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Paris La Defense, 1st February 2021

International Federation of Accountants
International Auditing and Assurance Standards Board
Mr. Seidenstein, Chairman of IAASB
545 Fifth Avenue - 14th Floor
New York NY 10017 USA

Re: IAASB Fraud and Going concern discussion paper

Dear Mr. Seidenstein,

Mazars is pleased to submit this letter in response to the invitation to comment from the IFAC International Auditing and Assurance Standards Board (IAASB), on its Discussion paper on Fraud and Going concern.

Mazars is an international, integrated and independent partnership, specialising in audit, accountancy, advisory, tax and legal services. As of 1st January 2021, there are over 24,400 professionals, including more than 1,000 partners, in 91 countries worldwide, trusted and committed in serving major international groups, entrepreneurial and small businesses, private investors and state-owned entities at every stage of their development.

Mazars is a member of the IFAC Forum of Firms, and thus fully supports, for more than 13 years now, the initiatives of IFAC IAASB, IESBA, Forum of Firms and Transnational Auditors Committee, as well as those of the regulators in these areas of common concern for public interest, in promoting high quality standards as part of the international roll-out of audit engagements. All Mazars firms and correspondents are committed to support and apply those initiatives.

We are committed to being #MazarsForGood – that is a global citizen devoted to having a positive impact on the world and communities in which we operate. We are dedicated to contributing to society in the best possible way, whether through providing quality services to our clients to help them achieve sustainable growth, enabling our talented people to reach their highest potential, or contributing to the public debate with positive insights for the future.

Should you want to get further information, you can refer to our 2019-2020 Group Transparency report Group transparency report 2019/2020 - Mazars Group

We would be pleased to discuss our detailed comments submitted hereafter with you and remain at your disposal, should you require further clarification or additional information.

Yours sincerely,

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Overall comments

Mazars is supportive of all initiatives taken to enhance audit and assurance quality and the future of the profession, for the benefit of the public interest, and thus we welcome the opportunity to add our views to the debate. We have found the paper clear and well-written, in a user-friendly format.

We believe that the topics of fraud and going concern are major topics of public interest and involve all stakeholders, especially in a crisis environment such as the one of Covid-19 we are facing for longer than 1 year now.

We believe it is high time to join efforts and forces for an integrated approach among legislators, corporate governance actors, accounting and auditing standard setters. The status quo is not an option, neither for the auditors nor for the other stakeholders.

In August and September 2020, Mazars CEO, has written articles on "Auditor: a complex job"[1] and "Preventing corporate fraud: a collective responsibility" [2] from which we want to highlight some extracts.

You will find our detailed answer hereafter.

[1] Auditor: a complex job (linkedin.com)
[2] Preventing corporate fraud: a collective responsibility (linkedin.com)

Request for comments

Question 1: In regard to the expectation gap (see Section I):

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

The expectation gap is split in the paper between knowledge, performance, and evolution gaps and we believe all are valid.

- We do not believe that the evolution gap is a significant contributor to the expectation gap at this time.
- The knowledge gap has historically, and continues to be, a significant cause of the expectation gap. This is in part due to the expectations of stakeholders, many of whom are not necessarily concerned with understanding the role and responsibilities of the auditor. Clearly there is a need to engage all financial statement users in having a common understanding of the relevant roles and responsibilities for addressing fraud and going concern among the auditors and the Management and TCWG.

Even though we believe it is not the main reason, the expectation gap may be also linked to the performance gap as described in the discussion paper.

Fraud

The discussion paper mentions "The public thinks the role of the auditor is to detect fraud, including non-material fraud." However, we believe that the main expectation is that material frauds will be discovered.

