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Willie Botha — Technical Director
International Auditing and Assurance Standards Board
International Federation of Accountants
529 Fifth Avenue, 6th Floor
New York, NY 10017

Dear Mr. Botha:

IAASB Discussion Paper - Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statement Audit

Deloitte Touche Tohmatsu Limited ("DTTL") is pleased to have the opportunity to provide comments on the discussion paper, *Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statement Audit* ("discussion paper"), issued by the International Auditing and Assurance Standards Board ("IAASB") in September 2020.

DTTL appreciates the formalized approach the IAASB has developed to determine the need for audit standard setting activities and scope its future projects, including fact finding activities and targeted information gathering. In the spirit of continuous improvement, and especially in light of recent financial headlines about high profile company failures across different geographies, we commend the IAASB's efforts in undertaking widespread outreach to various stakeholders including preparers, auditors, and users of the financial statements (e.g., holding multiple roundtables, exploring academic research, consultation with national standard setters, and development of this public discussion paper) on the topics of fraud and going concern in a financial statement audit. Gathering feedback from those most heavily invested in the process and involving those who can affect change is critical to exploring all options and avenues available to improve trust in financial statements.

DTTL believes the timeliness and quality of this discussion paper reflect the commitment of the IAASB to agility and responsiveness with respect to these important topics, and are confident that the feedback obtained during this research phase will be thoughtfully considered and result in development of a sound project proposal and outline for the activities of the future fraud and going concern task forces.

Overall comments:

Changes in the business environment, including technological advancements that (along with their many benefits) provide unique ways to perpetrate fraud, increased complexity in financial transactions and models, and mounting economic stress that threatens the ability for entities to merely survive much less meet earnings expectations, have increased pressures and provided opportunities that may lead to unwanted behavior in the preparation and presentation of financial statements. DTTL recognizes that it has been a number of years since ISA 240 and ISA 570 have been holistically evaluated for relevance and efficacy, and welcome proposals to consider whether enhancements are needed based on input received during this research phase. In response to recent corporate collapses due to fraud, the call to action for proposing enhancements to auditing standards has already been undertaken by other national standard setters (e.g., the UK's Financial Reporting

Council) and it is critical that the IAASB understands the basis for proposals by groups that are already considering changes for auditors, and to coordinate with global regulators so as to endeavor to implement a consistent and effective world-wide solution. We strongly believe that the profession must adapt to the changing environment, and DTTL is open to new ideas and stands ready to be an active participant in innovating and responding to recent challenges.

With that in mind, DTTL urges the IAASB to keep in mind the points of principle outlined below when considering the scope of revisions necessary to requirements in the auditing standards in order to achieve the overall objective of improved financial reporting and reliability of audited financial statements.

- As pointed out in the discussion paper, the responsibility for identifying and providing users with information on fraud and going concern is shared across multiple participants in the financial reporting ecosystem (e.g., the board of directors, audit committees, senior management, internal auditors, and external auditors) beginning with management and those charged with governance ("TCWG") through the proper design and operation of internal controls over financial reporting.
  - DTTL believes that, in jurisdictions where there is currently limited or no requirements or guidance for entities with respect to such areas, more assistance should be provided to enable management and TCWG to more effectively discharge their responsibilities for the prevention, detection, and communication of matters related to fraud and going concern.
- High quality financial reporting requirements, including requirements for transparent disclosures and accountability for strong entity internal controls, are foundational.
  - DTTL encourages policy makers, regulators and listing exchanges to create requirements to increase awareness and accountability of management and TCWG for developing and adhering to robust fraud prevention and detection programs and impose serious consequences for individuals and entities for fraudulent financial reporting or misleading the auditors.
  - DTTL believes the International Accounting Standards Board ("IASB") (and where needed, other accounting standard setters around the world) should provide clarity in the requirements and definitions within International Financial Reporting Standards ("IFRS Standards") (and where needed, other accounting standards) related to management's assessment of the entity's ability to continue as a going concern, as well as specificity and expansion of disclosure requirements to provide users with more insights into an entity's expected future performance (specifically related to management's assessment of going concern).
  - We recommend that the IAASB provides guidance to help auditors determine which controls are relevant to the audit—particularly those controls that relate to fraud risk management and evaluating going concern.
- The current scope of an audit is appropriately focused on identifying material misstatements in the financial statements.
  - DTTL recommends that the IAASB not broaden the audit to require procedures related to immaterial matters (for example, designing procedures to detect quantitatively immaterial fraud) or matters that do not impact the financial statements.
- Applying a risk-based approach to determine what audit procedures are most appropriate to be performed is a foundational principle of the auditing standards—"bolting-on" required procedures that do not have a basis in risks identified and assessed on a particular audit is not consistent with that approach.
  - DTTL recommends that the IAASB re-emphasize that current standards require specific tailoring of audit procedures to respond directly and appropriately to increased risks due to fraud and issues related to going concern, as well as provide non-authoritative guidance in the form of leading practice examples of such tailoring.
- There have been significant recent revisions to foundational auditing and ethical standards (see table below).

- When considering adding requirements to enhance the auditor's ability to detect instances of fraud and evaluate management's assessment of the entity's ability to continue as a going concern, keep in mind that some of the recent revisions specifically address the concerns noted in the discussion paper.
- DTTL recommends that the IAASB first monitor the implementation of these revisions for effectiveness to achieve the desired behavior changes in order to identify gaps which may need to be addressed through additional standard setting.

