MEMO

To: **International Auditing and Assurance Standards Board (IAASB)**
Submitted via the IAASB website

From: **IoDSA's Audit Committee Forum**

AUDIT COMMITTEE FORUM: COMMENTS FOR QUESTIONS COVERED IN DISCUSSION PAPER 'FRAUD AND GOING CONCERN IN AN AUDIT OF FINANCIAL STATEMENTS'

The Audit Committee Forum (ACF), is a formal forum of The Institute of Directors in South Africa (IoDSA) that provides valuable information to assist audit committee members to be effective in their role on audit committees through sharing knowledge with their peers, disseminating relevant information and focusing on key performance areas, thereby contributing to the effective governance and sustainability of their organisations and enhancing the economic environment of South Africa.

The International Auditing and Assurance Standards Board (IAASB) issued a Consultation Paper on Fraud and Going Concern in September 2020 in which they discuss 4 key questions and areas surrounding fraud and going concern in an audit of financial statements. The IAASB set out certain matters for consideration in the paper which have been raised to them through feedback forums or research.

This paper was discussed by the ACF on the 2nd November 2020, below are comments from the ACF in response to the questions posed.

Comments:

We start by acknowledging through this paper, that auditors are not primarily responsible for the prevention or detection of fraud or business collapse. However, given the significance of these matters to the greater public, the ACF is supportive of the IAASB re-consideration of how the work of auditors (and other role players in the financial reporting chain) may enhance both the perceived value of the audit, as well as further protect the public interest.

1. **Matters surrounding 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?***

The ACF Forum believes that the expectation gap arises directly from the combination of two specific gaps – the knowledge gap and the delivery gap.

The knowledge gap arises when the level of assurance with regards to the work performed by the auditor is assumed to be at a level higher than actually expected of the auditor under the current auditing standards.

The delivery gap arises when the work delivered by the audit team does not adequately meet even the current auditing standards relating to fraud and going concern. The delivery gap is a matter that both audit committees and audit regulators can pay increased attention to, in measuring whether auditors are compliant with current (and future) auditing standards on fraud and going concern.

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 should firstly reconsider whether the scope of work currently done by auditors could and should be increased to provide greater insight into and/or assurance over the fraud and going concern elements of an audit.

Specifically, with regards to going concern, users of financial reports are looking for greater information around the resilience of the business – and this is a specific area that the IAASB could focus upon – with increased requirements for management reporting in this area, and increased requirements for the auditor's evaluation of this broader resilience information. Users of the financial statements are less interested in historic data but rather the future outlook of a company. Furthermore, the information currently embedded in the financial statements that might give clues as to the impact of the future on management's expectations are also not always entirely understood by the users. Additional disclosures should be encouraged where resilience is of concern.

As relates to fraud, the IAASB should consider the feasibility of increasing the disclosure of what auditors currently do around fraud. If the users of the financials have a better understanding of the nature and extent of work performed by the audit team, they will be in a better position to derive an independent informed conclusion and narrow the expectation gap. Simultaneously the IAASB should consider the possibility of auditors extending the amount of work done over the management's controls and reporting over fraud. Working with other regulatory bodies – the IAASB should encourage greater reporting on the controls management has over fraud, and possibly considering extending the auditors brief to a review or assurance over these controls.

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?

As audit committee members we are aware that the main responsibility for the prevention and detection of fraud primarily rests with management. However, this does not preclude the need for enhanced requirements regarding fraud from management and the auditor's perspective. We have set out above our views on both increased disclosure of the audit procedures undertaken by the auditor in relation to fraud, as well as the possibility of the auditor reporting on management's controls over fraud as part of their auditor engagement.

In addition, the nature, complexity and industry of the company should have a direct correlation to the level of expertise and specialisation of the allocated audit team. The IAASB should consider greater disclosure around the key audit team experience in the sector, and should also consider the inclusion, where appropriate and feasible, of forensic expertise on the audit team should there be a heightened concern.

The IAASB should also consider whether the auditor's mandatory training curriculum contains sufficient material on fraud, with regular updates around how these are perpetrated, to ensure that auditors are aware and vigilant. Any increased requirements in this regard could be considered for incorporation into the work being done with the IAASB on the quality management standards of ISQM1.

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

Yes, the need for enhanced procedures for certain entities or in specific circumstances is evident.

If yes:

(i) For what type of entities or in what circumstances?

The risk of the entity needs to be addressed, both the audit and business risks. higher-risk entities together with listed and regulated entities (public interest entities) should include a level of enhanced minimum procedures.

