



Our Ref.: C/AASC

1 February 2021

International Auditing and Assurance Standards Board
529 Fifth Avenue, 6th Floor,
New York
NY 10017
USA

Dear Sirs,

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 Hong Kong Institute of Certified Public Accountants (HKICPA) is the only statutory body in Hong Kong that sets auditing and assurance standards, ethical standards and financial reporting standards. We are grateful for the opportunity to provide our comments on the captioned IAASB Discussion Paper (DP).

The HKICPA appreciates the IAASB's initiatives and effort in seeking stakeholders' inputs on whether the International Standards on Auditing (ISAs) related to fraud and going concern need to be updated to stay relevant in a rapidly evolving external reporting landscape. We appreciate the extensive discussion in the DP about the expectation gap and the possible actions that IAASB could undertake to narrow the expectation gap. The public's confidence and trust in the financial reporting ecosystem will be critical to the profession and financial markets.

In summary, we highlight our key comments on certain aspects of the DP as below:

- The expectation gap is mainly due to the general public and financial statement users not fully understanding the work performed by auditors during an audit, referred to in the DP as the knowledge gap.
- Educational sessions for the public on the role of the auditor in respect of fraud and going concern and to explain the limitation and inherent risk of an audit could help to narrow, but would not fully eliminate, the expectation gap.
- Stakeholders we engaged with generally agreed that there should be enhanced guidance on when to engage forensic specialist, but this should not be mandatory in every circumstance.
- Different jurisdictions and regulations have divergent requirements for the period subject to going concern assessment - whether it should be from the date of the balance sheet or the date of the audit report. Alignment of the going concern assessment period across jurisdictions could enhance the comparability of financial statements and help to reduce the expectation gap.
- Adequate and explicit wordings to describe the responsibility of the auditor for evaluation of management's assessment of going concern would serve as an effective means for users of financial statements to have a clearer understanding of the work performed by auditors.

Our responses to the specific questions in the DP are included in the Appendix. We believe that our comments would be constructive and helpful. If you require any clarifications on our comments, please contact Selene Ho, Deputy Director of the Standard Setting Department (selene@hki CPA.org.hk).

Yours faithfully,

Chris Joy
Executive Director

CJ/SH

**HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS'
COMMENTS ON THE IAASB'S 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**

Detailed comments on IAASB's Discussion Paper

1. In regard to the expectation gap:
 - (a) What do you think is the main cause of the expectation gap relating to fraud and going concern in an audit of financial statements?

 - (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?

Based on our outreach to stakeholders, we believe that the expectation gap is mainly a combination of the knowledge gap and the evolution gap. For the knowledge gap, it is observed that the general public and audit report users may not have a thorough understanding or knowledge of the role of auditors and the approaches used and procedures carried out by auditors under the current auditing standards. Hence, the public may over-expect what auditors actually do during an audit of financial statements.

Though we believe the extant auditing standards remain robust and fit for purpose, stakeholders who are preparers of financial statements expressed observations that the current auditing standards may not have kept up with the rapid changes in financial markets and technological advancements. This lag in the development of new standards is identified as the evolution gap.

Based on the feedback from stakeholders, we recommend that the IAASB work with local professional accountancy bodies and standard setters to educate the general public through discussion forums or publications. A full understanding of the work performed by auditors and its limitations and the responsibility of those charged with governance (TCWG) related to fraud and going concern would be helpful to narrow the expectation gap. The HKICPA is willing to work with the IAASB to organise discussion forums or develop publications.

2. **This paper sets out the auditor’s current requirements in relation to fraud in an audit of financial statements, and some of the issues and challenges that have been raised with respect to this. In your view:**
- (a) Should the auditor have enhanced or more requirements with regard to fraud in an audit of financial statements? If yes, in what areas?**
 - (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.**
 - (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?**
 - (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 agree that there may be certain entities or circumstances when it is appropriate to enhance procedures but do not agree that engaging forensic specialists should be mandatory for every audit. As audit is not a forensic investigation process, mandatory use of forensic specialist in all audits would involve significant costs and may cause inefficiencies.