Title	Dates	Changes relevant to issues noted in the discussion paper
International Code of Ethics for Professional Accountants	Issued Oct 2020, effective Dec 2021	• Raises behavioral expectations of all professional accountants through requiring them to have an inquiring mind as they understand their professional activities • Emphasizes the importance of accountants being aware of the potential influence of bias in their judgments and decisions
ISA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment	Issued Dec 2019, effective for periods beg on/after Dec 2021	• Enhances requirements relating to exercise of professional skepticism and documentation of such • Includes considerations for using automated tools and techniques in executing audit procedures • Introduces new concepts and clarifies definitions (significant classes of transactions, account balances and disclosures, relevant assertions, spectrum of inherent risk, inherent risk factors – including fraud risk)
ISA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures	Issued Oct 2018, effective for periods beg on/after Dec 2019	• Increases emphasis on professional skepticism • Highlights need for use of experts • Requires separate assessment of inherent risk and control risk • Explicitly recognizes spectrum of inherent risk • Introduces concept of inherent risk factors (estimation uncertainty, complexity, subjectivity) • Enhances risk assessment procedures related to obtaining an understanding of the entity and its environment • Emphasizes importance of auditor's decisions about controls relating to accounting estimates • Enhances the "stand back" requirement • Enhances requirements addressing disclosures • Emphasizes communication with TCWG
Non-Compliance with Laws and Regulations ("NOCLAR")	Issued Oct 2016, effective for periods beg on/after Dec 2017	• Clarifies the requirement regarding the auditor's determination of whether to report identified or suspected NOCLAR to an appropriate authority outside the entity while considering the auditor's duty of confidentiality • Highlights that the auditor may have additional responsibilities under law, regulation or relevant ethical requirements, including communicating to other auditors • Enhances the consideration of the implications of NOCLAR on the audit • Emphasizes the fact that communication with management or TCWG may be restricted or prohibited by law or regulation

DTTL's responses to the specific questions posed in the discussion paper (see **Appendix I**, "Response to Request for Specific Comments") elaborates on the points of principle noted above, and provides more detailed recommendations on what we believe the IAASB and others who play a role in the financial reporting ecosystem could do to improve the public's trust in financial statements.

DTTL hopes that the comments articulated in this letter will assist the IAASB in planning the scope of future projects to improve auditing standards and guidance related to fraud and going concern. We strongly encourage the IAASB to continue its outreach to key stakeholders throughout the duration of these projects and 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.

DTTL appreciates the opportunity to provide perspectives on the discussion paper and would be pleased to discuss this letter with you or your staff at your convenience. If you have any questions, please contact me via email (jkottkamp@deloitte.com) or at +1 212-436-4401.

Very truly yours,

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Appendix I

Response to requests for specific comments

DTTL's responses to the detailed questions included in the IAASB's discussion paper are set forth in this appendix.

1a. What do you think is the main cause of the expectation gap relating to fraud and going concern in an audit of financial statements?

DTTL believes that elements of the knowledge gap, performance gap, and evolution gap (as described in the discussion paper) all contribute to what has been described as the "expectation gap" (our recommendations on specific steps to address the knowledge gap, performance gap, and evolution gap are included in our response to Question 1b). However, we have specific concerns about the knowledge gap, as outlined below.

- *Knowledge gap - Lack of public understanding of the responsibilities of all constituents in the financial ecosystem.*

  The "expectation gap" that has been described and discussed for many years is not limited to the difference between the perceived role of the auditor vs. their actual responsibilities. There is a lack of common public understanding:

  - that the primary responsibility for the prevention, detection, and communication of matters related to fraud and going concern lies with both management and those charged with governance (TCWG), which includes company directors and others who oversee the strategic direction and obligations related to the accountability of the entity;
  - of the importance of internal controls over performing an evaluation of the entity's ability to continue as a going concern; and
  - of the importance of internal control over financial reporting and the part it plays in supporting strong capital markets, fraud prevention, and management accountability.

  Entity management, TCWG, and auditors all have a distinct part to play in providing the public with robust financial reporting worthy of trust—and DTTL believes the public's misunderstanding of these shared roles has perpetuated the expectation gap.

Responsibilities related to fraud

Specifically related to fraud, the varied responsibilities include: (1) management – implementing and executing a fraud risk identification, prevention, and detection program, (2) TCWG – understanding and actively monitoring/overseeing the program established by management, and (3) auditors – executing audits in accordance with auditing standards, which require that they plan and perform the audit to detect material misstatement due to fraud. While the audit report states the auditor's responsibility related to fraud in an audit of the financial statements, some readers may mistakenly interpret that "obtaining reasonable assurance" creates an obligation for the auditor to detect and prevent fraud that is indistinguishable from, or even greater than, the obligation of management and TCWG. DTTL believes it is both this public misunderstanding of "reasonable assurance," as well as a lack of common understanding about the responsibilities of all parties, that contributes significantly to the expectation gap described in the discussion paper.