To start, the expectation gap is impacted by the fact that the fraud term is not always clearly defined and there can be confusion with the concepts of Non-compliance with Laws and regulation (NoClar), corruption, and money-laundering. Even if you then get to a common understanding of the meaning of fraud and understand the role of the auditor to detect material fraud, the fact is, the public has no insight into the materiality thresholds applied in the audit. As a result, what is appropriately deemed non-material by the auditors may, if known, be considered material by the financial statement users. Beyond simply being knowledgeable of the role of the auditors, this literal lack of knowledge regarding materiality creates a knowledge gap. The fact that a fraud is noted which does not give rise to the financial statements being materially misstated, and thus is reported internally to management - depending on law and regulation possibly externally - but not necessarily publicly in the auditor's report (except possibly as KAM) is of little interest or value to certain financial statement users.

Going concern

We think that the main reason for the expectation gap regarding going concern is that there are "Differences of view as to the meaning and implication of material uncertainties and the going concern concept" which creates a knowledge gap. One possible way to close the gap is to use Key Audit Matters, as it is already possible in the existing standards when there is a close call (so not a material uncertainty). However, this may be difficult in practice as a going concern KAM, or simply disclosure, can be perceived as a "bad signal" for the entity and may result in actions by stakeholders which exacerbates the company's financial difficulties. This is clearly stated in the discussion paper "The auditor is pressured to accept less transparent company disclosures and/or not to include going concern uncertainties in the auditor's report because of fears that such disclosures/reporting will be a self-fulfilling prophecy."

Also impacting the knowledge gap is the frequent lack of clear disclosure of management's key assumption around the going concern analysis. While we recognize that it is outside of the purview of the IAASB, having stronger disclosures regarding the key assumptions and data used in assessing going concern assumption, as well as the time period considered, would benefit users.

Stronger disclosures requirements, if used more frequently, would lessen the negative impacts of going concern disclosures and help facilitate more frequent, constructive dialogue between the Management and auditors, which should result in more transparency of the financial condition on companies.

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(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?

While the role of the auditor is key, the role of the Management and Those Charged With Governance (TCWG) is crucial together with different stakeholders (such as banks when focusing on going concern issues). As mentioned in the paper by the IAASB chair "we [the auditors] cannot narrow the expectation gap alone".

However, a reminder of the primary responsibilities of the role-players, including the differences between management, governance (TCWG. Boards, Audit committees), and the auditor, through public / stakeholder engagement, is necessary but not sufficient.

We believe it is high time to join efforts and forces for an integrated approach among legislators, corporate governance actors, accounting and auditing standard setters. Benefits of an integrated approach include:

- Enabling all stakeholders to approach the going concern and fraud risks with a more consistent view of business risk and financial information;
- Increase usefulness of information for all stakeholders compared to a solely auditing approach or silo approach;
- Aid in the development of best practices for governance and audit committees (using for example the ones issued by the International Organization of Securities Commission (IOSCO) [3];
- Improving consistence in thought leadership papers focused on addressing and mitigating fraud and going concern issues produced by institutions, organisations, and other stakeholders, with a common view of the how all parties can support the public interest and design a kind of coordinated action plan with an effective, but limited number of integrated measures ; and
- Reinforcing the need for an improvement in the training and education of all stakeholders in a common set of expectations and understanding.

The status quo is not an option, neither for the auditors nor for the other stakeholders. Actions must be taken if we are to reduce the expectation gap.

Presently, there is a number of revised standards, including ISQM1, ISQM2, ISA 220 and ISA 315, that will help to enhance the quality of audits in all areas, including fraud and going concern.

So, the question raised in the discussion paper is what more can be done by the auditors to reduce the expectation gap.

As a pre-requisite for the effective implementation of any new proposals or measures on both topics of fraud and going concern, we strongly believe that, **at least as a short term for most-exposed entities and PIE as a priority**, the following could be done:

- **In terms of Corporate Governance**
  - The evolution of Corporate Governance, to manage and mitigate risks associated with dominance of certain individuals in the management, or as executive directors, is a must;
  - Non-financial reporting should be high on the agenda of Corporate Governance, to drive CEOs to be accountable for long term value creation, instead of short-term financial results and shares plans for management.
- **In terms of internal control**
  - Introduction of increased internal and external reporting on key controls, increasing the personal responsibility and accountability of management, and board members (via Audit Committee oversight re shareholder protection / resilience / sustainability / fraud / cash forecasts);

