The Malaysian Institute of
Certified Public Accountants
Institut Akauntan Awam Bertauliah Malaysia
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February 1, 2021

The Chairman
International Auditing and Assurance Standards Board
International Federation of Accountants
529 5th Avenue
6th Floor
New York 10017
United States of America

Via Online Submission

Dear Mr. Tom Seidenstein

COMMENTS ON FRAUD AND GOING CONCERN IN AN AUDIT OF FINANCIAL STATEMENTS

The Malaysian Institute of Certified Public Accountants ("MICPA") appreciates the opportunity to comment on the IAASB relating to fraud and going concern in an audit of financial statements. We also applaud the effort of the IAASB to enhance the clarity and understandability of the fraud and going concern in an audit of financial statements.

In this regard, we are pleased to attach MICPA's comments as set out in Appendix I for your consideration.

We trust our comments and accompanying recommendations to be of value and useful to IAASB, in your onward deliberation. MICPA looks forward to further strengthening such dialogues with your organisation.

Please do not hesitate to contact the undersigned or the Technical Director, Ms Chiam Pei Pei, at +603-2698 9622 should you require any clarification.

Thank you.

Yours sincerely,

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Our responses to the specific questions are as follows:

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?

Comment:

We acknowledge that there is indeed an expectation gap relating to fraud and going concern in an audit of financial statements. The components described in the Discussion Paper *(Knowledge Gap, Performance Gap and Evolution Gap)* are a reasonable way to articulate the expectation gap. However, it is not always clear which of these components are the main driver of the expectation gap as it is often a combination thereof.

For fraud, the expectation gap arises due to the different expectations of the different stakeholders involved in the financial reporting ecosystem. There is a knowledge gap, giving rise to the misconception with regard to the auditor's role in an audit of financial statements as the various stakeholders may not have a clear understanding about the fundamental principle of "reasonable assurance" and "materiality" and therefore expects auditors to audit and provide assurance in all areas of the financial statements.

With regard to going concern, unlike the auditing standard ISA 570 (Revised) *Going Concern*, which is quite comprehensive, there are minimal requirements in the accounting standard IAS 1 *Presentation of Financial Statements* to govern the management's assessment and disclosures related to going concern. Based on our observation, there is a lack of robustness in the management processes and controls for identifying and responding to the risks relating to fraud and going concern exacerbated by the lack of clarity on the responsibilities of those charged with governance in this process.

While it is therefore appropriate to consider whether there are ways in which the current auditing standards can be improved, it should be acknowledged that the root causes of the expectation gap and solutions to it are unlikely to be a function of the financial statement audit alone.

Our response to part (b) below and to the other questions explores further the interaction of the roles of others in the ecosystem and the IAASB and the types of broader responses that may be needed to "move the dial" to address the expectation gap relating to fraud and going concern in an audit of financial statements in an impactful and sustained manner.

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Question 1 (continued)

(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?

Comment:

In order to narrow the expectation gap relating to fraud and going concern in an audit of financial statements, there is a need to adopt a more holistic approach involving different stakeholders (preparers, management, those charged with governance, investors, regulators as well as auditors) in the financial reporting ecosystem.

In addition to enhancing the auditing standards, the IAASB should take the lead to understand the root causes of the concerns raised by the various stakeholders. The understanding of the root causes would be important for the IAASB in formulating what additional actions could be taken across the ecosystem to provide the insights the stakeholders are seeking in relation to fraud and going concern. This will involve looking at the responsibilities of management and those charged with governance in relation to risk assessment, controls, disclosure and transparency, as well as the legal and regulatory infrastructure needed to underpin them, in addition to the role of the auditor.

In this respect, we propose the IAASB to engage the authorities and regulators at the global level to narrow or close the expectation gap relating to fraud and going concern in an audit of financial statements in order that the understanding and messaging cascading down from the respective jurisdictional authorities and regulators are aligned. These institutions can institute jurisdictional changes which can encourage holistic action across relevant stakeholders and bring about positive and sustained reforms.

We suggest the IAASB or local standard-setters with the support of these authorities and regulators to provide education and awareness sessions to the various stakeholders i.e. explaining the roles, responsibilities, scopes and practices of the different parties and how they interrelate and reinforce one another is important to the efficacy of the system as a whole. This will assist to promote a shared commitment for all participants in the ecosystem to improve the quality and transparency of corporate reporting.

We also believe there is merit in providing practical worked examples or case studies explaining common fraud schemes and fraud risk indicators. Fraud schemes constantly evolve, and drawing on the experience and insight of forensic specialists to develop current examples of common or emerging fraud schemes and related indicators could heighten awareness and better enable auditors to be alert to fraud risk indicators in their audits. The IAASB or IFAC could play a valuable role in developing examples or case studies and issuing them as supplementary guidance. These supplementary guidance can be updated more frequently to reflect emerging fraud schemes and considerations related to evolving technology, including how such technologies can be used to perpetrate fraud.

