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

Dear Mr Botha

Ernst & Young Global Limited, the central coordinating entity of the Ernst & Young organization, welcomes the opportunity to offer its views on the *Discussion Paper on Fraud and Going Concern in an Audit of Financial Statements Discussion Paper* (the Discussion Paper) issued by the International Auditing and Assurance Standards Board (IAASB).

We support the IAASB proactively engaging in the growing debate about auditor responsibilities with respect to fraud and going concern and taking a leadership role in determining any changes or expansions in auditor responsibilities. We also support the approach taken by the IAASB to issue the Discussion Paper as a first structured step in information gathering, as well as the complementary roundtables and other forms of direct engagement with stakeholders. It is critically important that perspectives be gathered from all participants in the financial reporting ecosystem, especially because, as rightfully acknowledged in the Discussion Paper, the IAASB cannot narrow the expectation gap alone.

EY issued a publication in November 2020 entitled *Preventing and detecting fraud: how to strengthen the roles of companies, auditors and regulators* (the EY publication). The report examines the following key areas:

- Who is responsible for preventing and detecting fraud?
- Using data, forensics, behavioral analysis and training in the audit to detect fraud
- How EY is evolving the audit to detect fraud
- Promoting wider collaboration to effect change

Where relevant to the topics on which the IAASB is seeking feedback, we have included perspectives from this EY publication in this letter. The full report can be accessed here for further detail.

We find the Association of Chartered Certified Accountants' articulation of the expectation gap included in the Discussion Paper to be useful, particularly in determining the underlying causes of the stakeholder perspectives calling for the audit to evolve. We also see a relationship between the audit expectation gap and potential gaps in corporate reporting (i.e., gaps in the information provided to users by preparers, which may have similar underlying causes as, and in some cases contribute to, the gaps that comprise the audit expectation gap). We strongly encourage the IAASB to continue its outreach with investors and other users to better understand and define the information that is being sought about both management responsibilities and the auditor's work related to fraud and going concern. This understanding is critical to determining the appropriate parties and mechanisms for providing the desired information.

Although we agree there are opportunities for enhancements to the International Standards on Auditing (ISAs) for both fraud and going concern that would assist in addressing the expectation gap, it is important, in our view for all stakeholders to recognize that enhancements to the ISAs alone are not likely to have a substantial enough effect on the expectation gap.

Additional actions that could be taken by others include enhancements to corporate reporting, with a focus on expanding transparency related to management's responsibilities for prevention of fraud and assessing the entity's ability to continue as a going concern. We also see an opportunity for improvements in corporate governance for Public Interest Entities (PIEs), such as setting expectations for a system of strong internal control that includes fraud risk specifically and management and director certifications on the content of financial statements as well as internal control over financial reporting. Such enhancements would also enable more substantial enhancements to auditor responsibilities.

We see an opportunity for meaningful enhancements to the ISAs in relation to the auditor's work related to fraud, including the effect of corporate culture on fraud risk, circumstances when forensics specialists may be involved in the audit, fraud risks related to third parties and related parties, and an overall enhanced linkage of the auditor's work across the ISAs related to the identification and response to fraud risk.

We believe there is an underlying knowledge gap about the accounting requirements for going concern that is a strong contributor to the knowledge gap that exists with respect to the auditor's responsibilities for going concern. To address these gaps and because there is an interrelationship with accounting frameworks as it relates to addressing auditor responsibilities for going concern, we recommend that the IAASB engage with the IASB on the importance of commencing a project to clarify going concern requirements in IFRS. Although we believe there are opportunities for the IAASB to enhance auditor responsibilities related to going concern independently of how it is dealt with in the financial statements, enhancements to accounting frameworks would facilitate a more robust basis for the auditor's responsibilities related to going concern.

We acknowledge that the scope of the Discussion Paper excludes the auditor's use of technology in addressing fraud risks, as well as how technology is used to perpetrate fraud. As noted in our EY publication, the availability of electronic data and use of technology features prominently in how EY is evolving the audit to address fraud risks. We believe addressing the auditor's use of automated tools and techniques, as well as expanding guidance on risks created by the technologies used by entities, are critical components of any standard-setting project on fraud. We strongly encourage the IAASB to continue its outreach on topics related to technology and we would welcome a future opportunity to provide further input.

Our responses to the specific questions on which the IAASB is seeking feedback are set out below.

Building a better working world

Q1. 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?

Fraud

We believe that the "Knowledge Gap" as outlined in the Discussion Paper is the primary cause of the expectation gap relating to fraud in an audit of financial statements. Public opinion in many places indicates that auditors are expected to conduct the audit in a manner that extends beyond the requirement in ISA 240[1] to provide reasonable – not absolute – assurance to shareholders that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. It is also important that the public understand what can be reasonably be achieved by an audit.

