February 1, 2021

SENT ELECTRONICALLY

International Auditing and Assurance Standards Board

Dear Sirs/Mesdames:

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

Thank you for the opportunity to comment on the above Discussion Paper ("DP").

MNP LLP ("MNP") is one of Canada's largest chartered professional accountancy and business advisory firms. Our client base includes small to mid-size owner-managed businesses in agriculture, agribusiness, retail and manufacturing, natural resources as well as credit unions, co-operatives, Indigenous communities and businesses, medical and legal professionals, not-for-profit organizations, municipalities, government entities, and publicly traded companies. We believe that we are positioned well to provide feedback on this DP.

We have reviewed the DP and provided our responses to the specific questions posed, as follows.

__Questions posed in the DP__

1. In regard to the expectation gap:

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

We are of the view that the three components of the expectation gap, as stated in a May 2019 publication by the Association of Chartered Certified Accounts (ACCA): knowledge gap, performance gap and evolution gap, are all causes of the expectation gap relating to fraud and going concern in an audit of financial statements. In the context of the IAASB's workplan, we have focussed our comments on the knowledge gap and evolution gap.

As stated in the DP, some users of the financial statements do not understand what an audit entails and may have unreasonable expectations of what an auditor ought to do in comparison to what they are reasonably capable of doing due to the inherent limitations of an audit. That is, such investors may believe that the role of the auditor is to detect fraud, material or otherwise, and conflate resilience statements with the going concern concept.

In contemplating amendments to audit standards and broader deployment of newer audit techniques, we are conscious of their impact on cost-effective timely financial information. We are mindful of the ability of emerging growth public companies and small and medium sized enterprises (SMEs) to support such audit changes. In Canada, this would represent an extremely significant portion of the marketplace. Moreover, certain changes may deepen the expectation gap. For example, audit tools that test the internal integrity of 100% of a client's transactions may still not connect to external evidence nor necessarily detect fraud or management bias, despite a potential undue reliance by financial statement users on these technologies

(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?

The IAASB should segregate the expectation gap between those unreasonable expectations, which may not likely ever be resolved, and those that have a potential to be bridged. Below are our views on areas that the IAASB may explore and areas where other bodies may contribute to investor needs:

- *ISA 570 (Revised), Going Concern* offers guidance which requires the auditor to evaluate management's assessment of the entity's ability to continue as a going concern. Generally, this includes, but is not limited to, a cash flow projection over 12 months from the audit report date. That projection likely cannot reasonably capture the full spectrum of possible uncertainties to which that an entity is exposed. A separate challenge is that amongst emerging growth public companies, the presence of a going concern statement may be commonplace but still does not fully address an investor's information needs. In reflecting on this expectation gap, it is worth noting that securities regulators in many jurisdictions require reporting issuers to provide additional information in its Management Discussion and Analysis (MD&A) accompanying their financial statements. Under the umbrella of IOSCO, there may be a more effective path to meet investor needs via resilient disclosure in the MD&A. Auditors are required to refer to and describe their responsibility with regard to MD&A in their opinion.

- Current going concern guidance is largely within the audit standards whereas the accounting standards offer minimal guidance on this topic. Therefore, we suggest that the International Accounting Standards Board (IASB) explore guidance in the accounting standards, with an emphasis on practical illustrative examples to guide accountants, management and those charged with governance of organizations and auditors alike.

- Additional insight can also be provided by the governing bodies of Corporate Directors, who can provide additional education and guidance to its members surrounding the going concern topic. Some organizations have internal audit functions that can further explore resilience or provide additional transparency to Corporate Directors on the going concern topic.

- Securities regulators may contribute to investor needs with more refined guidance regarding expectations for Directors and management of organizations about their responsibilities regarding fraud and going concern.

- Regarding the evolution gap, IAASB should explore targeted improvements to the audit standards. However in order to ensure a path for private enterprises to list in public markets, as well as to keep public markets accessible for issuers of various sizes, there should not be a significant bifurcation in audit requirements between SMEs, emerging growth public companies and larger publicly accountable enterprises.

2. This paper sets out the auditor's current requirements in relations to fraud in an audit of financial statements, and some of the issues and challenges than have been raised with respect to this. 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, preventing and detecting fraud is foremost the entity's responsibility. The auditors are already required under paragraph .35 through .38 of *ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* to evaluate the impact of any fraud identified on the audit.

However, in instances where there is a diversity in the understanding and application of the current requirements, the IAASB should provide additional practical guidance and illustrative examples written to be accessible and understandable to both auditors and investors.

(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?

Certain entities are subject to separate regulation and reporting requirements that may also involve their auditors. The need for any enhancements to existing procedures is fact-specific and best addressed outside of the scope of the ISAs. Attempting to incorporate such guidance into the ISAs introduces a new key judgement around nature of the entity, or part thereof, to determine whether such requirements apply. Accordingly, we do not believe that there is a need for enhanced procedures for certain entities within the ISAs.

(ii) What enhancements are needed?

