21 January 2021

International Auditing and Assurance Standards Board (IAASB)
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Dear Sir/Madam

CFO FORUM SUBMISSION ON IAASB DISCUSSION PAPER: FRAUD AND GOING CONCERN IN AN AUDIT OF FINANCIAL STATEMENTS

In response to your request for comments on Discussion Paper *Fraud and Going Concern in an Audit of Financial Statements*, attached is the comment letter prepared by the CFO Forum, an interest group of the South African Institute of Chartered Accountants (SAICA). We have included our responses to the specific questions raised in the Discussion Paper in Appendix A.

This comment letter results from deliberations of the members of the CFO Forum, a discussion group formed and attended by the Chief Financial Officers of major Johannesburg Stock Exchange (JSE) listed and larger state-owned companies – with members representing a significant part of South African business. The CFO Forum has broad sectoral coverage ranging from financial services, mining, retail, media, telecoms, medical services and paper & packaging. Its aim is to contribute positively to the development of South Africa's policy and practice on financial matters that affect business – such as government regulatory issues and initiatives, taxation, financial reporting, corporate law and governance, capital market regulation and stakeholder communications for enterprises.

We thank you for the opportunity to provide comments on this discussion paper.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Jason Quinn
Chair of the CFO Forum

APPENDIX A: SPECIFIC COMMENTS

BACKGROUND

The purpose of the International Auditing and Assurance Standards Board (IAASB) Discussion Paper (the DP) is to gather perspectives from all stakeholders about the role of the auditor in relation to fraud and going concern in an audit of financial statements, and to obtain input on matters about whether the auditing standards related to fraud and going concern remain fit-for-purpose in the current environment. The information collected by the IAASB will help them to make an informed decision(s) about possible further actions and how they can contribute to narrowing the expectation gap.

The IAASB set out certain matters for consideration that have been raised to them through feedback forums or research.

Respondents may choose to answer all, or only some, of the questions. In addition, specific matters are detailed throughout the DP where the IAASB is interested to obtain stakeholder perspectives. Respondents may wish to comment on those matters. The questions set out in the DP should be considered in the context of the benefits that will be provided in the public interest, weighted against the cost to various stakeholders of implementing the suggested actions.

QUESTIONS TO STAKEHOLDERS

1. In regard to the expectation gap:

(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?

The CFO Forum believes that the expectation gap arises directly from a knowledge gap where the users of financial statements may either not fully understand or have unrealistic expectations of what an audit entails; as well as from a performance gap where there is a shortfall in the quality of the audit work performed.

The knowledge gap effectively represents the difference in knowledge between what the public assumes an auditor does during the performance of an audit together with the related level of assurance that the audit report provides, versus what auditors actually do and the level of assurance provided. This mismatch therefore stems from the public perception pertaining to the role of auditors.

For example, there is a common misunderstanding that detecting fraud is part of the auditor’s role. Although audit firms do perform procedures relating to fraud, due to the nature and cost of the audit, auditors can only test a sample of transactions. In addition, fraudulent activities are often carefully planned out and well concealed making it difficult for auditors to detect. Inherent limitations may therefore further inhibit the ability for auditors to detect all fraud committed by management and/or employees. Companies are required to have their own fraud prevention and detection processes and controls, and auditors test the effectiveness of these controls through audit procedures and sample testing. Auditors may therefore detect fraud during this process; however, it is not always well understood that it is not their primary responsibility to do so.

In addition to the knowledge gap we also believe that the expectation gap results from an evolution gap and a performance gap. An evolution gap represents the fact that the planning of an audit does not always sufficiently evolve over time to appropriately consider all the developments within an environment and industry that an audit client operates in. A performance gap relates to audit procedures (or a lack thereof) that may not always fully comply with audit quality requirements.

A performance gap may, for example, result from audit engagement team members not having sufficient and appropriate knowledge and/or understanding of the business environment, operations and the related business risks of the audit client in order to design appropriate audit procedures to address the relevant audit risks. This can also manifest in the inconsistent application of audit standard requirements where there is little guidance and/or supporting material to assist with the effective application thereof. A lack of "professional skepticism" or "suspicious mindset" further affects this performance gap.

(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?

