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submitted electronically through the IAASB website

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**Re.: Discussion Paper: Fraud and Going Concern in an Audit of
Financial Statements**

Dear Tom,

We would like to thank you for the opportunity to provide the IAASB with our comments on the Discussion Paper: "Fraud and Going Concern in an Audit of Financial Statements", hereinafter referred to as "the paper".

In this letter, we would also like to make the following general comments that provide the basis for the views expressed, in the appendix to this letter, in our responses to the questions posed, and our perspectives on the issues raised by the IAASB. This basis is fundamental to understanding the views that we have expressed in the appendix.

We very much support the IAASB initiative to explore the auditor's responsibilities in an audit of financial statement for fraud and going concern because major instances of fraud and corporate insolvencies have resulted in the public, and therefore legislators and regulators, calling the efficacy of audits of financial statements into question. Since the IAASB is responsible for promulgating auditing standards in the public interest, the IAASB is right to seek to gather information, about concerns that have been expressed about how well audits of financial statements deal with instances of fraud and with going concern issues, to form a basis for the IAASB's consideration of future action in this regard.

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Daniela Kelm, RA LL.M.;
Melanie Sack, WP StB

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No overselling of supposed panaceas

Given the fact that the IAASB (and its predecessor, the IAPC) have previously revised the standards on going concern and fraud a few times since the late 1990's, the IAASB needs to be particularly careful not to leave the impression that any actions it takes will more than just incrementally ameliorate supposed deficiencies in the role of auditors or audit effectiveness with respect to fraud or going concern. Both issues are excruciatingly difficult matters of public policy for which there will never be a "silver bullet" that will satisfy all stakeholders in all respects: it is therefore incumbent upon the IAASB to seek to not "oversell" its ability to resolve these issues and to engage in a frank dialogue with its stakeholders about some of the largely intractable aspects of these issues.

Remaining within the standard setting remit of the ISAs

In this vein, we therefore also welcome the IAASB having clarified that issues regarding the audit treatment of fraud and going concern are embedded in the financial reporting ecosystem and that therefore the IAASB is not in a position to resolve these issues alone. However, we would like to point out that the nature of the questions posed, and the perspectives sought, in the paper indicate that the IAASB may be prompting stakeholders to provide direction to the IAASB to seek to address matters in its standards that go beyond the remit of the IAASB as an international standard setter. The scope of the ISAs is the audits of financial statements (and other historical financial information, if one includes ISA 805) – not assurance or any other engagement with respect to matters other than financial statements. National legislators and appropriately legislatively empowered regulators can expand the scope of audits of financial statements to cover other matters and do so (e.g., the audit of internal control over financial reporting as part of the financial statement audit under the Sarbanes-Oxley Act in the United States, or assurance on the management report as part of the financial statement audit in Germany), but as an international standard setter, the IAASB cannot unilaterally expand the required scope of audits of financial statements to cover other matters. Doing so would lead to the ISAs no longer being universally applicable for audits of financial statements, because if the IAASB expanded the required scope of audits beyond the noted opinion and report, the ISAs would be at variance with most national legislation requiring audits of financial statements.

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Consequently, matters beyond those needed to express an opinion on the financial statements and report on the auditor's findings must be beyond the scope of the ISAs: such matters can only be addressed by national legislation or regulation and accompanying national standards. It is for these reasons that our responses to the questions posed, and perspectives sought, deny that required expansions of audit scope through the ISAs are possible or even desirable. Nevertheless, the IAASB may consider whether other assurance engagements in relation to fraud and going concern issues performed on a voluntary basis are of sufficient interest internationally to warrant a response by the IAASB, which may include, but may not necessarily be, standard setting in the first instance.

Using an evidence-based approach

The nature of the agenda papers in relation to fraud in the December webmeeting of the IAAB appear to indicate to us that the IAASB may already be considering potential changes to its standards without having undertaken a systematic analysis yet of the causes of the supposed audit scandals relating to fraud and going concern. This can only lead to longer, more complex standards with more requirements and application material – not necessarily better standards that address the causes.