[3] IOSCO issues good practices to assist audit committees in supporting audit quality

  - Improving and / or expanding corporate fraud prevention efforts (including robust internal control) and developing going concern red flags (including basic but reliable cash forecasts in all entities) to identify issues arising timely;
  - More timely and transparent communication and reporting, not only from the auditors, but also, and first, from the Management and Those Charged With Governance. This includes especially the public disclosure of the basis for the going concern assumption, even if there is "no problem", in the notes of the financial statements;
  - Management must report on the effectiveness of internal control
- The audit committee must exercise greater responsibility for the company's internal control, by setting up a risk and internal control quality dashboard
  - More active involvement and challenging of the Management by Those Charged With Governance, especially when there are dominant individuals; and
  - For PIE, reporting from the audit committee (AC) / Board to be public on select areas, including the key elements of challenge by the AC or the Board vis à vis Management. Such reporting which is already encouraged in some jurisdictions, could be helpful to enhance robust governance and transparency.
- The audit report must cover more extensively the work carried out on internal control and the conclusions of the auditors.

One of the challenges to developing consistent approaches to address fraud and going concern comes from the fact that, no international bodies addressing corporate law or corporate governance. We recognize that such mechanisms are difficult to design given the desire for a level of autonomy by countries when it comes to national law or regulation. However, having some universal and guiding principles would benefit all members in the financial reporting ecosystem. For example, in France, there is an alert procedure that allows the auditors to require the entities to call for a general shareholders meeting whenever it is necessary. We would encourage the IAASB to seek dialogue with other stakeholders, such as the IASB on accounting matters for going concern. We believe that stakeholder engagement to ensure that investors and other users of financial statements have a thorough understanding of an auditor's responsibility in relation to going concern and fraud, will go a long way towards addressing these issues.

However, we caution that, regardless of any additional requirements performed by the auditors, we believe that the expectation gap will never be reduced to zero. As a matter of fact, the auditing standards require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. The additional work required to provide much higher assurance, or for example, reasonable assurance related to immaterial fraud, if this is a clear expectation from the stakeholders, may be so significant that it could challenge the economic viability of the audit process as a whole.

The fraud and going concern topics require auditor professional judgement and professional skepticism in an evolving environment. **To allow for the need for auditors to adapt and be agile, we suggest that the IAASB keep the principles-based approach of the standards and avoid a "check-the-box approach" or create a "one size fits all" approach as it will impeded adaptation and weaken professional skepticism.**

It would be relevant to have the SMP committee is, at least, consulted to make sure that scalability is taken into account at an early stage.

In addition to the above, what could be done **for all entities**:

- On the two topics of fraud and going concern:
  - More education, pedagogy around the two topics throughout the audit process, in the auditor's report and during Shareholders' meetings. Focus by regulators and standards setters on developing educational material, as has been done by the IAASB, that can be presented to Audit committees and other stakeholders to give more explanations, insights about the role of the auditor and main concepts around audit (risk-based approach, materiality, key audit matters etc.) ;
  - Although the IAASB has no authority to call for local laws, defining internationally established best practices for good corporate governance, such as compulsory audit committees with independent members for entities with certain characteristics (PIE; size etc.) . This is especially important to

have a robust governance when there is a very dominant senior management. Also, the senior member of the supervisory board and audit committee need to have appropriate qualifications and knowledge in the area of financial statements, and the relevant industry to be able to challenge management independently and properly. Defined expectations on the financial qualifications ("financial expert") should be considered.