Engaging forensic specialists for certain regulated entities (e.g. banks, insurance companies with high risks financial instruments) may be reasonable since fraud activities arising in these entities are usually sophisticated and concealed, and may be difficult to be discovered by standard audit procedures. For other entities, including listed entities, unless red-flags or risk factors are identified during the audit, we are of the view that the audit team should not be mandated to engage forensic specialists. We consider it would be helpful for IAASB to develop guidance for circumstances in which audit teams should engage or consult with forensic specialists (For example, a short-seller report that challenges the result of the company or there is fraud allegation).

We support the view that auditors need to assess cautiously, both qualitative and quantitative indicators, to determine whether an identified non-material fraud is truly inconsequential and thus requires no further audit procedures. It is also important for auditors to communicate with appropriate stakeholders (e.g. TCWG) when non-material fraud is identified. We also agree that the audit should focus on the fraud related to financial statement audit as it would be extremely challenging for the auditor if fraud related to a third party is also included in the scope of an audit.

We recommend the IAASB to carefully consider if it should incorporate the concept of “suspicious mindset” in its auditing pronouncements. The term “suspicious mindset” sounds to extend far beyond the current professional skepticism concept, and some stakeholders have questioned whether “suspicious mindset” means the auditor needs to presume the client to be incorrect until proven otherwise. Some

stakeholders commented that being overly suspicious may lead to low audit efficiency and put relationships with audit clients in jeopardy.

The IAASB would also need to provide guidance under what circumstances auditors should have a suspicious mindset, instead of applying professional skepticism.

- 3. This paper sets out the auditor's current requirements in relation to going concern in an audit of financial statements, and some of the issues and challenges that have been raised with respect to this. In your view:**
- (a) Should the auditor have enhanced or more requirements with regard to going concern in an audit of financial statements? If yes, in what areas?**
 - (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.**
 - (c) Do you believe more transparency is needed:**
 - (i) About the auditor's work in relation to going concern in an audit of financial statements? If yes, what additional information is needed and how should this information be communicated (e.g., in communications with those charged with governance, in the auditor's report, etc.)?**
 - (ii) About going concern, outside of the auditor's work relating to going concern? If yes, what further information should be provided, where should this information be provided, and what action is required to put this into effect?**

Our stakeholders generally consider the extant audit requirements for the assessment of the appropriateness of the management's use of the going concern basis of accounting sufficient.

Some stakeholders have commented that the auditor should consider and evaluate management's assessment of the entity's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements. Different jurisdictions and regulations have divergent requirements for the period subject to the going concern assessment - whether it should be from the date of the balance sheet or the date of the audit report. Alignment of the going concern assessment period across jurisdictions could enhance the comparability of financial statements and help to reduce the expectation gap. The same stakeholders also indicated the going concern assessment period for a period of at least twelve months from the date of approval of the financial statements could provide a longer period. We would encourage the IAASB to communicate with international accounting standard setters to explore whether the disclosure and basis for going concern assessment should be re-considered and updated to meet stakeholders' expectations.

While we acknowledge that disclosure on an entity's going concern by way of emphasis of matter paragraph, key audit matter paragraph etc. in auditor's reports would be an alert to users of financial statements and helps to narrow the gap, it would not fully eliminate the expectation gap due to an unpredictable material uncertainty (e.g. outbreak of Covid-19) that is beyond the control of management. A

stakeholder also indicated that the auditor's approach and evidence obtained to assess an entity's going concern should be included in the audit report.

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?

Good corporate culture and integrity of the management team lay the foundations of corporate governance and internal controls system of the entity, which is important to detect and prevent fraudulent activities in an entity. The importance of setting the "tone at the top" by senior management should be periodically re-iterated. We also recommend the IAASB together with professional accountancy bodies to continuously educate stakeholders that not all misstatements in the financial statements will be detected, even though the audit is properly planned and performed in accordance with ISAs.

Whilst the current auditing standards do not require auditors to express an opinion on an entity's internal controls over financial reporting, the IAASB and professional accountancy bodies could highlight the value an audit brings (e.g. identification of weak internal controls) to management and TCWG. Given that all parties in the financial eco-system have a role to play, we recommend the IAASB to communicate with relevant regulators to consider if additional provisions (such as disclosures by entities on internal controls over financial reporting or an assurance report on the effectiveness of internal controls) may be useful.

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