

International Auditing and Assurance Standards Board
529 Fifth Avenue
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1 February 2021

Comment letter relating to the IAASB's discussion paper: Fraud and Going Concern in an Audit of Financial Statements

Dear Board Members,

1. The Irish Auditing and Accounting Supervisory Authority ("IAASA") appreciates the opportunity to comment on the IAASB's discussion paper on 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 ("the Discussion Paper"), issued in September 2020.

Overall comments

2. We welcome the IAASB's initiative to gather perspectives about the issues and challenges related to the key topics of fraud and going concern in an audit of financial statements.

Analysis of the current situation

3. Prior to exploring what could be done in relation to fraud or going concern in audit standard-setting or through other actions, it is essential to be clear on the auditor's role in these respects i.e., to be clear on the current scope of the auditor's duties.
4. According to ISA 200, auditors should obtain reasonable assurance about whether the financial statements as a whole are free from material misstatements whether due to fraud or error. This means that, when auditors express an unmodified opinion, they have obtained sufficient and appropriate audit evidence to reduce audit risk to an acceptably low level thereby enabling them to draw reasonable conclusions that there are no such misstatements, including due to fraud.
5. As part of an audit of financial statements in accordance with ISAs, auditors also conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. This means that, when auditors express an unmodified opinion, they have drawn reasonable conclusions, based on the audit evidence

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obtained, on whether management's use of the going concern assumption in the preparation of the financial statements is appropriate.

6. We believe it important to remember that these existing provisions drive the current role of the auditor conducting an audit in accordance with ISAs.

Further analysis

7. We would like to emphasise the fact that difficulty in detecting material misstatements in the financial statements resulting from fraud (rather than error) does not reduce the auditor's responsibility. Similarly, difficulty in assessing management's use of the going concern assumption and whether a material uncertainty exists related to future events or conditions that may cause an entity to cease to continue as a going concern does not reduce the auditor's responsibility.
8. In certain cases involving fraud, even where the fraud was very significant or where the auditor's report did not highlight concerns regarding the situation of an entity which collapsed shortly after its issuance, the "expectation gap" has been put forward by auditors to explain that no material misstatements or uncertainties were identified during the audit. However, in instances where auditors have not complied with the requirements of the ISAs, including ISA 240 (on fraud) and ISA 570 (on going concern), putting forward the "expectation gap" alone is not an appropriate explanation to justify the failure.
9. The Discussion Paper provides some examples of corporate failures and scandals. However, there is limited information presented on their detailed circumstances. Performing a root cause analysis on such recent corporate failures or scandals would be highly beneficial to understand the roles of the different parties and, in any cases involving audit failure, the reasons for that failure. This analysis should be carried out before considering which aspects of the audit engagement to change in the auditing standards.
10. In the light of these recent corporate failures and scandals, we encourage the IAASB to further explore the role of the auditor in relation to fraud and going concern in an audit of financial statements to ensure that the public interest is appropriately served and best promoted.

Specific areas to be considered by the IAASB

11. IAASA is of the view that the IAASB should strengthen the requirements regarding the exercise of professional scepticism in relation to fraud and going concern throughout the audit of financial statements. Indeed, professional scepticism is essential to audit quality and should be applied by auditors with sufficient rigor in all circumstances. We would also like to point out that professional scepticism is a requirement set by EU law (Directive 2006/43/EC, Article 21.2), particularly when the auditor reviews management estimates relating to future cash flow relevant to the entity's ability to continue as a going concern.
12. The IAASB should also consider other clarifications and enhancements to ISA 240 and ISA 570 to improve those standards. Some examples of areas that should be examined by the IAASB are highlighted below in the sections dedicated to fraud and going concern. Please note that our proposals are not intended, at this stage, to be a complete list of all potential enhancements that we consider should be made to these standards.

13. More generally, the question of the links and interactions between the ISAs dealing with the main principles applicable to audit and those dealing with specific elements of the audit (for example in relation to fraud or going concern) is often raised when standards are under revision. We suggest that the IAASB reflects further on the best way to facilitate the integrated application of all the ISAs.

Coordination with IESBA

14. As with other standard-setting projects, we would like to highlight the importance of appropriate coordination between the IAASB and the IESBA. Changes to the ISAs, if any, should be mirrored to ensure consistency with the provisions of the IESBA Code and coordinated with the IESBA.

Specific items for consideration by others

15. We encourage the IAASB to liaise with relevant other parties which are likely to take action to ensure coordination of efforts to address fraud and going concern issues.
16. Actions that should be further explored by other parties include for example:
- delivering educational actions, for instance explaining the role of auditors regarding fraud and going concern more clearly and precisely to stakeholders;
 - further developing the two-way communication culture in the audit profession with audit committees and those charged with governance (“TCWG”), in order to facilitate dialogue on fraud risks and going concern; and
 - considering whether corporate rules need to be enhanced or clarified regarding the roles and responsibilities within the entity (management, audit committees, TCWG) with respect to preventing and detecting potential fraud and going concern issues as well as the monitoring of compliance with corporate governance requirements. This includes consideration of the entity’s internal control requirements as discussed below in paragraph 25.

