



Confederation of Indian Industry

CII Views on the IAASB Discussion Paper on Fraud and Going Concern in an Audit of Financial Statements

CII would like to commend the International Auditing and Assurance Standards Board (IAASB) for proactively spearheading initiatives and for serving the public interest by setting high-quality international standards. The discussion paper on Fraud and Going Concern in an Audit of Financial Statement is significant in enhancing the confidence in external reporting. The outbreak of the COVID 19 pandemic has heightened the focus on fraud and going concern.

CII engaged with Members on the Discussion Paper and after inputs received, submits the views as under:

In regard to 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 discussion paper has a robust analysis of the expectation gap and the ACCA has appropriately classified causes into - knowledge, performance and evolution. There is clearly an increasing expectation amongst stakeholders for a higher level of assurance on the absence of material misstatement due to fraud than has been historically provided and accepted. Rapid developments in technology and availability of significant data and external evidence enable auditors to better meet those expectations.

In many corporate failures, fraud has led to concealment of factors that may lead to challenge of the 'going concern' assumption. In our view, this does not reflect on adequacy of the auditing standard on going concern but more on the audit procedures addressing the risk of fraud.

b. In your view, what could be done, by the IAASB and others (please specify), to narrow the expectation gap related to fraud and going concern in an audit of financial statements?

The IAASB should revise the auditing standards to provide a higher level of 'reasonable assurance' in respect of the risk of material misstatement due to fraud. This may be achieved by requiring more conclusive evidence for assertions that are identified as susceptible to fraud risk. The "evolution" gaps identified need to be examined and bridged considering the associated costs and benefits.

There is also a need from professional bodies overseeing the audit profession and accounting qualification to enhance the skills of auditors in areas of professional scepticism, risk identification, technology and analytics to lead to greater detection of fraud. Regulators may set up early warning systems and provide better access to auditors of such data that may be examined during audit. In respect to the standard on going concern there should be greater guidance on implementation and examples of behaviours that reflect professional scepticism.

Fraud

a) Should the audit have more or enhanced requirements with regard to fraud in an audit of financial statements? If yes, in what areas?

The current auditing standards state that the auditor's responsibility is to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements due to fraud. Further, the auditor is required to apply professional judgment in evaluating an entity's facts and circumstances and to design appropriate audit procedures to address the risk of fraud. Reasonable assurance seeks persuasive evidence and not conclusive. To manage stakeholders' expectations, and to address the extent of persuasive evidence required by the auditor in carrying out the audit, additional guidance may be provided by the IAASB. Such guidance may entail forensic type or more penetrative procedures in selected areas of the audit under certain circumstances.

The IAASB may publish implementation guidance for existing ISA requirements in areas like:

1. Implementation guidance for management override of control and how it is related to fraud and audit procedures relating to journal entry testing and management estimates (test for bias).
2. Implementation guidance for considering Key Performance Indicators ('KPIs') as part of fraud risk assessment and how these may link with internal frauds within an organization.
3. How auditors should use analytics to identify outliers which may be further investigated for potential fraud.

The IAASB may also consider addressing the circumstances in which the auditors may be required to address this in Key Audit Matters as required by ISA 701.

b) Is there a need for enhanced procedures only for certain entities or in special 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.**

It is expected that uniform audit procedures are performed for all entities; however, IAASB may consider identifying more rigorous procedures in respect of public interest entities ('public interest entities' as defined under IESBA Code of Ethics for Professional Accountants). Also, this is where the expectation gap is most severely felt. As described earlier the enhancements are needed to the nature of evidence that is sought to provide 'reasonable assurance'. The changes should be made within ISAs. The objective of the changes is to enhance the relevance and effectiveness of the audit and accordingly, the ISAs is the best place to make the changes.

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

- i. **Do you see a difference between a suspicious mindset and professional skepticism for the purpose of an audit? Please explain.**
- ii. **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?**

A "suspicious mindset" may be detrimental to the auditor/entity relationship and hinder the free exchange of information necessary to perform an audit. Also, it is important to

note that professional scepticism is already well-defined and foundational in the auditing standards and, while it does not mean to be automatically suspicious, it does mean a questioning and unassuming mind and a critical assessment of audit evidence, including contradictory evidence.

Rather than providing a new term in the auditing standards, the IAASB could work with the International Accounting Education Standards Board to develop implementation guidance and/or educational materials to improve the consistency of application of professional scepticism and aid in reducing risks associated with the “performance gap,” especially by highlighting areas which likely require increased professional scepticism (for example, via short videos that demonstrate how heightened professional scepticism led to the discovery of fraud).

- a) 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 to those charged with governance, in the auditor’s report, etc.)?**

It is important that there is communication between the auditor and those charged with governance relating to the auditor’s work in relation to fraud. Such communication should include fraud risk identification, internal controls over detection and policies for deterrence and the auditor’s evaluation of management’s programs and controls over fraud. In addition, enhanced communication about identified or suspected fraud, even when management is not involved, may be helpful to those charged with governance as they execute their processes to monitor the entity.

A more detailed description in the auditor’s report of the responsibilities of the auditor related to fraud is unlikely to be helpful to users.

The auditor’s responsibilities are currently included in the audit opinion, explicitly stating the financial statements are free of material misstatements whether due to error or fraud. Additional disclosure regarding audit procedures in the auditor’s report or otherwise accompanying the financial statements are not likely to significantly improve the understanding of audit procedures. Instead of adding language to the auditor’s report, it is more important to ensure that the audit report avoid use of highly technical terminology, and instead provide users with easy-to-understand information.

