IAASB
International Auditing and
Assuarance Standards Board

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IAASB's Discussion Paper on Fraud and Going Concern in an Audit of Financial Statements

FAR, the institute for the accountancy profession in Sweden, is pleased to provide you with some comments on the Discussion Paper *Fraud and Going Concern in an Audit of Financial Statements*.

General comments

Fraud and going concern are two important areas for auditors to form an opinion about in an audit of financial statements. These areas have also been subject to frequent discussions in the recent debates related to what is referred to as corporate collapses and scandals. We therefore welcome the IAASB's initiative to gather perspectives from stakeholders about the role of the auditor in relation to fraud and going concern.

With the above said we emphasize that the primary responsibility for dealing with fraud and going concern lies within the company, its management and those charged with governance. Our view is that there should be no shift of this responsibility to the auditor. If enhancements should be made in audit procedures and auditor reporting the starting point should however be increased requirements on the companies, their management and those charged with governance. We further believe that it would be unfortunate if the audit standards would become more rules based. Instead we are of the strong opinion that the audit standards should be principles based and that the auditor's ability to exercise professional judgment is of high importance for the audit quality.

With regard to effective prevention and detection of fraud it is important to remember that companies should have several lines of defence in place. The primary responsibility for preventing and detecting fraud lies with management and those charged with governance. Management should, with the oversight of those charged with governance, place a strong emphasis on fraud prevention. This could reduce the opportunities to commit fraud and deter individuals from committing fraud. Setting the tone at the top of a culture of honesty and ethical behaviour and an active oversight of those charged with governance reinforces the importance of fraud prevention. When those charged with governance exercise their oversight, they must consider that management is in a unique position to commit fraud because of the ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls.

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The objectives of the auditor are according to ISA 240 paragraph 11 to identify and assess the risk of material misstatement of the financial statements due to fraud, to obtain sufficient appropriate audit evidence regarding the assessed risks and to respond appropriately to fraud and suspected fraud identified during the audit.

If these lines of defence work effectively and carry out their respective responsibilities, we believe that the possibility to prevent and detect fraud increases.

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Comments 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 think that the description of the expectation gap in three components: the knowledge gap, the performance gap and the evolution gap is relevant to explain the expectation gap. Concerning fraud and going concern we believe that there primarily is a knowledge gap. There is a lack of common understanding that the responsibility for identifying and providing users with information and disclosures related to fraud and going concern begins first and foremost with the management and those charged with governance. However, we also believe that there is a difference between what auditors do and what the public thinks auditors do.

   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 order to narrow the expectation gap each participants role and responsibilities, and how they relate to each other, in what in the Discussion Paper is called the "financial reporting ecosystem", needs to be clarified. The focus should be on the roles and responsibilities of management, those charged with governance and the auditor. The requirements imposed on the auditor must be proportionate to the requirements imposed on the companies. We think that there is room to clarify the auditor's role, but this needs to go hand in hand with enhanced responsibilities of those charged with governance, management and others in the financial reporting ecosystem. In order to achieve the desired results and respond to stakeholders' expectations, changes must be timely and coordinated for all parties. The IAASB should work to influence standard setters to improve financial reporting requirements (e.g., require interim reviews, broaden disclosures of information on material changes in financial conditions or operations). The IAASB should also work with authorities to help them design reasonable consequences for non-compliance.

   Fraud and the auditors' related responsibilities is probably the most complex and most misunderstood area in relation to auditors' duties, why this area needs specific focus. It is important that the public understands that fraud is a broad legal concept and that the auditor does not make legal determinations as to whether or not fraud has occurred. The IAASB could release guidance explaining the auditor's role relating to fraud.