- On the going concern topic:
  - Prevention of going concern is a priority and to address this better, enhanced disclosures requirements of the going concern assumption in the accounting standards, including in close call situations or when the entity has made significant judgments to maintain a going concern as a basis of preparation, should be considered.
  - The independent auditor (but also the governance and the management) must be systematically informed of alerts on the company thanks to a system for consolidating alert signals
  - Auditors must better anticipate potential business failures, by carrying out additional due diligence-type assignments (issuing a certificate of resilience of the company?)
  - Consideration should be given to disclosures of managements' financial ratios / KPIs / non -financial indicators used to manage the business and / or comparisons with KPIs from sector industry benchmark could be helpful.
- On the fraud topic:
  - We could say that there is a short-term action which consists in reaffirming and better communicating our current limited liability for fraud. Especially there could be a reinforcement of the understanding of the concept of materiality through public/stakeholder engagement. This would be helpful regarding the fraud topic to avoid expectations on immaterial fraud;
  - On a medium/longer term, the auditor could be given more resources, to enable him to go further in identifying the risks of fraud;
  - Entities should dedicate more time and resources to the implementation of an internal control framework dedicated to the prevention, identification and correction of fraud. Consideration could be given to specific reporting from the entity for at least PIE entities;
  - The auditor should be required to report specifically on fraud risk and the quality of company's internal control and fraud detection systems, based on an annual declaration from management on the measures implemented to prevent or detect significant fraud;
  - Make it compulsory to enrich the training course for auditors on risk management, fraud investigations, CSR and IT security;
  - More guidance from standard setters around the application of professional skepticism and unpredictability in audits could facilitate better audit fraud procedures;
  - The cyber risk review must become mandatory in the auditors' mission.

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 with regard to fraud in an audit of financial statements? If yes, in what areas?

- No. We believe the standards are adequate to reach the objective of assessing the risk of material misstatements due to fraud. We believe that keeping a risk-based audit approach is necessary for the auditor to adapt under the different facts and circumstances and to avoid check-the-box behaviour and remain skeptical throughout the audit. There are things that could be done, however, that would aid the auditor in performing their responsibilities relate to fraud, including:
  - Making clarifications on the existing standard could be helpful:

- Further guidance regarding the risk of management override and how to address it though the implementation of unpredictability and journal entries testing and other tests would be beneficial;
- The articulation between ISA 240/ISA550 and the recently revised standards ISA 315 and ISA 540 could be improved.

  - Increased guidance from regulators and standards setters including guidance and examples, including:
    - Fraud use cases / accounting schemes;
    - Around the enhanced risks resulting from the increasing extent of electronic audit evidence and highly automated entity processes.
  - Developing resources of industry metrics or business trends that are available to all firms could aid firms in planning and risk assessment in all areas of the engagement, including fraud considerations and the going concern assumption.

(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.

- No. Fraud is a concern for all types of entities and the standards are sufficiently risk-based to account for differences across industries, jurisdictions, etc. However, if additional procedures are to be required for some entities, we would suggest that these are clearly explained in the audit reports for those entities, rather than requiring the public to have to understand the specific industry standards applied.
- See also our answers to question 1.

(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?

- No. We believe this new concept be counterproductive. General suspicion would transform the relationship with the company being audited and would be hugely detrimental. We cannot start an audit from a point of distrust. The use of professional skepticism provides the appropriate balance in client relationships to meet the objectives of the auditing standards.

(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.)?

- To start, we believe it is not necessarily to change the standards ISA 240 and ISA 570 if we consider the revised standard of ISQM1/2/ISA 220 and ISA 315.
- As it relates the auditors work and the auditor's report:
  - There may be benefit in enhancing the description about what the relevant parties' responsibilities are in relation to fraud, including possibly explanation around the concept of materiality and how it impacts the auditor's work in relation to fraud. Consideration could also be given to including in the audit reporting standards disclosure of the materiality level or ranges in the audit report;
  - The use of experts can be helpful under certain facts or circumstances but should not be systematic and should be risk-based and does not require disclosure in the report;
  - The auditor's use of technology can be an effective tool in the fraud procedures but should not be disclosed in the report;
  - A transparent and challenging discussion between the management and those charged with governance to assist the auditor in understanding how much challenge is done by governance.

