INDEPENDENT REGULATORY BOARD FOR AUDITORS

Building 2 Greenstone Hill Office Park Emerald Boulevard Modderfontein
PO Box 8237 Greenstone 1616 Johannesburg South Africa
Tel 087 940 8800 **Fax** 087 940 8873 **E-mail** board@irba.co.za
Internet www.irba.co.za

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Mr Seidenstein
Chairman
International Auditing and Assurance Standards Board (IAASB)
545 Fifth Avenue
New York
10017 USA

Dear Mr Seidenstein

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

The Independent Regulatory Board for Auditors (IRBA) is both the audit regulator and national audit and ethics standard setter in South Africa. Its statutory objectives include the protection of the public by regulating audits performed by registered auditors, and the promotion of investment and employment in the republic.

We appreciate this opportunity to comment on the Discussion Paper on Fraud and Going Concern in an Audit of Financial Statements: *Exploring the Difference Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statement Audit* (the Discussion Paper).

In compiling this letter, we sought a combination of formal and informal inputs from audit firms, financial regulators, professional accountants as well as the CFO and Audit Committee forums of South Africa. In addition, internal IRBA consultation provided insight into potential root causes of deficiencies in the areas of fraud and going concern; factors that may be contributing to the expectation gap; and the potential role of other participants in the financial reporting ecosystem in narrowing the expectation gap.

Our comments are presented under the following headings:

A. Introduction
B. Expectation Gap
C. Fraud
D. Going Concern
E. Other General Perspectives for Consideration

If further clarity is required on any of our comments, kindly e-mail us at LDuPreez@irba.co.za.

Yours faithfully,

Imran Vanker	**Liezel du Preez**
Director: Standards	**Professional Manager: Standards**

A. INTRODUCTION

1) The IRBA supports and commends the IAASB's efforts to enhance public confidence in external reporting through exploring the expectation gap in relation to fraud and going concern. We also are in support of how the IAASB can contribute to narrowing this expectation gap.

2) In South Africa, in particular, the current financial landscape reflects and potentially exceeds the global crisis of confidence in financial reporting. The expectations that the South African public has of auditors have been heightened by the general mistrust created by state capture, as well as further corporate failures that include Steinhoff, VBS Bank, Tongaat and EOH. This has further been exacerbated by media reports that have implicated auditors in some of these events, casting the general auditing profession in a bad light. Examples of these media reports include the following:

    a. The Cooking of the Books: Economic Crimes and the Enabling Role of the Auditor (8 July 2020)

    b. How the Auditors Keep Dodging the Fraud Bullet (3 July 2020)

    c. Is Auditing a Crisis in SA – What are the Experts Saying? (3 July 2020)

    d. SA Report Unravels Malfeasance and Poor Accountability in Auditing Industry (3 July 2020)

    e. When Good Auditors Go Bad (2 July 2020)

3) As such, from a public interest perspective, these conversations could not be occurring at a more critical and relevant time; and we look forward to seeing how the outputs of this Discussion Paper, and other IAASB initiatives in this regard, will help shape the future of audit for the benefit of the public.

4) In line with our Committee for Auditing Standards (CFAS) Strategy for 2020-2024, we are committed to continuing with monitoring international developments in this regard. We will also continue to submit comments on surveys, consultation papers, discussion papers and exposure drafts issued by the IAASB, including initiating further outreach projects, as and where needed, to contribute to the narrowing of the expectation gap in relation to fraud and going concern.

B. EXPECTATION GAP

Question 1

Regarding the expectation gap, refer to Section I in the Discussion Paper.

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?

1) The consolidated view of the stakeholders consulted (see the cover letter) is that each component – the "knowledge gap", the "performance gap" and the "evolution gap" – contributes to the audit expectation gap in a significant manner.

2) The "evolution gap" is a common concern shared by regulators and those charged with governance. Concerns raised include whether the audit product and, consequently, the standards that support the audit product are evolving at the same pace as business; and whether they can keep up with the evolving business models, information systems and accounting standards that are more judgement and estimation based today than they were a few years ago.

3) We have learnt – from our discussions with the Audit Committee and CFO forums, as well as from what is being reported in the media – that the public is expecting auditors to do more in relation to preventing corporate failures caused by undetected fraud and unidentified risks to the financial stability and the long-term going concern of corporations.

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

4) It is our view that, as an international standard setter that serves the public interest, the IAASB needs to prioritise the resolution of the evolution gap, as this is the most direct response to the public need. As the audit regulator in South Africa, we also share in this responsibility, for the purpose of enhancing public confidence.

5) Therefore, we support proposals to:

    a. Enhance audit procedures in relation to fraud and going concern, and for these to extend beyond what is currently required in the audit standards[1] (refer to discussions under Sections C and D, respectively).

    b. Modernise the audit standards to adapt to evolution in the corporate environment; for example, modernised business models and financial reporting systems[2]. We do not believe that it is feasible to fully resolve the evolution gap, especially as it pertains to fraud, without a concurrent consideration of the use of technology in assessing fraud risks and identifying misstatements due to fraud, as well as how technology is used to perpetrate fraud[3].

6) We do, however, agree that the IAASB can contribute to resolving the performance and knowledge gaps through:

    a. Drafting enhanced requirements that are clear and provide sufficient application guidance[4], so that such guidance lends itself to consistent practical application and

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[1] Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap, Sections II and III.
[2] Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap, page 13.
[3] Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap, page 30.
[4] Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap, page 13.

enforceability, to enable regulators to hold those responsible for quality execution accountable when the execution is substandard.

b. Enhanced communication of the auditor's responsibilities in relation to fraud and going concern in the audit opinion[5]. The audit opinion remains the sole evidence of the result of the audit, from a public perspective. The public does not see conversations between management/those charged with governance and the auditor, nor the extensive audit file documentation. Thus, enhanced requirements for the auditors' role and responsibilities in relation to fraud and going concern in the absence of enhanced reporting requirements will not have the same public benefit or impact. (Refer to discussions under Section C, question 2.d), and Section D, question 3.c), respectively.)

7) As it pertains to what can be done by others, we agree that *"each participant in the financial reporting ecosystem plays a unique and essential role that contributes towards quality financial reporting and therefore that it will take efforts from all participants of the financial reporting ecosystem to bring about meaningful change and improve financial transparency"*[6]. Specifically:

   a. We agree that the successful evolution of the auditing standards also requires the relevant accounting standard setters to make changes to the applicable financial reporting framework[7], particularly around going concern. The clarification and/or simplification of accounting requirements may contribute to the narrowing of the performance and knowledge gaps.

   b. Universities and professional accounting bodies that determine the training curriculum for auditors can contribute to the resolution of the knowledge gap through the evolution of the training curriculum. For example, this could include training on evolving information systems and common fair value models. We do not necessarily agree that forensic training is required, as this is a separate field of expertise. However, a general enhanced understanding of information systems, how fraud can be perpetrated through the use of information systems and fraud awareness can better enable auditors to apply auditor requirements in this regard in practice.[8]

   c. We agree that, as it pertains to key dependencies on others, *"management has a primary responsibility for the prevention and detection of fraud"* and *"assessing the entity's ability to continue as a going concern"*[9]. In addition, "*robust requirements for those charged with governance with regard to their role will increase the effectiveness of the financial reporting system as they may also be in a position to influence the quality of the audit"*[10], as per the examples provided.

