AUSTRALASIAN COUNCIL
OF AUDITORS GENERAL

29 January 2021

Tom Seidenstein
Chair
International Auditing and Assurance Standards Board
529 5th Avenue
New York, New York 10017
USA

Dear Mr Seidenstein

Fraud and Going Concern in an Audit of Financial Statements

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on the Fraud and Going Concern in an Audit of Financial Statements discussion paper.

The views expressed in this submission represent those of all Australian members of ACAG. ACAG's comments are primarily in the context of the public sector, which reflects ACAG's significant experience and involvement in the sector.

For the proposals to be useful and relevant for the public sector, ACAG believes that additional guidance is needed in areas specifically considering the public sector context, details of which are included in the attachment to this letter.

The attachment to this letter addresses the IAASB's specific matters for comment outlined in the Fraud and Going Concern in an Audit of Financial Statements discussion paper.

ACAG appreciates the opportunity to comment and trust that you will find the attached comments useful.

Yours sincerely

Andrew Richardson
Chairman
ACAG Auditing Standards Committee

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Attachment

FRAUD AND GOING CONCERN IN AN AUDIT OF FINANCIAL STATEMENTS

Questions	Responses from the ACAG Group
1. In regard to the expectation gap (See Section 1 of the Discussion Paper)	
(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?	We acknowledge the three components of the expectation gap published by the Association of Chartered Certified Accountants[1]. We noted the following as the main causes of the expectation gap: • The ongoing misunderstanding by users of the financial report of: -the scope of a reasonable assurance engagement (with linkages to fee pressure) - the period that the audit report covers; historical not forecasts -concept of materiality for the detection of fraud - extent of audit work done in relation to fraud -accountability for fraud • Detection risk: in particular when fraud is as a result of collusion. • Increased public expectations attributable to many factors including the use of enhanced auditing tools and industry responsiveness to significant frauds. We note that the expectation gap for going concern is less of a focus in the public sector.
(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?	Improve users understanding by: • Increasing auditor reporting transparency. Global auditor reporting reforms in recent years has been a significant step in this regard. The information about the auditor's and preparer's respective responsibilities in the current standards strike an appropriate balance between detail and brevity, however, there are opportunities for auditors to outline engagement-specific information related to fraud or going concern which may be helpful. For example, there may be an opportunity to increase transparency and understanding of the scope of an audit by including summary information around going concern, about the risk assessment made and procedures performed by the auditor, consistent with how the matter might be described if it were a key audit matter. However, this option is less likely to be suitable for fraud response where unpredictability is an essential element in the audit work. • Better defining the minimum requirements to be communicated to those charged with governance (TCWG). The reporting of auditor's fraud risk assessment and procedure performed by auditors to address fraud risk may reduce the expectation gap. • Considering the inclusion of disclosures about what has caused (control breakdowns or misstatement in judgements) material restatements of a financial report due to fraud. • Improving disclosures of the stress testing or scenario analysis within financial statements for going concern within IAS 1 Presentation of Financial Statements • Considering whether Director's Declaration or equivalent attestation to fraud and error controls may make a difference to the emphasis placed by the Directors on the control environment. • Educating users about why fraud may not be detected. There should also be an emphasis that the auditor is not signing an opinion stating that the entity and its financial statements are free from fraud and error, they are signing an opinion to state that the financial statements are not materially misstated.

