



For the attention of Mr. Willie Botha
Technical Director
International Auditing and Assurance Standards Board
529 Fifth Avenue, 6th Floor
New York, New York, 10017
USA

[Submitted via IAASB website]

29 January 2021

Dear Mr. Botha,

***IAASB Discussion Paper: Fraud and Going Concern in an Audit of Financial Statements:
Exploring the Differences Between Public Perceptions About the Role of the Auditor
and the Auditor's Responsibilities in a Financial Statement Audit***

The global COVID-19 pandemic has drawn renewed attention to fraud and going concern. There can be heightened incentives and opportunities for fraud and challenging economic conditions have given rise to an increased number of material uncertainties regarding the ability of some entities to continue as a going concern.

Against this backdrop, we¹ acknowledge the persistent expectation gap in relation to fraud and going concern. We, therefore, welcome the IAASB's initiative on fraud and going concern and appreciate the opportunity to comment on the Board's Discussion Paper (DP). We agree that the time is right to reflect on the various reviews that have been undertaken in different jurisdictions to understand these issues better and explore, across markets, how the audit can meaningfully contribute to addressing the expectation gap. In our responses to the questions posed in the DP, we comment on ideas for potential reforms and we look forward to hearing proposals from others. Our suggestions include:

- consideration of targeted revisions to the relevant ISAs to improve consistency in interpretation and application, together with supplementary non-authoritative guidance, such as providing practical worked examples or case studies explaining common fraud schemes and fraud risk indicators; and
- broader accountability reforms, such as giving consideration to a requirement for entities to provide a statement on the effectiveness of their internal control over financial reporting, with associated assurance required for some entities.

Audit is one part of the broader corporate reporting ecosystem

Effective auditing standards and consistent high-quality application of them by auditors are important elements to maintaining trust in audit.

Audit is, however, only one part of an inter-connected corporate reporting ecosystem. This ecosystem has several different participants – preparers, those charged with governance, investors, other users,

¹ This response is being filed on behalf of the network of member firms of PricewaterhouseCoopers International Limited and references to "PwC", "we" and "our" refer to the PwC network of member firms.



regulators, as well as auditors. Auditors undoubtedly have an important role to play in addressing the expectation gap, but solutions that deliver significant change will likely require a broader focus by all stakeholders in the ecosystem. In any ecosystem, effective functioning of the whole depends on each part being aligned, working together, and individually operating effectively. The roles and responsibilities of the various players in that system and how they interrelate and reinforce one another is important to the efficacy of the system as a whole.

We note that reforms introduced in jurisdictions that have had some positive impact have involved more holistic change. For example, changes to the auditor's responsibilities were made at the same time as complementary changes in management's responsibilities (e.g., for the design and effectiveness of internal control over financial reporting), governance responsibilities (e.g., for the evaluation of the entity's longer term viability), and the legal and regulatory framework (e.g., clearly defined responsibilities, accountabilities and consequences in law and regulation). In our view, prior revisions to auditing standards may have had some success in narrowing the performance gap; however, the evolving expectations in today's marketplace warrant consideration of more holistic change.

Focus on root causes in making an informed decision on the way forward

Stakeholders' needs are evolving, and we support consideration of whether the scope of the audit needs to also evolve to fully meet stakeholders' expectations in relation to fraud and going concern. Gaining an understanding of the root causes behind stakeholders' calls to further expand the auditor's responsibilities will be important in making an informed decision on the way forward.

Today's ISA audit focuses on the fair presentation of the financial statements prepared by the entity. The scope of the audit is not designed to address wider business model viability or risk, or the design and effectiveness of entities' fraud and other internal controls overall, nor are entities in most jurisdictions required to report on them. Leveraging the experience and findings from work undertaken across jurisdictions to date will provide useful input as to what actions could reasonably narrow the expectation gap. For example, outreach by our network firm in the UK indicated there may be a general lack of understanding in that market over whether an audit gives comfort over an entity more broadly (its behaviours, its culture, its business model, and its viability), or over the financial statements alone. Outreach also found that many users of financial statements in that market are calling for more insight into the risks that entities are facing and the future prospects of the business. There are opportunities to be explored with regard to assurance that could be provided in these areas. As noted above, addressing stakeholders' evolving needs will necessarily involve regulators looking at how the responsibilities of all of those in the corporate reporting ecosystem may need to change, and interrelate, to provide the infrastructure needed to support such insight.

In our view, the auditor's responsibilities to obtain reasonable assurance about whether the financial statements, as a whole, are free from material misstatement, whether due to error or fraud, remain appropriate in principle. We believe targeted changes to the ISAs can be made to better drive consistency in interpretation and application. However, change that "moves the dial" on fraud and going concern and addresses the expectation gap will require broader coordinated reform across the corporate reporting ecosystem.



Opportunity for the IAASB to lead the necessary dialogue

We believe that there is an opportunity for the Board to take a leadership role by bringing together and facilitating meaningful discussion among stakeholders in the corporate reporting ecosystem with the goal of achieving consensus on changes that would contribute to effective solutions. We encourage the IAASB to involve others, such as IOSCO, the IASB, IFAC, the OECD, Transparency International, the World Bank and the IMF, who are likely to have useful insights and whose support will be needed to effect the broader change we describe.