We believe that for issues as important as going concern and fraud, the IAASB's approach needs to be evidence-based – that is, the IAASB should concentrate on finding out “what went wrong” in supposed audit scandals over the last several years to the extent robust information about this is available and then, only if the problem is identified as a deficiency in existing standards (i.e., not a performance issue resulting from failure to apply a clear standard) should the IAASB undertake focused changes to its standards. In investigating and considering the underlying causes, it may be fruitful for the IAASB to dig deeper than just the high level causes often given by audit regulators and inspectors (e.g., the “catch-all” reasons such as “inadequate exercise of professional skepticism” or “not gathering sufficient appropriate evidence”) to address issues such as why certain “red flags” for fraud or going concern issues were missed or not appropriately taken into account in auditor actions. This is not to say that the IAASB should not explore all avenues, including augmenting its standards, but the IAASB should take an evidence-based approach when moving beyond exploration.

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We would be pleased to provide you with further information if you have any additional questions about our response, and would be pleased to be able to discuss our views with you.

Yours truly,

Melanie Sack
Executive Director

Wolfgang Böhm
Technical Director, Assurance Standards
Director, International Affairs

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Appendix: Questions for Respondents and Perspectives Requested

1. In regard to the expectation gap (see Section I):

(a) What do you think is the main cause of the expectations gap relating to fraud and going concern in an audit of financial statements?

As we point out in the body of our letter, the IAASB should take an evidence-based approach to considering the basis for its future actions. To this effect, the question posed in 1 (a) to stakeholders is an important source of information, but is not sufficient on its own. As we explain in the body of the letter, the IAASB should investigate the underlying causes of supposed audit failures involving fraud or going concern issues. The identification and evaluation of these causes would provide more robust information about what the main cause of the expectations gap relating to fraud and going concern is likely to be. Based on our understanding of the issues as described below, we surmise that the knowledge and reasonableness gaps together form the largest portion of the expectations gap.

We are convinced that there will only be at most marginal reductions in the **performance gap** for fraud and going concern issues if the IAASB improves the clarity of its standards and adds more guidance to support implementation. Other causes of the performance gap (see (b) below), which may be more significant, can only be addressed by other participants in the audit environment.

In relation to the **evolution gap**, we note that, if asked, users of financial statements and auditors' reports will always want more and better information and therefore seek to have audits evolve further. However, simply seeking to be responsive to these desires without considering that audits and any other additional engagements must be completed within a reasonable time to be relevant to users and at reasonable cost (which is a public policy issue on the proportion of GDP that a society wishes to expend on audits and additional engagements) does not adequately deal with consideration of the societal costs and benefits involved. In line with our comments in the body of the letter, unless the scope of financial reporting frameworks is generally extended worldwide, to the extent that the evolution gap involves seeking to satisfy stakeholder desires (e.g., future viability) beyond an audit opinion on the financial statements and communication of the auditor's findings thereon, such required scope

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extensions of the audit are beyond the remit of the ISAs and hence the IAASB for financial statement audits.

Adding very robust or enhanced procedures, to improve audits of financial statements, that ultimately cause the costs of audits to increase by orders of magnitude, or incrementally augmenting standards that costs substantially less but only marginally improves audit performance, is not likely to satisfy stakeholders either way: it is unlikely that, given the history of changes made to ISAs 240 and 570 over the last twenty-two years, the IAASB will miraculously discover previously undiscovered “significant quick wins” that substantially increase audit performance for fraud and going concern issues at reasonable cost. Furthermore, as the discussion on KAM when drafting ISA 701 showed, the need, due to independence requirements, to retain audit as an attestation, rather than direct engagement, which implies that original information about the entity ought to be provided by management rather than the auditor, and the related legal confidentiality requirements that the ISAs cannot overcome, mean that improving the transparency of auditor communication to users of the financial statements beyond ISA 701 may be difficult.

The **knowledge gap** and the **reasonableness gap** both reflect severe information asymmetry between parties knowledgeable about audits (e.g., auditors, auditing standard setters and knowledgeable regulators) and parties with comparatively little knowledge about audits (e.g., legislators, the media, users, less knowledgeable regulators, and the public). Given the available literature on auditing, including, but not limited to, introductory auditing textbooks, and the content of the auditor’s responsibility section of the auditor’s report (which was expanded for both going concern and fraud in 2015), lack of interest or diligence appears to be the only explanation for the **knowledge gap** for those parties supposedly interested in audits but that lack the knowledge to understand what auditors do and are required to do.

