28 January 2021

Thomas Seidenstein

Chairman

International Auditing and Assurance Standards Board (IAASB)

545 Fifth Avenue

New York

10017 USA

Dear Thomas

Comments on the IAASB's discussion paper on fraud and going concern in the audit of financial statements

The Auditor-General of South Africa (AGSA) has a constitutional mandate and, as the Supreme Audit Institution (SAI) of South Africa, exists to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.

We appreciate the opportunity to provide considerations in response to the discussion paper exploring the difference between public perceptions about the role of the auditor and the auditor's responsibilities in a financial statement audit.

Our response has been prepared by our internal audit research and development division and is presented in the attached annexure under the following sections:

1. Overall questions
2. Additional perspectives

If further clarity is required on any of our comments, kindly email us at ardsupport@agsa.co.za.

Yours sincerely

Alice Muller

Acting National Leader: Auditor-General of South Africa

ANNEXURE

Overall questions

Question 1

In regard to the expectation gap (see Section I): *(a) What do you think is the main cause of the gap relating to fraud and going concern in an audit of financial statements?* *(b) In your view what could be done, by the IAASB and/or others (please specify), to narrow the expectation gap related to fraud and going concern in an audit of financial statements?*

a) In our view, the main cause is the lack of understanding by users of the financial statements as to what the objective of an audit and the responsibilities of an auditor are. Users and the public at large do not understand what reasonable assurance means or that there are inherent limitations within an audit. The general public may also not understand that there is a difference between a regularity and a forensic audit and what the key differences are.

Unfortunately there is also an element of the incorrect application of the audit standards on fraud and going concern, partly due to the complexity of the standards and partly due to the limited application of professional scepticism by the auditors. Furthermore, the general public may not be regarded as a primary user of the financial statements, resulting in the information needs of the public not really being considered when planning the audit approach for fraud and going concern.

b) More guidance can be developed to help auditors better understand the fraud and going concern standards and how to apply these as well as how the needs of the general public may need to be considered.

Public awareness on the objective of an audit, the roles and responsibilities of an auditor and other role players such as management and those charged with governance as well as other areas of misconception with regard to audits can be increased through, for example, articles and journals in various media as well as social media posts.

Increased reporting related to the primary responsibility of management and those charged with governance for the assessment of going concern and the prevention and detection of fraud may be considered as part of the annual report. This could include specifying who is responsible for these functions as well as reporting on cases of fraud identified and the actions or consequences taken in response. This may provide some relevant information to the public and also serve as a deterrent to those considering to commit fraud. This may be a matter for IPSASB/IASB to consider.

Question 2

The discussion 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?
(b) Is there a need for enhanced procedures only for certain entities or in specific circumstances? If yes:
(i) For what types of entities or in what circumstances?
(ii) What enhancements are needed?
(iii) Should these changes be made within the ISAs or outside the scope of an audit (e.g. a different engagement)? Please explain your answer.
(c) Would requiring a "suspicious mindset" contribute to enhanced fraud identification when planning and performing the audit? Why or why not?
(i) Should the IAASB enhance the auditor's considerations around fraud to include a "suspicious mindset?" If yes, for all audits or only in some circumstances?
(d) Do you believe more transparency is needed about the auditor's work in relation to fraud in an audit of financial statements? If yes, what additional information is needed and how should this information be communicated? (e.g. in communication with those charged with governance, in the auditor's report, etc.)?

a) Our experience is that the current standards include sufficient requirements for the auditor to do a good risk assessment. The auditor should, however, be encouraged to consider the need to involve a fraud expert during this process, especially in instances where a heightened risk of fraud is identified. We are of the view that where additional requirements are added, these should not be done in a way that broadens the scope of an audit beyond what is required to provide a reasonable assurance opinion and therefore results in the scope no longer being in line with the achievement of the objective of an audit.

An enhancement that could be made to the current requirements is for there to be a differentiation in approach between private sector and public sector audits, as the opportunities, pressures and rationalisations between these organisations differ. For example, the private sector may be more concerned with revenue recognition when considering the presumed risks of fraud, whereas public sector concerns are more likely to relate to public procurement and the incurrence of expenditure.

b) No, enhanced procedures are not recommended, but the training of auditors on forensics and how to identify risks of fraud as well as providing additional examples of fraud indicators may be considered.

c) Yes, but only for specific audit steps or specific areas where a heightened level of fraud risk is identified. The appropriate exercise of professional scepticism will be sufficient at an overall audit level. Having a suspicious mindset in approaching the audit in its entirety is likely to have a negative impact on the auditor's relationship with the auditee, which may be a hindrance to the execution of an effective and efficient audit. However, a suspicious mindset may be beneficial when carrying out specific steps and verifying specific accounts that are generally more prone to fraudulent reporting.

i) The IAASB could therefore consider enhancing the auditor's considerations with regard to certain accounts of auditees where these accounts could be more prone to fraudulent reporting due to the nature of their business. Examples of procedures to be carried out with a suspicious mindset include looking for sources of contradictory information that could bring into question certain estimates made by management. This could be required for all audits, but with consideration of whether the accounts and nature of the auditee's business could be indicative of an inherent fraud risk. Utilising fraud expertise to assist in executing certain audit procedures could prove helpful in this regard.

d) Yes, currently the audit work performed in response to fraud indicators is not reported on in the audit report. This may perhaps contribute to the public's view that auditors are not doing enough. We suggest utilising available avenues such as key audit matters to highlight significant matters related to fraud which the auditor would like to bring to the attention of the users of the financial statements. Communication of fraud-related matters to those charged with governance is already considered to be sufficient.

