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Mr. Thomas Seidenstein
Chair
International Auditing and Assurance Standards Board
529 Fifth Avenue, New York NY 10017
United States of America
1 February 2021

Dear Mr Seidenstein,

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

RSM International Limited, a worldwide network of independent audit, tax, and consulting firms, appreciates the opportunity to comment on the IAASB's Discussion Paper – Fraud and Going Concern in an Audit of Financial Statements (Discussion Paper).

These two topics have long been important for both auditors and the users of financial statements. Recent significant business failures, such as Wirecard and others mentioned in the Discussion Paper, have heightened the focus on the role of the auditor in these areas, which may be further exacerbated by the effect on business of the current pandemic. We therefore welcome the IAASB's review of fraud and going concern procedures performed by auditors.

Overall, our view is that, whilst there is a continuing need to ensure that the users of the financial statements understand the current respective responsibilities of management, those charged with governance and auditors, it is not the only solution to the expectation gap.

In addition to continuing efforts to ensure clarity of respective responsibilities, the IAASB should initiate a wider discussion with users of financial statements and regulators on the scope and purpose of an audit. This would be valuable in closing the expectation gap, not by reaffirming the status quo, but by exploring new ways in which the audit could better serve the users of the financial statements. The audit should continue to evolve to the changing needs of users. This substantive work is key in addressing the evolution gap. We encourage the IAASB to continue the evaluation of these topics that has begun in this Discussion Paper and begin this substantive evaluation process.

Incorporating the feedback received from financial statement users, we recommend that the IAASB evaluate the current ISAs to assess whether enhanced procedures, such as updates to incorporate new technologies used by auditors, could be incorporated. We also recommend the IAASB collaborate with Accounting Standards setters to improve the financial statements disclosures upon which auditors express an opinion.

Our responses to the specific questions posed in the Discussion Paper are set out below. We would be pleased to discuss our views further with your staff. If you have any questions regarding our comments, please contact Steve Whitcher (steve.whitcher@rsm.global) or me at (marion.hannon@rsm.global).

Yours faithfully,

Marion Hannon

Marion Hannon
Global Leader, Quality and Risk

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Overall Questions

Q.1(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?***

Given the responsibilities of auditors, management and those charged with governance under the current auditing standards, in our view the main cause of the expectation gap which exists at the present time is the "knowledge gap".

However, we also acknowledge the findings of the recent report in the UK by Sir Donald Brydon "Report of the Independent Review into the Quality and Effectiveness of Audit", which was clear that auditors cannot solely blame this expectation gap on a lack of user knowledge. The profession has been attempting for decades to help users to better understand the nature and limitations of the audit, yet the expectation gap persists, so we suggest that a change of approach should be considered.

High-profile instances of audit failures in several, though not all, jurisdictions make it difficult to avoid the conclusion that there is also a "delivery gap" in the performance of audits that needs to be addressed. While this may be partly attributable to failures to follow the current ISAs, a "performance gap", we believe there is also a need to assess whether the ISAs in these areas are fit for the purpose of meeting users' reasonable expectations; an "evolution gap." Therefore, we welcome the IAASB's discussion paper on these critical audit areas and support a review into whether these current responsibilities remain appropriate.

In conducting this review, we believe the IAASB should continue to focus on principles based standards that permit the responsibilities of the auditor to evolve in line with the evolving needs of users. It is critical that consideration is given to whether the audit product is delivering what the users of the financial statements want and need, given the evolution of the expectations of an audit, such that it provides the confidence that capital markets require. This is further discussed below.

Q.1(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?***

Given the current responsibilities under the extant ISAs, the IAASB and others should continue the focus on communicating the responsibilities of management, those charged with governance and auditors to equip users of the financial statements with an understanding of their respective responsibilities with regards to fraud and going concern

This knowledge gap could also be addressed by improving the description in the audit report of the purpose and scope of an audit regarding the detection of material fraud and the consideration of going concern. However, it is important that any such wording is in "plain English" rather than technical language.