[1] Closing the expectation gap in audit | ACCA Global

	Continued development of auditors in: a. the application of the requirements of ISA 240 including analysis of information (clients' processes and monitoring of fraud risk and communication in managing fraud risk, data), and risk assessments, to apply scepticism and where appropriate collaboration of management's fraud risk assessments with other evidence. b. data analytics c. professional scepticism. Enhancements to auditing standards, such as: • Improved guidance on the relationship between fraud and internal control frameworks. • Better guidance on evidence requirements within ISA 240. Further guidance on risk factors, for example, in the public sector red flags could include under-resourced internal audit function and/or insufficient focus on routine financial hygiene topics, long-serving people in key senior roles and many short-term or acting people reporting to them, lack of capability and training to ensure strong financial management, the pattern/nature of complaints/referrals/protected interest disclosures received by the audit office or other public sector integrity agencies, history of previous audit findings, distance from/opacity to central Treasury scrutiny and accountability etc. • Improved guidance on the use of data analytics as a substantive test of detail or other tests of detail. • Guidance on the use of forensic accountants. • Consideration of a requirement of a more detailed entity assessment regarding the risk of fraud similar to the current assessment for going concern. With regards to going concern, there should be greater explanation in the standards regarding going concern in a public sector context Of note is the New Zealand Accounting Standards Board (NZASB) who has proposed additional disclosures in the financial statements relating to significant judgements and estimates regarding the appropriateness of the going concern assumptions, and additional disclosures where material uncertainties had been identified.
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?	The requirements of the current standards are considered adequate with respect to identifying and assessing risk of material misstatement in the financial statements due to fraud. . Execution is critical in terms of professional scepticism and improved ability for analysis with data analytics. If enhanced requirements are introduced, they need to be risk based and scalable. There also needs to be a holistic approach, starting with management and those charged with governance to set the tone at the top, in conjunction with efforts from standard setters, professional bodies and the profession itself, in order for any changes to be successful. In the public sector the mandate of the Auditor-General may include considerations that relate to probity, propriety and compliance. There may be enhanced expectations around fraud as a matter of public or parliamentary interest. The response to any such interest is better placed in the hands of Auditors-General than to be dealt with by general auditing standards given that any such work is set out with the intention of being additional and informed by that audit office's user interest.

	Additional complications for public sector auditors with respect to third party fraud in item eight below.
(b) Is there a need for enhanced procedures only for certain entities or in specific circumstances?[2] 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.	Audit procedures to detect material fraud will always require tailoring for certain entities and specific circumstances. This is fundamental to risk-based auditing and we believe the principle is sufficient. Differential levels of fraud response are likely to cause confusion and widen the expectation gap. If such procedures are considered necessary to address the risk of material misstatement then logically, they should apply to all audits or, where necessary, those where fraud poses an increased risk of material misstatement. Any enhancements should be focused on detecting fraud giving rise to material misstatements and be linked to the revisions to ISA 315 and auditor understanding of the entity and its environment. Where an entity has been assessed as high risk, there should be consideration for applying data analytics procedures to identify higher risk samples for audits. In the public sector context audit offices are not fraud investigatory bodies and, outside of the specific scope of our audit functions, they may be empowered or required by their respective legislation to refer frauds to other more relevant authorities to investigate fraud as appropriate. We separately discuss opportunities with regards to third party fraud in item eight below. If the IAASB were to mandate enhanced requirements for specific entities, e.g. listed entities or public interest entities, including the requirement to engage forensic accountants where there is a heightened risk of fraud, the enhancements should be included within the current ISAs.
(c) Would requiring a "suspicious mindset" contribute to enhanced fraud identification when planning and performing the audit? Why or why not?[3] (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	No, the current wording (i.e. professional scepticism) is more appropriate. We agree with the suggestion of amending the standards to describe professional scepticism on a continuum, with guidance to help auditors identify red flags (e.g. conflicting audit evidence or conditions that may indicate possible fraud) and therefore increase the level of scepticism in these instances. The introduction of a 'suspicious mindset' is likely to lead to confusion especially when the concept of professional scepticism has not always been either well understood or applied, as highlighted by the findings from regulatory reviews. We question whether a suspicious mindset, with the accompanying training, would enhance fraud identification compared to the appropriate practice of professional scepticism in the first instance. There is a significant distinction between a financial audit and a fraud audit or forensic investigation. In an audit, the risk of not detecting a material misstatement from fraud is higher than not detecting one from error. This is because frauds can involve collusion, override of controls by senior individuals, highly knowledgeable perpetrators, and the size and frequency of the amounts manipulated. An auditor's scope is constrained by materiality. An auditor cannot make any legal determination of whether a fraud has occurred. However, 'Deep suspicion' suggests a higher evidentiary standard with respect to fraud than other aspects of the audit. Whereas professional scepticism requires the

[2] Appendix B illustrates possible alternative ways any proposed enhanced procedures may be built into the standards – i.e., for all audits or only in specific circumstances or performed as part of the audit or as a separate engagement in addition to the audit. Respondents may wish to refer to Appendix B to better understand examples of some of the possible response options.
[3] See section titled Professional scepticism in Section IV that introduces the notion of a "suspicious mindset" if the circumstances require it.