   The Discussion Paper, however, does not detail the role of preparers of financial statements, boards and audit committees (collectively, those charged with governance) in narrowing the expectation gap. These players, who are usually professional accountants, hold the primary responsibility for narrowing the performance and knowledge gaps as, collectively, they have the professional obligation to account for and correctly report financial results in accordance with the applicable financial reporting framework; design and implement internal controls and

[5] Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap, page 12.
[6] Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap, page 8.
[7] Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap, page 15.
[8] Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap, page 18.
[9] Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap, page 14.
[10] Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap, page 14.

operating procedures that ensure quality financial reporting; and monitor the implementation of controls and operating procedures to identify weaknesses, including fraud and error, that negatively impact the performance of the company. Preparers and those charged with governance also play a pivotal role in narrowing the knowledge gap of the users of the financial statements through transparency in their communications with investors, analysts, lenders, consumers, the public and other stakeholders.

To enable themselves to do this, they have a professional responsibility to:

i) Remain up to date with financial reporting developments through maintaining their accreditation and ensuring their Continued Professional Development (CPD).

ii) Apply fair presentation, as opposed to a compliance mindset, to financial (and integrated) reporting.

i) Emphasise the importance of compliance with operating procedures and internal controls across the organisation, to ensure operations are accurately recorded, to begin with, rather than trying to fix failures in operating procedures and control from the top down.

ii) Appoint resources where the entity does not have the appropriate internal resources (including time) to effectively manage and monitor internal operating procedures and controls. This is where internal audit can also play a pivotal role.

d. Auditors are responsible for narrowing the performance gap through:

   i) Quality execution of audits. Audits should adhere to minimum requirements and also demonstrate the fundamental principle behaviours and a professional mindset. In doing so, auditors should maintain independence of mind throughout, regardless of the circumstances, and appropriately challenge preparers of the financial statements, as this pertains to fair presentation and judgements applied.

   ii) Remaining up to date with financial reporting and auditing developments by maintaining their accreditation and ensuring their CPD.

e. Regulators of private and public corporate entities need to assess where reporting requirements for preparers and monitoring requirements for those charged with governance need to be enhanced to meet the evolving public expectations; and through this, they can help narrow the evolution and performance gaps.

f. Audit oversight bodies have a duty to actively participate in and feed into initiatives around enhanced education and standards (contributing to resolve the knowledge and evolution gaps); and to monitor the quality execution of enhanced requirements in the areas of fraud and going concern (to address the performance gap).

C. FRAUD

Question 2

This paper sets out the auditor's current requirements in relation to fraud in an audit of financial statements, and some of the issues and challenges that have been raised with respect to this (see Sections II and IV). In your view:

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

1) Yes. In our view, the auditor should have enhanced or more requirements regarding fraud in an audit of financial statements, to meet today's evolving expectations of the public. Overall, we do not believe that these enhancements need to extend beyond the scope and purpose of a financial statement audit (i.e. to identify and assess the risks of material misstatement, whether due to fraud or error, **at the financial statement and assertion levels**) to effectively enhance quality.

2) Section II specifically proposes the enhancements detailed below.

   Requiring the use of forensic and other relevant specialists

   a. The IAASB is interested in perspectives about requiring the use of forensic specialists or other relevant specialists in a financial statement audit; and, if considered appropriate, in what circumstances the use of specialists should be required. [11]

   b. The Discussion Paper further states that *"... requiring the use of forensic specialists on an audit engagement … may help narrow the evolution gap by strengthening the procedures of the auditor with respect to fraud … Specifically, it has been noted that forensic specialists may be used during the engagement team discussion about possible areas of misstatement arising from fraud, during inquiries with management and others, and when performing audit procedures in response to certain risks of material misstatement".*

   c. We note that this is already performed at some firms and on some engagements, as it relates to:

      i) The engagement team discussion.

      ii) Designing and performing audit procedures in response to identified fraud risks or suspected fraud.

      Mandating forensic specialist involvement may result in this being applied more broadly and more consistently; however, it may not have a material impact, unless this is complemented with requirements around the nature, extent and timing of their involvement. Other considerations that are relevant to this proposal are matters related to cost, independence of the forensic specialists and availability.

      Practical pitfalls that undermine the efficiency of specialist involvement include:

      i) Involving the specialist too late in the process.

      ii) Not providing the specialist with complete, accurate or relevant information.

      The efficiency of specialists' involvement is highly dependent on the quality of information provided to them by the engagement team (as specialists generally do not

[11] Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap, page 18.

have independent access to the client). So, engagement teams still need to apply professional skepticism and appropriately identify fraud risk factors, to bring this to the specialists' attention. Should they fail to bring the relevant information to the attention of the specialists, the latter may also be unable to identify the risk.

However, combined with additional requirements around the nature, extent and timing of the specialists' involvement, this proposal may result in a more robust risk assessment through enhanced collaboration between engagement teams and specialists.

d. In addition, we note that unless there is also a requirement to report on the specialists' involvement to the stakeholders, stakeholders will still not "see" this "benefit". The outcome of the specialists' involvement only feeds into the audit plan and may or may not reap tangible results, depending on the facts and circumstances of the engagement, i.e. whether there is fraud or not and whether this was identified or not. As such, stakeholders will likely remain oblivious to the additional audit effort in the absence of a complementary communication and/or reporting requirement.

Additional focus on and procedures in response to non-material fraud

e. The IAASB is interested in perspectives about the perceived responsibilities of the auditor regarding non-material fraud in a financial statement audit (i.e. a broader focus on fraud); and what additional procedures, if any, may be appropriate. The IAASB is also interested in perspectives about whether additional audit procedures should be required when a non-material fraud is identified; and if so, what types of procedures.[12]

f. We agree that "… any misstatement related to fraud that has been identified may be indicative of a bigger issue" and that auditors should, in line with extant requirements, "… assess the impact on other aspects of the audit[13]…" and "… re-evaluate their original assessment with regard to the risk of material misstatement due to fraud and the impact on planned audit procedures in response to those risks … whether material or not …[14]". In addition, we believe that the responsibilities of the auditor regarding the above are also clearly articulated in ISA 240.

g. However, we disagree with the notion that additional procedures are only required to respond to "non-material fraud". Instead, we believe that more robust procedures are required to enable auditors to sufficiently respond to ALL (not just "non-material") suspected fraud. In other words, the standard needs to be enhanced to articulate more clearly what the auditor is required to do when they suspect that a misstatement may be the result of fraud, regardless of confirmation and materiality. We have proposed enhancements in our discussions under question 2) b. ii) below.