A further possibility would be for financial statements to include an explicit statement by those charged with governance regarding the responsibilities of management with regards to fraud and going concern. This is already in use in certain jurisdictions, sometimes in the form of a solvency statement. Broader adoption of this approach should be evaluated and engagement with key local legislative bodies could be considered. This consideration should also include the needs of users of the financial statements, such as whether such explicit statements are of equal value to all users of financial statements or of heightened value to public interest entity or listed entity financial statement users.

With respect to the performance gap, the increased focus on quality management at firm level that will be introduced through the International Standards on Quality Management should, in our view, improve the performance of audits in these areas. Individual firms and networks will be enhancing existing processes and controls to mitigate the risks associated with the poor performance of procedures on fraud and going concern.

In terms of the evolution gap, as the expectations of users of the financial statements change, the audit profession should change to be responsive to user needs. It will be imperative that changes to the audit profession are done in concert with changes to the entire financial reporting ecosystem. Activities and responsibilities of management and those charged with governance are foundational to all changes made by auditors and will also need to evolve to align with user needs.

We suggest that the IAASB begins to explore whether the current foundational principles of the auditor's responsibilities still meet the needs of those users. The audit of the future might need to have more layers to it, for example forensics or environmental issues, and could evolve into a base financial statements audit with additional assurance provided in specialist areas as needed or requested by the users. This would clearly have financial implications for audited entities and present challenges for audit firms in training staff with the appropriate skills but may be necessary to comprehensively address the current issues.

Q.2(a). ***Should the auditor have enhanced or more requirements with regard to fraud in an audit of financial statements? If yes, in what areas?***

Extant ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements, does not in our view, require extensive revisions and we also consider that the introduction of inherent risk factors in ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment, should improve the consideration of fraud in the risk assessment process.

However, the structure of the current ISAs tends to lead to the compartmentalising of the consideration of fraud. Apart from the consideration of fraud for significant risks, the identification of fraud risks can still very much be seen as a stand-alone exercise, separate from the rest of the audit. Extant ISAs do refer to fraud risks, for example paragraph 32 of ISA 540 (Revised), Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures, states that "where there is intention to mislead, management bias is fraudulent in nature", but we would like to see an even more integrated and pervasive approach. This would encourage a new mindset in auditors and further embed the consideration of fraud risks into the audit such that a thread of addressing these risks flows through all of the ISAs.

We would like to see the ISAs remain principles based, so the standards remain functional over the long-term to adapt and accommodate for new techniques and procedures as they are developed. However, we also agree that more explicit recognition in the application guidance of the ISAs of different techniques that are now used by auditors to detect fraud and more flexibility for building them into firms' risk models. One area where this increased flexibility might be appropriate is the effect of the increasing use of data analytics and other automated techniques in audits. Auditors still struggle to fit these technological solutions to auditing into the current evidence gathering model of substantive analytics, tests of controls and tests of details. We believe the project the IAASB has begun to evaluate the extant standard ISA 500, Audit Evidence, can play an important role in these considerations.

There is a greater sensitivity to fraud than to factual errors or to estimation uncertainty, since fraud, even of relatively small monetary value, may also raise serious concerns about management's integrity, or about the effectiveness of internal control. As such, there may be some value in issuing further guidance in relation to actions necessary where nonmaterial fraud is identified through routine testing.

Q.2(b). ***Is there a need for enhanced procedures only for certain entities or in specific circumstances?***

The suggestions in our response to question 2(a) would apply to all entities.

In terms of the areas in the Discussion Paper on which specific comments are requested:

- The use of forensic techniques could be useful in certain situations, but we do not consider that they should be mandatory for every audit or every type of entity. These techniques are wide and varied and it may be difficult to articulate a specific set of procedures that should be carried out on, say, all listed clients. In addition, only the larger firms are likely to have sufficient in-house experts in this area and therefore other firms would need to buy-in the expertise. This may lead to further concentration of the audit market – an area that governments and regulators in several jurisdictions have already expressed concerns about. In addition, an audit is not a in-depth forensic exercise and therefore mandating the use of forensics might widen the expectation gap, rather than narrow it.