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From the users of the financial statements' perspective, we suggest the IAASB to provide clearer guidance and explanation relating to the basis, concept and principle of going concern to the preparers of financial statements so that they have a better understanding and knowledge to perform the management's assessment on going concern. Additionally, creation of awareness via education and training sessions regarding the fraud and going concern in an audit of financial statements will be able to enhance their understanding of the roles, responsibilities, scopes and practices of the different parties in the ecosystem in order to narrow the expectation gap.

From the auditor's perspective, we believe more guidance on the communication between the auditors, management and those charged with governance to encourage the timely and two-way communication between these parties would be useful. We believe that with such guidance, the auditors will be able to design and implement appropriate responses to identify, assess the appropriate fraud indicators to design appropriate responses to the risk of fraud or suspected fraud identified during the audit.

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?

Comment:

We strongly believe that the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. An enhanced disclosure requirement should be created for those charged with governance of the entity and management as explained. For example, Malaysia has introduced a corporate liability provision, i.e. Section 17A of the Malaysian Anti-Corruption Commission Act 2009. This provision sets out that a commercial organisation is regarded as committing an offence if any person associated with the commercial organisation commits a corrupt act in order to obtain or retain business for the advantage of the commercial organisation. The only defence available to this offence is to have in place "adequate procedures". Such "adequate procedures" refer to top-level management's commitment to prevent corruption; a periodic, informed and documented assessment of the external and internal risks of corruption; establishment and implementation of the anti-corruption policies, procedures and controls; monitoring and reviewing procedures that check the efficiency and effectiveness of the anti-corruption programme; and adequate internal and external training programme. We believe similar disclosure requirements should be introduced in relation to fraud.

The importance of management having appropriate responsibilities for the identification and management of risks of fraud is evident. Creating a stronger framework of responsibility and reporting in respect of a company's system of internal control could help improve the prevention and detection of fraud.

We therefore propose the introduction of a framework of responsibility and reporting in respect of an entity's internal control relevant to financial reporting, including fraud-related controls. The framework would require a clear, public assertion from management/those charged with governance as to the design and operating effectiveness of the entity's internal controls, which would be underpinned by:

- A clearly communicated expectation of the level of rigour and diligence to be applied in making that assertion; and
- an accountability mechanism with consequences for management/those charged with governance in the event of non-compliance.

Consideration can then be given to a requirement for the auditor to make a corresponding attestation on internal control and the assertion made by management/those charged with governance.

Our comments on some of the specific areas that could be considered to enhance the auditor's procedures in relation to fraud:

Use of technology

Technology is clearly a new and powerful tool being leveraged by auditors. ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* should be expanded to provide guidance on the use of automated tools and techniques in audits by developing application material or other implementation guidance on how such tools and techniques could be used by the auditor to enhance the auditor's procedures to identify and respond to risks of material misstatement due to fraud. However, care should be taken to ensure that the revisions of ISA 500 *Audit Evidence* might not be interpreted in a way that inadvertently discourages, rather than encourages, the use of technologies in an effective way in the audit.

Use of forensic specialist or other relevant specialist (such as data analytics specialist) on audits

We do not support the mandating of the use of forensic specialists on audits. The involvement of forensic specialists in the audit needs to have the proper context. The expectation gap may in fact widen if stakeholders perceive the involvement of forensic specialists as implying an extended or different scope of the auditor's work. There is a clear distinction between the use of specialists in an audit support capacity than that of a specialist performing a forensic investigation. We are of the view that forensic specialists, like any other experts, should only be called upon if there are clear fraud risk indicators as opposed to a blanket mandate of their involvement.

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<u>Auditor responsibilities for non-material fraud</u>

We similarly do not support any actions which may be perceived to extend the auditor's responsibilities to non-material fraud.

ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* clearly recognises that there are inherent limitations on the ability of the auditor to design an audit to detect material misstatements resulting from fraud. Seeking to detect non-material misstatements arising from fraudulent activity are inconsistent with the scope and objectives of the audit. It should be recognised that no audit requirements can totally eliminate the risk of fraud. Implementing a requirement for auditors to identify and respond to risks of non-material fraud would therefore not only be costly and not practical, but in addition would most likely result in an increase in the expectation gap, as the risks of particular non-material frauds occurring and not being detected can never be eliminated as explained.

(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.

Comment:

(i) With regard to our proposed new requirement in our response to Question 2(a), we suggest to make mandatory for PIEs only. Non-PIEs can adopt such new requirement on a voluntary basis.

(ii) Please see our response to Question 2(a).

(iii) With regard to our proposed new disclosure and attestation requirements in our response to Question 2(a), we suggest to make it outside the scope of an audit as a separate engagement.

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Question 2 (continued)

(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?