While the knowledge gap is severe on its own, the **reasonableness gap** is a more serious and intractable problem because it relates to public expectations that can never be fulfilled due to the inherent limitations of audits. With the exception of a FEE Paper from 2007¹ that deals systematically with the inherent limitations of audits, both auditing standards and literature only address this

¹ FEE (now Accountancy Europe), „Selected Issues In Relation to Financial Statement Audits: Inherent Limitations, Reasonable Assurance, Professional Judgment and Its Documentation, and Enforceability of Auditing Standards“, October 2007.

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issue in cursory fashion which means that even if parties sought to improve their knowledge about audits in this respect, they would have great difficulty doing so.

Contributing to the **reasonableness gap** is the problem that for the uninitiated, auditing, like accounting, also suffers from what is often called “numeracy bias” or “precision bias” – that is, the belief that since financial accounting involves numbers and auditing involves examining the veracity of those numbers, properly audited numbers must be “right”. The undersigned have encountered numerous instances in which otherwise highly educated representatives of the media, legislators and regulators (often with prestigious law degrees), and members of the public react with disbelief (they appear to believe that the auditing profession is “just being defensive”) when the judgmental nature of accounting (recognition, measurement, classification, presentation and disclosures) and auditing and other assurance engagements (e.g., the persuasiveness of evidence) is explained to them.

This is all the more surprising for those with a legal education, since even they recognize that with the power of the courts to gather evidence from entities other than the entity whose financial statements are being audited, search for and seize documents, force the disgorgement of evidence, and subject individuals to interrogation or cross-examination under oath, the prosecution may not be able to obtain the conclusive evidence needed to prove in a court the guilt of a supposed perpetrator of a financial crime beyond any reasonable doubt even when there is virtually no doubt that a crime has been committed. These inherent limitations apply even more so to auditors of financial statements, who do not have these powers and where much of the evidence obtainable is persuasive rather than conclusive. As noted above and in relative contrast to court proceedings, to be relevant audits must be completed within a reasonable time and society expects audits to be performed at a reasonable cost, which represent real inherent limitations to audits beyond the inability to force the disgorgement of evidence, etc.

We believe that auditing standard setters and the auditing profession have exacerbated the information asymmetry versus other stakeholders about the reasonableness gap by not engaging in a frank dialogue with other stakeholders about this gap for fear of appearing “defensive”.

(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?

The IAASB can explore whether there are matters within the ISAs that are unclear that could be clarified and therefore might marginally improve auditor

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performance, but it seems to us that such measures will not narrow the **performance gap** significantly. Other causes of the performance gap (inadequate: time, auditor competence, compliance with clear standards, firm policies or procedures, etc.), which are likely to be significantly greater than issues of clarity of standards and insufficient implementation support, can only be addressed by other participants in the audit environment (legislators, regulators, those charged with governance, firms, educators, etc.), but the IAASB may have a role in facilitating work in this area.

Certainly, the IAASB can also explore whether the ISAs can be augmented to further improve auditor performance or whether other voluntary assurance engagements might be helpful to deal with the **evolution gap**. We just believe it to be unlikely that the IAASB will be able to improve auditor performance more than just incrementally with respect to fraud and going concern by means of auditing standards at reasonable cost. Furthermore, as noted in the body to our letter, expanding the required scope of the ISAs is not possible and the IAASB cannot require the performance of other assurance engagements. For the reasons noted in our response to (a), improving transparency in auditors' reports may require financial reporting frameworks to require additional disclosures related to going concern and fraud by management in the financial statements, which we understand is unlikely to occur in the short or medium-term – if at all.

With respect to the **knowledge and reasonableness gaps**, we note that the IAASB has an important public interest role in explaining to stakeholders what auditors ought to do and what auditors do (both related to the knowledge gap) as well as what auditors cannot do (reasonableness gap). This educational role of the IAASB – particularly in relation to the reasonableness gap – has not been adequately taken up by the IAASB in the past due to concerns about appearing “defensive”. We believe that the IAASB, national standard setters and the profession need to engage in a frank dialogue with other stakeholders about the knowledge and reasonableness gaps to seek to significantly reduce these gaps.