  Therefore we would not be in favour of an overarching requirement that forensic techniques should always be used, even for listed entities, since it would lead to inconsistent interpretations and applications. It could also lead to the application of ineffective and costly audit procedures if the performance of such procedures was mandated rather than applied in line with a risk based approach.

  However, guidance on the use of forensic experts in certain situations, for example when a material fraud is suspected in a listed client, would be welcome.

- We would welcome further consideration by the IAASB of the more robust approach that may be used by public sector auditors and any lessons that could be learned for other auditors.

- Non-material fraud does not cause business failures and therefore, in our view, it is the responsibility of management, assisted by Internal Audit where relevant, to design procedures and controls to prevent and detect non-material fraud. However, whilst a fraud may be considered as non-material in a given period, left unchecked it has the potential to grow in future periods to such an extent that it eventually becomes material. Auditors still need to consider the integrity of management and risk assessment procedures in subsequent periods could include consideration of the risk that identified non-material frauds could result in a cumulative material fraud.

  In respect of whether additional engagement quality control review procedures relating to fraud risks should be introduced, we recognise that, where material fraud is suspected or identified, this should be as a significant risk and therefore the engagement quality control review would cover the issue. We do not believe the engagement quality control review should have unique procedures related to fraud that are separate from those performed by the engagement team.

- We are also in favour of fraud procedures being enhanced as set out in the bullet points on p27 of the Discussion Paper in order to promote professional scepticism.

Other suggestions for improving fraud detection could include:

- Training auditors in fraud investigation techniques and interrogation methods and could be a useful activity for the International Forum for Accountancy Education Directors from Professional Accountancy Organizations and Firms;
- Setting "specific" materiality thresholds for fraud investigation procedures in consultation with a fraud/forensics team if material fraud were suspected;
- Agreeing specific fraud procedures in certain areas with those charged with governance.

Q.2(c). ***Would requiring a "suspicious mindset" contribute to enhanced fraud identification when planning and performing the audit? Why or why not? 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, having a suspicious mindset would not be appropriate. The relationship between auditor and management begins with mutual trust and an assumption of integrity on both sides. In ISA 315 the auditor assesses the culture of honesty and integrity at the entity and, therefore, a default position that the auditor should always have a suspicious mindset might lead to situations of distrust between auditors and management. This could lead to the break down of effective communication and working relationships such that the auditor could not complete the audit.

In our view the current principle of professional scepticism is appropriate, recognising that, if the auditor suspects fraud or obtains information during the audit which calls the integrity of management into doubt, their professional scepticism may well be heightened to the level of suspicion.

The issue that needs to be addressed is that the requirement to exercise professional scepticism is not being consistently applied on all audits. We believe the enhancements to ISA 220, Quality Control for an Audit of Financial Statements, as a result of the issue of the International Quality Management Standards will improve the consistency of auditors' understanding of how to apply the concept of professional scepticism. In addition, we suggest:

- Increased guidance in ISAs on exercising professional scepticism by challenging management and ensuring that auditors fully investigate issues that arise on the audit.
- More emphasis in ISAs in general on seeking disconfirming or contradictory evidence so that auditors do not just focus on confirming evidence. It is important that, when auditing the data and assumptions used by management in areas such as valuations, impairments and going concern, auditors stress test the models used to breaking point. This would entail varying management's assumptions to see where the model results in a material misstatement. If the data and assumptions used to "break the model" are reasonably possible outcomes, then the auditor needs to challenge management on whether its own data and assumptions are appropriate.

Q.2(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 be communicated (e.g. in communications with those charged with governance, in the auditor's report etc.)?***

We consider that a more detailed explanation to those charged with governance regarding the auditor's procedures in relation to fraud would enhance audit quality. It would enable those charged with governance to understand and challenge the auditor regarding the nature and extent of the procedures performed. A robust exchange of views between the two parties, clearly setting out their respective responsibilities with regards to fraud, could then be held.

As set out in our response to question 1(b), we would be in favour of a wider “plain English” description of the audit in the audit report for all entities so that the auditor’s responsibilities in this area are clearer.