Auditor's responsibility with respect to third-party fraud

h. The IAASB is interested in perspectives on whether enough emphasis is placed on the auditor's responsibilities around fraud related to third parties. We are also interested in feedback about the auditor's role in relation to third-party fraud that does not result in a material misstatement of the financial statements, but may have a negative impact on the entity (e.g. cybercrime attacks)[15].

[12] Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap, page 19.
[13] ISA 240.36.
[14] ISA 240.37.
[15] Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap, page 19.

i. As it pertains to whether "enough" emphasis is placed on the auditors' responsibilities around fraud related to third parties, there is no emphasis on this in ISA 240. Fraud risk assessment procedures and responses are designed and executed concurrently, regardless of the source of the fraud (there is no distinction between fraud committed inside or outside the entity).

j. As it stands, extending audit responsibilities to "detect fraud that is not directly related to risks of material misstatement of the financial statements" goes beyond the scope of the objectives of the statutory auditor. The responsibilities of the statutory auditor should not be expanded beyond the scope of being able to opine on the financial statements, as that would be impractical.

   i) The cost and time associated with investigating allegations and/or suspicions of fraud that relate directly to material misstatement of the financial statements are already onerous and can sometimes take a long time to resolve, and enable the auditor to opine, especially where some allegations or suspicions prove to be true.

   ii) It does not stand to reason to extend the scope of the statutory auditor beyond that of the financial statements when the purpose of the audit is to opine on the fair presentation of those financial statements.

   Regardless, the auditor cannot discount third-party fraud, even if there is no immediate financial statement impact. Business risks, under extant ISA 315[16], need to be identified, understood and assessed, since most business risks will eventually have financial consequences and, therefore, an effect on the financial statements. For example, a cyber-attack on the core business of the entity may have an impact on going concern, if it is severe enough to turn away clients.

   It may then be appropriate to emphasise this in ISA 240 and/or ISA 570 for context. But we do not believe that the expansion of requirements in this regard is necessary.

k. In addition, we note that separate extended reporting engagements (i.e. engagements that fall outside the scope of an ISA 700 audit), to respond to shareholder needs in this regard, may be feasible in future, assuming an appropriate reporting framework can be developed.

Additional engagement quality control review procedures

l. The IAASB is interested in perspectives on whether additional engagement quality control review procedures, specifically focused on the engagement team's responsibilities relating to fraud, should be considered for audits of financial statements of listed entities and those other engagements, if any, for which the firm has determined an engagement quality control review is required.[17]

m. We agree with the statement that "a material misstatement arising from fraud would likely be considered a significant matter or an area requiring significant judgement", and that it therefore already falls within the scope of the engagement quality control review.

n. In addition, we note that the "new requirements", as proposed by the "new" Japanese fraud standard, are already incorporated in the new ISQM 2.A29 (which speaks to the timing of the procedures performed by the engagement quality reviewer) and ISQM 2.24(b) (which includes a requirement, to be incorporated into firm policy, that

[16] ISA 315.11(d).
[17] Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap, page 20.

specifically precludes the engagement partner from dating the engagement report until the engagement quality review is complete).

o. We also reiterate ISQM 2.9: *"The engagement quality reviewer is not a member of the engagement team. The performance of an engagement quality review does not change the responsibilities of the engagement partner for managing and achieving quality on the engagement, or for the direction and supervision of the members of the engagement team and the review of their work."*

   This paragraph emphasises that the engagement quality reviewer does not change the responsibilities of the engagement partner. Ultimately, it is the engagement partner's responsibility to ensure fraud risks are appropriately identified and responded to by the engagement team. We note that there is no explicit requirement to this extent in either ISA 220 or ISA 240. We believe the role of the engagement partner in this regard should therefore be enhanced, as opposed to requiring the engagement quality reviewer to do more, given the engagement quality reviewer's responsibility to remain objective.

p. If the risks are identified by the team, the implicit requirements in ISQM 2 are sufficient to ensure that the matter also undergoes an appropriate engagement quality review.

b) Is there a need for enhanced procedures only for certain entities or in specific circumstances? If yes:
   i) For what types of entities or in what circumstances?
   ii) What enhancements are needed?
   iii) Should these changes be made within the ISAs or outside the scope of an audit (e.g., a different engagement)? Please explain your answer.

3) In our view, enhanced or more requirements regarding fraud in an audit of financial statements are required for ALL entities and in all circumstances; however, the extent of additional requirements should ultimately be driven by risk.

   In other words, the current standard requirements that apply to all audits should be enhanced or elaborated and, in addition, the auditor will need to assess the specific circumstances of the engagement to determine the nature, timing and extent of additional procedures to apply, to be responsive to the risk in accordance with the principles of ISA 330.6.

For what types of entities or in what circumstances?

4) We do not believe that enhanced or more requirements should be restricted to specific entities, as fraud is not necessarily restricted to certain entities. Often, fraud and the means for laundering money are a complex network of transactions across entities within a group of related parties. Only by investigating the transactions from different sides and looking at the broader picture of the flow of transactions can/will the fraud be identified.

   It is also not possible to identify all circumstances that indicate fraud or a higher risk of fraud. This is dependent on understanding, inter alia, the client's business, the client's governance framework as well as the control environment; using professional experience and judgement to make an informed risk assessment; and designing an appropriate response to mitigate identified fraud risks.

What enhancements are needed?

5) Over and above our views on the enhancements proposed under question 2a., we have identified the following areas where improvements to the standard can contribute to narrowing the expectation gap:

a. Characteristics of Fraud

There is scope for the standard to elevate and elaborate on circumstances that are likely to make the financial statements more susceptible to fraud (using insights obtained from recent corporate failures, especially academic analysis and research) through updating *Appendix 1: Examples of Fraud Risk Factors.*

b. Risk Assessment Procedures and Related Activities

Findings from our report on recent inspections[18] indicate that auditors are poor at identifying and assessing the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels. Practically, the greater challenge is that the risks and, consequently, misstatements due to fraud are not identified by the engagement team, to begin with. If risks are identified and understood, responding appropriately to the risk and, thus, identifying the misstatement due to fraud is at least possible. If auditors fail to identify and understand the risks, the same gap persists, even if procedures to respond to fraud are expanded.