Although the auditor plays an important role in detecting material fraud, it is important for the public to understand that the prevention and detection of fraud within an entity is primarily the responsibility of management under the oversight of those charged with the governance. Acknowledgement of this responsibility, and how it has been fulfilled, should be more evident from the entity's corporate reporting.

Although advancements in technology are out of scope for the purposes of the Discussion Paper, we do believe there is an evolution gap growing due to the use of technology by both entities and auditors that is important to be addressed through the IAASB's project on fraud. Refer to our response to Q4 for further details.

Going concern

We believe that the "Knowledge Gap" and the "Evolution Gap" as outlined in the Discussion Paper are the main contributors to the expectation gap relating to going concern in an audit of financial statements.

International Accounting Standard (IAS) 1, *Presentation of Financial Statements*, requires management to make an assessment of the entity's ability to continue as a going concern when preparing the financial statements and requires management to disclose material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, when management is aware of such uncertainties. This requirement does not drive transparency about the viability of the entity as it sets the threshold for requiring disclosures specific to going concern very high.

The expectations of the users of the financial statements have clearly evolved. Users expect greater transparency to better enable them to understand how management performed their going concern assessment and the relevant events, conditions and assumptions that were included. This has become

[1] International Standard on Auditing (ISA) 240 *The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements*

increasingly clear over the past year. During this period, regulators have stressed the need for entities to be transparent in their corporate reporting, including financial statement disclosures, about the effects of COVID-19 on their business and its future viability. This past year has stress-tested current accounting requirements around going concern and, in our view, has evidenced the need for formal consideration of whether accounting and auditing frameworks remain fit-for-purpose as they relate to addressing and assessing an entity's ability to continue as a going concern.

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

We support the IAASB pursuing standard-setting projects to revise the ISAs for both fraud and going concern, as we believe there are valuable enhancements that should be made to modernize and strengthen the auditor's work and reporting in these areas. Our thoughts on what can be done within the ISAs to narrow the expectation gap are included in our responses to Q2 and Q3.

However, it is critically important for all stakeholders to recognize that enhancements to the ISAs alone are not likely to have a substantial enough effect on the expectation gap. All members of the financial reporting ecosystem (as listed on page 8 of the Discussion Paper) need to work together to achieve meaningful change, including establishing increased reporting requirements for entities that address both fraud and going concern.

Fraud

As stated in the EY publication, we believe that to maximize the number of opportunities to prevent or detect fraud as efficiently as possible, adopting a "three lines of defense" approach as recently coined by the European Commission is useful: namely (1) corporate governance, (2) the auditor, and (3) capital markets supervision.

As it relates to corporate governance, the recommendations outlined in the EY publication for public interest entities (PIEs) include:

- *Implementing a system of strong internal control over financial reporting that includes fraud risk specifically*. Lack of or weak internal controls increase the risk of fraud as such weaknesses provide greater opportunity for fraud to be perpetrated. According to findings by the Association of Certified Fraud Examiners (ACFE) in its *2020 Report to the Nations*, a lack of internal controls could contribute to nearly one third of all frauds.

- *Exploring management and director certifications on the content of financial statements as well as internal control over financial reporting.* Such certifications could provide a basis for expanded reporting by the auditor (refer to our response to Q2(d)).

- *Expanding responsibilities for measuring and overseeing corporate culture and the influence of incentives*. We agree with the observations on the importance of corporate culture and tone at the top made in the *Management and Those Charged with Governance* section of the Discussion Paper. There is an opportunity for all involved — management, boards, auditors and regulators — to focus more on corporate culture and behaviors to support fraud detection.

- *Establishing strong whistleblower programs that both encourage and protect those who make reports*. We note that the Discussion Paper does not include any specific discussion on whistleblower programs. These programs are often the channel of last resort available internally before issues are taken up externally with other than the company. The ACFE views whistleblower programs as an effective entity-level control that an entity can implement as part of its fraud risk management programs. Where such programs exist, the auditor could understand the types of information being reported through such mechanisms as part of procedures performed to identify fraud or non-compliance with laws or regulations.

Where similar measures, as those recommended above, have been implemented (e.g., in the Sarbanes-Oxley Act in the US), they have led to better accountability of management and those charged with governance over the financial reporting process, improvements in audit quality, decreased severity of restatements and increased investor confidence.

As it relates to capital markets supervision, the recommendations outlined in the EY publication for PIEs include:

- Minimum corporate governance and reporting standards should be required as a precondition for a listing on a major stock market index.
- Where auditors have obligations to escalate, or determine whether to escalate, any breaches of laws or regulations that may impact the financial statements, the circumstances in which auditors have to report should be clearly defined in law or regulation and the reporting channels should protect good faith disclosure. Importantly, the regulator receiving reports should have a corresponding obligation and the resources to act on the information they receive.