Responsibilities related to going concern

The assumption that an entity will be able to continue as a going concern is fundamental to the preparation of the financial statements and because management sets the business strategy, operates the entity, and considers available operational alternatives, management has the most relevant information to assess the entity's future performance. Auditors play an important role in evaluating management's assessment, especially when events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern. However, current IFRS Standards (and possibly other accounting standards around the world) do not include a clear framework that can be consistently applied by management in assessing expected future performance (specifically related to management's assessment of going concern), which hinders the auditor's ability to evaluate management's assessment. The IASB (and other accounting standard setters) is key to defining the requirements of management related to the basis of accounting to be applied, definitions and time periods to be used when making assessments, and disclosures that are appropriate to provide stakeholders with more insight into an entity's viability. See suggestions for improvements to the international accounting standards which are included in our response to Question 1b.

- *Knowledge gap - Lack of understanding of the inherent limitations of an audit.*

  In addition to the lack of understanding of the responsibilities of management and TCWG, the repeated question, "Where were the auditors?" in each instance of a company's financial demise demonstrates that the public doesn't fully appreciate the inherent limitations of an audit.

  By definition, an audit of the financial statements provides reasonable, not absolute, assurance, and there will always be a risk that some material misstatements may not be detected by the auditor, even if the audit was properly planned and performed in accordance with professional auditing standards. The risk of not detecting a material misstatement due to fraud is even higher than not detecting one caused by an error because of the potential for sophisticated fraud schemes designed to hide fraud from detection during the audit, intentional misrepresentation to the auditor, and collusion between employees, or even management and TCWG.

  Related to going concern, there is an obvious limitation to predicting future events and conditions. The auditor evaluates management's assessment of the entity's ability to continue as a going concern based on information known at the time and reasonable assumptions made on such information. The occurrence of unexpected or unlikely circumstances could have a significant detrimental effect on the information and assumptions used, resulting in unforeseen challenges to the financial viability of an entity in the short term.

1b. 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 the financial statements?

IAASB

The IAASB has the ability to influence both the performance gap and the evolution gap by providing auditors with guidance to enhance the implementation of the existing principles-based requirements and improve consistency in application. Broadly speaking, there is an opportunity to:

- Emphasize the foundational requirement to plan and perform the audit to detect material misstatement due to fraud (regardless of the increased sophistication of fraud schemes), as well as the importance of a deep understanding of the business and transaction flows to be able to identify ways in which the financial statements could be manipulated.
- Better link existing requirements in individual ISAs (beyond ISA 240 and ISA 570) to their ability to detect fraud and identify issues related to going concern (e.g., by noting that a procedure could achieve the objective of both that individual ISA and ISA 240, or by explaining the "why" behind requiring a certain procedure—obtaining an understanding of and testing internal controls is a good example).

- Provide guidance on the use of increased professional skepticism (for example, related to fraud inquiries and when evaluating management's plans to alleviate any going concern issues).
- Provide examples of how advances in technology enable fraud to be perpetrated in new and unique ways and develop guidance to demonstrate the use of audit data analytics and other automated tools to execute audit procedures.

More detail on the above suggestions and other material which could be developed by the IAASB are provided in the responses to Questions 2 and 3.

In addition, given the IAASB's position within the profession, DTTL recommends (1) interfacing with regulatory bodies to collect information on exposed corporate fraud schemes (similar to what has been suggested in the Brydon report), (2) collaborating with academia to perform root cause analysis of actual cases, identify fraud characteristics, and highlight how the fraud was uncovered, and then (3) sharing redacted "lessons learned" (perhaps in the form of a database of cases) to provide auditors with examples and insights of how fraud can be perpetrated and detected. Further, the IAASB could use this information to determine if the current standards for performance are adequate given the evolution of the topic and may consider partnering with academia or other stakeholders to identify and develop examples of effective data analytics for use on the audit.

Others

- *Greater capital market regulator emphasis on the importance of and responsibility for internal control over financial reporting by management and TCWG, including fraud prevention and detection programs.*

  As noted in the discussion paper and elsewhere, the responsibility for detecting fraud rests first and foremost with management and TCWG of an entity. Discharging that responsibility occurs through the proper design and operation of internal controls over financial reporting. Policy makers, regulators, and listing exchanges play a key role in the financial reporting ecosystem and have the ability to swiftly impose requirements to increase awareness and accountability of management and TCWG for developing and adhering to robust fraud prevention and detection programs. Such requirements could include those similar to Sarbanes-Oxley (SOX) requirements in the US or analogous regulations in other countries. In particular, it is worth considering the merits, balanced against other factors such as cost, of establishing requirements for management to assess and provide personal certifications regarding the operating effectiveness of internal controls, including controls to prevent and detect fraud. Disclosure by management and TCWG of its fraud risk assessment processes and anti-fraud programs and controls would provide users with valuable information and insight into the entity's corporate culture. Such internal control programs could then be subject to audit procedures consistent with increasing the auditor's focus on internal controls.

  Metrics or studies related to the impact of SOX or analogous regulations on the quality of financial reporting warrant consideration by the IAASB and regulators, as stronger regulation could result in providing more reliable financial information to the investing public.

- *Stronger laws and regulations to impose serious consequences for individuals and entities for fraudulent financial reporting or misleading the auditors and protecting employees who provide evidence of fraud.*

  The regulatory and legal frameworks in many countries do not provide for adequate or equal oversight across the various constituents in the financial ecosystem. While auditors are closely regulated, in some jurisdictions only the entity itself is authorized to hold executives accountable for inappropriate actions.