The IAASB is interested in perspectives on what more is needed to narrow the knowledge gap with regard to the meaning of material uncertainty related to going concern, to enable more consistent interpretation of the concept.

The underlying problem with the clarity of the meaning of material uncertainty related to going concern and the related knowledge gap is the fact that what “going concern” and “material uncertainty” mean depends upon the requirements of the applicable financial reporting framework.

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The fact that financial reporting frameworks deal with going concern differently and with different meanings (see, for example, the differences between the current requirements in IAS 1 and the FASB requirements in the U.S.) leads to a conundrum for the IAASB as an international standard setter in seeking to write an ISA 570 that is neutral with respect to financial reporting frameworks, and accounts for the lack of a definitions section in that standard for meaning of “going concern” and “material uncertainty”, etc. Nevertheless, the importance of going concern issues to the very reason for having stakeholders require audits of financial statements causes stakeholders to seek to misuse the IAASB as a “repair shop” for deficient accounting standards in relation to going concern.

In conclusion, we note that the IAPC and then the IAASB had chosen to use IAS 1 as a base for the going concern concepts used in ISA 570, regardless of other financial reporting frameworks. Consequently, if greater clarity about the meaning of these concepts is desired, such clarity ought to be provided by the IASB. If no project is forthcoming from the IASB on this matter in the near future, which is very likely, the IAASB may need to consider whether using IAS 1 as a base is still appropriate and whether another financial reporting framework provides more and better guidance that the IAASB can adopt. Concepts that require clarification and delineation from one another include: “going concern”, “the ability of the entity to continue as a going concern”, “going concern basis of accounting”, and “material uncertainty”, and the “normal course of business”.

- 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).**

The IAASB is interested in perspectives about the perceived responsibilities of the auditor regarding non-material fraud in a financial statement audit (i.e., a broader focus on fraud) and what additional procedures, if any, may be appropriate. The IAASB is also interested in perspectives about whether additional audit procedures should be required when a non-material fraud is identified, and if so, what types of procedures.

In line with our comments in the body of the letter, we note that the objective of an audit is to form an opinion on whether the financial statements have been prepared, in all material respects, in accordance with the financial reporting framework. Consequently, in line with those comments, the required scope of an ISA audit cannot be extended to the detection of non-material frauds.

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Furthermore, due to the inherent limitations of an audit as described in our response to Question 1 (a) on the reasonableness gap, it simply is not possible for an audit to identify all non-material frauds, even with unlimited time and resources (an employee absconding with a paperclip is, strictly speaking, misappropriation of assets) – this is a matter that needs to be dealt with as part of the reasonableness gap. The resources and time needed to seek to detect immaterial frauds (and even then due to the inherent limitations of audits, not all of them would be found) would make audits prohibitively expensive and would cause them to be completed at a time at which the results of the audit would no longer be relevant to users. We would also like to point out that extending the scope of the audit to detect non-material frauds without a concomitant requirement for management and those charged with governance to prevent and detect such frauds would cause the responsibilities of auditors to exceed that of management and those charged with governance, who design and implement, or oversee the design and implementation, of controls to prevent and detect fraud – but the cost of controls to seek to have an entity prevent detect all non-material frauds would vastly exceed the benefits.

We believe that the current requirements in paragraphs 36 and 37 of ISA 240 for non-material frauds are appropriate and need not be augmented.

The IAASB is interested in perspectives on whether enough emphasis is placed on the auditor’s responsibilities around fraud related to third parties. We are also interested in feedback about the auditor’s role in relation to third party fraud that does not result in a material misstatement of the financial statements but may have a severely negative impact on the entity (e.g., cybercrime attacks).

As we point out in the body of our letter, fraud, including third party fraud, that does not result in a material misstatement of the financial statements but may have a severely negative impact on the entity (e.g. cybercrime attacks) is beyond the scope of the ISAs and cannot be made a required scope of the ISAs by the IAASB – only by legislators or appropriately legislatively empowered regulators. The audit profession may have a role in this area to the extent that those charged with governance or management or interested in having voluntary engagements performed in this area.