The inspection report also identifies "obtaining and documenting a thorough understanding of the entity, its environment and information systems" as a success factor to appropriate risk identification. The standard does not emphasise enough the importance of this assessment and how this impacts the auditor's fraud procedures.

i) In the *Objective*, *"it expands on how ISA 315 (Revised) and ISA 330 are to be applied in relation to risks of material misstatement due to fraud"*[19]*;*

ii) Under the *Requirements*, it cross-refers, in general, to the requirements under ISA 315[20]. However, it lacks specificity. For example:

- There is no requirement to evaluate the design and implementation of management's process for identifying and responding to risks of fraud, including related internal controls. Such a requirement should be considered because it will enhance the auditor's understanding of the internal control environment and, therefore, drive better fraud risk assessment and response.
- The standard does detail what the possible implications are for the audit or the auditor when governance surrounding the management of fraud risks is weak and/or the control environment does not support the prevention and detection of fraud, and what the impact of this is on the *Requirements* in ISA 240.
- The standard is not explicit around how the information obtained in ISA 315 informs the nature, timing and extent of further *Requirements* in paragraphs 13-25.

Furthermore, if we critically analyse the extant risk assessment procedures,[21] there is emphasis on "inquiry'' of management and those charged with governance. We

[18] IRBA Inspections Report 2019, page 1.
[19] ISA 240.1.
[20] ISA 240.17.
[21] ISA 240.18-22.

challenge whether inquiry alone supports the appropriate identification of fraud risks, especially considering:

- The inherent limitations on the auditor's ability to identify misstatements resulting from fraud and, in particular, management fraud[22].
- Technological advances over time (e.g. data analysis or that a combined approach may be more informative than inquiry alone).
- The nature, timing and extent of risk assessment procedures may not be equally sufficient in all engagement circumstances. For example, more robust risk assessment may be required where the control environment does *not* support the prevention and detection of material misstatement due to fraud, as opposed to where the control environment supports the prevention and detection of material misstatement due to fraud.

Therefore, we propose that risk assessment procedures be enhanced to include:

- An explicit assessment of a set of minimum fraud risk factors, if present. For example:
    - An inspection of whistle-blower policies and processes and the impact on the audit in general, when these are not effectively operating; OR
    - In a complex group structure, where funds or fees are being moved inter-company without a clear business rationale, requiring the auditor to obtain an understanding of those transactions from management or those charged with governance and corroborating and critically assessing management's explanations.
- A requirement to perform more robust analytical procedures, i.e. beyond analytics performed at the financial statement caption level, as the auditor is unlikely to identify "unusual or unexpected relationships", in the absence of a more detailed analytical review. This is in the context that even small companies these days have hundreds and thousands of data lines, given the automation of the general and subledger entries.
- Requirements to perform specific observations and inspections (in addition to inquiry), in line with the requirements of ISA 315 (Revised), paragraph 14, that will aid the identification of fraud risks.
- Requiring the auditor to adapt the nature, timing and extent of the fraud risk assessment procedures in response to their understanding of the control environment[23].

c. Responses to the Assessed Risks of Material Misstatement Due to Fraud

i) Suspicion of fraud

Once fraud is confirmed, it is possible to make the appropriate adjustments to the financial information and conclude the audit. However, confirming the fraud is onerous. The practical challenge lies in investigating and resolving mere suspicion and determining the impact that this has on the audit. The standard does not distinguish between responding to and resolving suspicion of fraud versus

[22] ISA 240.6 and 7.
[23] ISA 330.A2 and ISA 315.8.

responding to and resolving confirmed fraud. The audit risk in this “in-between phase” is thus high.

We, therefore, propose:

- As a starting point, that the standard should mandate an investigation to be performed, where fraud is suspected. For example, there should be an option for either management/those charged with governance to investigate the suspicion (as ultimately identifying and responding to fraud is their responsibility); OR for the auditor to investigate the suspicion on behalf of management/those charged with governance (with the use of forensic specialists identified by the auditor, if needed, and at the client’s expense). This is because it is only possible to design an appropriate audit response when the issue is properly understood. It may, in the absence of an investigation, be impossible to get to a “sufficient appropriate audit evidence” conclusion. If the investigation is refused, the auditor may then be able to modify the opinion, based on a scope limitation or take other appropriate action.
- That the IAASB explores whether there is a means for the auditor to complete the audit and report the presence of open investigations. An example would be through modifying the audit opinion and/or reporting on “suspicion of material misstatement due to fraud” and how the auditor came to this conclusion.

  Our rationale for proposing this is as follows:

  - The purpose is transparency and narrowing the expectation gap. If discussions and procedures to respond to suspected fraud occur solely “behind closed doors” or “in the boardroom”, no number of procedures will help narrow the expectation gap, as the only consequence will be more elaborate documentation in an audit file that no one, except the auditors and/or management, see.
  - Also, if this is disclosed in the financial statements OR the auditor’s report, with emphasis on the disclosure made by management, it is a means to hold management, instead of the auditor, accountable for “cleaning house”.
  - Investigations do not take days or weeks. They take months and years, and the battle between auditors and management, caused by the commercial and legal implications of these investigations, is real. Auditors cannot always delay the completion of the audit indefinitely based on “suspicion” alone.

  Thus, we recommend that the IAASB explores whether there is a middle ground between the auditor’s responsibility, legal limitations and transparency (e.g. disclosure of the matter in the notes to the financial statements) that will allow for a more thorough conclusion of audits in the face of suspicion of fraud and open investigations.

ii) Audit procedures responsive to risks of management override of controls (journal entry testing)

We propose expanding on and modernising journal entry testing procedures, specifically the testing of the appropriateness of journal entries, to improve the quality and consistency of execution of these procedures.

Effective journal entry testing could be the single most important audit procedure to help identify fraud committed by management. We believe that enhancements to these procedures may therefore be highly effective in narrowing the fraud expectation gap.

Specifically:

- ISA 315[24] requires the auditor to obtain an understanding of the information system, including journal entries (standard versus non-standard). The standard does not expand on the details required to be understood to enable the auditor to identify instances of management override of controls, such as the integration between sub-ledgers and general ledgers, the sources of the types of different journal entries, as well as the access and authorisation rights of different individuals that post journal entries. Therefore, there is scope to link the requirements of ISA 315.18 with ISA 240.33 and to expand on the minimum requirements.
- Public Interest Entities have millions or even hundreds of millions of journal entry data and most postings are now automated. So, we would challenge whether it is feasible to get sufficient appropriate audit evidence over the risk of management override of controls in the absence of being required to obtain and analyse the entire journal entry data set (through data analysis) in these circumstances. This is in line with ISA 315.A94, which reads: *"When automated procedures are used to maintain the general ledger and prepare financial statements, such entries may exist only in electronic form and may therefore be more easily identified through the use of computer-assisted audit techniques*."
- There should be an explicit requirement for the auditor to test the completeness of the journal entry data population before selecting journal entries for further testing. Some guidance on the implications for the audit when a journal entry data set is incomplete may also be helpful.
- The extant procedures state what is required, but do not expand on what the purpose of the procedures is and how these procedures are to be executed. The presumptions underpinning these procedures may also need to be reconsidered. For example:
    - *Make(ing) inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments*[25]. This is only effective when you can be specific. The client respondent will not know what is considered non-standard/indicative of fraud. Data analysis is a useful tool to enable the auditor to ask more specific questions. In addition, it should be made clear that the team should not be inquiring from someone who forms part of the management team, such as the financial manager.
    - *Select(ing) journal entries and other adjustments made at the end of a reporting period*[26]. It is presumed that fraudulent journal entries and other adjustments are often made at the end of a reporting period[27]. Is