Going concern in an audit of financial statements

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

We do not consider a need to have enhanced or additional requirements with regards to going concern in an audit of financial statements. We believe that the most helpful changes can be affected through implementation guidance for auditors for areas such as how 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 about going concern assumption.

This thought process also stems from the fact that the auditor is bound to use professional scepticism; an overarching principle which cannot be over-emphasized. That the auditor should understand the nature of the business, its intricacies and make enquiries – all these procedures are not stand-alone; they are persistently and consistently to be followed as the auditor’s DNA. That each audit partner/firm does not deal with this area in the right proportion or the appropriate depth could well be the

reason of the many failures seen in the current times which led to the introduction of ISA 570.

The “performance gap” being more relevant than “evolution gap” in the going concern assessment. The current framework is quite prescriptive and has also listed out the conditions when going concern risk may be higher.

The following should be noted if disclosures per US GAAP should be adopted:

Under US GAAP, certain disclosures are required when management initially identifies conditions or events that raise substantial doubt about an entity’s ability to continue as a going concern within one year after the financial statements are issued (or available to be issued, when applicable) but concludes that its plans alleviate substantial doubt. There is no disclosure requirement under IFRS for similar circumstances.

If, after considering management’s plans, substantial doubt about an entity’s ability to continue as a going concern is alleviated as a result of consideration of management’s plans, an entity must disclose in the footnotes information that enables users of the financial statements to understand all the following (or refer to similar information disclosed elsewhere in the footnotes):

- Principal conditions or events that raised substantial doubt about the entity’s ability to continue as a going concern (before consideration of management’s plans)
- Management’s evaluation of the significance of those conditions or events in relation to the entity’s ability to meet its obligations
- Management’s plans that alleviated substantial doubt about the entity’s ability to continue as a going concern

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

- i. **For what kind 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.**

We can consider the procedures on a cost-benefit analysis. Since the impact of audit failures is always higher for public listed entities, the committee could consider certain enhancements on the requirements for such entities.

For the kind of enhancements, additional corporate finance or restructuring specialists could be used to do a finance health assessment of the company.

These changes are recommended to be outside the ISA and included in the specific listing regulations or legislations which will carry more emphasis. Including these requirements as part of other regulatory requirements will help to mandate the compliance by the relevant parties.

Examples of enhanced procedures

1. Assessing the availability of debt financing and the entity’s capacity to borrow. Reviewing current loans, credit or other agreements for provision or covenants which may restrict the entity’s ability to borrow additional funds or restructure its debt.
2. Assessing the impact of new financing on the operations and timings of cash flow.

3. Considering the impact of terms associated with new capital
4. Assessing marketability of assets that management plans to sell
5. Reviewing management forecasts such as cash flow or profit
6. Reviewing latest interim financial statements
7. Requesting information from the entities legal counsel of any ongoing issues, the expected outcome and impact on the entity.
8. Running Altman Z Score Analysis

Auditors are also engaged to carry out compilation, review, and similar other attestations. These changes can be added as a special performance engagement narrative in ISA for example: A third party opinion on going concern of the target acquiree or borrower.

c. Do you think 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 communication with those charged with governance, in the auditor's 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?**

The current auditor's report is already at least 3 pages and including any additional disclosures will just mean that more details may be lost in the plethora of information. Assessing the going concern is the management's responsibility and should continue to remain so. Therefore, we do not recommend the inclusion of further additional information on going concern in the auditor's report. We believe that inclusion of a framework with related requirements in the accounting standards would go a long way of reducing the expectation gap relating to going concern which currently exists due to the non-coherent approach by auditors towards this aspect.

Should a specialist report be issued to the Company per the earlier suggestions, the summary of the report should be disclosed as part of the corporate governance report or other areas of the annual report as part of the management report to the different stakeholders.

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?

a) Re-emphasis on importance of collaborative effort necessary from a variety of constituents around the world.

To achieve improvements in the prevention and detection of fraud, and clear understanding of the evaluation and disclosure of matters related to going concern, collaboration is necessary with regulators, listing exchanges, auditing standard setters, accounting standard setters, entity management and TCWG, investors and auditors. The responsibilities of entity management and TCWG regarding appropriate procedures and controls in the area of fraud and going concern are critical to driving change. It will be critical for the IAASB to work together with other national auditing standard setting bodies to develop guidance that is consistent across multiple jurisdictions to reduce confusion and inconsistency in execution.

b) About what more is needed to narrow the knowledge gap with regards to the meaning of material uncertainty related to going concern to enable more consistent interpretation of the concept.

Going back to the main suggestion that specific guidelines would be of great assistance; we consider that if certain instances are chosen and explained in the guidance the knowledge gap would tend to reduce. According to us the gap arises because the strict versus not-so stringent interpretation of a similar factual situation. Example - in a case where a client has defaulted on its loan covenants and this is one of the material defaults and later either the client or the holding company thereof has obtained a waiver from the bankers for the same; whether this aspect should be interpreted as being acceptable from an overall going concern consideration with an appropriate disclosure in the financial statements or would there be a matter of emphasis paragraph in the audit report. So; relevant guidance along with a flowchart depicting various questions and/or situations for interpretation and analysis would be helpful.

c) About whether entities should be required to assess their ability to continue as a going concern for longer than 12 months and eventually the auditor should also be so required to extend the period.

We believe that a twelve-month period is appropriate and should not be stretched further. The current requisition of 12 months is a reasonable time period of assessment for both; the management and the auditors. Anything beyond may be difficult due to significant judgements that may be required.