In terms of reporting by auditors we consider that the existing requirements to report key audit matters under ISA 701, Communicating Key Audit Mattes in the Independent Auditor’s Report, are sufficient to describe the auditor’s response to material fraud when it is suspected or detected.   We would not be in favour of extending these requirements to all entities.

Q.3(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?***

As with fraud, we would be in favour of ISA 570 (Revised) Going Concern being enhanced as set out in the bullet points on p27 of the Discussion Paper. We agree that these would promote a more questioning and sceptical mindset.

The extant requirements on going concern require the auditor to perform procedures over management’s assessment of going concern. However, we recommend consideration of the additional requirements that the UK’s Financial Reporting Council has added to ISA 570 including:

- The performance of risk assessment procedures over going concern with a focus on the Entity and its Environment, the Applicable Financial Reporting Framework and the Entity’s System of Internal Control
- A greater focus on the auditor evaluating the evidence about the entity that has been obtained through the performance of audit procedures rather than simply reviewing management’s assessment of going concern
- More explicit requirements for evaluating management’s assessment of going concern, irrespective of whether a significant doubt about going concern has been identified
- Extending the auditor’s responsibilities where management refuses to extend its assessment beyond the period required by the financial reporting framework to include discussions with those charged with governance and the consideration of whether a significant deficiency in internal control exists
- A requirement for audit reports to contain a positive statement on going concern, with additional requirements for auditors of listed and larger private entities to explain how management’s going concern assessment has been evaluated and the conclusions thereon.   We would recommend linking any requirement in this area to entities subject to ISA 701.

The Discussion Paper requests views on the period for which going concern is assessed. We suggest that, in common with a number of jurisdictions, this time period should be twelve months from the date of the approval of the financial statements or the audit report rather than just the date of the financial statements set out in ISA 570 paragraph 13. If such a change is considered, we recommend that the IAASB engage in discussions with the Accounting Standards setters to align the financial reporting and auditing requirements. As a transitional measure in order to avoid conflict with financial reporting frameworks that have an established time period management that is required to assess going concern, we recommend that the auditing standards specify that the evaluation should cover the time period included in the financial reporting framework until such time as alignment is achieved. Otherwise, the time period above should be used.

The requirement in ISA 570 paragraph 11 to remain alert throughout the audit for evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern would, in our view, include circumstances known to the auditor beyond the period of management's assessment. For example, a requirement to repay a loan in 18 months, which could cause an issue with an entity's ability to remain a going concern despite it being outside the assessment period required under the relevant financial reporting framework would require evaluation by management and the auditor. More explicit guidance in this area would be welcome.

Better linkages between going concern and other areas of the audit would be welcome. The detection of a significant doubt about going concern should also raise the auditor's awareness of issues elsewhere in the audit, including fraud, whereby management could be motivated to misstate results.

Q.3 (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.

The conclusion on going concern is fundamental to the presentation of the financial statements and, as mentioned above, management's responsibilities are defined by the financial reporting framework. Going concern is therefore relevant to all users of financial statements and we would want to see the same standards and procedures applied to all entities.

The only exception to this would be the requirement to report on going concern in the audit report which, as set out in the answer to question 3(a), should only apply to those entities to which ISA 701 is applicable.

Q.3(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 communication with those charged with governance, in the auditor's report etc)?

As set out in our response to question 3(a), we would be in favour of additional requirements to report on going concern in the audit report.

We also consider that a more detailed explanation to those charged with governance regarding the auditor's procedures in relation to going concern would enhance audit quality. It would enable those charged with governance to understand and challenge the auditor on the nature and extent of the procedures performed.

(ii) about going concern, outside of the auditor's work relating to going concern? If yes, what further information should be provided, where should this information be provided, and what action is required to put this into effect?

Yes, greater transparency would enhance users' understanding of the basis on which management made its assessment about "material uncertainties" and therefore the judgments made by the auditor. In our view, more information than is currently required by most financial reporting frameworks should be provided by management to set out the assumptions, methods and data which they have used in assessing going concern.

This would need to be a joint effort between the Accounting Standards setters and the IAASB to ensure a consistency of approach and to avoid the audit report disclosing information that is not also included in the financial statements.

Q.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?*

We have no other comments to make in this area.