Mexico City, January 29, 2021.

Mr. Thomas R. Seidenstein
Chairman
International Auditing and Assurance Standards Board - IAASB

Comments requested on fraud and going concern in an audit of financial statements – expectation gap.

Dear Mr. Seidenstein

The Mexican Institute of Public Accountants, "Instituto Mexicano de Contadores Públicos", A.C. (IMCP), association founded in 1923, grouping 60 professional colleges and more than 24 thousand of public accountants associated in Mexico, is thankful about the opportunity to submit comments on fraud and going concern in an audit of financial statements – expectation gap.

The IMCP's Audit and Assurance Standards Commission (CONAA) analyzed the discussion paper of exploring the difference between public perceptions about the role of the auditor and the auditor´s responsibility in a financial statement audit.

As requested in the discussion paper mentioned above, the IMCP prepared a document where the IMCP feedback is provided for the IAASB, for each of the questions. Such document is attached to the present letter, as APPENDIX 1.

We are open to discuss, clarify or widen our comments in this letter per your request.

Very truly yours,

C.P.C. y Mtra. Diamantina Perales Flores
Chairman
Instituto Mexicano de Contadores Públicos, A.C.

Appendix 1
Overall 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?

Users expect a high degree of protection for the results of decisions they make based on audited financial statements. The auditor cannot assume the role of provider of that protection.

Despite the existing literature on auditing matters, many users of audited financial statements still do not have a whole understanding of the nature, scope and limitations of an audit of financial statements, nor the responsibilities of external auditors. Consequently, users' expectations exceed the corresponding professional standards and regulatory requirements.

Fraud

- Frequently, users of audited financial statements expect auditors to discover all types of frauds, ignoring that auditor's responsibility is limited on that matter, and do not recognize that ultimate responsibility for the identification and assessment of fraud risks, as well as the design and implementation of policies and procedures to prevent, and to detect and correct those risks, lies with management and those charged with governance of the entity.

Going Concern

- Users of audited financial statements know the risks of their decisions, however if those risks materialize, then what was assumed as a risk may become a claim.

- There can be other causes of the gap between expectations and reality regarding the entity's ability to continue as a going concern, such as auditors' work not complying with professional standards or regulatory requirements, or financial statements preparers not disclosing in conformity with the applicable financial reporting framework. But the main cause of that gap is the out of proportion users' expectation about the auditor's work on this matter.

- Even though the entity's management has assessed and determined its capacity to continue as a going concern, and the auditor has obtained sufficient evidence supporting such determination, as of the date of the financial statements and the date of the auditor's report, if the entity ultimately cannot continue as a going concern, users of the entity's audited financial statements will ask: "why did the auditors not disclose it in their audit report?"

- This approach involves a combination of the knowledge gap and the evolution gap. Occurs both by: 1) an expectation based on the needs of users, regardless of whether the auditors' professional and legal requirements are sufficient for their purposes; and 2) an incomplete response to this expectation, given the nature and scope of an audit of financial statements, and what the financial statements themselves present and disclose, in accordance with the applicable financial reporting framework.

(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?

- To issue guidance to inform users of audited financial statements about the scope and limitations of the audit work on fraud and going concern matters, as well as the distinction of the different types of fraud.

- To require the auditors, through professional standards, to explain with greater clarity and precision, their level of responsibility, as well as the responsibility of the entity's management and those charged with governance, regarding fraud and going concern in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of the audit report. Also, through the professional standards, require the auditors to disclose in their audit report, in a summarized manner and without issuing a specific conclusion on each case:

    - The results obtained from their fraud risk assessment and the procedures applied indicating that, despite this, the possibility of an error due to fraud remains
    - The results obtained from their going concern risk assessment and, where appropriate, the procedures applied, as well as a clarification that the auditor cannot predict whether future events or conditions have effect on the entity's ability to continue as a going concern.

