

International Auditing and Assurance Standards Board  
529 Fifth Avenue  
New York, NY  
10017

01 February 2021

Dear Sirs

**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 Statement audit**

PKF International Limited ("PKFI"), administers the PKF network of legally independent member firms. The PKF International network consists of member firms and correspondents with over 400 offices operating in over 150 countries providing assurance, accounting, and business advisory services. PKF International Limited is a member of the Forum of Firms and is dedicated to consistent and high-quality standards of financial reporting and auditing practices worldwide. This letter represents the perspectives of PKF International Limited, but not necessarily the views of any specific member firm or individual.

We welcome the opportunity to comment on the International Auditing and Assurance Standards Board's (IAASB's) Discussion Paper: Fraud and Going Concern in an audit of Financial Statements and the structured steps to better understand how the auditing standards and the role of the auditor can meaningfully address the expectation gap between the audit profession and the stakeholders to the financial statements. We would like to thank the Chairman and the IAASB for the efforts and consultations in recognizing the expectation gap and the challenges faced by practitioners in applying the ISAs.

The many financial reporting ecosystems around the world and related technologies, are evolving, so must the role of the auditor. However, there must be a balance. Management and Those Charged with Governance must also acknowledge and fulfil their responsibilities and should also be held accountable. We take this opportunity to share our thoughts, perspectives, and interpretations in the form of responding to the specific questions raised within the discussion paper. Where relevant, we also take this opportunity to include additional thoughts, perspectives, and interpretations that we believe are important to note. These are all contained in [Appendix 1](#) of our submission.

If you would like to discuss any of our comments, do not hesitate to contact me at [jamie.drummond@pkf.com](mailto:jamie.drummond@pkf.com).

Yours sincerely



**Jamie Drummond**

Director of Assurance  
PKF International Limited

## Appendix 1

### Questions for respondents

#### Question 1

*In regard to the expectation gap (see Section I):*

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

#### Response

- a) The expectation gap relating to fraud and going concern in an audit of financial statements is caused by a combination of two factors:
- i) users of financial statements not having an accurate understanding of how the audit is conducted; and
  - ii) ineffective communication from auditors to the users of financial statements on how the audit is conducted.

The expectation gap is further widened where users of financial statements desire, and believe they receive, a greater level of assurance from the audit than the reasonable assurance that the audit opinion provides.

The expectation gap comes under increased public scrutiny for each high-profile corporate failure. In light of current global conditions and the economic outlook for the medium-term, it is probable that more situations will arise which will provoke further debate on this topic.

- b) Examples of measures that could be taken by the IAASB to narrow the expectation gap related to fraud and going concern in an audit of financial statements include:
- More effective communication by the IAASB to users of financial statements on the scope and requirements of an audit in context of fraud and going concern:  
The profession is frequently criticized on the approach of auditors to fraud and going concern, especially in those instances where a significant fraud or a going concern issue has affected a public interest entity. Regardless of whether the audit in question has complied with the relevant auditing requirements, public criticism may still be directed at the auditor including via significant press attention. Where it is left to an individual firm or network to respond to such, the firm's explanation can often be taken as being a defense of a poorly conducted audit. Rather than leave firms to be the lone voice in justifying audit requirements that they did not themselves set, there is an opportunity for the IAASB to contribute more openly to the debate and to speak with authority and credibility about the scope and requirements of an audit.
  - Review the guidance and requirements for the content of the auditor's report on the financial statements, as it relates to fraud and going concern:  
Recently, other standard setters in some countries have taken measures to enhance their auditing standards on the auditor's report by expanding and improving the wording to provide the

user with greater context of how the audit was conducted in these areas. The IAASB should monitor the outcomes of these country specific initiatives and consider whether there are benefits that could be brought into the ISAs.