  Providing a strong legal deterrent (power to investigate and sanction) to willfully issuing inaccurate financial statements, providing false personal certifications to the public, or misleading or lying to auditors would result in the reduction of such acts. Additionally, research has shown that internal tipoffs are by far the most common method of initial fraud detection (see 2018 Global Study on Occupational Fraud and Abuse by the Association of

Certified Fraud Examiners, which states that "tips account for 40% of initial fraud detection"). Preventing retaliation against whistleblowers by imposing strict penalties (fines and/or other appropriate punitive measures) would increase the willingness of employees with inside information, suspicion, or evidence of possible fraud to speak up.

- *Improved financial reporting requirements by the IASB (and where needed, other accounting standard setters) related to going concern.*

  We believe that many of the current challenges related to going concern are due to a lack of clarity in the requirements within certain accounting standards (IFRS Standards and possibly other jurisdictional accounting standards). Management is responsible for the assessment of the entity's ability to continue as a going concern and the preparation of the financial statements in accordance with that assessment. Because of the lack of clarity in IAS 1, *Presentation of Financial Statements*, related to how management performs that assessment, auditors may look to requirements in the auditing standards to challenge management on the adequacy of their assessment and disclosure. Instead of creating accounting requirements via auditing standards, IFRS Standards should provide a clear framework which:

  - Requires the performance by management of an assessment of the entity's ability to continue as a going concern;
  - Expands the time period of management's assessment to cover twelve months from the date of approval of the financial statements, not the reporting date (for example, as already required by the UK Corporate Governance Code) and US GAAP);
  - Specifies that developments after the reporting date but before the financial statements are approved should, as necessary, be factored into the assessment of going concern even if they are not themselves adjusting events under the general requirements of IAS 10, *Events After the Reporting Period*; and
  - Clearly defines what is meant by "material uncertainty" and "significant doubt."

  In addition, DTTL notes that the requirement to disclose the judgments made by management in "close call" scenarios (where it is unclear whether a material uncertainty over going concern exists) is currently encapsulated only in an IFRS Interpretation Committee Agenda Decision (July 2014) referring to the general requirements of paragraph 122 of IAS 1 on significant judgments made in the process of applying the entity's accounting policies. This Agenda Decision is used in the IFRS Foundation's recently published educational material "Going Concern – A Focus on Disclosure" to illustrate different disclosures that might become appropriate as an entity's circumstances deteriorate. While we believe this illustration is useful (and consistent with existing guidance, for example, from the UK Financial Reporting Council), its recommended that a clear and concise framework for disclosure relating to going concern be added to the IFRS Standards themselves.

  The IASB may also consider including, in its Practice Statement on Management Commentary, a requirement (similar to those already in existence in some jurisdictions) for management to provide a longer-term viability statement to the public which includes specific information (not simply boilerplate language) that articulates their business model, short/medium/long term strategies, and risks to the business model.

  Application by management of a clear framework laid out in IFRS Standards related to going concern would enable auditors, under existing auditing standards, to more consistently evaluate management's assessment, plans, and disclosures. In addition, more robust disclosures would provide financial statement users with more insights into an entity's future performance.

- *Increasing focus of internal audit on detecting fraud.*

  For those entities which have established an internal audit function, this group of individuals plays an important role which management and TCWG could leverage to increase the ability to detect fraud. For example, an entity's internal audit function could be given enhanced responsibilities to review and assess management's anti-fraud procedures and controls. Policy makers, regulators, and listing exchanges could encourage entities to establish internal audit functions and suggest potential areas of focus to enhance monitoring of internal control over financial reporting.

- *Education for the public regarding inherent limitations of predicting prospective performance as it relates to evaluating an entity's ability to continue as a going concern.*

  Regardless of the thoroughness of assessments performed by management, evaluations performed by the auditors, disclosures included in the financial statements, and explanatory material provided in the auditor's report, predicting prospective performance is difficult. Potential effects of the inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions, including those that may cause an entity to cease to continue as a going concern. Professional accountancy organizations, policy makers, regulators, and listing exchanges should collaborate on how to educate users of the financial statements about how to identify potential red flags of poor future performance themselves—by more thoroughly understanding the entity, industry, competitors and business environment, as well as considering additional information available outside of the financial statements.

- *Education or educational requirements for entity management and TCWG.*

  It is critical for TCWG to play an active and informed part in overseeing the entity. Additional education to management and TCWG in matters such as the development and execution of effective anti-fraud programs and controls could be championed by professional accountancy organizations, board associations, shareholder groups, or required by listing exchanges, and would help enhance their knowledge of matters key to responsible governance.

2a. Should the audit have <u>more or enhanced requirements with regard to fraud</u> in an audit of financial statements? If yes, in what areas?

Existing ISA requirements on fraud

The current auditing standards appropriately state that the auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements due to fraud, and their principles-based nature enables the auditor to apply professional judgment in evaluating an entity's facts and circumstances to assess risks and design appropriate audit procedures to address the risk of fraud. This focus on applying a risk-based approach to responses (which requires the performance of additional procedures to respond to increased risk) is a fundamental premise of the auditing standards which should not be lost by the addition of "bolt-on" requirements that are not rooted in the risk assessment process.