We note that management and those charged with governance – not auditors – are responsible for preventing and detecting fraud by other third parties that lead to a material misstatement of the financial statements: such third party fraud generally relates to misappropriation of assets. For example, retailers and other entities with physical or electronic assets of value are responsible for

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having effective controls in place to prevent “customers” and burglars from stealing merchandise or other items of value. However, the cost of those controls needs to be balanced against the benefit of preventing or detecting such theft. Third party (other than management or employees) misappropriation of assets also often takes place through suppliers not delivering goods or services as ordered, or not delivering them in the quality or quantity as ordered, but being paid as if they had. Again, the responsibility for preventing and detecting such misappropriation of assets is the responsibility of management and those charged with governance by establishing effective controls over goods and services received. When management or employees collude with other third parties to commit such fraud against an entity (e.g., the third parties misappropriate the assets with the connivance of management or employees in exchange for kick-backs, including having management or employees choose certain suppliers even though their price is higher than that for other suppliers for the same quality, or the quality is less than that of other suppliers for the same price), it is a case of corruption that may be exceedingly difficult to detect as part of the financial statement audit because management or employees may forge documents to cover up such fraud or, in some cases, there may not even be any documents within the entity to indicate such fraud.

Based on these considerations, we conclude that seeking to further increase auditor emphasis on third-party fraud as part of a financial statement audit is misplaced. This would not preclude management or those charged with governance from seeking voluntary engagements in this area.

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 line with our comments in the body of the letter, the IAASB should undertake an evidence-based analysis before considering whether enhanced or more requirements with regard to fraud ought to be introduced in an audit of the financial statements. However, we do believe that it may be worth exploring three issues in particular as a basis for this: 1. Whether the connection between fraud risk factors and the assessment of misstatement risk at the financial and assertion levels is adequate, 2. Whether more clarity could be given as to when indications for material misstatements due to fraud in the financial statements are strong enough for auditors to need to take further measures, and 3. When auditors may need to be required to undertake forensic measures due to the risk of material misstatement in the financial statement due to fraud.

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The IAASB is interested in perspectives about the impact of corporate culture on fraudulent financial reporting and what, if any, additional audit procedures for the auditor should be considered by the IAASB in this regard.

We expect that any evidence-based analysis by the IAASB of fraudulent financial reporting over the last several years will likely show that corporate culture – particularly as it relates to management and those charged with governance – is central to whether or not such material frauds occur. Consideration may therefore be given to exploring whether auditors may need to consider certain kinds of corporate cultures as potential fraud risk factors.

The IAASB is interested in perspectives on whether additional engagement quality control review procedures specifically focused on the engagement team’s responsibilities relating to fraud should be considered for audits of financial statements of listed entities, and those other engagements, if any, for which the firm has determined an engagement quality control review is required.

We do not believe that additional engagement quality control review procedures or engagement quality review procedures specifically focused on the engagement team’s responsibilities relating to fraud should be considered for audits of financial statements of listed entities, and those other engagements, if any, for which the firm has determined an engagement quality control review or engagement quality review ought to be required, because the purpose of both engagement quality control reviews and engagement quality reviews are directed towards an objective evaluation of the significant judgments made by the engagement team in reaching its conclusions to form the audit opinion. This automatically includes any significant judgments related to the procedures undertaken to identify and assess the risks of material misstatement due to fraud, to detect fraudulent financial reporting or the misappropriation of assets, and how the engagement team dealt with detected fraudulent financial reporting or misappropriation of assets. There is therefore no reason to add additional engagement quality control review or engagement quality review procedures.

The IAASB is interested in perspectives about requiring the use of forensic specialists or other relevant specialists in a financial statement audit, and, if considered appropriate, in what circumstances the use of specialists should be required.