In addition to the above, we agree with the suggestion in the Discussion Paper that an understanding of forensics and fraud awareness should be part of the formal qualifications and continuing professional development for all auditors. We also believe that steps could be taken to enhance auditor's professional skepticism through education and training in topics such as behavioral science, including the concepts of conscious and unconscious bias. We encourage the IAASB to liaise with the International Panel on Accountancy Education to encourage their consideration of embedding such skills and training into education standards and curricula.

Going concern

We believe that an underlying knowledge gap about the accounting requirements for going concern is a strong contributor to the expectation gap that exists with respect to the auditor's responsibilities for going concern. Further, we believe an information gap exists between the information that an entity is required to disclose about its going concern assessment and the information stakeholders need to understand the viability of an entity. During the COVID-19 pandemic we have seen increased demands for additional reporting on this topic.

To address the gaps affected by the accounting standards, we recommend that the IAASB engage with the IASB on the importance of commencing a project to clarify going concern requirements in IFRS. In 2012 – 2014, the IFRS Interpretations Committee and the IASB considered whether to develop additional guidance with respect to going concern-related disclosures, either in the form of amendments to IAS 1 *Presentation of Financial Statements* or in the form of an agenda decision, but decided not to do so. One of the main reasons for this conclusion was that they believed the issue could be better addressed through local regulatory or audit guidance. In January 2021, the IASB also issued educational material on going concern, highlighting the current requirement under IFRS and identified Going Concern as a potential agenda item in the upcoming agenda consultation of the IASB.

Considering recent economic developments as highlighted above, we believe it is justified for the IASB to revisit the IAS requirements that address going concern. In that case, the following may be considered:

- The difference between the material uncertainty threshold and liquidation basis of accounting threshold. Currently perceptions may exist that the disclosure of a material uncertainty may become a self-fulfilling prophecy of an entity's failure
- The threshold(s) for when disclosures about the entity's ability to continue as a going concern, and management's assessment thereof, are required
- The location of the going concern disclosures, in particular whether there is a need to present in one place all information relevant to the going concern assessment
- The entity-specific information to disclose about going concern (e.g., events and conditions identified, significant assumptions)
- The period covered by the going concern assessment

Q2. 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?

Yes. We recognize that auditors need to evolve how they perform audits to address fraud to assist in addressing the expectation gap and to enhance their capabilities to detect material fraud.

We are supportive of the IAASB revising the ISAs to provide auditors with a stronger framework to support the detection of fraud. Although ISA 240 is the specific ISA that addresses fraud, requirements across the suite of ISAs support the auditor's identification and response to fraud risks. One of the objectives of the IAASB's project on fraud should be to develop enhanced connections between ISA 240 and the other ISAs, which could also involve the development of implementation guidance that can bring together and describe these connections in a single document. Developing such implementation guidance as well as implementation guidance on ISA 240 will assist with addressing any performance gap that may exist today as it will drive more consistent application of the current requirements.

We believe it is critical that the auditor has an end-to-end view of fraud risk across the audit, from risk assessment procedures through to designing and executing procedures to address risks of material misstatement due to fraud and consequential communications. We have included specific comments below on how the fraud risk identification and assessment process could be better integrated with the enhanced risk assessment process established by ISA 315 (Revised)[2].

We have organized our response below by the specific topics that are identified in the Discussion Paper as areas of interest to the IAASB. These comments are followed by other specific topics and suggestions where we believe there are opportunities for enhancing the auditor's procedures in relation to fraud.

Corporate culture

We strongly agree with the IAASB placing importance on an entity's culture and the effects of that culture on fraud prevention and fraud deterrence. ISA 315 (Revised 2019)[3] requires an evaluation of whether management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior. We believe that auditors would benefit from more guidance on the aspects of an entity's culture to specifically consider in order to perform a more effective evaluation.

With respect to enhancements to the auditor's procedures, we suggest providing guidance on the consequences, including communication with those charged with governance, of any weaknesses in the control environment identified in conjunction with the required evaluation of the entity's culture for the risk of management override and the identification of other fraud risks.

Use of forensic specialist on audits

Forensic specialists can provide increased insight into the fraud risks of an entity and can also assist with the development of procedures to respond to fraud risks. However, as highlighted in the Discussion Paper, we agree that the effectiveness of using forensic specialists must be considered in the context of the objectives of each financial statement audit and the nature and circumstances of the specific engagement. As the facts and circumstances can vary significantly from one audit to another, the use of forensic specialists would not in all instances result in an increase in audit quality. Further, there are capacity constraints, as well as cost implications, to consider related to the availability and use of forensic specialists.