In summary, across the PwC network we are committed to working hard to ensure the quality and perceived value of the audit continually improves. We support the IAASB in embarking on this consultation and other outreach to inform the Board's decisions on a way forward. We anticipate that there will be areas where amendments can be made to the standards to help with their consistent interpretation and application. Broader, more holistic, change, will, in our view, be needed to meaningfully reduce the expectation gap. We stand ready to participate in shaping that change. We encourage the Board to think broadly about the role it can play in engaging other stakeholders in dialogue on the evolution of the roles and appropriate responsibilities of all ecosystem members that collectively can make a substantive change in addressing the expectation gap with respect to fraud and going concern.

We hope our observations in this letter and the accompanying appendix provide useful input as the Board progresses its thinking on these topics. We would be happy to discuss our views further with you.

If you have any questions regarding this letter, please contact Diana Hillier, at diana.hillier@pwc.com, or me, at james.chalmers@pwc.com.

Yours sincerely,

A handwritten signature in black ink that reads 'James Chalmers'.

James Chalmers
Global Assurance Leader

Appendix - Responses to specific questions

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?

We believe that the components described in the Discussion Paper (DP) – Knowledge Gap, Performance Gap and Evolution Gap – are a reasonable way to articulate the expectation gap.

It is not always clear which of these components is the main driver of the expectation gap relating to fraud and going concern in an audit of financial statements. In reality, it is often a combination thereof.

In addition, perceptions of the expectation gap at any point in time are likely to vary depending on recent events or conditions as well as contextual factors including the local jurisdictional legal and regulatory regime, and the corporate reporting and governance model in place. This complicates finding solutions that are applicable and equally effective globally.

As we explain in our cover letter, while it is appropriate to consider whether there are ways in which the current auditing standards can be improved, the root causes of the expectation gap and solutions to it are unlikely to be a function of the financial statement audit alone.

In addition to possible changes to auditing standards, we encourage the Board to take the lead in exploring what additional actions could be taken across the ecosystem to provide the insight stakeholders are seeking in relation to fraud and going concern. That involves 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.

Reflecting on the experiences of other jurisdictions, we believe that solutions that are capable of meaningfully addressing the expectation gap will need to involve changes to the responsibilities of not only auditors but also others in the corporate reporting ecosystem.

Our response to part (b) explores further the interaction of the roles of others in the ecosystem and the IAASB, and our responses to other questions explore the types of broader responses that may be needed.

(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?

In our view, the auditor's responsibilities to obtain reasonable assurance about whether the financial statements, as a whole, are free from material misstatement, whether due to error or fraud, remain appropriate in principle. The ISAs are principles-based standards, which is important as it enables the auditor to adapt to addressing the evolving business environment, including new fraud and going concern risks, and innovations including technology.

It is useful to keep in mind that some occurrence of fraud is inevitable in the corporate world; no proportionate system of internal control or audit can fully eliminate the risk of fraud, particularly where

financial impact is relatively low. Further, neither entities nor auditors can predict the future, and some entities will fail. It may also be that some expectations of stakeholders may not be achievable.

All of which does not diminish the importance of addressing the expectation gap. In doing so, it is important, however, not to dismiss that ISA 200 explicitly acknowledges: a) the inherent limitations of an audit to detect fraud because it may involve sophisticated schemes to conceal it; and b) the inherent limitations of the auditor's ability to detect future events or conditions that may cause an entity to cease to continue as a going concern because the auditor cannot predict such future events and conditions. Promoting an understanding and awareness of these explicit acknowledgements is important, as is the awareness of the cost/benefit to be weighed in considering options.

Need for coordinated reform across the ecosystem

More could be done to help stakeholders better understand the risks of fraud facing an entity, the controls in place to mitigate those risks and the relative responsibilities of management/directors and auditors. To achieve these sorts of reforms, the responsibilities of the auditor need to be aligned with the responsibilities and disclosures required of management, supplemented by robust dialogue with those charged with governance about their observations and oversight. The accountability and governance of preparers creates a necessary foundation for complete, accurate and insightful corporate reporting. Audit cannot effectively compensate for weaknesses in the corporate reporting regime. We encourage the Board to focus on broad ecosystem-based solutions. Solutions based on limited scope changes to the auditing standards alone are unlikely to meaningfully address stakeholders' calls or reduce the expectation gap. Change that "moves the dial" on fraud and going concern will require broader coordinated reform.

The legal and regulatory environment in a jurisdiction also has direct implications for the audit, perceptions of the audit, and the effectiveness of the corporate reporting ecosystem as a whole. The strength of the legal and regulatory environment is an important contributor to the perceived usefulness of information provided to stakeholders, in terms of promoting an environment of accountability, transparency and communication. However, the legal and regulatory regimes that underpin individual jurisdictional reporting ecosystems vary. It may be difficult for the IAASB to develop broader solutions that work globally across entities of all sizes and complexities (listed and unlisted entities). Changes to auditing standards may also not be operable in isolation of other important considerations, such as auditor legal liability frameworks.