circumstances ?	auditor to have a questioning mind and take critical assessments about the sufficiency and appropriateness of evidence, deep suspicion could cause the auditor to not give appropriate weight to high quality evidence. There may be a risk associated with introducing and crystallising the term "suspicious mindset". This will be impacted by and may impact materiality. The auditor is not appointed to form an opinion that the entity and its financial statements are free from fraud and error particularly where the Directors are not equally focused on the existence of effective controls. Additionally, adding an element of suspicion into audit tests still leaves auditors vulnerable to issues with the expectation gap because it is an inherent risk of audit that frauds, including those that are potentially material, will go undetected.
(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.)?	We are of the view that the auditor has the option to include additional disclosures (similar to that of a key audit matter) on fraud and the auditor's work on fraud if considered necessary to mitigate any expectation gap within the auditor's report. This could include improved disclosure of the evidence and evaluation of management's processes in complying with the requirements of ISA 240 regarding enquiring/understanding management's processes in relation to fraud risk identification and management's controls. However, additional emphasis on fraud in the auditor's report, beyond that which is focused on the impact on the financial statements, may increase the expectation gap by setting a higher standard around fraud. We are of the view that more clarity around materiality and what it means is required, particularly in the context of fraud and how users may see qualitative materiality as being more important than quantitative materiality when it comes to fraud. This can help to narrow the expectation gap in relation to management's responsibilities to address fraud risks and the effectiveness of their system of internal control to prevent and detect instances of fraud. Additional information can be included in communications to those charged with government on the audit procedures but has to be balanced with not creating fraud risk by disclosure of audit procedures.
3. The 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 II and IV of the Discussion Paper). 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?	Generally, not considered a significant issue for the public sector, particularly where the entity is reliant on ongoing government funding. We are of the view that ISA 570 addresses the requirements with regards to going concern. More explanation for the public sector context is always welcome. If enhanced requirements were to be introduced it is appropriate that any enhanced requirements apply initially to management with regard to appropriate assessment and sufficient disclosure. In relation to auditors, the requirements are sufficient given there is an existing requirement to highlight an emphasis of matter in the auditor's report where there may be material uncertainty in relation going concern. *Extending going concern procedures beyond management's time period* Where material uncertainty exists over going concern <u>and</u> there are indicators that the entity's going concern issues are likely to extend beyond 12 months, the auditor could consider the longer time period in their assessment. Guidance will be needed to identify the conditions that would cause the auditor to extend procedures into a longer period. *Going concern and other concepts of resilience*

	We note that these concepts are defined by the relevant jurisdiction's legislation. Alignment of these concepts between different jurisdictions would require considerable effort. *Is it necessary to have different concepts of going concern and resilience?* Different concepts would require clear definitions so that users of financial statements understand their meaning and how they apply to their circumstances. *Narrowing the knowledge gap on the meaning of material uncertainty related to going concern* The requirements to under IAS 1 to disclose management's assumptions and judgements on going concern could be more specific. However, as the discussion paper identified, ISA 570 requires disclosure of the nature and implications of material uncertainty, which addresses the knowledge gap in some way.
(b) 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	Preparation of the financial statements on a going concern basis is fundamental to the audit. Therefore, any going concern procedures conducted as a result of an audit should be consistent across all entities and should remain within the scope of the audit to ensure the expectation gap is not widened. Additional guidance on the application of the audit of going concern to public sector entities (such as restructures of administrative arrangements where public functions are ceased or transferred between legal entities) may be helpful. We welcome the IAASB providing indicators of going concern for public sector entities.
(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	There may be an opportunity to increase transparency and understanding of the scope of an audit by including summary information about the risk assessment made and procedures performed by the auditor with respect to going concern, consistent with how the matter might be described if it were a key audit matter. In effect, this level of information may already be provided in KAM reports where there is uncertainty about going concern (where the reporting requirements of ISA 570 do not apply) but which is a KAM. Given that IAS 1 *Presentation of Financial Statements* already requires suitable disclosure by the auditee in the financial statements where there is a material uncertainty, we considers there is little scope for the auditor to present more information about the material uncertainties as primary responsibility falls upon the financial statement preparer and it would not be appropriate, unless it was the basis for a qualification, for the auditor to present additional information about the auditees' financial performance and position. The auditor should be providing to those charged with governance communication about what an auditor is required to do to mitigate the risk and there should be more disclosure by Directors about how they have assessed and determined that the entity is a going concern and will remain so for the foreseeable future.