We therefore do not believe that the use of forensic specialists should be required on all audits. We suggest including guidance in ISA 240 that forensic specialists may be involved in the auditor's identification, assessment and/or response to fraud risks. Consideration could be given to establishing a requirement similar to that included in ISA 540 (Revised)[4], where the auditor is required to determine whether the engagement team requires specialized skills and knowledge to

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[2] International Standard on Auditing (ISA) 315 (Revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment

[3] International Standard on Auditing (ISA) 315 (Revised 2019) *Identifying and Assessing the Risk of Material Misstatement*

[4] International Standard on Auditing (ISA) 540 (Revised) *Auditing Accounting Estimates and Related Disclosures*

identify and respond to fraud risks; however, the scalability of such a requirement for less complex audits would need to be determined.

We also believe it is important to recognize in the guidance that a financial statement audit is broader in scope and not forensic in nature, and as a result not as effective as a separate forensic audit engagement given that forensic specialists are typically accustomed to a scope of procedures that is often narrowly focused on specific alerts or allegations.

Because of the expertise of forensic specialists to respond to specific instances of identified or suspected fraud, we support the consideration of a requirement for the auditor to determine whether a forensic specialist should be involved to assist in determining the implications of any such instance for the audit, which could include non-material frauds unless they are clearly inconsequential.

Auditor responsibilities for non-material fraud

Financial statement audits are designed to identify material misstatements whether due to fraud or error. We do not believe that the materiality threshold should be altered for the purposes of identifying, assessing and responding to risks of fraud. Doing so would have significant consequences to the scope and costs of the audit, which would require careful consideration with significant levels of stakeholder involvement. We do however agree that the auditor should have a responsibility to respond to identified or suspected instances of fraud, including non-material fraud unless clearly inconsequential. In many cases, the materiality of a matter identified may not be truly understood without further investigation.

As discussed under the *Responsibility for Compliance with Laws and Regulations* section of the Discussion Paper, fraud is a matter that is often inter-related with non-compliance with laws and regulations. Fraud often constitutes an illegal act. As such, Section 360 of the IESBA Code[5] addresses the auditor's response to identified or suspected instances of non-compliance of laws and regulations.

We believe that the nature of the required responses to identified or suspected instances of non-compliance with laws and regulations as set out in the IESBA Code also appropriately address instances of identified or suspected instances of fraud, including non-material fraud, unless they are clearly inconsequential in line with the provisions of Section 360 of the IESBA Code.

We encourage the IAASB to clarify within ISA 240 the relationship between responding to non-compliance with laws and regulations and responding to instances of fraud. The recently issued Staff publication, *Navigating the Heightened Risks of Fraud and Other Illicit Activities During the COVID-19 Pandemic*, includes a useful list of examples of types of frauds that would fall within the scope of the accountant's responsibilities under Section 360 of the IESBA Code.

[5] The International Ethics Standards Board for Accountants' International Code of Ethics for Professional Accountants (including International Independence Standards), Section 360 *Responding to Non-Compliance with Laws and Regulations*

We however recognize that the provisions in the IESBA Code are not implemented in all jurisdictions and the IAASB may therefore determine that ISA 240 requires enhancement to address auditor responsibilities for non-material fraud. Any procedures added should be consistent with the requirements of Section 360 of the IESBA Code such that there are not implementation issues for those auditors that need to comply with both the ISAs and IESBA Code.

Fraud related to third parties

We believe it is important to recognize that there are limitations to detecting fraud when an instance of fraud involves third parties. This however does not detract from the auditor's responsibility to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

In our view, additional emphasis should be placed in ISA 240 on the auditor's responsibilities around fraud related to third parties, and the fact that the nature of fraud risks specific to third parties, with possible collusion with management, and the nature of the auditor's response may need to differ from risks of fraud internal to the entity.

We suggest the IAASB consider enhancing audit procedures that address fraud risks related to third parties as follows:

- As part of obtaining an understanding of the entity and its environment, including the entity's internal control and significant classes of transactions, the auditor should consider whether and where third parties are involved.
- Where involved, the auditor's understanding could be expanded to include understanding management's processes and controls over the involvement of the third party, when such involvement represents a risk of material misstatement. In addition, the auditor could also consider the third party's objectivity and integrity, including whether the third party is a related party.
- When audit evidence is obtained from third parties, the auditor should evaluate the validity of the evidence received. Refer to our comments below related to ISA 500 *Audit Evidence* for further details.

In regard to the question posed in the Discussion Paper related to the auditor's role around third party fraud that does not result in a material misstatement of the financial statements, but may have a severely negative impact on the entity, we refer to our response above that addresses auditor responsibilities for non-material fraud.

Engagement quality review procedures

Because an engagement quality review involves an objective evaluation of the significant judgments made by the engagement team, we believe that significant risks, including fraud risks, inherently fall within the scope of the review. We also believe that the recently released ISQM 2[6], includes provisions that will support the engagement quality reviewer in evaluating the engagement team's significant judgments in relation to fraud (e.g., the new requirement to perform the engagement quality review at appropriate points in time). Nevertheless, we would not be opposed to ISQM 2 including specific guidance on the expectation that the engagement quality review involves evaluating the judgments made in relation to fraud risks and any instances of identified or suspected fraud.