Recognising this, we believe there would be significant benefit in the IAASB working with others to coordinate a country-by-country analysis to better understand the conditions (regulatory and legal structures) in which the ISAs are expected to be applied, to provide insight and help inform further consideration of appropriate responses (for example, leveraging any work done by IFAC, the IASB, the OECD, Transparency International, the World Bank and the IMF, to highlight opacity-related accounting/financial reporting and business issues). This has been done for income tax compliance and corruption indices and can serve as a catalyst for change. More transparency for users about the landscape in which ISA audits are conducted, and the strengths (or weaknesses) of other elements of the financial reporting ecosystem, could be helpful to reduce the expectation gap and to potentially further the dialogue about what actions could be taken by others that would complement actions by the IAASB. For example, we believe it would be useful to understand:

- the types of information stakeholders are seeking and the consistency of provision of such information across jurisdictions; and

- where viability problems were identified for entities in a jurisdiction, what went wrong with the sufficiency or credibility of information reported by those entities such that stakeholders were unaware of the issues.

As part of these broader considerations, we recommend the IAASB engage with relevant stakeholders to:

- Seek support from governments and national standard-setters (both accounting and auditing) in encouraging holistic action across relevant stakeholders;
- Further explore whether changes to financial and broader corporate reporting frameworks could help to address users' evolution and knowledge gap concerns. For example:
 - Whether additional disclosure by entities about risks to their business, including fraud risks and how they were addressed, would be helpful. This could include, for example, matters such as cybersecurity and third-party fraud (see further discussion in response to question 2(a));
 - Enhancing disclosures of liquidity and other risk factors, and how the entity has considered its future longer-term viability (see further discussion in response to question 3(a)); and
 - Clarifying or replacing terminology or key concepts, for example, considering whether changing certain terms applied across the financial reporting ecosystem (e.g., "going concern basis of accounting" and "material uncertainty") to more readily understandable terms would have a tangible impact on users' understanding.

Exploring such changes would require concerted action across stakeholders.

- Discuss how regulators of certain types of entities, for example financial institutions, may be in a position to provide timely communication of relevant information to which they have access in order to assist auditors in the assessment of risks of material misstatement and design of responses;
- Through IFIAR, understand from national and global audit regulators the nature of deficiencies identified relating to fraud and going concern as well as any best practices identified while conducting inspections;
- Through IOSCO, discuss with regulators about if, and how, relevant securities regulations might be providing, or could facilitate, the provision of information users are seeking; and
- Highlight that the current scope of the audit does help to mitigate fraud (incidence of fraud would be exponentially higher in the absence of an audit) and, in that context, have open and honest dialogue about the practicalities and cost/benefits of the changes that stakeholders seek (for example see our response to question 2(a) with respect to non-material fraud).

Auditing standards

In addition to the matters addressed in our cover letter and in response to the questions that follow, we support the IAASB considering what, if any, changes are needed to respond to what it learns from its outreach regarding ways to reinforce the consistent application of those ISAs, including the appropriate application of professional scepticism. To the extent that the IAASB's outreach shows that the root causes of a failure to detect recent frauds or material uncertainties that precipitate corporate failures can be attributed to a lack of clarity in the ISAs or inconsistent application of requirements, we support making clarifications to the ISA requirements and application material.

Fraud schemes

In addition to the matters we note in response to question 2, we believe there is merit in developing practical worked examples or case studies explaining common fraud schemes and fraud risk indicators. Fraud schemes constantly evolve. 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 by developing examples or case studies. A digital repository, updated on an appropriate periodic basis, supplemented by an annual Staff Practice Alert drawing attention to any changes, might be one way to do this. Regulatory authorities are also well placed to share insights from oversight activities, including investigations. The IAASB (or IFAC) could collaborate with jurisdictions to obtain examples of findings, guidance or other similar example repositories that may have been developed that could inform any such global guidance materials. For example, in the UK, the Brydon recommendations call for an open access case study register detailing corporate frauds. More frequent touchpoints with jurisdictional bodies could also facilitate more timely updating of any such materials.

Role of technology

Auditors are exploring ways of leveraging new technologies to identify anomalies (potential material misstatements) in large populations of transactional data reflected in an entity's accounting records. This can help inform risk assessments and the design of responses. This is mentioned in ISA 315 (Revised 2019), but implementation guidance that emphasises how auditors can consider the results of applying such technologies and how the auditor's approach to assessing fraud risks may be adapted could be helpful. We also encourage the IAASB to consider this in its revision of ISA 500, to avoid any risk that the ISAs might be interpreted in a way that inadvertently discourages, rather than encourages, the use of technologies in an effective way in the audit.

While we do not believe there is a need for changes to requirements of the respective ISAs, updates to application material or the development of supplementary non-authoritative guidance outside the standard could helpfully clarify areas of inconsistent interpretation, better reflect the evolving business environment, or further underscore the appropriate exercise of professional scepticism.