The nature of the procedures used by forensic specialists are not generally different from those used by financial statement auditors. The main difference is how they are used and in what combination. For example, forensic specialists

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also use inquiry as a procedure, but they use inquiry in a more systematic and aggressive way to find gaps or inconsistencies in responses to enable the specialist to gather evidence that may contradict the documentary record and, for example, demonstrate forged evidence. The length and intensity of such inquiry exceeds that normally used in an audit of financial statements, and such inquiry is used in combination with other forensic approaches, which also exceed those used in audits of financial statements in length and intensity. Using such forensic approaches generally in a financial statement audit would cause auditors to perform such procedures even when the risk of a material misstatement due to fraud has been assessed as being acceptably low, which would cause an exorbitant increase in the costs of audits. For this reason, such forensic approaches need to be directed to instances where fraud is suspected, rather than being used for financial statement audits generally.

Since the nature of the procedures used by forensic specialists is not generally different from those used by financial statement auditors, we believe that when financial statement auditors identify and assess risks of material misstatements due to fraud at assertion level as not being acceptably low, they are capable of performing procedures to appropriately respond to that risk. Furthermore, when financial statement auditors suspect potential material misstatements due to fraud, they are generally capable of designing procedures to respond adequately to that suspicion. Consideration may be given to exploring whether, when after having performed such procedures to respond to such a suspicion, the financial statement auditor still has reasonable grounds for believing that the audit risk due to fraud is not acceptably low, that auditors would need to consider whether an expert with expertise not normally within an engagement team, such as forensic specialists, may be needed.

(b) Is there a need for enhanced procedures only for certain entities or in specific circumstances? If yes:

We do not believe there are grounds for introducing enhanced procedures within the scope of the audit of financial statements for only certain kinds of entities, because it would lead to the need to perform those procedures for those entities even when auditors assess particular risks of material misstatement due to fraud at assertion level as being acceptably low. However, based on our response immediately above and to (a), consideration may be given to exploring enhanced procedures generally and in certain circumstances within the scope of the audit of the financial statements. Since the IAASB cannot prescribe when engagements must be performed, we do believe that legislators

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may wish to consider whether assurance engagements on internal control or the compliance management system over material misstatements due to fraud are appropriate for listed entities or PIEs.

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

As noted in our response to (b) above, we do not believe that a distinction ought to be made by type of entity or for certain circumstances except as described below in our response to ii.

ii. What enhancements are needed?

As noted in our response to (a), consideration could be given to exploring: 1. Whether the connection between fraud risk factors and the assessment of misstatement risk at the financial and assertion levels is adequate, 2. Whether more clarity could be given as to when indications for material misstatements due to fraud in the financial statements are strong enough for auditors to need to take further measures, and 3. When auditors may need to be required to under-take forensic measures due to the risk of material misstatement in the financial statement due to fraud, including, when needed, using specialists, such as forensic experts.

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.

We believe that enhancements within the scope of the audit financial statements should be made within the ISAs. Other potential matters, such as assurance on internal control or the compliance management system over material misstatements due to fraud, should be done outside of the ISAs, but only legislators and appropriately legally empowered regulators – not the IAASB – can prescribe additional engagements.

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

We do not support requiring a “suspicious mindset”. First, unlike “professional skepticism”, it is not a defined term, nor one whose meaning has been explained in any technical auditing literature. Without knowing what the concept actually means, it would be frivolous to support it. Second, if we were to take it to mean that auditors need to actively assume that every piece of evidence may not be authentic, then the logical implication would be that auditors would need to perform procedures to verify the authenticity of each piece of information,

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which would convert the entire financial statement audit into a forensic audit. A forensic audit would lead to the costs of audits increasing by orders of magnitude (which means the benefits of audits would no longer be worth the costs) and taking so much time so as to no longer being relevant to stakeholders.

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?

We refer to our response to (c) above as to why we do not support the concept of “suspicious mindset” generally. In addition, we note that although the concept of professional skepticism is considered to be an invariant concept (there are no levels of professional skepticism) by the IAASB (we note the one exception in ISA 240), the actions that auditors must take to exercise professional skepticism do vary depending upon the circumstances. This means that in cases where auditors suspect instances of material misstatement due to fraud, auditors must adjust their responses accordingly to address the increased risk of material misstatement due to fraud. There is therefore no need to introduce the concept of “suspicious mindset”.