Additionally, it is appropriate for the auditing standards to retain a focus on quantitatively and/or qualitatively material fraud. While the concept of materiality may play into the expectation gap (as users may assume that it is the auditor's responsibility to detect any and all instances of fraud), immaterial frauds are not the primary issue facing the profession. Rather the primary issue relates to not identifying frauds that either lead to a material misstatement when they exist or indicate intentional management bias to manipulate the financial statements to a specific goal, and this should remain the focus of standard setters and the auditors' obligations. It is important to note that the auditing standards already include the following requirements related to the identification of <u>immaterial</u> fraud:

- Evaluate whether <u>any</u> misstatement identified is <u>indicative of fraud</u>.

- If the auditor has reason to believe any misstatement is or may be indicative of fraud:
  - Evaluate the implications to other aspects of the audit, particularly the reliability of management representations.
  - Reevaluate the assessment of risks of material misstatement due to fraud and its resulting impact on the nature, timing, and extent of audit procedures to respond to the assessed risk.
  - Consider whether circumstances or conditions indicate possible collusion involving employees, management, or third parties when reconsidering the reliability of evidence previously obtained.
- Communicate to TCWG in a timely manner any fraud the auditor has identified, or suspects, when that fraud is committed by management, employees who have significant roles in internal controls, and others where the fraud results in a material misstatement to the financial statements.

If fraud is identified at the entity, management and TCWG should perform a thorough investigation (internal and/or external, as appropriate, based on the facts and circumstances), discipline those involved and/or report them to legal authorities, and remediate internal processes and controls to enhance the prevention of fraud. As described in the current auditing standards, the auditor's role is to evaluate the effect of the fraud (including non-material fraud) on the financial statements and consider the broader impact on the audit, especially the re-assessment of risks of material misstatement, the adequacy of scope and procedures performed, and the evaluation of the reliability of evidence obtained. This rationale also relates to the auditor's consideration of third-party fraud— the focus of the auditor should be the effect on the financial statements, and not extend beyond that.

Enhancements to ISAs and staff guidance on fraud

While DTTL believes principles underlying the current audit standards are still relevant and the current requirements appropriate, we support the IAASB's efforts to understand the efficacy and implementation of its standards in practice and strive for continuous improvement. We also welcome proposals to enhance the auditor's ability to identify issues related to fraud and going concern. To this end, it is strongly recommended thatadditional application material or staff implementation guidance be created by the IAASB (e.g., case studies or examples) in the areas noted below to assist auditors in their risk assessment process and applying the current requirements in a globally consistent manner:

- *Implementation guidance for the currently required audit procedures to address management override of control.*

  In some audits, the procedures performed to address management override of controls has become a compliance activity to fulfill the requirements in ISA 240. The IAASB could develop implementation guidance such as staff alerts to share leading practices in refining the testing of journal entries and other adjustments for evidence of possible management override of control, management bias, or material misstatement due to fraud. Implementation guidance could include emphasis on identifying (1) what matters most to the entity, management, and other stakeholders (i.e., key performance indicators), (2) a detailed understanding of who receives what financial information during the reporting process (e.g., flash reports, sales pipeline, etc.), and (3) when such financial information is received, thus enhancing focus where there is more risk. Implementation guidance may provide helpful education and clarity in this area and could be utilized by multiple constituents including management, TCWG, investors, and auditors.

- *Consideration of Key Performance Indicators (KPIs) as part of fraud risk assessment.*

  The IAASB can create application material or implementation guidance demonstrating how auditors may consider an entity's KPIs, including identification of KPIs and how data and information involved in their calculation may be manipulated by management or TCWG, combined with linking such considerations into the fraud brainstorming process, management fraud inquiries, and refining journal entry testing procedures. In creating implementation guidance, the IAASB may consider building case studies through analysis of known frauds and how understanding KPIs may have helped identify the risk related to the fraud. As part of these case studies, it is important to note the strong link between management fraud and tone at the top issues, especially related to “achieving targets at any cost.”

In addition, the IAASB may provide guidance for unique risks that may be present for a listed entity versus a private entity by including examples of KPIs more commonly used by investors and how auditors may consider analytics that are based on both internal and external information sources that are commonly available for listed entities.

- *Fraud inquiries with management and others.*

  An important part of informing an auditor’s fraud risk assessment is gathering information through effective fraud inquiries. Implementation guidance may be helpful to an auditor’s consideration of how to tailor fraud inquiries and identify appropriate individuals within the entity for such inquiries. Information gathered from fraud inquiries of management helps to provide additional context on KPIs as well as leads to more effective fraud brainstorming and other procedures. Implementation guidance could demonstrate how these activities may work together.

- *Improve the efficacy of the fraud brainstorming discussion.*

  We recommend providing guidance on how to reinvigorate the usefulness and effectiveness of the engagement team’s fraud brainstorming discussion to continue to enhance its function as an engaging activity which considers the changing business environment and triggers new ideas in how to identify potential fraud.

- *Potential use of internal and external information and analytics.*

  The extent of information and data available both within and outside the entity is ever-increasing and auditors can use this to their advantage in increasing the effectiveness of audit procedures. The IAASB can provide examples of information that may be gathered and analytics that may be applied to such information to assist in identifying areas where the risk of material misstatement related to fraud may be elevated. Exemplifying data such as (1) statements and communications on the entity website and (2) analytics using external information such as trend analyses, comparison to peers or industry benchmarks, or media sentiment analysis, may aid in identification of fraud risk factors. This is an area the IAASB’s Technology Working Group may be able to help with generating ideas and examples.