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?

While we do not believe ISA 240 is fundamentally broken, there are some targeted changes that could be made to the application material to bring the standard more up-to-date and reflect the changing business environment. Outreach may also indicate practical implementation challenges, either through inconsistent understanding of the intent of requirements or inconsistent execution, including a perceived lack of the appropriate application of professional scepticism.

Fraud risk factors and engagement team discussion

Consistent with the goals of ISA 315 (Revised 2019), drawing attention to the auditor's consideration of management's tone at the top and risk assessment process, together with the auditor's well-reasoned risk assessment, may be helpful to reinforce consistent auditor behaviour. In addition to what we describe in our response to question 1 with respect to fraud schemes, ISA 240 (Revised) could be updated to better reflect fraud risk factors/considerations relevant to the modern business environment, including how technology may be used to perpetrate fraud. The IAASB may find that leveraging experience of fraud specialists to inform updates to the ISAs or other implementation guidance could be useful. In order to develop changes that will remain appropriate over a longer period of time, there will likely be a need to balance any changes contemplated to the body of the standard with supplementary guidance. Supplementary guidance can be updated more frequently to reflect emerging fraud schemes and considerations related to evolving technology.

Updated fraud risk factors, at an appropriately granular level, could provide a basis for a more focused discussion within the engagement team about the potential for fraud, tailored to the nature and circumstances of the entity. This could assist in promoting better identification of risks and more tailored responses that reflect the audit engagement in question, taking into account the entity's system of internal control, to help mitigate the potential risk of generic, untailored risks and responses. We also believe there is merit in exploring the benefits of changes regarding the engagement team discussion being proposed by the UK FRC in this area. This includes, for example, more specificity in the standard regarding the engagement team discussion, including an exchange of ideas among engagement team members about fraud risk factors such as incentives for management or others within the entity to commit fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated.

Additional thought should also be given to addressing special considerations that apply in the context of a group audit in relation to the identification, assessment of, and response to, risks of material misstatement due to fraud in the group financial statements. Such considerations should also be a focus in finalising proposed ISA 600 (Revised).

Internal control relevant to financial reporting

As described in our response to question 1(b), the importance of management having appropriate responsibilities for the identification and management of risks of fraud cannot be underestimated. Creating a stronger framework of responsibility and reporting in respect of an entity's system of internal control could help improve the prevention and detection of fraud. There is an opportunity to evolve the audit scope beyond today's model.

For example, we would support 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. At the heart of such a framework would be a clear public statement by 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 statement; 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.

In designing and implementing any such regime, there would be a number of key decision points, including the proportionality of the cost/benefit of introducing such a regime, the entities to which the requirements would apply, and the internal controls brought into scope. As noted, this is an area where the IAASB could usefully engage with IOSCO, national standard setters and others with responsibility for establishing or strengthening such requirements in their respective jurisdictions.

The proportionality and scalability of any changes proposed in this area are important factors that the Board will need to consider, recognising that an entity's system of internal control may be less formal and less mature in smaller and less complex entities.

Irrespective of whether any expanded scope of audit were to require an opinion on internal control, we believe it is important that the auditor obtain a robust understanding of how management has identified and evaluated risks of fraud and of the related controls that have been designed and implemented by management to address such fraud risks. The recent changes to ISA 315 (Revised 2019) may assist in that regard, but further consideration could be given as to whether linkages to those new requirements would be appropriate in ISA 240.

In the context of the auditor's understanding and evaluation of internal control, in accordance with ISA 315 (Revised 2019), ISA 240 could, for example, address whether the entity has designed and implemented certain expected controls (for example those set out in the COSO Fraud Risk Management guide). Consideration could also be given to expanding the communication requirements to those charged with governance to explicitly refer to reporting of any identified significant deficiencies in that regard, in accordance with ISA 265.

Unpredictability

Consideration could be given to reinforcing unpredictability in the design of audit procedures, with additional examples given to illustrate. In particular, guidance could be included with the objective of:

- better connecting the concept of incorporating an "element of unpredictability" with an enhanced consideration of fraud schemes and specific fraud risk factors identified by the auditor; and
- emphasising how changes in an entity's circumstances could give rise to opportunities for management override of control or other fraud, and the importance of taking a "fresh look" at the audit plan.

The sections that follow address the specific areas identified in the DP on which the IAASB is seeking input.

Impact of corporate culture on fraudulent financial reporting and what, if any, additional procedures should be considered

We agree that corporate culture within an entity is important and support the changes recently made to ISA 315 (Revised 2019) with respect to evaluating the control environment. It is appropriate to allow those new requirements to settle before deciding if further action is needed.

Requiring the use of forensic or other relevant specialists and in what circumstances

The IAASB has recently finalised ISQM 1 and ISA 220 (Revised), which give emphasis to the importance of determining that the engagement team has the right resources to conduct the engagement. If proposing revisions to ISA 240, the IAASB could consider incorporating linkages back to these principles, including with respect to the firm's policies and procedures. We note that there is a range of specialist support that engagement teams can draw upon (commonly the starting point is the firm's risk management and methodology specialists). Engaging forensic specialists is often reserved for circumstances when addressing identified or suspected fraud.