Other topics to consider

ISA 315 (Revised 2019)

The understanding of the entity and its environment and the entity's system of internal control forms the auditor's primary source of information for identification of risks of material misstatement, whether due to fraud or error. ISA 315 (Revised 2019) includes several enhancements that are directly relevant and beneficial to the auditor's identification of fraud risks. Although some conforming and consequential amendments were made to ISA 240 as a result of the revisions to ISA 315, we believe more can be done to further enhance ISA 240 to draw out how the fraud risk identification and assessment process is integrated with the enhanced risk assessment process for the financial statements as a whole. We have the following specific suggestions:

- Emphasizing that information from the auditor's procedures regarding acceptance or continuance of the client relationship or the audit engagement may include information directly relevant to the identification of fraud risks
- Explaining the importance of a robust understanding of the entity and its environment to the identification of risks of material misstatement due to fraud and expanding on how the understanding of the elements of the business model (as outlined in Appendix 1 of ISA 315 (Revised 2019)) can give rise to fraud risk factors
- Providing guidance on the application of the fraud triangle (i.e., incentives/pressures, opportunities and rationalization) as a "lens" on the evidence obtained from risk assessment procedures to provide a framework for the auditor to objectively consider fraud risk factors, which would also support the auditor appropriately exercising professional skepticism
- Clarifying that the auditor's understanding of the entity's risk assessment process and monitoring process includes how these processes address fraud risks, as well as any consequences of the evaluations of these components in the context of ISA 240
- Clarifying that the auditor's required understanding of controls that address fraud risks includes any fraud risk management programs and controls that operate above the transactional level (e.g., whistle-blower hotlines, internal audit departments)

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[6] International Standard on Quality Management (ISQM) 2 *Engagement Quality Reviews*

- Clarifying that the new standback requirement to evaluate whether the audit evidence obtained from risk assessment procedures provides an appropriate basis for identification and assessment of the risks of material misstatement also applies with respect to fraud risks

We also have suggestions above that have a relationship to ISA 315 (Revised 2019) for the specific topics of corporate culture and third-party fraud on which the IAASB is specifically seeking feedback.

ISA 500 Audit Evidence

We support the IAASB's recently commenced standard-setting project on audit evidence and that the scope of the project includes whether fraud considerations are appropriately addressed in ISA 500[7]. We believe a specific focus on enhancing the guidance related to authenticity of documents would be useful. With advances in technology, alterations to documents are difficult to detect in many circumstances. We note that the Exposure Draft of ISA (UK) 240 includes useful examples of conditions that indicate a document is not authentic or has been tampered with.

In addition to the above, we would also be supportive of clarifying the expected work effort related to evidence obtained from external sources. The requirement for the auditor to "consider" the relevance and reliability of information obtained from external information sources implies a relatively low work effort, which may not have a desired level of effectiveness as it relates to addressing the authenticity of audit evidence obtained from external sources.

We also encourage the IAASB to consider expanding on the role of external confirmations in addressing fraud risks. ISA 240 provides only brief acknowledgement through an example that external confirmations may be a response to fraud risk. Guidance in ISA 240 could be enhanced, or alternatively, ISA 505[8] could be enhanced to set stronger expectations for obtaining external confirmations in certain circumstances (e.g., existence of cash or other assets with higher assessed risks of material misstatement).

Although the use of technology is not included in the scope of the Discussion Paper, we encourage the IAASB to consider how technology can be used to obtain audit evidence directly from third parties (e.g., electronic confirmation services, open banking arrangements) and how tools, similar to those used by forensic specialists today, can assist the auditor in evaluating the authenticity of audit evidence obtained from the entity as well as from third parties (e.g., bank statements, contracts).

ISA 550 Related parties

As part of the IAASB's consideration of the auditor's responsibilities for fraud, we encourage the IAASB to consider whether any revisions may be warranted to ISA 550[9]. This may include a comparison analysis to the US PCAOB Auditing Standard 2410.

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[7] International Standard on Auditing (ISA) 500 *Audit Evidence*
[8] International Standard on Auditing (ISA) 505 *External Confirmations*
[9] International Standard on Auditing (ISA) 550 *Related Parties*

In addition, the prominence in ISA 240 of the work performed to address risks related to related party transactions as it relates to the auditor's responsibilities for fraud could be enhanced.

(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)?***

Our comments and suggestions included in our response to Q2(a) are generally applicable to audits of all entities. However, as we note in our comments above, the use of forensic specialists should not be required for all audits. Rather, consideration could be given to establishing a requirement for the auditor to determine whether specialized skills and knowledge may be needed to identify and respond to fraud risks. However, a different approach may be appropriate for audits of less complex entities.

