

BY E-MAIL ONLY

February 1, 2021
International Auditing and Assurance Standards Board
To: Mr. Thomas R. Seidenstein (Chair)
529 Fifth Avenue
New York, NY 10017
USA

Subject: Responses on the IAASB discussion paper on Fraud and Going Concern in an Audit of Financial Statements

Dear Mr. Seidenstein,

1. The International Forum of Independent Audit Regulators (IFIAR) appreciates the opportunity to comment on the International Auditing and Assurance Standards Board (IAASB) request for input on its Discussion Paper related to Fraud and Going Concern in an Audit of Financial Statements. As an international organisation of independent audit oversight regulators that share the goal of serving the public interest and enhancing investor protection, IFIAR is committed to improving audit quality globally through the promotion of high-quality auditing and professional standards, as well as other pronouncements and statements.
2. IFIAR's objectives are as follows:
 - Sharing knowledge of the audit market environment and practical experience of independent audit regulatory activity, with a focus on inspections of auditors and audit firms.
 - Promoting collaboration and consistency in regulatory activity.
 - Initiating and leading dialogue with other policymakers and organisations that have an interest in audit quality.
 - Forming common and consistent views or positions on matters of importance to its members, while considering the legal mandates and missions of individual members.
3. The comments we provide in this letter reflect the views expressed by many, but not necessarily all of the members of IFIAR. However, the comments are not intended to include, or reflect, all of the views that might be provided by individual members on behalf of their respective organisations.
4. Where we did not comment on certain specific matters, this should not be interpreted as either approval or disapproval by IFIAR.

Overall comments

5. IFIAR supports the IAASB's efforts of seeking inputs from stakeholders on expectations with respect of the auditor's performance and responsibilities in relation to fraud and going concern in financial statement audits.
6. International Standard on Auditing (ISA) 200¹ sets out the overall objective for the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatements, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. The clarity of the objectives of any standard is critical to achieving consistent applications of the requirements and related guidance for its specific subject matter. The IAASB should specifically consider whether the introductory language in ISA 240² and, in particular, the section on "Inherent Limitations of an Audit in the Context of Fraud," undermines the objective of the audit.
7. We are in support of the overall objective of an audit as described in the auditing standards, but at the same time we encourage the IAASB to examine the benefits of strengthening the standards or providing additional guidance as set out in the remainder of this letter. Our comments are not intended, at this early stage of the IAASB project, to provide definitive direction. IFIAR will further assess its position based on the evidence gathered during the next steps of the process.
8. In addition to the IAASB's assessment of responses to this discussion paper, we encourage the IAASB to analyse recent financial scandals, corporate failures and their root causes. Doing so may inform the IAASB's assessment of whether areas of the standards could be enhanced, or additional guidance could be issued, to respond to the potential weaknesses shown by those experiences.

Expectation Gap

9. We would not support any proposals that would lessen the expectations or requirements for the auditor in the areas of fraud and going concern in an audit of financial statements.
10. The IAASB raised the question about whether requiring a "suspicious mindset" could contribute to enhanced fraud identification. We suggest performing further research to understand the root causes of the issues that the IAASB expects to be addressed by the introduction of the "suspicious mindset". Clear linkage to the root cause of the underlying issues will help the IAASB to evaluate whether the introduction of this new concept could result in meaningful improvements to audit quality.

Potential areas for improvement in audit procedures related to fraud in an audit of financial statements

11. We encourage the IAASB to explore the areas outlined below and consider how these could be addressed, if needed, either through changes to the standard or issuing additional guidance:

¹ ISA 200 – *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

² ISA 240 – *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

- How professional skepticism is addressed in ISA 240, and whether the importance of exercising professional skepticism could be reinforced, for instance through the use of stronger language (such as “challenge, question and reconsider”) and a requirement to “stand-back” by taking into account all evidence obtained in forming conclusions at the end of the audit.
- How risk assessment and risk responses focus on fraud risk factors, and whether the auditor, including during engagement team discussions regarding susceptibility for fraud and fraud risks, sufficiently focuses on the broader aspects of the entity’s system of internal control, on the risks related to management override of controls and on inherent risks before delving into more specific fraud risks.
- Whether the requirements and guidance sufficiently convey the message that the exercise of increased professional skepticism and further audit procedures (such as varying the nature, timing and extent) are necessary if there are signals that indicate an elevated risk of a material misstatement due to fraud.
- Whether technology has an impact on the ability of management of the entity or others to perpetrate fraud. Specifically, we suggest considering whether the standard provides sufficient guidance to the auditor about the resulting risks and also about the opportunities offered by technology to respond to the risks.
- How the reliability of audit evidence is required to be assessed and whether paragraph 11 of ISA 500³ requiring additional procedures only when there are doubts about the reliability of information to be used, may, in practice undermine the auditor’s assessment of the reliability of evidence.
- Whether the standard provides sufficient guidance to auditors on assessing the qualitative and quantitative aspects of materiality in the context of fraud.
- Whether auditors appropriately engage with Those Charged with Governance (TCWG). This includes the application of appropriate rigor in determining whom to speak to, whether meetings should include management, whether the auditor is sufficiently considering management bias, and whether the auditor appropriately communicates to TCWG how fraud risks were addressed and results of the relevant audit procedures.
- How required analytical procedures in the planning and closing stages of an audit are being dealt with, since high level year-on-year analytics are unlikely to support the identification of fraud risks.
- How the rebuttable presumed fraud risk in revenue recognition is understood in practice.
- Whether the extant requirement to assess fraud risks as significant risks⁴, is understood correctly in practice, or whether its current application focuses too much on journal entry testing.
- Whether auditors are appropriately incorporating elements of unpredictability in audit procedures when addressing risks of material misstatements.

³ ISA 500 – *Audit Evidence*

⁴ As addressed in paragraphs 27 and 31 of ISA 240.

- Whether the identification of material misstatements in the financial statements due to fraud requires the use of specialists, generically or in certain circumstances, and if so, what such specific circumstances could be. In this context it may be helpful to understand the extent to which fraud specialists are currently engaged or included in audit teams, and, if so, what is the nature of the procedures they are performing.
- 12. When considering enhancing the standards, we also suggest that the IAASB assess the costs and benefits of potential enhanced reporting by the auditor about how fraud risks were addressed in the audit, for instance in the expanded auditors report.

Potential areas for improvement in audit procedures related to going concern in an audit of financial statements

- 13. We observe that a number of jurisdictions have amended the local auditing standards to go beyond the requirements currently set out in ISA 570⁵ in response to public interest considerations identified in these jurisdictions.
- 14. We suggest that IAASB explore examples where jurisdictions have taken additional steps to enhance the role of the auditor by requiring additional communication to outside parties, including to relevant authorities, with a view to protecting the public interest. Those initiatives could be taken into consideration by IAASB when determining the need to enhance ISA.
- 15. We reiterate that the objective of the audit of financial statements by the external auditor is to assess whether, in their opinion, the entity's financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. We appreciate that it would be challenging for an auditor to be required to go beyond auditing how management has applied the requirements of the applicable financial reporting framework. A greater impact on the quality of going concern assessments and the related audit procedures will be realized when both the accounting and auditing standards have been updated. In that context we suggest the IAASB explore with accounting standard setters, including the International Accounting Standards Board, whether the current interplay of the International Financial Reporting Standards and the International Standards on Auditing best serve justified stakeholder interest or whether enhancements to the financial reporting framework should be pursued.
- 16. We propose that IAASB explore how the assessment of indicators about whether there are potential threats to an entity's ability to continue as a going concern, can benefit from information gathered during the risk assessment procedures.
- 17. We observe that the step between deteriorating financial conditions of an entity and a situation of significant doubt about the entity's ability to continue as a going concern may be significant. We suggest assessing whether the requirements and guidance sufficiently convey the message that further inquiries and more robust procedures, amongst others to assess management's representation, would be necessary if early indicators of potentially significant financial distress were present. This may be earlier than when events or conditions that cast doubts on going concern can be identified.

⁵ ISA 570 – *Going Concern*

18. Currently, the auditor is only required to communicate matters to TCWG when events or conditions are identified that may cast significant doubt on the entity's ability to continue as a going concern. Where relevant, the auditor should be required to communicate to TCWG on going concern, including commenting on the quality of management's assessment and how they have evaluated relevant events and conditions. This would encourage early, transparent dialogue between the auditor, those charged with governance and management.
19. Finally, we suggest considering whether professional scepticism needs to be further highlighted in the standard related to going concern, either through changes to the standard or issuing additional guidance.

Please do not hesitate to contact me or Martijn Duffels, Chair of the IFIAR Standards Coordination Working Group, to discuss any of our comments.

Yours Faithfully,



Duane DesParte, Acting Chair

Cc:
Martijn Duffels, SCWG Chair,
Carl Renner, Executive Director