[24] ISA 315.18.
[25] ISA 240.33(a)(i).
[26] ISA 240.33(a)(ii).
[27] ISA 240.A45.

this presumption still relevant? Has fraud not evolved beyond this over time? From recent corporate failures, is there any evidence that supports that fraudulent adjustments are more likely to be made at year-end than throughout the year? In addition, there is no guidance on how these journal entries are selected, for example, a risk-based selection that requires the auditor to understand the means (incentive, opportunity and rationalisation) through which financial results may be manipulated through journal entry adjustments.

  - *Consider(ing) the need to test journal entries and other adjustments throughout the period*[28]. ISA 240.A45 states that "… because material misstatements in financial statements due to fraud can occur throughout the period and may involve extensive efforts to conceal how the fraud is accomplished, paragraph 33(a)(iii) requires the auditor to consider whether there is also a need to test journal entries and other adjustments throughout the period." Linking to the challenge above, whether the underpinning presumption that "fraudulent adjustments are more likely to be made at year-end" remains true, consideration should be given to mandating the testing of journal entries and other adjustments throughout the period. At a minimum, consideration should be given to whether the application guidance in paragraph A44 needs to be modernised. Specifically, the *"characteristics of fraudulent journal entries or other adjustments"* have become boilerplate and are no longer effective. Fraudsters have become much smarter and fraudulent financial reporting much more complex.

- It is generally very difficult to filter through large populations of journal entries to identify those that are truly indicative of fraud. Therefore, we are often asked: "How much do we need to test?" We then think it is important to remind practitioners (in the application guidance, perhaps) that journal entry testing is risk-based and that the objective is to test all the outliers in the data set. Stratifying the population to distinguish between "standard" and "non-standard" journals is a critical part of the test and forms a key part of audit evidence. As such, it differs from other substantive procedures where key items and random samples are selected to enable the auditor to conclude on a balance. Due to its unique nature, we do not envisage that the extent of journal entry testing can be prescribed. Again, it should be emphasised that the auditor requires an in-depth understanding of the sources of journal entries and other relevant characteristics for this to be effective, and may also need to make use of data analytic tools.

- Lastly, we recommend that *Documentation* also be updated to include minimum documentation requirements for journal entry testing procedures.

d. Evaluation of Audit Evidence

i) ISA 240.36 states: *"If the auditor identifies a misstatement, the auditor shall evaluate whether such a misstatement is indicative of fraud.*"

As it pertains to distinguishing between whether an identified misstatement has occurred because of fraud or error, there is no application guidance in ISA 240.

[28] ISA 240.33(a)(iii).

ISA 450.A1 states that examples of misstatements arising from fraud are provided in ISA 240 and cross-refers practitioners to ISA 240.A1-A7. However, these example "characteristics of fraud" rely heavily on the auditor's ability to identify "intent", for example, "intentional omission", "intentional misapplication" and "overriding controls intentionally". In practice, it is very hard to establish a person's true "intentions".

As such, we believe that the enhancement of application guidance is required to better enable the auditor to identify misstatements that result from fraud and, in turn, design an appropriate response.

e. Auditor Unable to Continue the Engagement

i) Enhancements should be made to the *Auditor Unable to Continue the Engagement* section, providing more explicit guidance on what the auditor is expected to do where there are suspicions of management fraud and other indicators that bring into question the integrity and ethical values of management and those charged with governance, post client acceptance, and which circumstances would be severe enough to allow the auditor to resign (the practical application of ISA 240.39). The extant paragraph is ambiguous in its referral to "exceptional circumstances" and, as such, there is no real clarity regarding under what circumstances the auditor would be allowed, or even encouraged, to resign from a client where there are serious suspicions of fraud and no progress is made in resolving these suspicions.

Should these changes be made within the ISAs or outside the scope of an audit (e.g. a different engagement)? Please explain your answer.

6) There is scope for many changes to be effected within the ISAs (see above). There is also scope for additional assurance engagements outside the scope of the financial statement audit, for example, separate extended reporting engagements, to respond to fraud that does not impact the financial statements. Refer to question 2a. We also encourage the development and release of non-authoritative guidance to address some of the practical challenges highlighted (where it is not possible to address these through amendments to the standards).

a. 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?

7) Professional skepticism requires *"an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence*". Suspicion, in turn, means *"a cognition of mistrust in which a person doubts the honesty of another person or believes another person to be guilty of some type of wrongdoing or crime, but without sure proof"*. The latter thus implies a more inherently mistrusting attitude, as opposed to an attitude of doubt in general or in response to a particular trigger.

8) While this may contribute to enhanced fraud identification, we do not believe that this will overcome the practical challenges or the inherent limitations auditors are facing in applying an appropriate mindset. Consideration should be given to the following matters before introducing another "mindset" concept into the standards:

a. Although "lack of professional skepticism" is one of the top five root causes identified by auditors in response to the most common findings raised in inspection reports in South Africa, there is no clarity as to what is giving rise to this. It is possible that the underpinning cause could be a technical misunderstanding or misapplication of the concept of professional skepticism, but it may also be behavioural (as implied in the Discussion Paper). This needs to be further investigated. If the underpinning issue is technical clarity, this can be addressed through introducing additional requirements around how to apply professional skepticism consistently in practice (like the enhancements introduced in other revised standards). If the issue is behavioural, additional monitoring and enforcement may be required, on top of expanded requirements.

b. As it pertains to inherent limitations, observations of the IAASB-IAESB-IESBA Professional Skepticism Working Group have highlighted challenges to the application of professional skepticism in practice that may equally apply to the application of a "suspicious mindset", such as:

   i) Environmental factors that influence the ability of the auditor to exercise professional skepticism, for example, tight deadlines, resource constraints and culture.

   ii) Personal traits and biases, e.g. independence, confidence, an inquisitive nature and an individual's response to stress.

   iii) Lack of business acumen in a complex and ever-changing business environment.

   Thus, introducing a new mindset concept into the standards may not address the underpinning practical application or behavioural issues.

9) The IESBA has just approved the Role and Mindset revisions to the Code which include a new requirement for professional accountants to have an "inquiring mind" and differentiate having an inquiring mind from the exercise of professional skepticism when performing audits, reviews and other assurance engagements. The implication of this is two-fold:

   a. The new requirements may already contribute to the identification of fraud without the need to introduce a third mindset concept.

   b. Introducing a third mindset concept further complicates the application and enforcement of application – both of which are already challenging to do under the current "professional skepticism" requirement.