The IAASB is interested in perspectives about whether more is needed in relation to professional skepticism when undertaking procedures with regard to fraud and what additional procedures, if any, may be appropriate.

In line with the approach taken by the IAASB in the further development of ISA 540, ISA 315 and ISA 600, we do not believe that simply adding further references to professional skepticism in the ISAs will serve to improve auditor performance with respect to its exercise. As pointed out in the body of our letter, whether or not additional requirements or procedures are needed or not ought to be based upon an evidence-based analysis. For this reason, we refrain from making suggestions as to whether additional requirements or procedures are needed.

(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.)?

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The IAASB is interested in perspectives about whether more transparency is needed with regard to communications with those charged with governance.

The IAASB is interested in perspectives about whether more information is needed in the auditor's report regarding fraud, and if so, further details about the transparency needed.

We would like to point out that the vast majority of users of auditors' reports in our jurisdiction considered the increases in the length of auditors' reports since 2015 to be excessive (even without KAMs). Hence, we are not convinced that increasing the length of auditors' reports beyond what is currently required actually meets users' needs – the additional material will not be read if it is included. If users seek to understand more about what auditors do generally in relation to fraud in a financial statement audit, there is considerable literature, including the auditing standards, that can serve to inform them. For listed entities under the ISAs (in the EU PIEs), if fraud is a key audit matter, the auditor's response to that key audit matter would be described in the auditor's report. For these reasons, we do not believe that further information is needed in auditors' reports in relation to fraud.

However, given the important role that those charged with governance play in overseeing management, including management's responsibility for establishing internal control systems to deal with fraudulent financial reporting and misappropriation of assets, we believe that enhanced communication by auditors to those charged with governance may be worth exploring – particularly if the auditor suspects or detects fraud.

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).

The IAASB is interested in perspectives about whether the concept of, and requirements relating to, a material uncertainty in the auditing standards is sufficiently aligned with the requirements in the international accounting standards.

As we note in our response to the perspective under Question 1 (b), the IAPC/IAASB had used IAS 1 as a basis for the treatment of going concern in ISA 570. Consequently, with one exception, ISA 570 is in line with the wording in IAS 1. However, as we note in our response to the perspective under

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Question 1 (b), this does not resolve the ambiguities within IAS 1 that therefore also exist in ISA 570.

The one crucial exception to the alignment of ISA 570 with IAS 1 with respect to wording is in paragraphs 2 and 19 (b) of ISA 570, in which reference is made to the going concern basis of accounting relating to the entity being able to, and a material uncertainty meaning the entity may be unable to, respectively, “realize its assets and discharge its liabilities in the normal course of business”. This wording was originally adapted from the AICPA Auditing Standards and does not stem from IAS 1. These variances in wording from IAS 1 cause further ambiguity as to the meaning of “going concern” and “material uncertainty”. We note that the wording originally taken from the AICPA Auditing Standards at the time actually reflects what “going concern” has always meant in common law jurisdictions until the advent of IAS 1 (and in the U.S. the redefinition of going concern by the FASB much later).

The IAASB is interested in perspectives about whether changes are needed with regard to going concern and other concepts of resilience (within the purview of the IAASB’s remit).

In line with our response immediately above and in our response to the perspective under Question 1 (b), we believe that the going concern and material uncertainty concepts need to be less ambiguous. To this effect, changes would be needed to IAS 1 and other accounting standards in the short to medium term, but we believe this to be unlikely.

Unless financial reporting frameworks were to add or include other concepts, such as resilience, we believe that, given the IAASB’s remit for the ISAs, such other concepts cannot be included within a financial statement audit. Rather, if such concepts are not included in financial reporting frameworks, then the required audit scope can only be extended to such concepts through legislators or appropriately legally empowered regulators.

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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?

As we note in our comments in the body of the letter, whether auditors should have enhanced or more requirements with regard to going concern in an audit of financial statements is a matter that should be explored using an analysis by the IAASB that is evidence-based. Furthermore, as noted in our responses immediately above, the ambiguities of the meaning of the going concern concepts used in ISA 570 also need to be addressed. We are therefore not convinced that a case has been made that enhanced or more requirements are needed in relation to going concern.