We do not believe that any further enhancements are needed within the standards. For example, *ISA 315 (Revised 2019), Identifying and Assessing the Risks of Material Misstatement* has adequately addressed audit procedures to be performed by the auditor for identifying risks of material misstatement which specifically references risks arising from fraud. These requirements have not yet been implemented.

We do believe that a root cause analysis of recent corporate failures and frauds would assist the IAASB to understand whether enhancements to the ISAs would be effective at addressing the expectation gap.

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

We do not believe any changes need to be made for certain entities or specific circumstances within the ISA or outside the scope of an audit.

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

We do not believe that a "suspicious mindset" would contribute to an enhanced fraud identification during the planning, or any other phase of the audit, unless such suspicions are corroborated based on the accumulation of such audit evidence. Training on applying professional skepticism and guiding practitioners to apply it in relevant circumstances would be more appropriate than applying a suspicious mindset.

The revised ISA's continue to emphasize professional skepticism within the standards such as *ISA 540 (Revised), Auditing Accounting Estimates and Related Disclosures* and *ISA 315 (Revised 2019), Identifying and Assessing the Risks of Material Misstatement.* We believe that IAASB should continue to emphasize professional skepticism and revise auditing standards to ensure that the standards foster a professionally skeptical mindset, such as the requirement to "stand-back" and evaluate all audit evidence obtained in forming conclusions.

A suspicious mindset, especially if it is exhibited on a constant basis throughout the audit engagement, could deter management from entering into a free-flowing sharing of information with the auditor and accordingly hinder audit quality.

If management feels the auditor is deeply suspicious of them, they may become defensive and be less likely to cooperate, provide brief responses to open ended questions, confer in advance, not share draft documents and potentially build resentment towards the auditor and continuous questioning. It may also discourage auditors from pursuing the profession.

Even if, with additional time and effort, an auditor may overcome the challenges identified above, an impact would still be had on the timeliness of the audit and increase overall audit cost, a potential burden to investors for a relatively minute incremental benefit.

If a suspicious mindset was also applicable to SMEs (if a separate set of audit standards were to be developed), SMEs may be discouraged from seeking an audit or adopt greater use of local audit standards which may better suit their users' need.

All these factors would be counterproductive to the execution of a quality audit rather than resulting in a higher quality one.

(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?

As noted above, we do not believe that enhancing the auditor's consideration of a "suspicious mindset" would contribute to an enhanced fraud identification. In our view, the IAASB should explore targeted application guidance around fraud but the broad adoption of suspicious mindset may be counterproductive.

(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.)?

Auditors are required to determine and communicate key audit matters in the auditor's report for certain types of entities and if fraud is most significant to the audit of the financial statements, this information will be conveyed to the users of the financial statements through these key audit matters. This audit standard has recently become effective for certain entities in Canada, as such the impact on users is not yet clear.

Communications with all parties involved would help auditors to be more transparent about the auditor's work in relation to fraud in the audit of the financial statements. We support the suggestion on page 31 of the DP regarding a required annual assurance meeting led by the audit committee and attended by the auditors who would be available to answer questions. We believe this may achieve a level of transparency and education of the relevant stakeholders that would be beneficial.

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?

In our view, the term going concern is not well understood outside the accounting profession as such, a more descriptive term is needed.

Further, there is a lack of clarity as to what constitutes a "material uncertainty". *ISA 570 (Revised), Going Concern* does not define a material uncertainty and contains a limited description of what a material certainty is. It is recommended that additional guidance be provided of what constitutes a material uncertainty to ensure clarity and consistent application by auditors. Also reiterating our response to 1(b) it is our suggestion that greater guidance be provided in the accounting standards, with an emphasis on practical illustrative examples to guide accountants and auditors alike.

(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?

We do not believe that the nature or type of entities should be a factor in determining the procedures performed by the auditor, as separating levels of assurance for various entities will only serve to further complicate already poorly understood standards We believe one set of standards appliable to all entities but that are scalable to the entity's particular attributes is a better path.

When a going concern issue is specifically identified by the engagement team, the auditor shall perform the required audit procedures in accordance with *ISA 570 (Revised), Going Concern*. We believe that the auditor shall exercise professional judgement in obtaining sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern for all entities and not just certain entities.

(ii) What enhancements are needed?

Refer to our response in 3(a) above for enhancements that should be made for all entities and not just specific entities.

(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.

As noted in our response above we do not believe that there are specific procedures or enhancements necessary for certain entities or specific circumstances however we do believe that there should be clarifications made to terminology and these clarifications should be made within the ISAs. We also believe exploring avenues for education/transparency to stakeholders regarding the concepts of fraud and going concern, the various responsible parties and the limitations of an audit would be helpful.

(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.)?

Auditors are required to determine and communicate key audit matters in the auditor's report for certain types of entities. If going concern is most significant to the audit of the financial statements, this information will be conveyed to the users of the financial statements through these key audit matters. This audit standard has recently become effective for certain entities in Canada, as such the impact on users is not yet clear, although we believe the enhanced transparency is likely to be beneficial to users provided that they do not become boilerplate disclosures.