10) We note that the FRC is driving a "challenge culture" campaign in response to its audit quality inspections results analysis that identified "ineffective management challenge", in the execution of professional skepticism, as a critical root cause for poor quality results. Monitoring its further research and outputs from the conference to be hosted in June 2021 may provide further insight into practical professional skepticism application challenges and how the requirements could be enhanced/expanded to incorporate some of these "challenge" concepts.

11) Therefore, we recommend that the IAASB should prioritise the work commenced by the Professional Skepticism Working Group and continue to monitor existing research and developments in this area before concluding on whether introducing an additional mindset concept is justified. We, however, agree that more is needed when it comes to professional skepticism requirements about identifying, assessing and responding to fraud risk factors.

b. 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.)?

12) Yes. Section IV proposes more information regarding fraud in the auditor's report and/or more transparency regarding communication with those charged with governance.

13) From a public perspective, the audit opinion remains the sole evidence of the result of the audit. Therefore, more transparency is required in the audit report. We propose that the audit opinion should reflect the nature and the extent of the work performed around fraud risk assessment, identification and response. For example:

    a. Whether the risk assessment process included a testing of management's controls around fraud risk assessment and identification (and/or other entity level controls); and, if not, why not (e.g. if there are no processes in place or the processes are insufficient for testing purposes, that fact should be stated).

    b. Actual fraud risks identified and how this compares to the risks identified by management (including context as to the basis for concluding what the fraud risks are).

    c. Details of any non-compliance and whether this is investigated by the client or not (and/or if investigations have been performed and concluded, details of the conclusions and whether this gives rise to a fraud risk or not, as well as a basis for the conclusion).

    d. A requirement to distinguish between general fraud responses, e.g. increased senior personnel, journal entry testing and specific audit responses designed to respond to the identified fraud risks.

    e. Specifying limitations, e.g. no investigation being performed by management, details of suspicion and if/how this was escalated without investigation/legal interpretation, etc.

    f. Details of matters resolved since the last audit.

14) As it pertains to whether more transparent communication with those charged with governance is required, we note that collaboration between those charged with governance and the auditor is key in narrowing the expectation gap around fraud. We recognise the value in transparent communication between these parties and believe the transparency of communication should go both ways. We propose that communication between the auditors and those charged with governance be required to be formalised, for transparency and documentation purposes.

D. GOING CONCERN

Question 3

This paper sets out the auditor's current requirements in relation to going concern in an audit of financial statements, and some of the issues and challenges that have been raised with respect to this (see Sections III and IV). In your view:

a) Should the auditor have enhanced or more requirements regarding going concern in an audit of financial statements? If yes, in what areas?

1) Yes. In our view, the auditor should have enhanced or more requirements regarding going concern in an audit of financial statements, to meet today's evolving expectations of the public. Overall, we do not believe that these enhancements need to extend beyond the scope and purpose of a financial statement audit (i.e. to identify and assess the risks of material misstatement, whether due to fraud or error, **at the financial statement and assertion levels**) to effectively enhance quality.

2) Section III specifically proposes the following enhancements:

Requiring entities and auditors to assess the ability of an entity to continue as a going concern for a period longer than 12 months.

a. The IAASB is interested in perspectives on whether entities should be required to assess their ability to continue as a going concern for longer than 12 months; and, therefore, whether auditors should be required to consider this longer period in their assessment, beyond the current required period. If stakeholders believe a longer timeframe should be required, alignment will need to be retained between the requirements under the applicable financial reporting framework and the auditing standards for auditors to be able to adequately perform their procedures.

b. IAS 1.26 requires management, in assessing whether the going concern assumption is appropriate, to consider **all available information about the future, which is at least, but is not limited to, 12 months from the end of the reporting period**.

   In addition, the Conceptual Framework for Financial Reporting defines the Going Concern Assumption as "the assumption that the reporting entity is a going concern and will continue in operation for the **foreseeable future**".

   Both management and auditors should therefore, in theory, not be limiting their assessment to 12 months, post the financial year-end, as this is not in line with IFRS.

   In South Africa, in addition to IFRS, we need to comply with the following Companies Act requirements (Companies Act, No. 71 of 2008):

   Section 129(1): "… the board of a company may resolve that the company voluntarily begin business rescue proceedings and place the company under supervision, if the board has reasonable grounds to believe that – (a) the company is financially distressed; and (b) there appears to be reasonable prospect of rescuing the company."

   Section 128(1)(f): "Financially distressed, in reference to a particular company at any particular time, means that – (i) it appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the ***immediately ensuing six months****; or (ii) it appears to be reasonably likely that the company will become insolvent within the* ***immediately ensuing six months …"***

Practically, the above often results in going concern assessments extending beyond 12 months, post the financial year-end, as concluding the financial reporting process and the audit is delayed by the complexities surrounding the going concern issues, including the practical application of the above legislation.

c. Therefore, we do not believe that simply extending the minimum assessment period will result in improved going concern assessments. We recommend focusing on qualitative enhancements instead. For example:

   i) Inserting a requirement for management to perform a going concern assessment (<u>in all circumstances</u>, as opposed to only when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern).

   The requirement needs to detail the minimum nature and extent of management's assessment, specifically distinguishing between (i) the appropriateness of the going concern basis of preparation assessment (alternatively, the "factual" IFRS assessment); and (ii) the identification of events and conditions that may cast significant doubt on the entity's ability to continue as a going concern assessment. Practically, these are two separate assessments.

   The factual IFRS assessment entails an assessment of compliance with the requirements repeated in ISA 570.2: *"General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations or has no realistic alternative but to do so."*

   Consequently, management's "assessment" often constitutes a simple factual statement that it does not intend to liquidate and has no creditors threatening to liquidate the company. Therefore, management concludes on that basis that the company is a going concern. Often, there is no formal or detailed assessment of the events or conditions that may jeopardise the going concern assumption of the company.

   The assessments being provided to the auditors, as a starting point, are therefore often inadequate.

   As such, we propose specifically requiring management to, as part of its assessment of events and conditions that may cast significant doubt on the entity's ability to continue as a going concern, <u>perform a business model and cash flow analysis</u>. The purpose of the business model analysis is to assess whether the company's business purpose is still appropriate, i.e. that it still has long-term value. It also provides the auditor with appropriate insight into how the company generates its value. A business model that does not adapt to changing circumstances could indicate a longer-term going concern risk. The purpose of the cash flow analysis is to ensure that the entity is liquid and thus able to pay debt, as and when it falls due. The period of the required cash flow assessment will differ and depends on the company's cash flow risks.

   ii) We propose that enhancements be made to ISA 570.10, *Risk Assessment Procedures and Related Activities*, and ISA 570.12-14, *Evaluating Management's Assessment*. For example:

   - An explicit requirement for the auditor to request two assessments from management, namely, (i) the appropriateness of the going concern basis of preparation assessment (factual assessment); and (ii) the identification of events and conditions that may cast significant doubt on the entity's ability to continue as a going concern assessment.