For at least the audits of PIEs, we view our suggestion to clarify that the auditor's required understanding of controls that address fraud risks include any fraud risk management programs and controls that operate above the transactional level (e.g., whistle-blower hotlines, internal audit departments) as particularly important to the auditor's assessment of fraud risk. We also believe the standards should require a discussion between the auditor and those charged with governance about those programs and controls. Where internal audit departments exist, the discussion could include observations about the nature and sophistication of the audits conducted with respect to addressing fraud risks. As part of considering such enhancements, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Fraud Risk Management Guide may be a useful reference source.

(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?***

We are not supportive of requiring that the auditor apply a "suspicious mindset" when executing procedures to identify and respond to fraud in all cases for all audits. We believe that the concept of professional skepticism remains the appropriate concept to apply. Throughout the audit, the auditor should scale professional skepticism based on its understanding of the entity, the risk assessments performed, and the circumstances encountered through the audit.

For the auditor's procedures related to fraud, we would agree that a heightened level of professional skepticism is warranted, and in certain circumstances (e.g., when concerns about management integrity have been identified) the auditor may need to scale up their skepticism to the level that one may equate with a "suspicious mindset". This approach is consistent with the continuum of professional skepticism described in the Global Public Policy Committee publication, *Enhancing Auditor Professional Skepticism*. Therefore, we suggest an approach whereby ISA 240 be enhanced to include guidance on the scaling of professional skepticism, including how facts and circumstances affect the level of professional skepticism applied.

Should the IAASB determine to continue to pursue a requirement for a "suspicious mindset" as the default mindset for audit procedures related to fraud, we believe that specific consideration needs to be given to the consequences, including potential unintended consequences. For example, requiring the auditor to act with suspicion in all cases may result in management and those charged with governance being less likely to cooperate fully with auditor's requests and may also impact the effectiveness of two-way communication with management and those charged with governance, including fraud discussions. We suggest there be consideration given to whether this could impact the attractiveness of the profession.

In addition to enhancing the guidance on professional skepticism, we believe more could be done in ISA 240 to emphasize risks related to auditor bias. The enhanced guidance on types of auditor biases included in ISA 220 (Revised)[10] is useful and could be supplemented in ISA 240 with guidance specific to how such biases could negatively affect the effectiveness of the auditor's identification, assessment and response to fraud risks.

(d) Do you believe more transparency is needed about the auditor's work in relation to fraud in an audit of financial statements? If yes, what additional information is needed and how should this information be communicated (e.g. in communications with those charged with governance, in the auditor's report, etc.)?

Yes. We believe more transparency is needed about the auditor's work in relation to fraud, particularly enhancements to required communications with those charged with governance. As it relates to enhancements to the auditor's report, we believe the ability to significantly enhance the auditor's report has a prerequisite of greater transparency by preparers.

Communication with those charged with governance

In our view, the required communication about significant risks is not specific or robust enough for effective communication about fraud risks. We recommend a specific communication requirement for fraud risks to promote a two-way discussion about the fraud risks identified, the audit strategy to respond to the identified fraud risks and the controls that have been implemented by the entity to address fraud risks.

At least for audits of PIEs, the discussion with those charged with governance should include understanding their views about fraud risks specific to the entity and, to the extent implemented, management's controls to address fraud risks. Views related to the effects of the entity's corporate culture on fraud risks and whether those charged with governance have considered the elements of the fraud triangle in their understanding of fraud risks would be particularly useful for the auditor to obtain.

With regard to expanding communication requirements for audits of PIEs, we recommend that the IAASB consider the requirements for inquiries of those charged with governance within PCAOB AS 2110[11], including:

- Their views on fraud risks in the entity

[10] International Standard on Auditing (ISA) 220 *Quality Control for an Audit of Financial Statements*
[11] Public Company Accounting Oversight Board (PCAOB) AS 2110.56b

- Whether they are aware of tips or complaints regarding the entity's financial reporting
- Whether the entity has entered into any significant unusual transactions

Such inquiries could assist in corroborating the responses by management to the auditor's inquiries about fraud. Further, we do not believe that the auditor's communication with those charged with governance about identified or suspected fraud should be limited to those frauds that meet the materiality threshold in the current requirement. The auditor should use professional judgment in determining whether other instances of identified or suspected fraud should be communicated, which is consistent with the communication requirements in IESBA Code Section 360.

We also believe that the auditor's required communication to those charged with governance of significant deficiencies in internal control in accordance with ISA 265[12] would benefit from additional guidance to communicate the potential implications of such deficiencies for fraud risks.

Auditor's report

We believe the auditor's responsibilities section of the auditor's report would benefit from a more prominent description of auditor responsibilities for detecting fraud. In addition, we suggest that the current description be expanded to include the auditor's required procedures for both addressing fraud risks and when fraud is identified or suspected.

With respect to requiring further disclosure by the auditor of the work performed, we agree that reporting key audit matters under ISA 701[13] is the appropriate mechanism when matters relating to fraud risks rise to the level of matters of most significance in the audit.