- *Increased emphasis by regulators or listing exchanges on internal controls over financial reporting, including management’s fraud risk assessment process, for listed entities may necessitate the development of additional requirements by auditing standard setters.*

  While audit procedures to assess the “design and implementation” of relevant controls are currently required by the ISAs, such requirements do not currently extend to obtaining evidence that such controls are operating effectively (aside from responding to risks of material misstatement where substantive procedures alone are not sufficient (as required by the ISAs) or for audits performed pursuant to standards of the PCAOB and certain other jurisdictions with internal control over financial reporting (“ICFR”) requirements). Considering that management and TCWG hold the primary responsibility to prevent and detect fraud and that such prevention and detection requires controls, the effective design <u>and operation</u> of such internal controls are fundamental to accurate financial reporting. As noted in our response to Question 1, enhanced requirements for management and TCWG related to ICFR, including related to fraud such as anti-fraud programs and controls, coupled with certification backed by assurance from auditors, could effect change by driving the auditor to test operating effectiveness, not only as part of a control reliance strategy, but also as a means for reporting on an entity’s ICFR. Should such regulation occur it would be appropriate for the IAASB to modify the auditing standards for consideration of such regulations. Some examples of implementation guidance include examples or case studies to provide enhanced direction to auditors regarding key tenants of auditing an entity’s fraud risk assessment for effectiveness, specifically including enhanced understanding of the entity’s tone at the top and highlighting participation of TCWG in evaluation and monitoring of antifraud programs and controls.

It is important to note that the advent of new technologies, from cloud computing to artificial intelligence, as well as changes in the cost and accessibility of these types of digital tools, have enabled entities to increasingly incorporate automation into the design of both business processes and control functions. The digitization of financial data and records, connection of supply chains to blockchain, and use of complex information systems have increased the number of areas where "substantive testing alone would not provide sufficient appropriate audit evidence" and expand the need and importance for auditors to closely evaluate the entity's controls underpinning these areas. Implementation guidance which addresses the continuously rising effect of technology on the audit and heightens the auditor's focus on internal control, including IT controls, related to these advancements would prove extremely helpful.

- *Addition to the management representation letter*

  In its proposed revisions to ISA 240 (UK), the UK Financial Reporting Council suggests an extension of the existing management representation on fraud as follows: "They acknowledge their responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud **and that they believe they have appropriately fulfilled those responsibilities**." If regulators and listing exchanges do not create laws and regulations requiring management to personally certify the effectiveness of internal control over financial reporting, a similar addition to the management representation letter in the ISAs may persuade management to perform additional procedures to ascertain the effectiveness of its system of internal control.

- *Increase linkage of requirements in individual ISAs to the identification of fraud.*

  Many of the procedures already required in standards other than ISA 240 assist in the identification of fraud risk factors and risks of material misstatement due to fraud, as well as in designing procedures to detect fraud. Providing examples of the linkage of requirements across the ISAs, and demonstrating how "fraud risk assessment" is integrated into "all areas of the audit that are related to identification and response to the risk of material misstatement" would provide helpful background for auditors in understanding the consideration of fraud throughout the audit process.

- *Enhance client acceptance and continuance procedures.*

  We recommend that the IAASB develop examples of criteria or analysis, built on the principles of ISA 315 to thoroughly understand the entity and its environment, that can better inform client engagement acceptance or continuance decisions by auditors. For example, criteria such as the entity's ownership and governance structures, management characteristics, compliance risk, and key performance indicators, when taken together may be indicators of an entity being more susceptible to fraud. If the audit of the entity is accepted by an audit firm, specific procedures should be developed to address such risks.

- *Key audit matters related to fraud.*

  While most auditors would likely include fraud-related items as a key audit matter, DTTL recommends providing examples of descriptions to include in the audit report of the robust audit response made in connection with the key audit matter.

- *Rebuttable presumption related to fraud risks over revenue.*

  The rebuttable presumption of fraud risks related to revenue was originally included in ISA 240 because multiple financial statement frauds committed in that time period involved manipulation of revenue. DTTL suggests that the IAASB consider providing modern examples of fraud risks related to revenue, as well as how to more closely pinpoint the fraud risk to a specific aspect of revenue transactions and develop targeted procedures to respond to that risk. In addition, it may be useful to provide examples of entities like emerging growth companies which have little to no revenue, and what accounts other than revenue might be worthy of particular attention related to fraud—to match the entity's circumstances with the accounts most likely to be manipulated.

- *Unpredictability of audit procedures.*

  Regulators have expressed concern that auditors tend to repeatedly perform the same audit procedures when addressing fraud. They believe that when audit procedures become predictable, the effectiveness of the procedure is undermined. DTTL suggests that the IAASB consider developing guidance on how the auditor can tailor procedures based on the fraud risks that are relevant to the entity and provide examples on how to vary procedures from year to year to introduce an increased level of unpredictability.

- *Tone at the top.*

  Given the tight connection between poor tone at the top and management or employee fraud, we encourage the IAASB to provide additional guidance to auditors on how to address situations where senior management is dominated by strong personalities or deal with entities that foster a culture focused on the achievement of positive financial results no matter the cost.

2b. 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?