(ii) What enhancements are needed?

As described in the sections above.

(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 those elements relevant to the work and scope of an audit should be included within the scope of the auditing standards to ensure consistency of application of the standard among audit firms and companies in different industries. However, the IAASB should work with other bodies and regulators, to consider the requirements for enhanced reporting required by management on fraud (Reporting standards setters) and the enhanced fraud prevention and detection controls that should be in place for public interest entities (regulators).

c) Would requiring a "suspicious mindset" contribute to enhanced fraud identification when planning and performing the audit? Why or why not?

Yes, the change of base case from a "sceptical mindset" to a "suspicious mind-set" would be one way to enhance the evaluation of management's controls over fraud prevention and detection. The introduction of a different set of terminology from that used in the past (i.e. sceptical v suspicious) ensures that auditors' attention is drawn to this matter. There are however downsides to the constructive working relationships needed for an effective audit, and should a "suspicious mindset" not be handled correctly this could actually impede the effectiveness of the audit. This is an area that the auditing standards should provide clear guidance on.

The issuing of enhanced standards may ensure consistency in this regard and strengthen supervision and review requirements relating to auditor's response to the risk of fraud.

(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?

Yes, the risk grading of the audit should drive the level of application and the extent of any additional required audit work. The IAASB could assist in providing a matrix framework for the factors to consider in determining the inherent risk of fraud in an entity on the one hand, as well as the public interest impact of the fraud on the other. This could drive consistency in audit treatment of the level and nature of work done in this area by auditors, including the level of specialist forensic involvement on the audit.

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.)?

Yes, as mentioned above, the recent audit failures have left the users of financials with many open questions which result in undue expectations. By increasing the level of transparency, the level of disclosure is enhanced. Disclosure is key. If there is proper disclosure, the user will be able to digest the information, in alignment with their own models and make independent assessments.

This supposes greater disclosure by management in the first instance of greater information around their controls over fraud. Thereafter, the auditor's report can be enhanced to include specific inclusion of the nature of the procedures performed by the auditor over both fraud and going concern (or the greater resilience of the business). A consideration around the link between fraud and the key audit matters reported should be also included.

As the IAASB considers the overall quality standards for audit firms under ISQM1, the IAASB can also consider audit firm's transparency reporting in relation to their training and processes required to comply with the enhanced auditing standards over 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. 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?

Yes, the ACF believes that there should be enhanced procedures and information on going concern in an audit of financial statements. The public at large has an expectation of both management and the auditors to provide more transparent information regarding the resilience of the business and the greater disclosure of the procedures auditors have adopted over resilience.

Areas of risk and judgement are a specific focus area for both fraud and going concern and need to be adequately assessed and robustly challenged – and the enhanced disclosure of how both management and the auditors have satisfied themselves on these matters would increase both focus and transparency

Guidance on audit considerations and procedures pertaining to whether entities should be required to assess their ability to continue operating as a going concern for longer than 12 months and whether auditors should consider the longer timeframe in their assessment should be compiled. We are of the view that the going concern assessment timeframe should be extended beyond 12 months, for a period that would adequately incorporate solvency risk associated with the entity. Users would also benefit from disclosures explaining the solvency risk period that was assessed. Due to uncertainty around extended time periods, as a minimum, key risks to long term sustainability should be disclosed.

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

Yes, the need for enhanced procedures for certain entities or in specific circumstances is evident.

If yes:

(i) For what type of entities or in what circumstances?

The risk of the entity needs to be addressed, both the audit and business risks. Higher-risk entities together with listed and regulated entities (public interest entities) should include a level of enhanced minimum procedures.

(ii) What enhancements are needed?

Our recommendations in this regard are set out above.

(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.

These changes will result in additional required procedures and have a direct effect on the cost of the audit. For this reason, paired with the need to ensure consistency between audits, we believe it should be within the scope of the audit.

c) Do you believe more transparency is needed?

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

Yes, we do believe that more transparency is needed about the auditor's work in relation to going concern in an audit of financial statements. In the first instance, management should be required to provide greater information regarding the resilience of the business. Thereafter, both the audit procedures performed, and related findings should be disclosed in a paragraph within the audit report to enhance levels of transparency. The level of assurance provided by the auditor (in line with any revised auditing standards) should be made clear in the audit report for enhanced transparency.

(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?

It is clear that stakeholders in businesses require greater disclosure around the resilience of the business. Whether this is provided as part of the ESG reporting or as part of the financial reporting of the business can be deliberated.

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?**

No further commentary to add.

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