When matters related to fraud do not rise to the level of key audit matters, we are not convinced that the information that would narrow the expectation gap would be information about audit procedures performed to address the fraud risks identified under ISA 240 (e.g., tests of journal entries, tests of revenue recognition, or other testing to address risks of fraud in specific accounts). We believe users may be seeking information that would assist them in understanding the soundness of the entity's processes and controls to address the risk of fraud, as well as the auditor's work or observations related to those processes and controls.

Consistent with our response to Q1(b), we believe entities should have a system of strong internal control over financial reporting that includes fraud risk specifically. Management and director certifications on the content of financial statements as well as internal control over financial reporting should be explored. Such requirements for entities would provide a basis for auditors to evaluate, and potentially separately report on, management's processes and controls to prevent or detect fraud. Whether separate reporting on internal control over financial reporting is appropriate is a decision to be made at a jurisdictional level. Regardless, we believe that enhancements to management's responsibilities for internal control to prevent or detect fraud, as well as increased corporate

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[12] International Standard on Auditing (ISA) 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*
[13] International Standard on Auditing (ISA) 701 *Communicating Key Audit Matters in the Independent Auditor's Report*

reporting about those responsibilities, could provide a basis for including in the auditor's report information about significant deficiencies in those controls that were identified in the course of the audit in accordance with ISA 265.

We strongly encourage the IAASB to continue its outreach with those charged with governance, investors and other users to better understand and define the information that is being sought about management responsibilities related to fraud and the auditor's work to detect fraud. This understanding is critical to determining the appropriate party and mechanism for providing the desired information.

Q3. 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?

Consistent with our responses to Q1(a) and Q1(b), we believe that meaningful change in addressing the expectation gap related to going concern needs to involve enhancements to accounting frameworks. The auditor's responsibilities should then be reexamined in light of any enhancements made. Nevertheless, we believe that there are some opportunities to enhance current ISA 570 (Revised)[14], including to address any performance gap that may exist related to implementation of the current requirements. We have the following suggestions:

- *Expanding guidance on considering the appropriateness of the period used by management in its going concern assessment*, particularly when events or conditions relevant to the entity's ability to continue as a going concern have been identified beyond the period of management's assessment.
- *Providing enhanced clarity of the linkage between ISA 570 (Revised) and ISA 315 (Revised 2019)*, particularly with respect to the importance of a robust understanding of the entity and its environment to the auditor's identification of events or conditions related to going concern. We believe this understanding is also essential to the auditor's ability to exercise appropriate professional skepticism when evaluating management's assessment of going concern. In addition, it could be clarified that understanding the entity's financial reporting process under ISA 315 (Revised) includes management's assessment process for going concern.
- *Enhancing the guidance for the auditor's evaluation of management's assessment with consideration to the enhancements made to ISA 540 (Revised) for auditing accounting estimates.* When events or conditions are identified that may cast significant doubt on the entity's ability to continue as a going concern, management applies significant judgment and estimation in its assessment of going concern. Guidance could be enhanced related to how the auditor considers the significant assumptions and data used in management's assessment, including with respect to evaluating management's plans for future actions and the ability to execute these actions, as well as whether the assumptions used are consistent with related assumptions used in other areas of the financial statements (e.g. asset impairment analyses).

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[14] International Standard on Auditing (ISA) 570 (Revised) *Going Concern*

Other perspectives requested by the IAASB

With respect to whether the IAASB should explore enhancements to the audit related to an entity's resilience, we hold a similar view that the auditor's responsibilities need to be determined in context of the entity's reporting responsibilities. Because reporting responsibilities vary by jurisdiction (e.g., viability statements, solvency declarations), we do not view broader auditor responsibilities for auditing resilience (beyond the requirements of the applicable financial reporting framework) as within the purview of the IAASB.

With respect to the clarity of the meaning of material uncertainty related to going concern, we refer to our response to Q1(b) where we recommend that the IASB clarify the difference between the material uncertainty threshold and liquidation basis of accounting threshold as we believe that this difference is not sufficiently understood. With regard to the question whether the concept of material uncertainty is sufficiently aligned in the ISAs, we do not see any issues in alignment.

(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)?

We believe the enhancements to ISA 570 (Revised) that we have suggested in our response to Q3(a) are applicable to audits of all entities.

(c) Do you believe more transparency is needed:

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

Consistent with our response to Q1(b), we agree that users are seeking more information about the auditor's work in relation to going concern; however, we believe that addressing this requires consideration of an underlying information gap in management's disclosures. To effectively address user needs for information about an entity's ability to continue as a going concern, greater transparency in the financial statements about management's assessment is necessary first, in our view, for the auditor to increase transparency about the work performed to evaluate that assessment. We see a significant risk of unintended consequences, including widening the expectation gap, should auditor reporting requirements be expanded in a manner that would put the auditor in the position of disclosing information about the entity's viability that is not included in the financial statements, or is not included in the context of going concern.