- To require the external auditor to indicate clearly and broader, in the communications with those charged with governance of the entity (ISA 260), the responsibilities for the entity's management, those charged with governance of the entity, and the auditors regarding fraud and going concern matters. Similarly, to enhance the description of the auditor's responsibility for fraud in both the engagement letter and the management representation letter.

<u>Going Concern</u>
In relation to the evolution gap:

- Disclosure requirements of financial reporting frameworks should be extended for specific cases in which there are elements that may affect the entity's ability to continue as a going concern, such is the case of entities with long-term debt for significant amounts, or companies whose income depends on the price of commodities and which can be affected by negative fluctuations in market prices. Although predictability is a characteristic of financial information, it is not possible to attribute to it the ability to predict everything that may occur.

- For decision-making purposes, users of financial statements should also refer to financial and non-financial information contained in information sources other than audited financial statements, including information on the entity's exposure and management of financial risks.

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?

- To require the use of specialists based on the assessed risk of fraud.

- To issue guidelines on areas with the highest risk of fraud. For example:
  - Revenue recognition;
  - Related parties;
  - Management overriding of controls;
  - Fair value and intangible measurement;
  - Other accounting estimates.

- To require, through professional standards, the participation of more experienced personnel in the process of identifying areas more prone to fraud risk, in the documentation of the fraud risk identification, and in the design and execution of procedures addressing such risk. This should be applicable for any audit work, emphasizing audits of listed companies, public interest companies or those in which the risk profile so requires.

(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.

- Items i, ii and iii, see comments on previous questions.

(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?

- The use of the concept "suspicious mindset" is not considered convenient. The term professional skepticism should be used. The need to maintain such skepticism in general, and especially in areas of high risk and prone to fraud, should be emphasized, as this would help to improve the identification of fraud when planning and executing the audit. It is necessary to have broader guidance and examples of areas and specific situations where the skepticism is critical.

(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.)?

- ISA 260.- To require the auditor to clearly communicate the responsibilities regarding fraud, of: (a) management, (b) those charged with governance of the entity, and (c) the auditor.

- To obtain from those charged with governance, directors and senior management a specific written representation regarding fraud, including:
    - Their responsibility on fraud,
    - The policies and procedures established to identify and address fraud risks,

- Conclusion of their assessment of compliance with the policies and procedures established, indicating that as a result of their assessment they did not identify indicative of fraud.
- This representation should be in accordance with the agreements established in the engagement letter.

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?

- It is not necessary to increase the going concern audit requirements. However, it is necessary to issue more detailed guidance regarding the audit procedures that can be execute and the evidence expected in evaluating management's action plans and projections, particularly for entities with conditions such as long-term debt of significant amounts, or whose income depends on the price of commodities and that can be affected by negative fluctuations in market prices.

(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.

- No, audit procedures must be applicable to all entities based on their assessed risks in a scalable way. Financial reporting standards should require entities to further analyze and disclose in cases such as those indicated above (long-term debt or obvious market risks).

(c) Do you believe more transparency is needed:
(i) About the auditor’s work in relation to going concern in an audit of financial statements?
If yes, what additional information is needed and how should this information be communicated (e.g., in communications with those charged with governance, in the auditor’s report, etc.)?

- Yes, we believe that documents could be issued by the IAASB for audit committees and users of audited financial statements, explaining the auditor's responsibilities and the limitations inherent to auditing the going concern determination by the entity.

(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?

- To enhance disclosures on the financial statements regarding the assumption that the entity is a going concern. Those disclosures should include the management’s methodology for its going concern determination, the period covered, and factors that could adversely affect such determination.

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?
Fraud

- To issue specific guides on how to use technological tools to detect fraud.

- To ask IFAC affiliated organizations the delivery of specific learning courses and material on fraud and going concern.

- To ask accounting standards issuers to issue clear and precise standards about management responsibility regarding fraud and going concern, including the corresponding disclosures in the financial statements.

- Require entity’s management to fully disclose its risk management policies and procedures in notes to the financial statements, emphasizing fraud and going concern.