- An explicit requirement for the auditor to confirm that management's assessment, as detailed under (ii) above, includes the business model/purpose and cash flows analysis elements (for completeness).
- Requirements to perform specific minimum observations and inspections of management's assessments (in addition to inquiry), in line with the requirements of ISA 315 (Revised), paragraph 14, and ISA 540 (Revised), paragraphs 16 and 17, including an assessment of the adequacy of management's assessment, given the auditor's understanding of the business and events or conditions identified by the auditor that may cast doubt on the entity's ability to continue as a going concern.
- An explicit requirement for the auditor to request management to perform an assessment of the business model and cash flows, where no assessment was performed; OR to elaborate on an inadequate assessment (in all circumstances, as opposed to only when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern).
- We disagree with the notion that to "discuss with management the basis for the intended use of the going concern basis of accounting" and "inquiry of management whether events or conditions exist that … may cast significant doubt" are sufficient for risk assessment purposes, in the absence of an assessment corroborating management's statements. Certain minimum procedures should be elevated to be required in all instances as part of risk assessment, as the risk cannot be understood and events and conditions cannot be identified in the absence of management making certain basic assessments and the auditor performing specific minimum observations and inspections with regard to management's assessment(s).

iii) We also propose that enhancements be made to ISA 570.16, *Additional Audit Procedures When Events or Conditions Are Identified:*

- Deletion of ISA 570.16(a) (in the context of the proposal to insert a requirement for management to extend a going concern assessment in all circumstances, as opposed to only when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern).
- Dissociation of the elements that make up the requirement in ISA 570.16(b), to clarify that there are three different steps or objectives, namely, (i) obtaining an understanding of how management intends to respond to the event(s) or condition(s); (ii) assessing if the response is likely to mitigate the event(s) or condition(s); and (iii) assessing the feasibility of management's planned response. More application guidance in paragraph A17 may also be helpful, as A17 again overemphasises reliance on inquiry.
- Alignment of ISA 570.16(c) requirements with ISA 540. ISA 540 (Revised), inter alia, requires testing the appropriateness of underpinning data, significant assumptions, developing a point estimate or range, etc. This also includes all

concepts that will contribute to an enhanced evaluation of cash flow forecasts (which is also an estimate) through an increased management challenge.

Clarifying "going concern" and aligning it with "other concepts of resilience"

d. The IAASB is interested in perspectives on what more is needed to narrow the knowledge gap regarding the meaning of material uncertainty related to going concern, to enable more consistent interpretation of the concept. In addition, the IAASB is interested in perspectives about whether the concept of, and requirements related to, a material uncertainty in the auditing standards is sufficiently aligned with the requirements in the international accounting standards.

e. The term "going concern" is not defined in the ISAs. The audit procedures and requirements in ISA 570 are ultimately driven by the definition provided in the accounting framework.

   As inferred above, there are technically two assessments that need to be performed in accordance with IFRS: (i) the appropriateness of the going concern basis of preparation assessment (factual assessment); and (ii) the identification of events and conditions that may cast significant doubt on the entity's ability to continue as a going concern assessment.

   Assessment (i) is the very literal/factual assessment that assesses the intent of management and creditors to liquidate. Assessment (ii) applies the broader definition in the conceptual framework, which states "that the entity will continue in operation for the foreseeable future".

   This distinction is not clear in ISA 570, nor to the public.

   i) It is the conceptual definition that is more commonly understood. In ordinary terms, going concern equates to *"a business that is operating and making profit".*

      "Business resilience", in turn, refers to the "*ability an organisation has to quickly adapt to disruptions while maintaining continuous business operations and safeguarding people, assets and overall brand equity*". This goes beyond *"operating and making profit".* We only really know whether a company is adaptable or not when it is forced to adapt and this is either successful or unsuccessful. There is currently no framework that allows for consistent measurement or comparison of business resilience among companies. Consequently, the auditor is not able to opine on the business resilience of the company.

   ii) While we recognise the stakeholder need expressed by Sir Donald Brydon[29], we believe that with some enhancements to the current requirements that fall within the scope of the going concern assessment, for example, a better understanding of the business model/purpose of the company and enhanced risk assessment, as well as more transparent reporting in this regard (refer to question c) below), the existing going concern assessment is still sufficiently useful, if executed appropriately.

   iii) We disagree with the notion that more focus on unravelling the meanings of the different concepts will necessarily enhance the quality of the assessment itself. The

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[29] Sir Donald Brydon, Report of the Independent Review into the Quality and Effectiveness of Audit, December 2019, as referenced in Fraud and Going Concern in an Audit of Financial Statements – Expectation Gap, page 22.

key in our minds is to rather simplify the definition or understanding of the general concept for ease of application by the auditor and understandability from the public perspective, as the intention or objective is generally the same; that means, identifying risks to the financial stability and long-term going concern of the companies.

b) Is there a need for enhanced procedures only for certain entities or in specific circumstances? If yes:
   i. For what types of entities or in what circumstances?
   ii. What enhancements are needed?
   iii. Should these changes be made within the ISAs or outside the scope of an audit (e.g., a different engagement)? Please explain your answer.

3) In our view, enhanced or more requirements regarding going concern in an audit of financial statements are required for all entities and in all circumstances; however, the extent of additional requirements should ultimately be driven by risk. In other words, the current standard requirements that apply to all audits should be enhanced or elaborated. In addition, the auditor will need to assess the specific circumstances of the engagement to determine the nature, timing and extent of additional procedures to apply, to be responsive to the risk in accordance with the principles of ISA 330.6.

For what types of entities or in what circumstances?

4) We do not believe that the proposed enhancements should be restricted to certain entities or certain circumstances. That is because the basic principles that underpin going concern are the same for all entities.

What enhancements are needed?

5) We have elaborated on the proposed enhancements under question 2a above.

6) In addition, we note that:

   a. ISA 570.24 suggests that the auditor may modify the audit opinion when management is unwilling to extend its going concern assessment. This is not practically feasible because of the factual nature of the "appropriateness of the going concern basis of preparation" assessment (assessment (i) above), which is almost always provided.

   b. The auditor has to perform their own assessment of events and conditions identified (assessment (ii) above) to enable a modification of the report, as the auditor is obliged to identify the events and conditions that they believe should have been disclosed in the financial statements.

      In practice, management will often agree to disclose what the auditor proposes based on their assessment. This impedes the robustness of the going concern assessment. Management, which comprises those who are in a much better position to perform an adequate going concern risk assessment, does not take responsibility for the assessment or the disclosures.