- **What enhancements are needed?**
- **Should these changes be made within the ISAs or outside the scope of an audit (e.g., a different engagement)? Please explain your answer.**

There should be no difference in the requirements for certain entities unless there are additional requirements or responsibilities placed on management and TCWG (e.g., for listed entities) which would in turn require or necessitate additional procedures to be performed by the auditor. The existing principles-based standards enable auditors to apply professional judgment based on facts and circumstances (including extraordinary situations) in designing proper responses to assessed risks, which requires performing additional procedures to address increased risk or specific challenging circumstances.

For a circumstance like COVID, DTTL looks to economic considerations and changes in the entity's environment, processes, and controls to determine whether there are new or different fraud risks and continue to re-evaluate our fraud risk conclusions throughout the audit. We may decide to perform additional fraud brainstorming sessions, change our inquiries with management (or perform additional inquiries with others in the entity), or consider bringing in forensic specialists for assistance.

It is important to note that current auditing standards highlight that special circumstances already lead auditors to perform additional procedures when fraud is suspected or identified (e.g., communication, reassessment of risks of material misstatements, consideration of scope/sufficiency of audit procedures, evaluation of reliability of evidence obtained).

2c. 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?

In October 2020, International Ethics Standards Board for Accountants released revisions to the International Code of Ethics for Professional Accountants to better promote the role and mindset expected of all professional accountants. Among other matters, the revisions require accountants to have an inquiring mind when undertaking their professional activities and emphasize the importance of being aware of the potential influence of bias in their judgments and decisions. DTTL recommends that the IAASB allow for these revisions to take effect (31 December 2021), monitor implementation, and then consider whether there is a need for further guidance specific to implementation within the auditing standards.

In addition, it is important to note that professional skepticism 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 all audit evidence, including contradictory evidence. A "suspicious mindset" is a negative starting position and implies that there has been previous wrongdoing, which is not justified in all audits. Introducing this new concept into the auditing standards could result in a change in the auditor/management relationship to an adversarial one that may inhibit the free flow of information between entity personnel and the auditor, which would not be in the public interest. Effective professional skepticism means using professional judgment to question information which contradicts other evidence obtained, seems to be indicative of management bias, or just doesn't "feel right."

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 skepticism and the "inquiring mind" and aid in reducing risks associated with the "performance gap," especially by highlighting areas which likely require increased professional skepticism (for example, via short videos that demonstrate how heightened professional skepticism led to the discovery of fraud and how the use of techniques such as data analytics, understanding and evaluating KPIs, and understanding the financial close and reporting process may have helped to discover the fraud). Further, many CPA and Chartered Accountant licensing jurisdictions already require periodic training regarding ethics, and complementary training to educate and reinforce the importance of a skeptical mindset would be beneficial.

2d. 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.)?

- *Communication with TCWG is critical.*

  To improve fraud identification, detection, and deterrence, open communication between the auditor and TCWG regarding the auditor's evaluation of management's programs and controls over fraud is critical. In addition, enhanced communication about identified or suspected fraud, even when management is not involved, may be helpful to TCWG as they execute their processes to monitor the entity. It is also important that TCWG understand the significance of their role in the financial ecosystem and that they are committed to using the information communicated to fulfill their fiduciary responsibilities.

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

  The auditor's responsibilities are currently included in the audit report, explicitly stating that one of the objectives is "to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements, whether due to error or fraud." Additional general disclosure 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 standard 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, as users may not even understand the current description of reasonable assurance. As noted in our response to Question 1a, some readers may mistakenly interpret that "obtaining reasonable assurance" creates an obligation for the auditor to detect and prevent fraud that is indistinguishable from, or even greater than, the obligation of management and TCWG. DTTL suggests that, as part of the post-implementation review of the reporting standards, the IAASB engage with users of the financial statements to validate that the wording in the audit report is fit for purpose.

  In the case of a key audit that relates to fraud matter, the more specific the description of audit procedures performed in response to the increased fraud risk and/or identification of fraud, the more helpful it would be to users.

- *Listed entities - focus on management's disclosures.*

  For listed entities, additional disclosures from entity management (possibly outside the financial statement disclosures) regarding their fraud risk assessment and anti-fraud programs and controls may foster an improved understanding of the responsibilities of management to prevent and detect fraud and transparently providing this information publicly will likely increase focus on fraud detection and prevention by management and TCWG.

3a. Should the auditor have enhanced or more requirements with regard to going concern in an audit of financial statements? If yes, in what areas?

In the response to Question 1b, specific actions were noted that we believe certain accounting standard setters should undertake to improve the assessment, evaluation, and disclosure of going concern issues. In relation to the IAASB, DTTL does not believe that enhanced or additional requirements for the auditor are needed. Rather, that the most helpful changes can be affected through implementation guidance for auditors which may prove useful in reducing the expectation gap. For example, staff implementation guidance or audit practice alerts which:

- Focus on how to understand management's processes and controls to assess going concern, including the information used in the development of any projections or forecasts, and provide examples of "what good looks like."
- Demonstrate how audit procedures already required by auditing standards other than ISA 570 may assist in the identification of conditions or events which may give rise to significant doubt.
- Illustrate an auditor's possible decision process via a flowchart: consideration of the existence of conditions or events, determination of whether those conditions or events may raise significant doubt, identification of whether management has plans to alleviate the significant doubt, consideration of whether management's plans are probable of being effectively implemented, evaluation of whether management's plans would mitigate the conditions or events, and determination of whether disclosures necessary are sufficient. See examples in Australia Standards on Auditing 570 and in US GAAP (see FASB ASC 205-40-55-1).
- Provide examples of procedures that may be performed when there is indication of a material uncertainty.