Question 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). In your view:
(a) Should the auditor have enhanced or more requirements with regard to going concern in an audit of financial statements? If yes, in what areas?
(b) Is there a need for enhanced procedures only for certain entities or in specific circumstances? If yes:
(i) For what types of entities or in what circumstances?
(ii) What enhancements are needed?
(iii) Should these changes be made within the ISAs or outside the scope of an audit (e.g., a different engagement)? Please explain your answer
(c) Do you believe more transparency is needed:
(i) About the auditor's work in relation to going concern in an audit of financial statements? If yes, what additional information is needed and how should this information be communicated?(e.g., in communications with those charged with governance, in the audit report, etc.)?
(ii) About going concern, outside of the auditor's work relating to going concern? If yes, what further information should be provided, where should this information be provided, and what action is required to put this into effect?

a) We do not consider it necessary for all auditors in general to have enhanced or more requirements with regard to going concern in an audit of financial statements.

b) Enhanced procedures may, however, be considered for specific entities and related to specific circumstances:

(i) Enhanced procedures should only be considered for public interest entities.

(ii) Enhancements could be made with regard to the auditor's procedures on specific transactions that have a significant impact on going concern, such as revenue recognition, asset valuations and recognition of obligations. Specific procedures could also be considered to confirm that entities are honouring those obligations required from them to remain a going concern, such as the settlement of employee benefits and environmental obligations. These changes could be made within the ISAs.

c)(i) No, because if material uncertainties regarding going concern exist, then it is already reported in the audit report. The current requirements for communicating with those charged with governance on matters related to going concern are also considered to be sufficient.

c)(ii) Yes, as per the response to question 3(b)(ii), increased reporting may be considered on the honouring of obligations that may be significant to the auditee's continued going concern position. Auditees may be required to report on this as part of their annual reports and auditors could be required to follow up on these matters from the prior year's going concern assessment in a subsequent audit.

Question 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 are of the view that regularity auditors should be trained on matters such as the identification of fraud, verifying the authenticity of documentation and how to distinguish between acts that are intentional and those that are not intentional, as this could assist in identifying the perpetration of fraud. The purpose of the training would be to equip regularity auditors to be more alert and aware of possible fraudulent practices at their auditees.

Additional perspectives

We also have the following perspectives to share on matters addressed in the discussion paper:

- Additional procedures that could be considered by the auditor in response to the possible impact of corporate culture on fraudulent financial reporting are tests, including computer-assisted audit techniques to identify conflicts of interest due to relationships between management and suppliers or customers.
- We are of the view that it would be beneficial to require the use of forensic specialists in circumstances where the pre-engagement procedures reveal a significant possibility of fraudulent activities. We already perform such an assessment as part of our audits at the AGSA and consequently require the involvement of fraud experts on relevant audits.
- The auditor should not have any specific responsibility with regard to non-material fraud to guard against the unintended consequence of making the auditor responsible for the identification of all fraud.
- Although the auditor should not have any responsibility with regard to the identification of fraud related to third parties, the auditor cannot ignore it if it comes to his/her attention. Fraud related to third parties already detected by management or those charged with governance, or reported on by the media or investigating authorities, should be considered in terms of the impact that it may have on the risk of misstatement of the financial statements as well as its possible impact on the assessment of the integrity of management.
  There should also be a consideration of whether the auditor has any professional or ethical responsibility to alert another authority of such instances. To manage public perception, the auditor could also consider including reference to investigations currently underway with regard to his/her auditees in their audit reports.
- No additional engagement quality control review procedures are considered necessary as the current procedures already place sufficient focus on the discussion of significant matters and review of significant judgements, which in our view would include the assessment of, and response to, fraud risk at the auditee.
- We are of the view that entities should be required to assess their ability to continue as a going concern for longer than 12 months. Although there may be limitations in looking too far into the future, an assessment of 12 months may not provide enough information to the users of financial statements on whether the business is likely to remain financially viable in the foreseeable future. The assessment should include the current position of the entities as well as the impact of strategic risks they may face. We would suggest requiring an assessment for a period of between 18 and 24 months.

- Understanding of the concept of material uncertainty may be improved through providing examples of uncertainties identified on a continuous basis. In addition, virtual workshops during which the application of the theory is discussed and experiences are shared could be considered.