Specific comments on fraud

Professional scepticism

17. Introducing a new concept of “suspicious mindset” in parallel with that of professional scepticism in ISA 240 might be a source of confusion and be negatively perceived by the management and employees of the audited entity. We do not believe that introducing this concept in the standard will add value.
18. However, as mentioned in our general comments, IAASA is of the view that the IAASB should strengthen the requirements regarding the exercise of professional scepticism in relation to fraud throughout the audit of financial statements. Specific requirements should be added to the conditions mentioned in paragraph 27.

19. For example, the IAASB should include requirements in ISA 240 that are similar to those recently added in ISA 315 (revised) i.e.:
- a requirement to design and perform audit procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory; and
 - a requirement to “stand-back” by taking into account all audit evidence obtained in forming conclusions at the end of the audit.
20. In the same vein, use of stronger language in ISA 240 (such as “challenge”, “question” and “reconsider”) would be a good way to foster an appropriate mindset and action by the auditor.
21. The IAASB should also emphasise the importance for the auditor to investigate responses to inquiries of management and TCWG that are implausible or inconsistent, for example with the business rationale behind transactions.
22. ISA 240 paragraph 14 stipulates that, unless the auditor has a reason to believe the contrary, the auditor may accept records and documents as genuine and that if conditions are identified the auditor shall investigate further. The IAASB should require auditors to be more sceptical when evaluating audit evidence (including external confirmations) of crucial importance for obtaining reasonable assurance on specific issues.
23. The standards (e.g., ISA 580) should provide that, in any case, written representations by management do not relieve the auditor from the requirement to obtain sufficient and appropriate audit evidence, to avoid overreliance by the auditor on management representations.

Risk assessment procedures and related activities

24. The IAASB should draw clearer links between the auditor’s responsibilities in respect of fraud and the auditor’s understanding of the entity’s system of internal control that the auditor is required to develop in accordance with ISA 315. A robust understanding of management’s process for identifying and responding to the risk of fraud in the entity enhances the auditor’s assessment of the risks of material misstatement due to fraud. It also helps the auditor to better assess the risk of management override of controls. The importance of the assessment of internal control by the auditor should be re-emphasised by the IAASB.

Level of involvement of the auditor regarding the entity’s internal control related to fraud

25. The IAASB should examine the level of involvement of the auditor on the entity’s internal control related to fraud. The extent (scope and depth) of those audit procedures should be consistent with the responsibilities of the entity’s management with regard to internal control measures to prevent and detect fraud. All changes to legislation related to management’s responsibilities in this area should also be considered by the IAASB when examining the level of involvement of the auditor required (See also our comments in paragraph 16 regarding corporate rules).

Auditor's responses in case of signals that indicate the possibility of a material misstatement due to fraud

26. IAASA is of the view that the auditor should adopt a more robust approach when there are signals that indicate the possibility of a material misstatement due to fraud. Such signals could include for example lack of appropriate "tone at the top" at the audited entity's management level, relevant information received through whistle-blowing systems or public information.
27. The IAASB should determine what further audit procedures the auditor should perform in such circumstances.

Identified fraud that does not result in a material misstatement of the financial statements

28. We believe that the procedures required by extant ISA 240 regarding non-material fraud (including communication to management and TCWG and the follow up of remediation and the action plan) should be maintained. In particular, ISA 240 requires auditors to consider, in their audit procedures, all frauds and suspected fraud, whether material or not, as they may be indicative of a failure in internal control or governance. As such, identification of fraud (or suspicion thereof) will feed into the auditor's assessment of risks and adaptation of the level of audit work accordingly.

Use of forensic specialists or other relevant specialists

29. The general provisions of the ISAs apply to the use of forensic specialists or other relevant specialists (for example in cybersecurity and data analytics) in an audit of financial statements. The IAASB should explore whether the auditor should be required to consider the need for forensic specialists or other relevant specialists in certain circumstances. For example during the risk assessment, notably when considering the possibilities and likelihood of fraud occurring, when there are signals of fraud, or when a fraud involving management has been identified or is suspected.
30. The use of a forensic specialist does not affect the extent of the auditor's responsibility for the audit. The auditor remains responsible for forming and expressing the audit opinion. In addition, it is important for the auditor to be clear on the expertise expected from that specialist and the link with the audit engagement. Forensic specialists are generally engaged after a trigger event has occurred to analyse specific issues and their engagement does not exempt the auditor from performing the procedures required to achieve the audit objectives. Discussing the need for forensic specialists' involvement with TCWG may prove beneficial.

Auditor's report

31. To increase transparency on audit procedures related to fraud, the IAASB should require the auditor to explain the extent to which the audit was considered capable of detecting fraud in the auditor's report, while avoiding "boiler plate" statements. At a minimum this should be required for PIE audits, as required by European Union legislation.

Communications with TCWG and other parties

32. Communicating more information to TCWG, including audit committees, and to other authorities allows the entity to take remediation measures in relation to fraud on a timely basis.