We do not support mandating involvement of forensic specialists, as such a requirement risks making specialist involvement perfunctory and less effective over time. It may not have a discernible impact on audit quality on engagements where there are no identified significant fraud risk indicators, bringing the cost/benefit into doubt.

Whether, and the extent to which, it is considered appropriate to involve specialists in identifying, assessing, and helping design an appropriate audit response to, fraud risks is a matter of professional judgement made in the context of the engagement circumstances. If involvement is deemed appropriate, this can range from limited advice in response to specific questions, to more significant and direct involvement in risk assessment and development of the response to assessed risks. When deciding to involve forensic specialists, they can be engaged in different ways and their role will vary depending on whether they are consulting, coaching, or actively assisting in an execution role.

Application material to ISA 240 could describe this spectrum of involvement and provide illustrative examples of relevant factors that an engagement team could consider in determining whether involvement of specialists may be appropriate in the circumstances. For example, if one or more heightened fraud risk factors or indicators of fraud are identified, the use of a specialist can enhance the engagement team's understanding of how the risk factors or other indicators are likely to manifest (i.e., fraud schemes) and/or help in developing an effective audit response to these circumstances.

Time, cost and scalability are also important considerations, under the overall context of judging whether involvement of specialists will enhance quality on the audit engagement.

It is important that the involvement of forensic specialists is clearly understood in the context of the scope of an audit. The expectation gap may 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 use of specialists in an audit support capacity and the nature, timing and extent of work that a specialist performs in a forensic investigation. In the latter capacity, forensic specialists carry out an investigation of allegations or suspected fraud to determine the facts and, as appropriate, to support the entity in remedial and recovery actions. Whatever the precise objectives, these go beyond assisting the audit team within the terms of the financial statement audit, and beyond the scope of work expected in an audit.

The perceived responsibilities of the auditor regarding non-material fraud, what additional procedures, if any, may be appropriate, and whether additional audit procedures should be required when a non-material fraud is identified

As ISA 240 already explains, 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 is inconsistent with the scope and objectives of the audit. Time and cost barriers make this impracticable. No proportionate audit requirements can eliminate the risk of fraud. Implementing a requirement to identify and respond to risks of non-material fraud (i.e., fraud that does not result in a material misstatement of the financial statements) would be costly and likely increase the expectation gap, as the risks of fraud occurring and not being detected cannot be eliminated. Accordingly, we are not supportive of expanding the scope of the auditor's responsibilities beyond the identification, assessment and response to risks of material misstatement of the financial statements due to fraud.

The inquiries required by ISA 240 of management, internal audit, and those charged with governance could identify non-material fraud, and greater emphasis could be given in application material on how the results of those inquiries may affect the auditor's risk assessment. For example, when potential non-material fraud has been identified through management's processes and controls, understanding how management has investigated and evaluated the matter, including any discussion with those charged with governance, would assist the engagement team in their re-assessment of risk and other evaluations made as part of the audit. This includes understanding the view of management and those charged with governance as to whether the matter is a stand-alone event or indicative of a more structural fraud scheme.

The focus on internal control relevant to financial reporting we describe in the earlier section of this response can also inform the auditor's risk assessment, and help the auditor to form a view as to whether non-material fraud may be indicative of a more significant or pervasive risk. From a perspective of avoiding potential contributors to the expectation gap, we also suggest that the term "non-material" fraud could itself be subject to different interpretations. In that regard, clearly explaining that this means fraud that quantitatively or qualitatively does not cause a material misstatement of the financial statements, would be helpful.

While an indicator of "fraud" may not give rise to a material misstatement of the financial statements, there may nevertheless be considerations as to whether the matter gives rise to non-compliance with applicable laws or regulations. We believe the IAASB could explore whether the relationship and linkage between ISA 240 and ISA 250, in particular the inter-relationship between identified fraud risk indicators and identified or suspected non-compliance with laws and regulations, is sufficiently clear.

Whether enough emphasis is placed on the auditor's responsibilities around fraud related to third parties and also the role of the auditor in relation to third-party fraud that negatively impacts the entity but does not result in material misstatement of the financial statements e.g., cyber attacks

As the DP describes, the ISAs already include reference to third parties with respect to considering risks of material misstatement due to fraud. There does not appear to be a gap in the underlying requirements. It is therefore unclear exactly what stakeholders are seeking when stating that additional emphasis should be placed on procedures related to identifying third-party fraud. What seems most relevant is facilitating an appropriate risk assessment.

In that regard, we note that appendices 1 and 3 of ISA 240 do not explicitly address fraud risk factors relating to third-parties or circumstances that may be indicative of fraud, which could be helpful to the auditor in thinking about fraud risk. Consistent with our earlier responses, we believe the standard (and/or supplementary non-authoritative guidance) could be updated to reflect additional fraud risk



factors and fraud indicators/schemes and, in doing so, could include sections more specifically addressing risks related to third parties.