The expectation gap could be narrowed if users are able to better understand the nature and extent of audit work performed and not performed, together with any associated limitations. Users also need to be made more aware of the areas that require them to perform their own analysis of the available information and form their own opinion. One way to assist to address the knowledge gap is for auditors to include a paragraph like the one on "other information" in the audit opinion to state the role and responsibility of the auditor relating to fraud and going concern.

The many accounting scandals over recent years have certainly not helped this matter and have inevitably widened the gap. A further solution for narrowing the gap is for there to be more transparency on recent failings as this normally does not get shared or takes far too long to share with the general public. The envisaged transparency should include the publication of a report detailing the reasons why the auditors did not identify the material matters as well as whether sufficient and appropriate audit work was performed in accordance with all the relevant standards. In addition to general outreach and socialization, impacted regulators may also consider publishing educational material on the topic.

In terms of evolution and performance gaps it would be useful for the IAASB to provide additional guidance for practitioners in the current auditing standards. Please refer to sections 2.2 and 2.3 below for a more detailed response on this aspect.

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. 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?

Although the main responsibility for the prevention and detection of fraud rests with management, the CFO Forum agrees that the auditor should have enhanced requirements regarding fraud, particularly in the areas of mindset and business understanding. This is especially relevant where client operations are of a technical nature and require some level of experience. The auditor should apply an appropriate level of skepticism to both management responses and evidence provided, to support identifying material fraud. The suspicious mindset is key, which in combination with a good understanding of the business will certainly contribute to enhanced fraud identification.

Auditors further need to ensure that management has put in place robust controls pertaining to identifying and preventing fraud and auditors should spend time understanding whether the implemented controls achieve the fraud identification/detection objectives. As mentioned in the DP, corporate culture and tone at the top impacts the occurrence of financial statement fraud. Corporate culture reflects how much emphasis management and those charged with governance place on fraud prevention and fraud deterrence which is listed as a fraud risk factor in the auditing standards. We believe that the auditing standards should be expanded to provide more guidance on how to evaluate and address this risk.

Due to the nature and complexity of fraud, there are members that believe that it will be beneficial for audit teams to use forensic specialists. The IAASB could accordingly consider requiring audit firms to include forensic audit training as part of the audit firm's International Standard on Quality Control (ISQC) process and procedures for engagement performance, as well as provide guidance on the application of technology in performing fraud-related procedures (for example run data analytics to identify exceptions and anomalies). However, these members do not believe that the cost of including such forensic specialists should be excessive or borne solely by the audited entity/group, but rather that the audit firm/s themselves should share in these costs as the audit firms are aligning to audit on a risk identification basis.

(b) Is there a need for enhanced procedures only for certain entities or in specific circumstances?

Yes, there are members that believe that there is a need for enhanced procedures for certain entities or in specific circumstances.

If yes:

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

Enhanced procedures should apply to listed entities, regulated entities and high-risk entities (this would involve a level of judgement but includes entities or groups where high-risk factors are present based on industry for example, state-owned entities, scrap metal companies etc.) or with consideration to other high-risk factors (such as negative media attention, shareholder activity etc.).

(ii) What enhancements are needed?

The use of forensic skills within the audit process.

(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.

As previously mentioned, corporate culture plays an important role in preventing and deterring fraud. If enhanced fraud procedures are voluntary, entities that have robust policies and processes, or entities that do not place a lot of emphasis on fraud prevention and deterrence, may not be willing to incur an additional cost that is not mandatory. Due to the impact of increased corporate failures relating to fraud these changes should be included within the scope of an audit.

(c) Would requiring a "suspicious mindset" contribute to enhanced fraud identification when planning and performing the audit? Why or why not?

Yes, requiring a "suspicious mindset" is crucial to enhance fraud identification. As detailed in the DP, some audit team members may tend to focus on evidence that will confirm a client's explanation/assertion rather than challenging or disproving the evidence. This behaviour is referred to as unconscious bias and this influences the auditor's judgement and actions, which affects the auditor's independence, objectivity and ability to identify misstatements, including fraud.

However, there needs to be a balance between having a suspicious mindset on relevant matters and over/re-auditing matters that are either immaterial or matters that have previously been audited and concluded on.

(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?

Yes, the IAASB should enhance the auditor's considerations around fraud to include a "suspicious mindset". We believe this should be for all audits, however the extent and level of application should be based on the risk and materiality assessment of the underlying accounts and assertions. In other words, enhanced procedures should be more extensive for high risk and material items, and less extensive for low risk items.