      To help resolve this issue, we propose that paragraph 24 of ISA 570 be adapted to allow for the modification of the audit report when the assessment provided by management is inadequate in the view of the auditor. The auditor can then modify the opinion and provide a basis for concluding that it is inadequate, as opposed to being "forced" into a position where they are performing the assessment on behalf of management.

Should these changes be made within the ISAs or outside the scope of an audit (e.g. a different engagement)?

7) There is scope for many changes to be effected within the ISAs (refer to question 2a) above). However, to extend the auditors' requirements to an assessment of the business resilience of the company at present still falls outside the scope of the ISAs. Unless the accounting standards are updated to incorporate elements of business resilience into the financial reporting process, specifically, this should remain out of scope.

8) We note that separate extended reporting engagements (i.e. engagements that fall outside the scope of an ISA 700 audit), to respond to shareholder needs around business resilience, may be feasible in future, assuming an appropriate reporting framework can be developed.

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.)?
   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?

9) Yes. Additional transparency about the auditor's work in relation to going concern in an audit of financial statements is needed and can be achieved through making enhancements to the audit report.

10) No. Additional transparency about going concern outside the auditor's work in relation to going concern is not needed. It is reasonable for the auditor to assume that users of financial statements have reasonable knowledge of business and economic activities as well as accounting and a willingness to study the information in the financial statements[30], including the audit report, with reasonable diligence. Enhancing the audit report should therefore provide sufficient transparency.

What additional information is needed?

11) We propose adaptations of management's responsibility statement to align directly with the requirements of the accounting framework. For example:

    Extant paragraph:

    "*In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.*"

    To be replaced with:

    "Management is required to prepare the financial statements on the going concern basis of accounting, unless management either intends to liquidate the entity or cease trading or

[30] ISA 320.4(a).

has no realistic alternative but to do so, in accordance with IAS 1.25. This involves management making an assessment of an entity's ability to continue as a going concern. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. In assessing whether the going concern assumption is appropriate, management considers all available information about the future, which is at least, but is not limited to, 12 months from the end of the reporting period."

12) We propose removing the auditor's responsibility statement and replacing it with a Going Concern Assessment paragraph (to be disclosed under a separate heading). The purpose of the Going Concern Assessment paragraph will be:

    a. To share with the users of the financial statements some factual insights into the going concern assessment process, as it occurred between management and the auditor.

    b. To provide confirmation on the adequacy of the going concern assessment provided by management, for further audit analysis.

    c. To factually assert whether the auditor agrees/disagrees with management's conclusion around the appropriateness of the going concern basis of preparation, and explain the rationale for this conclusion in accordance with the accounting framework requirements.

    d. To emphasise the disclosure of events and conditions identified that were further analysed by management.

    e. In the case of a material uncertainty conclusion, to emphasise in a different manner that there is uncertainty, and what the implication of this is for the user.

    f. To provide insight into the procedures performed by the audit team in reaching its material/not material uncertainty conclusion.

    For example:

    The auditor obtained management's assessment of the appropriateness of the use of the going concern basis of preparation, as defined in the accounting standards. In addition, the auditor obtained management assessment of events and conditions that may cast significant doubt on the entity's ability to continue operating as a going concern in the foreseeable future. The assessments were evaluated for completeness and accuracy, in the context of the auditor's understanding of the business and events or conditions that may cast doubt on the entity's ability to continue as a going concern, and concluded to be adequate for further auditor analysis.

    Events and conditions that may cast doubt on the entity's ability to continue as a going concern, and have been identified for further analysis, are disclosed in note x (this applies regardless of whether the conclusion is that this does or does not cast significant doubt, as even not significant conclusions need to be disclosed for fair presentation (ISA 570.20)).

    Management concluded that these events cast significant doubt/do not cast significant doubt [delete as appropriate] on the entity's ability to continue as a going concern. We agree with management's conclusion.

    [Only applicable if the conclusion is that there is a material uncertainty.] We emphasise the material uncertainty that these events and conditions cast on the going concern assessment of the entity. However, the audit report is not modified in this respect as the

matters have been sufficiently disclosed in the financial statements, allowing you as the user to assess the potential impact of these matters on the future operating performance of the company or to make further enquiries from management and those charged with governance, as needed.

In reaching our conclusions, we have performed the following procedures:

[List the minimum required procedures.]

[List the additional procedures performed, based on risk/auditor judgement.]

Our conclusions are based on the audit evidence obtained up to the date for our auditor's report. However, our conclusions do not constitute a positive affirmation that the company is indeed a going concern and/or will remain as such. Future events or conditions may cause the company to cease to continue as a going concern.

E. OTHER GENERAL MATTERS FOR CONSIDERATION

d) 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?

1) The IAASB expressed specific interest in perspectives about the impact of corporate culture on fraudulent financial reporting and what, if any, additional procedures for the auditor it should considered in this regard.

2) We agree that a corporate entity's culture is an important factor in influencing the behaviour of its personnel. Poor governance surrounding the management of fraud risks increases the susceptibility of the financial statements to misstatement due to fraud and diminishes the auditor's ability to identify and respond to fraud. Enhancements to auditor's procedures in this regard need to complement enhancements to the requirements of preparers and those charged with governance.

3) A corporate entity's culture (including the "tone at the top") and governance structures are initially assessed by the auditor at the time of client acceptance and/or continuance, as this is where the auditor first assesses the integrity and ethical values of the client[31]. The auditor further enhances their understanding of the culture and governance structures through understanding the entity and its environment[32] and the entity's system of internal control[33].

4) Findings from our most recent inspections[34] indicate that auditors are poor at assessing and/or interrogating the integrity and ethical values of management at the time of accepting the client. There is usually a presumption that management, which constitutes the key people with whom the auditor engages, has integrity and is ethical and therefore cannot or will not be involved in fraudulent financial reporting. Thus, auditors might then engage in client relationships that they should not be accepting. Secondly, our findings also indicate that poor risk assessment, due to an insufficient understanding of the entity's environment and system of internal control, impedes the auditor's ability to perform appropriate fraud risk assessments at the overall financial statement and assertion levels.

5) We note that further analysis of the root causes underpinning the poor assessments indicated various causes, such as commercial interests being put ahead of quality, insufficient time being dedicated to risk assessment procedures, insufficient objectivity and/or inexperience of team members performing the assessments.

   Although these root causes extend beyond the realm of the standards, scrutinising the standard requirements indicated that there is also room for the standards to be enhanced to help address these issues.

   Our proposed enhancements have been incorporated into the discussions under Section B, question 2b.ii above.

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[31] ISQM 1.30(a)(i).
[32] ISA 315.19.
[33] ISA 315.21-26.
[34] IRBA Inspections Report 2019, page 16.