Whether or not cybercrime or similar attacks upon an entity are considered “fraud”, they may nevertheless be relevant to the audit if they have a material impact to the entity’s financial statements. To the extent that such matters pose material risks to the business and its ability to operate, this can have a bearing on several aspects of the audit, including assessing the entity’s ability to continue as a going concern and any related material uncertainties.

Whether additional quality management review procedures focused on the engagement team’s responsibilities relating to fraud should be considered for engagements for which an engagement quality review is required

We agree with the assertion in the DP that judgements relating to consideration of fraud risk factors and related assessments of the risks of material misstatement would already fall within the scope of significant judgements addressed by the engagement quality reviewer.

ISQM 2 has recently been approved and was drafted on a principles-basis. With respect to significant matters and significant judgements, the Board concluded that including lists of matters to be considered by the engagement quality reviewer was not appropriate, as it would always be subject to perceptions of being incomplete. The ISQM therefore cross-refers to ISA 220 (Revised) where examples of significant judgements are given (paragraph A93). Those examples make no reference to fraud risk indicators or assessed fraud risks. To the extent that emphasis is warranted on the importance of the engagement quality reviewer giving attention to these judgements, consideration could be given to adding further application material to ISA 220 (Revised).

(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?

See response to part (a). To the extent that there is stakeholder and Board support for additional reporting by auditors on internal control (preceded by appropriate responsibilities placed on management and those charged with governance), we believe this would likely be most appropriately targeted at listed entities (with future consideration of applicability to public interest entities more broadly, based on the outcomes of the IESBA and IAASB considerations of adopting revised definitions for such entities).

(ii) What enhancements are needed?

See response to part (a).

(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 explained in our covering letter and responses above, some targeted changes could be made to application material in the ISA to support consistent interpretation and application. Further changes that would more meaningfully address what we believe stakeholders are seeking would result in the

scope of the auditor's responsibilities going beyond opining on the financial statements. As described in our response to question 2(a), the scope of the auditor's responsibilities could evolve, as it has, for example, in those jurisdictions where the auditor is also required to opine on the entity's internal control over financial reporting. However, for the reasons we discuss in that response, this would necessarily involve complementary changes to the roles and responsibilities of management, those charged with governance and others in the corporate reporting ecosystem. It is important to consider such changes holistically.

The decisions on these matters may differ in different jurisdictions depending on their own circumstances and markets, making it difficult to introduce a common global regime. In the absence of a common global regime, however, management or those charged with governance may also decide it is appropriate to request or require additional assurance beyond the scope of the audit, for example relating to the effectiveness of their controls addressing cybersecurity risks, in fulfilling their responsibilities and accountability to their relevant stakeholders.

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

The exercise of professional scepticism is a fundamental element of the audit. It has been the subject of many reviews and debates both by the IAASB and the broader profession for many years. Indeed, the IAASB has an ongoing project, which has already looked at various terms associated with professional scepticism.

Scepticism and suspicion are terms describing the auditor's mindset and are therefore inherently behavioural in nature. In recent projects, the IAASB has concluded that simply adding the words “professional scepticism” throughout the standards does not change behaviours. We agree with that conclusion. Further, a clear understanding of the behaviours and outcomes that are sought seems more pertinent than the phrase or term to be applied.

Actions that change behaviours are likely to have a more meaningful impact in achieving the desired outcomes than adding a new term. What seems more important is to reinforce key concepts that underpin critical behaviours, including:

- *Tone at the top and commitment to quality across the engagement team* – conveying the importance of scepticism, and the need for more persuasive evidence the higher the assessed risk. The recently approved changes to ISQM 1, ISA 220 (Revised) and ISA 315 (Revised 2019) may assist in that regard;
- *Avoiding bias when seeking audit evidence* – designing and performing 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. This principle has already been emphasised in the recent revisions of ISA 540 and ISA 315.
- *Bringing effective challenge to bear on the audit* – linked to tone at the top, but empowering engagement teams to bring appropriate challenge to bear, and not accepting explanations at face value if they are not persuasive. Some of the measures we describe in our responses above relating to practical guidance around fraud schemes, updated fraud risk factors and involvement of specialists, and engagement team discussion, combined with relevant training, could support auditor awareness and provide the foundation for effective challenge.

Where specific risk factors are identified, additional emphasis could be given to the need to remain alert for indicators of fraud when conducting further audit procedures (which could again be supported through non-authoritative illustrative examples of fraud schemes and indicators). Reinforcing the importance of robust two-way dialogue with those charged with governance when the auditor has become aware of potential or actual fraud would also be helpful.

Lastly, we note that moving to a concept where the auditor starts from a base of suspicion (or presumptive doubt) could move the financial statement audit toward that of a forensic audit and may not be timely or cost-effective. It could also have the unintended consequence of potentially chilling important dialogue with management and those charged with governance. Robust fraud inquiries of management and those charged with governance are critical steps in the audit process but approaching such discussions with a “suspicious mindset” could put management and those charged with governance on the defensive and significantly diminish the effectiveness of such inquiries over time.