(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.)?**

Yes, we do believe that more transparency is needed about the auditor's work in relation to fraud in an audit of financial statements. The nature and extent of procedures performed by the audit team, as well as their role and responsibility relating to fraud should be clearly articulated in the audit report. This can be achieved by including a paragraph similar to the one on "other information" in the audit opinion. Details relating to the audit procedures performed and resulting findings should be communicated with management and those charged with governance.

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. 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?**

Yes, the CFO Forum does believe that there should be enhanced procedures about going concern in an audit of financial statements. Again, an auditor's overall understanding of the business operations together with relevant experience from clients in similar industries is of paramount importance. Although existing procedures may be fairly prescriptive, it is not always clear how much time is spent stepping back from the detail and understanding the overall risk, which together with detailed business insights will allow for founded challenge to be raised on management's assumptions, plans and other data. Auditors should focus less on simply obtaining evidence with a bias to support each assumption made by management; and more time should be taken to step back from the detail and consider the broader commercial picture. This should also include an assessment of whether appropriate and adequate disclosures are made within an entity's significant judgements and estimates in relation to material assumptions and uncertainties.

Furthermore, the Financial Reporting Council (FRC) launched an inquiry led by Lord Sharman to identify lessons for companies and auditors addressing going concern and liquidity risks. The final report of the Sharman Inquiry "Going concern and liquidity risks: lessons for companies and auditors" (the report) was issued in 2012. The FRC highlighted the importance of solvency risks and why they should be incorporated in an entity's going concern policy.

Evidence obtained by the Sharman Inquiry confirmed that the principal focus of the going concern assessment process is on liquidity and that, outside the regulated financial services industry, there is little focus on solvency. The panel believes that solvency risk is important because it underpins the ability to obtain and maintain debt funding as well as equity funding for the business. Contrast with liquidity risk, solvency risk is about the viability of the business model and the maintenance of capital. Solvency risk is therefore longer-term focused and may be more qualitative and judgemental, whereas liquidity risk is more short-term focused and quantitatively based.

We are accordingly of the view that the IAASB could provide more guidance on audit considerations and procedures pertaining to solvency risk. This is also in line with the IAASB's question to stakeholders on whether entities should be required to assess their ability to continue operating as a going concern for longer than 12 months and whether auditors should consider the longer timeframe in their assessment. We are of the view that the going concern assessment timeframe should be extended beyond 12 months, for a period that would adequately incorporate solvency risk associated with the entity. Users would also benefit from disclosures explaining the solvency risk period that was assessed.

(b) Is there a need for enhanced procedures only for certain entities or in specific circumstances?

Yes, we do believe that there is a need for enhanced procedures for certain entities or in specific circumstances.

If yes:

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

Enhanced procedures should apply to listed entities, regulated entities, high-risk entities and entities that have indicators of going concern uncertainty (for example, entities that are in a loss-making and/or in a net liability position).

(ii) What enhancements are needed?

The going concern assessment should be extended beyond the 12 months horizon when required based on relevant risk triggers. This will require additional solvency risk procedures to be performed.

(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.

We are of the view that changes should be made within the scope of an audit. It is unlikely that entities will be willing to pay for a separate engagement on going concern if it is not required based on guidelines and/or the audit team's risk assessment, especially if management is of the view that their going concern assessment is appropriate and adequate. The high-profile corporate failures that have recently occurred in South Africa have highlighted the need for auditors to better consider and address fraud and going concern in their audits. The CFO Forum is therefore in favour of incorporating these changes within the ISA's.

(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.)?

Yes, we do believe that more transparency is needed about the auditor's work in relation to going concern in an audit of financial statements. The nature and extent of procedures performed by the audit team, as well as their role and responsibility relating to going concern should be clearly articulated in the audit report. This can be achieved by including a paragraph similar to the one on "other information" in the audit opinion. Details relating to the audit procedures performed and resulting findings should be communicated with management and those charged with governance.

(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?

We believe that International Financial Reporting Standards (IFRSs) require management to sufficiently disclose going concern related matters and any associated material uncertainties or significant judgements. Considering our support to incorporate additional changes within the ISA's (refer to question 3(b)(iii)) together with the proposal for more transparency as detailed under question 3(c)(i), we do not consider it necessary for any further additional transparency to be provided.

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?

The CFO Forum does not have any further commentary to add.