally has global, or at least European-wide, recognition.

We believe that auditor responsibilities in respect of a formal engagement over such a program would be a critical part of establishing public trust and should be either in the form of an integrated audit over the entity’s system of internal control in relation to financial reporting (which would include anti-fraud processes and controls) with a separate auditor’s report over internal control, or a separate assurance engagement, performed in accordance with the ISAE 3000 (Revised) suite of standards.

Audit is One Piece of the Puzzle

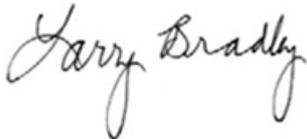
We highlight in our response to the IAASB that an audit is only one “piece of the puzzle” in the wider financial reporting ecosystem. Notwithstanding the fact that the auditor has a very important role to play in facilitating public trust in the capital markets,

we agree with Accountancy Europe that any changes made to the role and responsibilities of auditors in respect of fraud and going concern need to be supported by complementary changes to requirements in respect of the key roles and responsibilities of other stakeholders in this ecosystem. We note that changes to roles and responsibilities would need to be substantially aligned and supported by clear frameworks for evaluation/measurement of matters relating to fraud and going concern, and implementation would need to be appropriately sequenced to enable the ecosystem to operate effectively as a whole. We recognise that this would necessitate the introduction of legal/ regulatory/ corporate governance code requirements, which would need to be effected consistently across jurisdictions.

As part of engaging in the debate, we also suggest that Accountancy Europe considers discussing with other bodies the possibility of changes in the regulatory arena to encourage greater transparency by entities and also by auditors and more effective “early warning” mechanisms. These could involve, for example, the introduction of ‘safe harbour’ provisions for management/ those charged with governance of entities which establish appropriate systems of internal control in respect of fraud and going concern, and changes in the liability landscape regarding auditor reporting in relation to such matters.

Please contact Sheri Anderson at sranderson@kpmg.com if you wish to discuss any of the issues raised in this letter.

Yours sincerely



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