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?	

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?

ACCA's three components of the expectation gap are valid: Knowledge Gap, Performance Gap, and Evolution Gap – this is widening as a result of big data and accounting estimates.

A holistic approach is required, consider collaborating with accounting standards boards and professional bodies to ensure a consistent approach to requirements for all parties including management and those charged with governance.

5. The IAASB is interested in perspectives about the impact of corporate culture on fraudulent financial reporting and what, if any, additional audit procedures for the auditor should be considered by the IAASB in this regard.

It is important that the auditor understand the governance and culture of audited entities as it applies to all aspects of audit planning and risk response, including with respect to fraud. This understanding needs to be collaborated to appreciate the extent to which it is practised. We note that the increased requirements within ISA 315 relating to the overall risk response and consequential improvements to the fraud requirements promote the need to better understand an entity's corporate culture.
Additional guidance (to that available at ISA 315 for auditors on assessing the risk of fraud where corporate culture is weak, could better support the auditor response to ISA 315. Corporate culture is reviewed through understanding the entity during the planning phase of the audit and any risks identified through this process are considered, and as such we are not of the view that additional procedures are required.

Guidance could consider:

- Definition of the desired culture – has the desired culture been communicated?
- Embedment – has the desired culture been embedded into every part of the organisation? What evidence supports this?

- Monitoring and measurement – how are the board and senior management monitoring culture? What evidence supports this?
- Governance – how does the board and those charged with governance oversight this? What evidence supports this?

6. The IAASB is interested in perspectives about requiring the use of forensic specialists or other relevant specialists in a financial statement audit, and, if considered appropriate, in what circumstances the use of specialists should be required.

This is an auditor judgment expected to be made by the engagement leader having done a robust risk assessment. Forensics specialists may be a suitable response in particular circumstances where a specific fraud risk that poses a risk of material misstatement that is beyond the skills of the generalist audit team to address has been identified.

Use of forensic specialists is unlikely to be an appropriate generic response because it is beyond the scope of an audit engagement and may divert audit attention and resources away from areas of higher non-fraud related risk. Requiring the engagement of forensic specialists must have regard to materiality and recognise time and cost impacts for the audit.

In the public sector context, suspicion of fraud may be referred to other regulatory bodies who have specialised forensic teams.

7. As the world is changing and non-material frauds are becoming more prevalent, the IAASB would like to explore whether more needs to be done in relation to non-material frauds identified. As such, the IAASB is interested in perspectives about the perceived responsibilities of the auditor regarding non-material fraud in a financial statement audit (i.e., a broader focus on fraud) and what additional procedures, if any, may be appropriate. The IAASB is also interested in perspectives about whether additional audit procedures should be required when a non-material fraud is identified, and if so, what types of procedures.

The basis of a financial audit is materiality, notwithstanding this, if a non-material fraud is identified, current practice for auditors is to identify how the fraud occurred. This would assist in determining the risk of any non-discovered material fraud in relation to the financial statements. This may not be clearly understood as a current requirement, therefore, suggest the IAASB expand on this requirement with further guidance to help auditors apply the requirement.

Any activity needs to not confuse users or practitioners about the auditor's responsibility with respect to fraud. The auditor's responsibilities for reporting fraud are already considered clear in the auditing standards. From a practical perspective, it would be difficult to apply an audit methodology that require two levels of materiality – one for the financial statements and one for fraud.

In the public sector context, there may be specific requirements for the referral of fraud for further investigation. Auditor-Generals may decide to consider the public interest perspective (qualitative, nature) and resource other audit activities additional to the scope of the financial audit.

8. The IAASB is interested in perspectives on whether enough emphasis is placed on the auditor's responsibilities around fraud related to third parties. We are also interested in feedback about the auditor's role in relation to third party fraud that does not result in a material misstatement of the financial statements but may have a severely negative impact on the entity (e.g., cybercrime attacks).