Reference to this procedure could be made, but the details should not be disclosed in the report;

- Regarding engagement quality review, we believe that ISQM2 enables for the engagement quality reviewer to do what is needed, even though the topics of going concern and fraud are not explicitly mentioned.

- As it relates to management and governance's procedures:
  - Enhanced disclosures related to management's approach to identifying and mitigating fraud, including risks coming from collusion of senior management, could be beneficial;
  - As the discussion paper explains, "third-party fraud is often committed in collusion with employees at the company." Enhanced disclosure of how management and governance manage such risk could be beneficial.

Question 3: This paper sets out the auditor's current requirements in relation to going concern in an audit of financial statements, and some of the issues and challenges that have been raised with respect to this (see Sections III and IV). In your view:

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

- It could be useful to clarify in the standard the meaning of "a minimum of 12 months."
- The auditing standard mentions that the auditor should remain alert throughout the audit. This concept is not well understood and is applied differently in jurisdictions, some have adopted a proactive alert / safeguard mechanism, while others have not. Some have also put in place forecasts accounts that need to be approved by a board at a certain period of time. We encourage the IAASB to give more guidance on what is expected around "remain alert throughout the audit".

(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.

- No, we do not believe that enhanced procedures are needed for any certain industries.

(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?

See also our answers to question 1. Yes, we believe more transparency would be useful in the following areas:

- A reminder of the primary responsibilities of Management and Those Charged With Governance related to conclusion on the appropriateness of the going concern assumption would be helpful;
- A public disclosure of the basis for the going concern assumption, even if there is "no problem", in the notes of the financial statements, including clear period covered would benefit users. We recognize that this requires the IAASB to liaise with the IASB;
- The paper mentions that "Stakeholders seek more insight into a company's future viability than is currently provided for in accounting and auditing standards." (P 13) We believe that more insight, possibly through additional disclosures would be beneficial. Given that a company's future viability, is connected to the resilience of the business model and corporate structure, both financial information and non-financial information should be considered for disclosure.

- On the question related to the assessment for longer than 12 months, we believe there is a need to clarify the period covered and the starting point. If there is a longer period of assessment, it requires from the entities more robust and transparent disclosures on assumptions and scenarios used. On this basis, the auditor could report on the underlying process, assumptions and scenarios. On the material uncertainty related to going concern, PIEs can use Key Audit Matters when there is a close call (so not a material uncertainty). We suggest considering extending the idea of a Key Audit Matter regarding going concern to non-PIEs.
- On the concept of resilience, the statement of solvency indicating the company can pay all debts as and when they become due and payable (existing in Australia as mentioned in the paper) can be a useful practice and subject to reporting from the auditor. In the UK, the reporting on the entity's longer-term viability is subject to procedures performed by the auditor which result in a "requirement to report in the auditor's report whether there is anything material to add or draw attention to in respect of management's assessment." We believe it would be helpful to have a post-implementation review in those two countries to see if those two measures enable the auditor to target the objective of preventing corporate failures.

Question 4: Are there any <u>other matters</u> the IAASB should consider as it progresses its work on fraud and going concern in an audit of financial statements?

See also our answers to question 1.

- A benchmark, even though restricted in some countries, of how many entities have used the KAM for going concern and /or fraud in the period of Covid-19 would be helpful.
- Public and easy availability of some red flags and indicators /ratios per sector industry (prepared by the banks/analysts/central banks and other institutions) for use by the entities and auditors could assist with assessing going concern.
- Easy availability to a data base of fraud schemes, possibly complied among various regulators /investors, could help inform auditors and influence the risk assessment process. This presently can be done by large firms, but is more challenging for smaller firms.
- Greater consistency between countries on the different governance fraud prevention mechanisms could be considered, recognizing that it will be dependent on the legal national frameworks.
- More guidance for auditors on how address fraud and going concern in a transnational group under ISA 600 would help all practitioners
- More guidance for auditors on how to use of technology and data analytics in addressing the fraud consideration, and to a lesser extent going concern, would help all practitioners.