- Continual improvement of the ISAs as they relate to the audit of fraud and going concern. In the short-term further improvements could be made including on the requirements and guidance around:
  - the level of skepticism to be exercised by the auditor.
  - the design and scope of requirements for risk assessment and identification.
  - how the auditor identifies and assesses indicators of management bias.
  - the extent of review procedures performed by more experienced members of the audit team over the conclusions reached by junior members of the audit team.
  - Enhanced requirements over communications to those charged with governance relating to the audit procedures performed and conclusions reached in respect to the audit of fraud and going concern.
  
- Longer-term the IAASB should consider:
  - How ISAs can be improved to encourage better use of automated audit technologies (such as data analytic procedures) to work with bigger populations of client data.
  
  - Expanding the requirements of ISQM 1 by including firm-level quality objectives relating to the audit of fraud and going concern. For example, objectives might be set which require that responses be developed by firms which include targeted learning and development programs and specific requirements on the review of the audit of fraud and going concern by the Engagement Quality Reviewer on applicable engagements.
  
  - Embarking on a joint project with IESBA to consider correlations between significant failures in the audit of fraud and going concern with breaches of the International Code of Ethics on such engagements.

## 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:*

- a) *Should the auditor have enhanced or more requirements with regard to fraud in an audit of financial statements? If yes, in what areas?*
  
- b) *Is there a need for enhanced procedures only for 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.*
  
- c) *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?*

- d) 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.)?

## Response

- a) Yes. The ISAs could be enhanced, or more requirements developed, with regard to fraud in an audit of financial statements. The IAASB could consider the following areas:
- A project should be initiated to identify how wider application of new audit technologies over larger populations of data can be encouraged. The ISAs could be adapted in this regard to help facilitate a modernization of the audit approach.
  - Prior to agreeing the terms of engagement, acceptance and continuance requirements could be enhanced. For example, audit practices could be required to consider whether staff have sufficient competency and expertise specifically to identify fraud risk factors given the nature and complexity of the client.
  - ISA requirements could also be enhanced on other areas of fraud, for example:
    - regarding how the auditor applies professional skepticism to the identification of fraud,
    - risk identification and assessment procedures on fraud,
    - communications to Those Charged with Governance on procedures and conclusions relating to fraud, and
    - on the commentary on fraud provided in the Auditor's report.
- b) Yes, there is a need for enhanced requirements and procedures for certain entity specific circumstances.
- i) Audit procedures could be added specifically to address the circumstance where the audit team has identified a suspected fraud. Where the audit team has identified a suspected fraud, additional requirements and expanded guidance within the ISAs could encourage a more consistent response to such circumstances. Such enhancements could help to:
    - reduce the risk of the audit team incorrectly dismissing an actual instance of fraud without having properly investigated and resolved it, and
    - provide a framework for the audit team to support the process of adequately addressing the fraud matter.
  - ii) Enhanced procedures could be added to ISA 402 *Audit Considerations Relating to An Entity Using a Service Organization*. Paragraph 19 in ISA 402 could include further requirements for the user auditor over the risks of fraud that might arise a result of the relationship between the client and its service organisation, including:
    - enhanced risk assessment procedures, and
    - a more robust approach to the inquiries and procedures that the auditor performs as part of the process to identify instances of fraud.
  - iii) Changes should be made within the ISAs for the points that we have outlined in our response to (a) above. However, we believe there is also merit in further evaluation of the possible solutions for changes outside the scope of an audit such as those presented as "Alternative C" in Appendix B to the Discussion Paper "Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap".