(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?

See response to part (c).

(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 strong advocates of the benefits of transparency and believe that the ISA requirements regarding constructive two-way dialogue between auditors and those charged with governance, and the more recently implemented enhanced auditor reporting, have had a positive impact on stakeholders’ understanding of the audit. Those requirements provide the basis for informative and insightful communication about the auditor’s work in relation to fraud.

We support the focus in the auditor’s report on describing key audit matters (KAMs), as that provides informative insight into the areas that were of most significance in the particular audit. Auditors are not required to distinguish between the risk of fraud or error in describing KAMs. What is most important is that the description provides meaningful insight into the assessed risk(s) of material misstatement and how such risks were addressed in the audit. Sharing best practices of descriptions of KAMs could serve as a useful guide to encourage informative and insightful communications. We support the IAASB developing such examples as part of the Post-Implementation Review of the 2014 Auditor Reporting standards (AR PIR) and believe it is important to continue to emphasise the importance of KAMs being tailored and specific to the engagement circumstances and not encouraging boilerplate language.

We believe that a focus on KAMs is most appropriate. There are significant challenges in describing, in a meaningful way that is tailored to the specific circumstances of the audit, a separate description of how the particular audit addressed the risk of fraud. Experience in the EU, which has required the auditor to describe the extent to which the audit is capable of detecting fraud, has been mixed. In most cases this has simply resulted in boilerplate language that adds little value. Stakeholders have consistently indicated strongly that they find boilerplate disclosures unhelpful.



To the extent that further transparency is desired about the risks facing the business, including fraud risks, and how those risks are being managed, they are best communicated in the first instance as an integral part of entities' accountability to their stakeholders, for the reasons we note in response to question 1. Taking into account the respective costs and benefits, if broader reforms regarding internal control were implemented, the auditor's responsibilities could be correspondingly expanded to provide assurance on management's assertions regarding the effectiveness of the entity's internal controls. In jurisdictions where such responsibilities and accountabilities have been implemented, we believe they have had a positive impact. To be effective, however, requires reform across the corporate reporting ecosystem.

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?

Contextual observations

We do not believe that ISA 570 (Revised) is fundamentally broken in the context of the current financial reporting requirements and audit of the financial statements. This standard was updated by the Board in conjunction with the introduction of the enhanced auditor's report and the feedback from the AR PIR will provide important insight into how the changes with respect to reporting on going concern, specifically the new section on material uncertainties relating to going concern, have been received.

However, as explained in our covering letter, we believe stakeholders are seeking more insight into the risks facing a business and its future prospects. The auditor's responsibilities in this area could be expanded in conjunction with changes to the entity's financial reporting and disclosure requirements. If there is consensus on the information regarding business risks, going concern and viability that is needed by users, the respective responsibilities in relation to the information to be reported by management and those charged with governance, and related auditing regime, could be reformed. Entities will still fail. But providing stakeholders with the right information about the risks that could lead to failure may enable them to make better and more timely decisions about their relationship with the entity. This promotes a shared commitment to the quality of corporate reporting and is a holistic approach to addressing the expectation gap.

Clear responsibilities and reporting regimes with respect to going concern and longer term viability/resilience are typically determined at a jurisdictional level, and result in disclosures that complement management's going concern assessment (such as those addressing risk factors, liquidity risk, financing plans, contractual obligations, and forecasts). Consequently, any additional auditor obligations, such as those in the UK, likely need to also be addressed at the jurisdictional level, as they complement the responsibilities and disclosures of management and those charged with governance. However, the IAASB could be the catalyst for debate and take a lead in driving forward such reforms.

Understanding oversight by those charged with governance

ISA 570 (Revised) does not have a requirement for the auditor 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. Presently the communication requirement is solely focused on the auditor's findings after performing their required procedures. We believe a new requirement would be a useful enhancement in ISA 570 (Revised) to promote a two-way communication with those charged with governance about: what they consider to be events or conditions that may indicate a material uncertainty exists; the areas of potential focus in evaluating management's assessment; and the audit plan. The effectiveness of any such communication is, however, premised on those charged with governance having appropriate responsibilities and accountability for going concern as part of the broader corporate reporting ecosystem.

The sections that follow address the specific areas identified in the DP on which the IAASB is seeking input.

Should entities be required to assess their ability to continue as a going concern for longer than twelve months and should auditors be required to consider this longer time period?

We believe that if the period is to be reconsidered, changes are needed to management's period of assessment in the first instance. We support the principle established in ISA 570 (Revised) that the auditor covers the same period as that used by management to make its assessment. Auditors cannot consider a period extending beyond that which management is required to consider by the applicable financial report framework because the auditor's assessment involves evaluating management's forecasts and plans for future.

A minimum period of 12 months, as set out in ISA 570 (Revised), seems appropriate given the inherent uncertainties associated with predicting the future. However, we also note that different financial reporting frameworks have different requirements regarding the point at which that 12-month period commences. For example, under IFRS, the period is considered from the end of the reporting period. In circumstances when the financial statements are prepared and an audit is performed significantly after the balance sheet date, this can mean management's assessment may only extend for a few months beyond the date on which the financial statements are approved. As part of the wider discussion with stakeholders across the ecosystem, we believe it would be useful for the IAASB to discuss with financial reporting standard setters whether the 12-month consideration should commence with the date of approval of the financial statements by management and/or those charged with governance.