The IAASB is interested in perspectives on whether entities should be required to assess their ability to continue as a going concern for longer than twelve months, and therefore whether auditors should be required to consider this longer time period in their assessment, beyond the current required period. If stakeholders believe a longer timeframe should be required, alignment will need to be retained between the requirements under the applicable financial reporting framework and the auditing standards in order for auditors to be able to adequately perform their procedures.

The COVID-19 crisis has shown only too clearly that even an assessment of the ability to continue as a going concern for twelve months may be a very difficult task under certain conditions. Furthermore, the further into the future such assessments are made, the greater the uncertainty as to their veracity. In addition, we believe that calls by some stakeholders to increase the period of assessment beyond twelve months after the balance sheet date are really not about going concern as defined, but rather about the longer term resilience of an entity and the sustainability of its business model. Furthermore, if the period of assessment is increased for auditors, but not for management, it would mean that auditing standards are setting forth requirements for management, which is beyond their remit (note our comment in our response to the perspective under Question 1 (b) about auditing standards being used as the “repair shop” for supposedly deficient accounting standards). Consequently, unless financial reporting frameworks increase the period of assessment beyond twelve months after the balance sheet date (which we believe is unlikely) or include new concepts such as resilience or the sustainability of an entity’s business model

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beyond this, we do not believe that a longer timeframe for going concern is appropriate.

The IAASB is interested in perspectives about whether more is needed in relation to professional skepticism when undertaking procedures with regard to going concern and what additional procedures, if any, may be appropriate.

As we note in our comments in the body of the letter, whether auditors should have enhanced or more requirements with regard to the exercise of professional skepticism regarding going concern in an audit of financial statements is a matter that should be explored using an analysis by the IAASB that is evidence-based. In any case, simply increasing the incidence of the use of the term “professional skepticism” in ISA 570 will not serve any useful purpose.

(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.**

As we note in our comments in the body of the letter, whether auditors should have enhanced or more requirements with regard to going concern in an audit of financial statements in line with the applicable financial reporting frameworks is a matter that should be explored using an analysis by the IAASB that is evidence-based. Furthermore, if other matters are sought to be required beyond going concern as defined in financial reporting frameworks, then these must be required by legislators or appropriately legally empowered regulators – not the IAASB. This would not preclude the IAASB from considering whether engagements on other matters (for example, assurance on resilience or the sustainability of an entity’s business model, assurance on the risk management system related to going concern) might be appropriate on a voluntary basis.

(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.)?**

The IAASB is interested in perspectives about whether more transparency is needed with regard to communications with those charged with governance.

The IAASB is interested in perspectives about whether more information is needed in the auditor's report regarding going concern, and if so, further details about the transparency needed.

We believe that that the IAASB might wish to consider exploring whether further transparency in the auditor's report about the auditor's conclusions with respect to the appropriateness of the going concern basis of accounting and the existence of a material uncertainty might be appropriate to reduce the knowledge gap even when the former is appropriate and the latter does not exist. However, as noted in our response to the evolution gap in question 1 (a), since an audit of financial statements is an attestation engagement due to independence requirements, such auditor assertions in the auditor's report are predicated upon financial reporting frameworks actually requiring management assertions in the financial statements about the appropriateness of the going concern basis of accounting and the conclusion that a material uncertainty does not exist. Without such management assertions in the financial statements, additional assertions in this respect would not be appropriate.

Since those charged with governance are responsible for overseeing management's assessment of the ability of the entity to continue as a going concern, consideration may also be given to having auditors provide more information to those charged with governance about the auditor's evaluation of management's assessment.

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?

We very much believe that management needs to include much more information in the notes to the financial statements about its assessment of whether the going concern basis of accounting is appropriate and whether a material uncertainty exists. However, this would need to be required by the applicable financial reporting framework.

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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?

We believe that while there are cases where instances of fraud have caused going concern issues, and that potential going concern issues have led to the commitment of fraud, fraud and going concern are actually very much different issues that need to be treated separately. We believe it would have been better for the IAASB to issue a separate consultation on each: asking questions about both together tends to “muddy the waters” in the responses given. In any case, going forward the IAASB ought to treat going concern and fraud as largely separate issues and therefore projects.