- Highlight the importance of professional skepticism when evaluating management's plans to alleviate significant doubt by providing examples of (1) how to challenge management's assessment and plans (when relevant), (2) situations when increased professional skepticism may be warranted, (3) how to assess alternative/plausible future scenarios, and (4) how to evaluate whether implementation of management's plans is "probable" (for example, if the plans rely on third-party actions which management cannot control, implementation is likely not probable).
- Provide examples of significant findings from the audit related to going concern which are required to be communicated to TCWG (i.e., qualitative aspects of the entity's accounting practices, financial statement disclosures, significant difficulties encountered during the audit like management's unwillingness to extend the period of its assessment of the entity's ability to continue as a going concern, circumstances that affect the content of the auditor's report, significant events or transactions, and business conditions)

3b. 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.

In respect of the fundamental concept of going concern, there should be no difference in the accounting standards or auditing procedures required for certain entities (for example, listed vs. non-listed). However, reporting on going concern may be different for listed entities because of requirements to disclose key audit matters.

We believe that the existing principles-based standards allow for auditors to apply professional judgment based on facts and circumstances, including extraordinary situations, and dictate the need to evaluate and properly respond to increased risks, which likely includes performing additional procedures in response to the effect of specific challenges on entities under audit. For a circumstance like COVID, DTTL looks to economic considerations and changes in the entity's environment, processes, and controls to determine whether there are new or different risks to the entity's ability to continue as a going concern.

3c. 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.)?

(ii) About anything else with regard to going concern? If yes, what further information should be provided and where should this information be provided?

Provide guidance for when a material uncertainty may be considered a key audit matter.

ISA 570 requires that, if a material uncertainty exists and adequate disclosure of such uncertainty is made by management in the financial statements, the auditor's report include a separate section under the heading "Material Uncertainty related to Going Concern." Some interpret this section in the auditor's report to be the only available option for providing information in the auditor's report related to the material uncertainty. It would be helpful to provide auditors with examples of when this situation might result in a key audit matter where the auditor could provide additional information in the report regarding procedures performed to evaluate management's assessment of the entity's ability to continue as a going concern and assess adequacy of disclosures in the financial statements.

- *Instead of requiring additional material in the auditor's report, DTTL believes that including a clear framework and requirements in IFRS Standards (and where needed, other accounting standards) would assist in reducing the expectation gap related to going concern.*

  Auditor's reports referring to the ISAs currently include statements regarding:

  - Management's responsibility to assess the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate, as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment is required to include a description of when the use of the going concern basis of accounting is appropriate.
  - The auditor's responsibility to conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If the auditor concludes that a material uncertainty exists, the auditor is required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify the opinion. The auditor's conclusions are based on the audit evidence obtained up to the date of the auditor's report. However, future events or conditions may still cause an entity to cease to continue as a going concern.

  These statements help provide transparency into both management and the auditor's responsibility, but as previously mentioned, inconsistencies can exist given the lack of consistent application and interpretation of existing accounting standards as there is no clear definition in IFRS Standards as to what constitutes a material uncertainty related to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern. Instead of requiring additional material in the auditor's report, DTTL believes that including a clear framework and requirements in IFRS Standards would assist in reducing the expectation gap related to going concern.

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?

- *Consideration of specialist involvement (e.g., forensic, debt restructuring, etc.).*

  The IAASB may consider developing implementation guidance that provides considerations or examples regarding the potential use of specialists in an audit of the financial statements related to fraud or going concern matters (e.g., forensic specialists assisting with risk assessment procedures or helping to respond to identified instances of fraud or debt advisory; restructuring specialists evaluating management's plans to mitigate going concern issues).

  For example, related to forensic specialists, the guidance may be based on evaluation of risk—as fraud risk increases, greater consideration is warranted regarding whether to involve a forensic specialist. Providing examples demonstrating when fraud risk may increase could be helpful, such as substantial debt from unusual sources or on unusual terms; the entity engages in unique, highly complex and material transactions; or management is dominated by one strong personality. Additionally, it may be helpful to provide areas where a forensic specialist can assist as part of the audit response, for example, participating in the risk assessment process, fraud brainstorming session, management inquiries, the design and/or evaluation of testing related to identified risks (e.g., management override/journal entries) and to follow up on identified or suspected fraud. In addition, the IAASB may develop examples for how forensic specialists can be integrated into ongoing audit-related training which provides auditors more exposure to fraud considerations to apply to their audit engagements.

  DTTL does not believe that adding a requirement for the use of a forensic specialist or a specialist to evaluate management's plans to mitigate going concern issues is appropriate, as this is not a risk-based approach, and involvement of a specialist is not necessary on every audit. It is also important to note that, in the current state, it may not be feasible to fulfill a requirement to include such types of specialists on every audit due to lack of available resources with the necessary training and certification. A consideration for colleges and universities is to add courses to their curriculum in these specialized areas and include related elements to the minimum requirements for professional certification of auditors.

- *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 policy makers, regulators, listing exchanges, auditing standard setters, accounting standard setters, management and TCWG, investors, and auditors. The responsibilities of management and TCWG regarding appropriate procedures and controls in the area of fraud and going concern are critical to driving change. It will also 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.