   Going concern is an accounting term used to describe a company which is assumed to be stable enough to continue to operate for the foreseeable future. Management of a company assesses its ability to continue as a going concern. The auditor in turn evaluates management's assessment of the entity's ability to continue as a going concern and conclude on the appropriateness to use the going concern basis of

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accounting in the preparation of the financial statements. Management is also required to make disclosures about the existence and the nature of material uncertainties that can lead to significant doubts about the company as a going concern. The auditor shall also conclude whether a material uncertainty exists about the entity's ability to continue as a going concern and if the disclosures in the financial statement about a material uncertainty are adequate. The IAASB can clarify the difference between these two parts. It is important to acknowledge that assessing the continuity of a company has its inherent limitations due to the fact that no one can predict future events with certainty.

The IAASB should also allow recent changes to auditing and ethical standards to be implemented and monitored before introducing new procedures.

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?*

   In order to answer this question, it is essential to know if there actually is a problem concerning the auditors work on fraud and if so how big this problem is, or if there only is a perceived problem because of the expectation gap. To take a position on the issue, an empirical basis is needed.

   If the auditor should have enhanced or more requirements with regard to fraud in an audit of financial statements a cost benefit analysis should be carried out. What is the expected gain for the society and what is the expected increased cost for companies?

   We believe that the starting point for the discussion concerning fraud should be the requirements placed on the companies. What are the responsibilities of the management and those charged with governance and what processes needs to be in place in order to prevent fraud? The auditor can check how these processes are complied with but cannot be expected to detect every occurrence of fraud.

   Management and those charged with governance are responsible for preventing and detecting fraud and could also have a responsibility to report which actions they have taken to fulfil this obligation. The auditor can then make a statement about the accuracy of the report and communicate what work has been performed to reach the conclusion.

   b) *Is there a need for enhanced procedures only for certain entities or in specific circumstances?*

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If a problem can be identified referring to the answer in question *2 a* we believe that there can be a need, but only for certain entities.
If yes:

i. *For what types of entities or in what circumstances?*

In our opinion the possible need for enhanced procedures, which should be based on a cost benefit analysis, concerns public interest entities.

ii. *What enhancements are needed?*

Any enhancements made should take a starting point in increased requirements on companies concerning processes and reporting concerning fraud. Enhancements on audit could be foreseen as well in audit procedures as in auditors reporting, to the company and in the public reporting. As a first step ISA 240 could be clarified with guidance on how to make a risk assessment that builds the basis for procedures concerning fraud, this can be done by giving case-based examples.

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.*

To the extent the changes made concerns the audit of financial statements, they should be made within the ISAs but as stated in *2 b i* these procedures should, if introduced, only concern public interest companies. Besides revising ISA 240 the IAASB can provide staff implementation guidance (e.g., auditing key areas of the entity's fraud risk assessment, consideration of key performance indicators, use of data analytics, using fraud inquiries in combination with other procedures, case studies on management override of controls over journal entries).

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?*

No, we do not believe that the IAASB should include the term "suspicious mindset". To introduce a new term will not make the auditors role concerning fraud clearer. It would be more useful if the auditor's responsibilities concerning fraud were clarified. The use of a "suspicious mindset" could affect the client's openness and willingness to give the auditor information and access to data which could reduce the possibility to detect fraud.

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However, we believe that with enhanced audit procedures and reporting concerning fraud increased training in the area will be needed, which in turn will lead to increased attention and awareness.
We also believe that the IAASB should monitor the implementation of new requirements by IESBA for the auditor to have an "inquiring mind" and be aware of their own potential bias when exercising professional scepticism.

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.)?*

Transparency is key to maintain trust and we are open to more transparency about the auditor's work. More transparency can help reduce the expectation gap. This can be done by an improved dialogue with those charged with governance, where for example the risk for fraud could be discussed more in depth between the audit committee and the auditor.

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 section III and IV). In your view:*

   a. *Should the auditor have enhanced or more requirements with regard to going concern in an audit if financial statements? If yes, in what areas?*

In order to answer this question, it is essential to know if there actually is a problem concerning the auditors work on going concern and if so how big this problem is, or if it there only is a perceived problem because of the expectation gap. To take a position on the issue, an empirical basis is needed. For example a comparison can be made between companies that have ceased their operations due to financial problems and how the latest auditors report issued before the ceasing of operations was designed.