However, as noted in our contextual observations in response to question 3(a), rather than the time period, what we believe stakeholders are seeking is more insightful information about the future prospects of the business, provided by management with oversight by those charged with governance. That is best achieved through action by securities regulators and others in the corporate reporting ecosystem establishing accountability and reporting frameworks. Simply extending the period of time considered will not achieve those goals.

Whether changes are needed with regard to going concern and other concepts of resilience (within the IAASB's remit)?

See response to part (a).

Whether more is needed to narrow the knowledge gap with regard to the meaning of 'material uncertainty'?

Related to our contextual observations in response to question 3(a), a common area of feedback we hear (and an area to be explored in the AR PIR) is that the concept of a "material uncertainty" is not well understood. That view arises primarily from:

- Challenges relating to the knowledge gap, due to a lack of a sufficiently clear definition and/or criteria for determining when a "material uncertainty" exists in applicable financial reporting frameworks, leading to inconsistent application and disclosure;
- A lack of specificity in current financial reporting requirements with respect to disclosures of material uncertainties expected to be made by management, resulting in disclosures that may not have sufficient detail. Significant judgements made when concluding that a material uncertainty does not exist may also not be well-disclosed; and
- The nature of such disclosures, and the matters they describe, often being "stale" by the time they are reported.

Trying to better explain the term itself is not, in our view, going to significantly address the challenges around material uncertainties and how they contribute to the expectation gap. Likewise, aligning the use of different terminology across financial reporting frameworks (material uncertainty/significant doubt/substantial doubt) is also unlikely to narrow the expectation gap. Instead, we believe that greater transparency in management disclosures about matters related to longer term viability and future prospects would provide more timely and relevant information to users about the entity's financial condition, and would allow users of financial statements to apply their own judgement in making decisions based on that more relevant and useful information.

Whether the concept and requirements relating to a material uncertainty are sufficiently aligned with requirements in international accounting standards?

See above.

(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?

See response to part (a). We see no specific rationale for a distinction based on entity type. However, the level of interest for auditors to do more is most commonly cited in relation to audits of listed entities. Discussion with IOSCO and other regulators would help inform the debate around whether any targeted measures would be appropriate, for example assurance over internal control relevant to financial reporting. However, again this is likely dependent on the specific jurisdictional circumstances.

(ii) What enhancements are needed?

See response to part (a).

(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.

For the jurisdictional reasons described above, we believe the opportunity for, and ability to make, impactful change through the ISA alone is limited. In many jurisdictions, additional expectations of the entity or other stakeholders, including requirements set forth by regulators, may best be addressed through legislation and/or applicable national auditing standards, or alternatively through separate engagements.

(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.)?

We believe the following matters could be addressed as part of the IAASB's AR PIR:

- It would be helpful for the IAASB to resolve the implicit discrepancy between the extent of disclosure of the auditor's response when a material uncertainty relating to going concern section has been included (no requirement to describe how the matter was addressed) and a KAM on a going concern "close-call" i.e., where no material uncertainty exists (requiring more fulsome disclosure of the auditor's response).
- For entities other than listed entities, when KAMs are not required to be included in the auditor's report, providing additional guidance to highlight the availability of using an emphasis of matter paragraph in the auditor's report to draw attention to disclosures in the financial statements that are considered fundamental to users' understanding (in circumstances when events or conditions were identified but ultimately no material uncertainty was deemed to exist). In some respects, communication by the auditor in this manner would draw users' attention to these important disclosures.

(ii) About going concern, outside of the auditor's report? If yes, what further information should be provided, where should this information be provided, and what action is required to put this into effect?

See response to part (a). In addition, the IAASB should consider whether any changes to the reporting requirements under the ISRE standards may be appropriate in light of changes made to corporate reporting obligations within the overall ecosystem, in particular in respect of the identification and disclosure of material uncertainties.

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?

In proposing any changes, it is important to demonstrate that the suggested actions will be responsive to stakeholders' needs, and capable of being meaningfully implemented (for example, not resulting in boilerplate disclosures). Education of stakeholders about the nature and purpose of any contemplated changes will also be important. Clear feedback from stakeholders about whether they believe the proposed actions will address areas of concern will be needed.

Additional matter on which the IAASB is seeking input:

Whether more is needed related to professional scepticism when undertaking procedures with regard to fraud and going concern and what additional procedures may be appropriate?

Professional scepticism is behavioural. As the IAASB has concluded in recent years, adding additional requirements or guidance reiterating that the auditor must maintain their professional scepticism has little meaningful impact. What is more effective is focussing on the expected actions of the auditor that encourage and reinforce scepticism, and in what circumstances. These matters are well addressed through the considerations described in the discussion paper. See our response to question 2, in particular 2(c).