There are two concepts for third party fraud relevant here. As noted, the potential for third parties to impair the ability of the entity through activities like cyber-attacks is an increasing risk in the current environment. There is a possibility of undetected attacks happening during the audited year that undermines control effectiveness, there is also the possibility that inabilities to prevent such attacks presents a threat to the ability of the entity to operate as a going concern. Assessing comprehensively the entity's susceptibility to third party fraud may require specialist industry knowledge and skills. As such, this assessment is dependent on management/those charged with governance having inhouse or engaging external expertise. The auditor is dependent on mgt's expert's assessment . More guidance on this would be beneficial.

In the public sector, third party fraud may be significant where government activities, such as the payment of benefits or the application of taxation, is dependent upon information provided by third parties. While it is generally accepted that transactions made by governments in good faith where fraud or error by a third party has not yet been detected should be recorded and recognised in financial statements, auditing the appropriateness and fair presentation of related disclosures remains a challenge to public sector auditors. Additional guidance in this area would be beneficial.

9. The IAASB is interested in perspectives on whether additional engagement quality control review procedures specifically focused on the engagement team's responsibilities relating to fraud should be considered for audits of financial statements of listed entities, and those other engagements, if any, for which the firm has determined an engagement quality control review is required.

Current coverage for EQCR around key judgements, of which fraud may be a matter in audit planning, is sufficient as the EQCR is already involved in work around significant risk and judgements in the audit file.

10. The IAASB is interested in perspectives on whether entities should be required to assess their ability to continue as a going concern for longer than twelve months, and therefore whether auditors should be required to consider this longer time period in their assessment, beyond the current required period. If stakeholders believe a longer timeframe should be required, alignment will need to be retained between the requirements under the applicable financial reporting framework and the auditing standards in order for auditors to be able to adequately perform their procedures.

The auditor's responsibilities with respect to going concern already pose significant challenges given the need to obtain and audit forecast information to cover the relevant period. Any extension of this period would significantly increase audit risk and therefore necessary audit effort, given the increased uncertainty of forecast information over time. We do not believe this is the responsibility of the auditor. The auditor may not always have sufficient information to assess or support an opinion in relation to an entity's going concern beyond 12 months, due to the inherent limitations of an audit (mentioned above) and how this impacts on the auditor's ability to determine events or conditions beyond 12 months and therefore the entity's going concern status. Auditing assumptions and forecasts of more than twelve months is likely to be inherently risky and unreliable given industry/environmental changes.

11. The IAASB is interested in perspectives about whether changes are needed with regard to going concern and other concepts of resilience (within the purview of the IAASB's remit).

No considered a significant issue for the public sector.

12. The IAASB is interested in perspectives on what more is needed to narrow the knowledge gap with regard to the meaning of material uncertainty related to going concern, to enable more consistent interpretation of the concept.

Not currently considered a significant risk in the public sector audit environment. However, a broader education piece for the public and users of the financial statements would be useful.

13. In addition, the IAASB is interested in perspectives about whether the concept of, and requirements related to, a material uncertainty in the auditing standards is sufficiently aligned with the requirements in the international accounting standards.

Considered sufficiently aligned.

14. The IAASB is interested in perspectives about whether more is needed related to professional Scepticism when undertaking procedures with regard to fraud and going concern and what additional procedures, if any, may be appropriate.

Effective professional scepticism is driven by suitable involvement, coaching, and direction of staff, especially in the risk identification and response stages of the audit. As stated above we can do more to enhance professional scepticism in the execution of our audits. Additional guidance in relation to applying professional scepticism in relation to fraud and going concern would be useful and appropriate.

Many auditors have a natural "confirmation bias" (which also brings a perception of a less challenging audit experience) which could be addressed through guidance and training.

15. The IAASB is interested in perspectives about whether more information is needed in the auditor's report regarding fraud or going concern, and if so, further details about the transparency needed.

Current requirements are considered sufficient.

16. In addition, the IAASB is interested in perspectives about whether more transparency is needed with regard to communications with those charged with governance.

The current requirements are considered sufficient.
As noted above there is opportunity for more guidance for the auditor to state to TCWG what they have done in relation to fraud including cybersecurity, however TCWG should have to communicate what they have undertaken in the same manner.