- c) We do not believe that the IAASB should enhance the auditor's considerations around fraud to include a "suspicious mindset":
- i) We have outlined some areas in which the ISAs could be enhanced to support the identification of fraud, including procedures that are performed when planning and performing the audit. We believe that these measures would contribute to the objective of closing the expectation gap. As such, we do not consider that it would be necessary to also introduce further requirements on a "suspicious mindset".  
A change of this nature would likely represent a significant step change to the process of auditing fraud. Its introduction could heighten the public perception of what is involved in the process of auditing fraud, leading to a further widening of the expectation gap. We believe that the outcome of any project to address the current expectation gap would be more successful if it were to focus more so on closing the current gap.
  - ii) If the concept of a "suspicious mindset" were introduced into ISAs it could lead to a fundamental change in the auditor-client relationship and have a significant impact on the scope of the audit. Consequently, it would require further careful definition and very specific objectives would need to be established for the auditor. Without careful consideration of the consequences of introducing this term, there could be varying interpretations and diverging practices as to the level of evidence that is required to address the auditor's suspicions. Where the level of sufficient appropriate audit evidence required to address the auditor's suspicions is judged as being necessarily high, this might be unduly onerous on the audit process and may increase audit costs beyond the value to be gained from the intended benefits. The intended benefits might alternatively be achieved through enhancements made to other aspects of the ISAs as noted above.
- d) Yes, we believe that more transparency would assist enhancing the understanding of the work performed in relation to fraud in an audit of financial statements. More transparency on the auditor's work in relation to fraud in an audit of financial statements could be a helpful measure as part of the overall response to address the expectation gap. Information could be included in the auditor's report which is similar to the new requirements in the UK. These require that the auditor's report includes an explanation on the extent to which the audit was considered capable of detecting irregularities, including fraud. The IAASB could also consider whether to extend the KAM requirements, from ISA 701, to fraud risk and the auditor's work effort in relation to addressing fraud risk.

### 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:*

- a) *Should the auditor have enhanced or more requirements with regard to going concern in an audit of financial statements? If yes, in what areas?*
- b) *Is there a need for enhanced procedures only for 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.*

- c) 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?

## Response

- a) Yes, we believe that the ISAs could be enhanced with more requirements with regard to going concern in an audit of financial statements as follows:
- Risk Identification and Assessment requirements:  
More rigorous requirements could be introduced over the identification of risks relating to material uncertainties over going concern.
  - Linkages to ISA 540 (Revised):  
The ISAs could be improved by strengthening the linkages between ISA 540 (Revised) *Auditing Accounting Estimates and Related Disclosures* and ISA 570 *Going Concern*. Examples of where ISA 570 procedures over the auditor's work on management's assessment of going concern could be aligned with ISA 540 (Revised) include:
    - a more structured approach to the procedures performed over the method, significant assumptions and data used in management's assessment of going concern, and
    - requirements to consider potential indicators of management bias in the preparation of management's assessment of going concern.
  - Subsequent events requirements  
Enhancements could be made, which require more detailed work by the auditor over the going concern assessment, toward the end of the audit. Such procedures would be introduced to ensure that if the initial audit work over management's assessment of going concern is performed significantly earlier than the date on which the auditor's report is signed, that rigorous top-up procedures are performed to update the audit work for current circumstances affecting the going concern assessment.
- b) Yes, enhanced requirements and procedures for certain entity specific circumstances.
- i) In our view the improvements in ISAs to address the expectation gap would be better achieved through enhancing the principals and requirements of the ISAs as they generally relate to the audit of going concern, rather than by reference to certain specific circumstances.
  - ii) No comments to note.
  - iii) No comments to note.
- c) No, we do not believe that there is a need for additional transparency in relation to the auditor's work done on going concern.
- i) Additional information in relation to the auditor's work on going concern is not necessarily required. This is on the basis that, for applicable engagements, information relating to a material uncertainty on going concern should be presented in the auditor's report. Furthermore, many financial report frameworks include requirements for going concern and the judgements and assumptions made, irrespective of whether there is material uncertainty.

ii) No comments to note.

#### Question 4

*Are there any other matters the IAASB should consider as it progresses it's work on fraud and going concern in an audit of financial statements?*

#### Response

In addition to the responses above, the IAASB should also consider the post implementation results of ISA 315 (Revised). The clarifications made to the requirements could assist in narrowing the expectation gap. In combination with the various other standards that have been revised, we encourage the IAASB to also allow time for the revisions and enhancements to yield its intended objectives.

#### Glossary of terms

IAASB	International Audit and Assurance Standards Board
IESBA	International Ethics Standards Board for Accountants
ISA	International Standards on Auditing
ISQM	International Standards on Quality Management
KAM	Key Audit Matter
UK	United Kingdom