As mentioned above, we do believe that more formal communication such as a required annual assurance meeting would help auditors to be more transparent about the auditor's work in relation to going concern in the audit of the financial statements and also serve to enhance the communication & transparency between various interested parties while also achieving an enhanced expectation of responsibility to those charged with governance.

(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?

We believe that management should be required to explain going concern in more detail to the users of the financial statements within the financial statements and potentially within their MD&A, if required. Currently *IAS 1, Presentation of Financial Statements* paragraph .25 states that "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. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern." Management should be encouraged to reveal to the users of the financial statements more detailed and entity-specific information that will allow more transparency surrounding going concern.

Consistent with our response to Question 1 (b), additional transparency can be provided by:

- The governing bodies of Corporate Directors can provide additional education and guidance to its members surrounding the going concern topic. Some of the larger reporting issuers often have internal audit programs that are used by experienced internal auditors who are members of governing bodies.

- Securities regulators in several jurisdictions can require issuers to provide additional information in its MD&A section of their financial statements

4. Are there any other matters the IAASB should consider as it progresses its work on fraud and going concern in an audit of financial statements?

IAASB has highlighted other matters raised to date which will be considered in further information gathering and outreach activities as disclosed in Appendix A of the DP. We believe that this list is reasonable and currently there are no other matters that we want to bring to your attention.

In addition to the specific questions above, we offer further considerations below regarding some of the items raised in the IAASB DP:

- **As noted on page 18 of the DP, you are interested in perspectives regarding 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.**

  In our opinion, forensic specialists should be brought in only when specific circumstances arise (e.g. alleged or suspected fraud). However, this may create a scalability issue based on accessibility to a forensic specialist and the increased cost of an audit, particularly in audits of SMEs, whereby in many cases management and those charged with governance are one and the same.

  We believe a requirement for the involvement of a forensic expert in all audits, would increase the expectation gap with users to the role of the auditor in identifying fraud if forensic specialists were brought in more broadly in audits. The public should be aware that, in providing an audit opinion, auditors are using professional judgment to identify any high-risk transactions or suspicious transactions. Auditors cannot practically review all transactions and therefore utilize the concept of "materiality" which is a term not well understood by some relevant stakeholders. IAASB should consider ways to make this terminology more commonplace to reduce the expectation gap.

  Moreover, the vast majority of audited financial statements are likely not be subject to undetected material fraud. Any significant changes to standards contemplated should reflect on the costs and benefits to all audits, especially the potentially disproportionate cost to smaller entities.

- **As noted on page 19 of the DP you are 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.**

  As noted above, preventing and detecting fraud is foremost the entity's responsibility. As such if a fraud has been identified, the auditor is required to complete procedures as noted in *ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements.* If the auditor can conclude that the financial statements are not materially misstated as a result of fraud, the auditor has met the requirements.

  If the auditor is required to perform audit procedures on non-material fraud, this would be in direct contrast with *ISA 320, Materiality in Planning and Performing an Audit*, which requires 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.

  If the auditor is responsible for non-material fraud, the guidance under *ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* would need to be reconsidered to address such a responsibility.

- **As noted on page 23 of the DP you are interested in perspectives on whether entities should be required to assess their ability to continue as a going concern for longer than twelve months, and therefore whether auditors should be required to consider this longer time 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 in order for auditors to be able to adequately perform their procedures.**

  We do not believe auditors should be required to assess the entity's ability to continue as a going concern for a period greater than twelve months. If this were the case, users may increase their expectation that the auditors will guarantee that the entity will survive for a longer period of time, widening the expectation gap. Users already overestimate the level of assurance provided by the auditors. Further, as the time period for assessing an entity's ability to continue as a going concern increases, that assessment becomes less meaningful since the level of uncertainty and unpredictability increases over time. A period in excess of 12 months would require significantly more estimation and judgement, all of which are challenging to audit (i.e., often have little tangible evidence associated) the longer the time period is. Small variations to inputs can have massive overall implications

- **As noted on page 25 of the DP you are interested in perspectives on what more is needed to narrow the knowledge gap with regard to the meaning of material uncertainty related to going concern, to enable more consistent interpretation of the concept. In addition, 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.**

As noted in our response to 3(a) above, clarity is needed is needed in defining and describing a “material uncertainty”. In *ISA 570 (Revised), Going Concern* there is no definition of material uncertainty and there is limited description of this term within this standard.

Further, the international accounting standards reference material uncertainty once in *IAS 1, Presentation of Financial Statements*, and once in *IAS 10, Events After the Reporting Period*. There is no emphasis or guidance regarding this term, and it is not sufficiently aligned with the auditing standards.

We believe that additional guidance needs to be provided in both auditing standards and accounting standards regarding what constitutes a material uncertainty to ensure clarity and consistent application by the entity and the auditors. As well, any avenue whereby additional education of and transparency to stakeholders regarding this term is worth exploring.

We would be pleased to offer our assistance to the IAASB in further exploring issues raised in our response and in helping to find alternative solutions which meet the needs of the financial statement users.

Yours truly,

MNP LLP

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