Comment:

We disagree with the proposal to include a "suspicious mindset" as part of the auditor's considerations around fraud in an audit of financial statements for all entities. The current practice, i.e. the exercise of professional skepticism is sufficient and adequate for the auditor's considerations around fraud. Having robust fraud inquiries with management and those charged with governance are critical steps in the audit process, but approaching such discussions with a "suspicious mindset" could have the unintended consequences of putting the management and those charged with governance on the defensive and significantly diminishing the effectiveness of such inquiries.

Professional skepticism is inherently behavioural in nature. Actions that change behaviours are likely to have a more meaningful impact than adding a new term like "suspicious mindset". Consequently, what is more important is reinforcing key concepts that will drive the right critical behaviours, including:

- Tone at the top and commitment to quality
- Bringing effective challenge to bear and not accepting explanations at face value
- Avoid biasness when seeking and evaluating audit evidence

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Question 2 (continued)

(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.)?

Comment:

We agree to have more transparency about the auditor's work in relation to fraud in an audit of financial statements.

The enhancements that can be considered include:

- The current guidance does not promote specific communications with those charged with governance or robust discussions about fraud risks. The enhanced guidance should emphasise a two-way discussion about the fraud risks identified, the controls that have been implemented by the entity to address those fraud risks, and the audit strategy to respond to the identified fraud risks.
- Improved disclosure requirements that are similar to the key audit matters in the auditors' report, such as:
  - (i) a separate section to disclose what control procedures, including the proposed "adequate procedures" pertaining to fraud has been put in place by management; and
  - (ii) to disclose which control procedures have been audited by auditors.

Consistent with our earlier responses, for these changes to be effective, however, requires reform across the corporate reporting ecosystem and all stakeholders playing their part and fulfilling their responsibilities and not just the auditors.

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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?

Comment:

Fundamentally, we believe stakeholders are seeking more insights into the risks facing a business and its future prospects.

Provided the information regarding business risks, going concern and viability that is sought for by users can be determined, the respective responsibilities in relation to the information to be reported by management and those charged with governance, and related auditing regime, could be aligned and reformed, if necessary. Additional disclosures that complement management's going concern assessment regarding the viability of a business together with the auditors' responsibilities around such disclosures are typically driven at the jurisdictional level and we recommend that the IAASB takes the need to drive these reforms with the relevant authorities.

As mentioned in our response to Question 1(b), the IAASB should similarly consider working closely with the International Accounting Standards Board ("IASB") to align the requirements and expectations around going concern in both the auditing and accounting standards. Some of the alignments/enhancements that can be considered include:

(i) ISA 570 (Revised) *Going Concern* to include a requirement for the auditors to have a two-way communication with those charged with governance to obtain an understanding of how those charged with governance exercise oversight of management's process regarding going concern, and/or preliminary assessment of the entity's ability to continue as a going concern as there is currently no such requirement.

(ii) Clarity on the term "foreseeable future" as this term is not defined within ISA 570 (Revised) *Going Concern*, but IAS 1 *Presentation of Financial Statements* deems foreseeable future to be a period of 12 months from the end of the reporting period. In light of the inherent limitations regarding forecasting into the future, we believe maintaining a 12 month period is appropriate, but perhaps the period should start from the date of approval of the financial statements.

(iii) Provide clearer linkage between ISA 570 (Revised) *Going Concern* to ISA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* particularly the importance of the auditors' robust understanding of the entity and its environment and to exercise professional skepticism in evaluating the management's going concern assessment.

Question 3 (continued)

(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.

Comment:

We are of the view that the enhanced procedures should cover all entities regardless of the sizes, complexity, listed, non-listed or private entities.

In regards to the enhancements that can be considered, please refer to our response to (a).

Ability to make, impactful change through the ISA alone is limited in our view. In many jurisdictions, additional expectations of the entity or other stakeholders, including the requirements set forth by regulators, may best be addressed through legislation and/or applicable national auditing standards.

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Question 3 (continued)

(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?

Comment:

We are supportive of the proposal requiring more transparency about the auditor's work in relation to the going concern in an audit of financial statements. We suggest to include disclosure requirements that are similar to the Key Audit Matters in the auditors' report, such as disclosing whether the financial statement disclosures by management have addressed the going concern assumption and the corresponding work performed by auditor on those disclosures.

We would also recommend the IAASB to clarify whether or when the requirement related to Key Audit Matters should similarly apply to reporting of Material Uncertainty Related to Going Concern ("MUGC"), i.e., for the auditors to include a description of how the matter was addressed in the audit. We believe such disclosures are appropriate.

As indicated in our earlier responses, we recommend that the IAASB should continue to engage with the IASB to align and enhance the accounting standard in relation to going concern including disclosures on management's assessment of the entity's ability to continue as a going concern. In addition, we believe that more application guidance on the accounting and auditing standards relating to going concern will be helpful to preparers and auditors of financial statements.

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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?

Comment:

Given that any changes will have a cost and effort vs benefit impact, it is important to have clear feedback that the suggested actions will be responsive to stakeholders' needs and address their areas of concern, and are capable of being meaningfully implemented.