However, in the context of current accounting requirements, we do see certain opportunities for enhancement in the auditor's communications about going concern with those charged with governance, as well as in auditor reporting when a material uncertainty related to going concern exists.

Communication with those charged with governance

The current communication requirement in ISA 570 (Revised) is written as a communication of outcomes or conclusions that the auditor has reached (e.g., whether management's use of the going concern basis of accounting is appropriate, whether events or conditions constitute a material uncertainty, etc.). There is no supporting application material to this requirement to indicate the nature, timing or extent of communication expected.

We believe that the communication requirement should be enhanced, and application material developed, to promote a more robust dialogue with those charged with governance that would include sharing views about management's assessment of going concern, as well as a discussion of significant assumptions made in light of the identified events or conditions. The auditor could also communicate about the procedures performed to evaluate the assessment.

Auditor's report

We included in our response to the *IAASB's Auditor Reporting Post-Implementation Review Stakeholder Survey* two observations about the current requirements related to reporting about a material uncertainty related to going concern as follows:

- In many jurisdictions, including a separate section under the heading "Material Uncertainty Related to Going Concern" was not seen as a significant change from the Emphasis of Matter paragraph that was historically required under former ISA 706[15]
- We have received a fair amount of questions from auditors, and management and those charged with governance, regarding the required wording for the auditor's report and the use of the separate Material Uncertainty Related to Going Concern section versus including more descriptive entity-specific information about the material uncertainty in the Key Audit Matters section of the report

Although the separate Material Uncertainty Related to Going Concern section is referred to in the Key Audit Matters section when it is included, and the material uncertainty is referred to as a key audit matter (KAM), the material uncertainty section is written much differently to that of KAM and is not required to include the same elements. To increase transparency and clarity for users, we would recommend the IAASB clarify whether or when the requirement related to KAM to include a description of how the matter was addressed in the audit should apply to reporting of material uncertainties related to going concern. We believe the auditor should at least be required to consider whether additional information about the audit work performed should be included in the Material Uncertainty Related to Going Concern section of the auditor's report, or included as a separate matter in the Key Audit Matters section of the report.

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[15] International Standard on Auditing (ISA) 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*

(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?***

Yes. Refer to our response to Q1(b) in which we recommend the IASB commence a project to clarify going concern requirements in IFRS.

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?

Use of technology in addressing risk of fraud

Although the use of technology in assessing fraud risks and identifying misstatements due to fraud, as well as how technology is used to perpetrate fraud is not included in the scope of the Discussion Paper, we recommend that the IAASB address the fact that an entity's technology is critical to the opportunities for fraud (i.e., committing fraud is likely to involve use of technology) and the auditor's use of technology is equally important to the ability to analyze complete sets of data, analyze trends and identify anomalies.

Entities have never been as data-rich as they are today, potentially providing entirely new opportunities for auditors to detect material frauds through data mining, analysis and interpretation. Auditors are already increasingly using automated tools and techniques to identify unusual transactions and patterns of transactions that may indicate a material fraud. We would be supportive of the IAASB modernizing ISA 240 to embed the use of automated tools and techniques by developing application material or other implementation guidance on how such tools and techniques could be used by the auditor to enhance the auditor's procedures to identify and respond to risks of material misstatement due to fraud.

Further, entities are implementing new technology applications, including adoption of innovative technologies, at an increasing pace. This continual change in an entity's IT environment needs to be subject to appropriate governance and monitoring to mitigate the creation of opportunities for fraud through technology.

Also, as noted in our EY publication, we believe that developments in technology and research on human behaviors could enhance the assessments by entities and auditors of the pressure and rationalization elements of the fraud triangle.

Auditing remotely

Due to the current pandemic, many 2020 audits around the world have been conducted largely through remote working. We believe it is important for stakeholders to recognize that this manner of conducting audits came out of necessity and does not necessarily represent the "new normal". Direct face-to-face interaction with management, those charged with governance and entity personnel is essential to audit quality. Although video-conferencing will continue as one method to achieve face-to-face interaction, we do not believe technology can completely replace in-person interaction.

Auditors visiting and working in clients' environments best facilitates conducting audit procedures involving observation. The auditor is also able to have direct experience with the entity's culture and interact with many personnel other than those involved in financial reporting.

As the IAASB progresses its projects, particularly related to the auditor's responsibilities for detecting fraud, we strongly encourage the IAASB to communicate more explicitly its views or expectations about the ways in which the audit may or should be conducted to achieve audit quality.

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We would be pleased to discuss our comments with members of the IAASB or its staff. If you wish to do so, please contact Jean-Yves Jegourel, Global Vice Chair, Professional Practice (jean-yves.jegourel@fr.ey.com).

Yours sincerely,

Ernst + Young Global Limited