33. For example, for PIEs in the European Union, when an auditor suspects or has reasonable grounds to suspect that irregularities, including frauds with regard to the financial statements of the audited entity, may occur or may have occurred, the auditor is required to inform the audited entity and invite it to investigate the matter and take appropriate measures to deal with such irregularities in the future. Where the audited entity does not investigate the matter, the auditor is required to inform the authorities responsible for investigating such irregularities (for example regulatory and/or enforcement authorities). Those provisions should be fully integrated in the ISAs.
34. In the same vein, in such circumstances, the IAASB should also consider requiring the auditor to assess whether the measures taken by management are appropriate and evaluate the impact on its relationship with the audited entity.

Specific comments on going concern

Expanding the role of the auditor

35. Expanding the role of the auditor in relation to going concern should be further explored by the IAASB. This would first require actions from accounting standard setters and regulators in order for auditors to be able to perform procedures on new requirements for management and/or TCWG in this area. However, the auditor should not be required to assess information that management would not be expected to take into consideration when assessing the entity's ability to continue as a going concern in preparing the financial statements.

Professional scepticism

36. As mentioned in our general comments, IAASA is of the view that the IAASB should strengthen the requirements regarding the exercise of professional scepticism in relation to going concern throughout the audit of financial statements. Specific requirements should be added to the conditions in paragraph 39.
37. For example, the IAASB should include requirements in ISA 570 that are similar to those recently added in ISA 315 (revised) i.e.:
- a requirement to design and perform audit procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory; and
 - a requirement to “stand-back” by taking into account all audit evidence obtained in forming conclusions.
38. In the same vein, use of stronger language in ISA 570 (such as “challenge”, “question” and “reconsider”) is a good way to foster an appropriate mindset and action by the auditor.

Auditor's responses where there are conditions that may cast significant doubt on the entity's ability to continue as a going concern

39. In addition, where there are conditions that may cast significant doubt on the entity's ability to continue as a going concern (for example financial difficulties), the IAASB should determine what further audit procedures the auditor should perform, including in relation to the related disclosures in the financial statements.
40. In those cases, auditors should also request management to provide written confirmation of the appropriateness of its assessment, based on sufficient and appropriate supporting evidence.

Auditor's report

41. Information provided in the auditor's report regarding going concern should be reinforced by including a statement that the scope of an audit does not include assurance on the future viability of the audited entity. This will help stakeholders, including investors, to better understand what the role of the auditor is in relation to going concern.
42. In addition, audit reports should be expanded to support an enhanced focus by auditors on going concern, by requiring the auditor to include:
- where no issues are identified, a statement that the auditor has not identified a material uncertainty related to going concern and conclusion that management's use of the going concern basis of accounting is appropriate; and
 - for larger entities such as PIEs, information on how the auditor evaluated management's assessment of going concern.

Communication with TCWG and other parties

43. If management is reluctant to make or extend its assessment to at least 12 months when requested to do so by the auditor, the IAASB should further explore requiring the auditor to discuss the matter with management, and if appropriate, with TCWG. If management, or TCWG, do not provide sufficient information about the entity's ability to continue as a going concern, the auditor should be required to consider the implications for the audit engagement and the audit opinion.

Public interest role of the auditor

44. There is an increased public expectation regarding the public interest role of the auditor. In this regard, where issues related to going concern are identified by the auditor that lead to modification of the audit opinion, the auditor should be required to consider whether the auditor is obliged by law, regulation or ethical requirements to report to an appropriate external authority.

Other areas for consideration

45. We identified further provisions of the standards that create difficulties and where improvements could be made. As such, we encourage the IAASB to examine:

- whether the definitions of key terms in ISA 240 such as “fraud” and “fraud risk factors” are sufficiently robust and still fit for purpose. This includes examining their potential convergence with the definitions commonly used by anti-fraud experts and/or organisations and the links with the notions of bribery, corruption, money laundering etc;
- whether the scope of journal entries testing in response to risks related to management override of controls in ISA 240 should be enhanced with at least a requirement to test journal entries and other adjustments throughout the period;
- how to further emphasise in ISA 240 the importance to make inquiries of the internal audit function and to review internal audit reports and documentation related to fraud;
- whether certain criteria indicating when and how to rebut the presumption that there is a risk of material misstatement due to fraud in revenue recognition should be included in ISA 240;
- whether the audit documentation requirements should be enhanced in ISA 240 particularly on inquiries of management, TCWG or others in the entity, their consequences on the audit approach and on the assessment by the auditor of the appropriateness of the entity’s processes for identifying and responding to the risk of fraud;
- whether additional documentation of the auditor’s work effort on going concern would improve audit quality. For example, requiring in ISA 570 documentation of :
 - the entity's internal controls related to going concern;
 - any indicators of possible management bias related to going concern and the auditor's evaluation of the implications for the audit; and
 - significant judgments regarding:
 - whether or not a material uncertainty related to going concern exists; and
 - the appropriateness of management's use of the going concern basis of accounting disclosures in the financial statements; and
- whether to add guidance in ISA 570 on how to demonstrate whether or not a material uncertainty exists.

Please do not hesitate to contact me should you have any questions on the content of this letter.

Yours faithfully,



Kevin Prendergast

Chief Executive