If the auditor should have enhanced or more requirements with regard to going concern in an audit of financial statements a cost benefit analysis should be carried out. What is the expected gain for shareholders and society and what is the expected increased cost for companies?

We believe that the starting point should be the requirements on the companies concerning going concern. Enhanced requirements on them should then be reflected in the auditors' work. It is management's responsibility to assess the entity's ability to continue as a going concern and then prepare financial statements in accordance with that assessment. Management is also required to make disclosures about the existence and the nature of material uncertainties that can lead to significant doubts about the company as a going concern. The threshold for not preparing the financial statements on the basis of going concern is high why the

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importance of disclosures about the existence and the nature of material uncertainties that can lead to significant doubts about the company as a going concern is very important. It is also important to acknowledge that assessing the continuity of a company has its inherent limitations due to the fact that no one can predict future events with certainty. The auditor evaluates the assessments made by management and evaluates whether disclosures are correct and sufficient. We believe that focus on going concern should be on requirements on disclosures in the financial statements and the audit of these disclosures.

We believe that there is a need for revised accounting standards to require management to perform and document its assessment of the entity's ability to continue as a going concern for a period of twelve months from the financial statement issuance date, define "material uncertainty" and "significant doubt," and require specific disclosures. Any enhanced requirements for the auditor should be based on requirements on management to make disclosures in the financial statements. Clear and accurate information in the financial statements and the auditor's report will help stakeholders to make their own assessment of the company's continuance.

b. *Is there a need for enhanced procedures only for certain entities or in specific circumstances?*

If a problem can be identified referring to the answer in question *3 a* we believe that there can be a need, but only in specific circumstances.

If yes:

i. *For what types of entities or in what circumstances?*

   In contrast to fraud we believe enhanced procedures can be needed in specific circumstances regarding going concern. Rather than to focus on certain entities the focus should be on specific circumstances. The level on requirements on disclosures and the audit of these disclosures varies depending on the category of the company. It is likely that the need is higher for public interest entities than for small or less complex entities.

ii. *What enhancements are needed?*

   The circumstances mentioned in *3 b i* can take a starting point in certain measures that indicate uncertainty in going concern and risk that material uncertainty exists. Such measures could be stated in ISA 570. Application material can be designed to help auditors' in their risk assessment and more examples concerning different scenarios relating to going concern issues would also be helpful.

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.*

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To the extent the changes made concerns the audit of financial statements, they should be made within the ISAs but as stated in *3 b i* these procedures should only concern specific circumstances.

The IAASB could issue staff practice alerts to support auditors (e.g., demonstrate how audit procedures already required by auditing standards other than ISA 570 Going Concern may assist in the identification of conditions or events which may give rise to significant doubt, illustrate an auditor's evaluation process via a decision tree, highlight the importance of professional scepticism when evaluating the management's plans to alleviate significant doubt).

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.)?*

   Transparency is key to maintain trust and we are open to more transparency about the auditor's work. More transparency can help reduce the expectation gap. This can be done by an improved dialogue with those charged with governance and through more transparency in both the financial statements and the auditor's report. It is however again important to stress that the primary responsibility for the assessment and reporting on going concern lies within the company and those charged with governance.

   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?*

   The IAASB should promote requirement of additional disclosures by management (e.g., material changes in financial condition or operation, going concern risks prior to mitigation, and mitigation plans).

   The IAASB should also consider promoting requirements for disclosure by management of longer-term viability assessments.

4. *Are there any other matters the IAASB should consider as it progresses its work om fraud and going concern in an audit of financial statements?*

As we have pointed out several times in our comments it is important to recognise that the primary responsibility for dealing with fraud and going concern lies within the

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company, its management and those charged with governance. The auditor alone cannot solve these issues, why enhanced audit procedures and reporting need to go hand in hand with increased requirements on the companies, their management and those charged with governance.

The IAASB should collaborate with a variety of constituents –regulators, accounting standard setters, and national auditing standard setters - to ensure that root causes are addressed by those who have influence/authority, and for consistency and convergence across jurisdictions.

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