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Attention: Willie Botha
Technical Director
IAASB
529 5th Avenue
New York, New York 10017

Via online submission: www.iaasb.org

Dear Willie

IAASB Public Consultation on Fraud and Going Concern in an Audit of the Financial Statements: Expectation Gap

CPA Australia welcomes the opportunity to comment on the IAASB's discussion paper on fraud and going concern in an audit of the financial statements (the DP), dealing with the important issue of how to address the audit expectation gap, or gaps, which threaten the future relevance of audits in meeting user needs. CPA Australia represents the diverse interests of more than 166,000 members working in over a 100 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

Whilst this is not a new issue, having been a topic of debate for several decades, it is nevertheless still relevant and we welcome the IAASB's DP raising and seeking to resolve the problem, in so far as that is possible. Arguably the expectation gap grows with the proliferation of information relevant to evaluating company performance, which makes a solution increasingly pressing. In Australia these issues are particularly pertinent as a recent Parliamentary Inquiry into the Regulation of Auditing in Australia has recommended a formal review of the sufficiency and effectiveness of reporting requirements under Australian standards in relation to the prevention and detection of fraud and management's assessment of going concern. This review will no doubt encompass, but not be limited to, the Australian auditing and assurance standards, which conform with the IAASB's standards.

Please see the Attachments for responses to the questions posed in the DP and perspectives sought.

If you require further information on the views expressed in this submission, please contact Claire Grayston, Policy Advisor Audit and Assurance at claire.grayston@cpaaustralia.com.au.

Your sincerely

Dr. Gary Pflugrath
Executive General Manager, Policy and Advocacy

Enc: **Attachment 1:** Responses to Questions in IAASB Discussion Paper.

Attachment 2: Responses to Perspectives Sought in IAASB Discussion Paper.

ATTACHMENT 1

Responses to Questions in IAASB Discussion Paper – *Fraud and Going Concern in an Audit of the Financial Statements: Expectation Gap*

Q 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?

We consider that the main causes of the expectation gap in relation to fraud and going concern are explored and articulated well in the DP. The DP describes the expectation gap as comprising knowledge, performance and evolution gaps. However the components are categorized, in essence they arise when:

- Occurrence and detection of fraud immaterial to the financial statements, but which was not identified by the external auditor and is unlikely to be, due to the scope of an audit and application of materiality (knowledge and evolution gaps).
- Occurrence and detection of fraud material to the financial statements, but which was not identified by the external auditor, due to either inadequacies in the conduct of the audit (performance gap) or the nature of the fraud which often involves collusion, concealment and/or deception which impedes detection (knowledge and evolution gaps).
- The entity collapses or enters into some form of administration without warning signs which, had warnings been available, may have enabled a more timely response or could have put stakeholders on notice of the risks and uncertainty faced by the entity (knowledge, performance and evolution gaps).

(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 could:

- Develop assurance standards to address the evolution gap for:
    - Internal control assurance engagements which would provide a basis for engagements on the design, implementation and operating effectiveness of controls over financial reporting or controls specifically to prevent or detect fraud. This would provide a platform for national policy-makers and regulators to introduce requirements for such engagements for certain public interest entities. The most notable existing regime of internal control reporting and assurance is that in the United States under Section 404 of the Sarbanes-Oxley Act, requiring both a management assessment of controls and external assurance. A standard exists in Australia for conducting such engagements, ASAE 3150 *Assurance Engagements on Controls*, although without requirements for entities to make an assertion or obtain external assurance.
    - Assurance engagements on management commentary, encompassing Director's reports, which may address fraud and going concern risk assessments, viability or resilience statements and future prospects. Whilst these engagements cannot be mandated by the IAASB, standards would provide a basis for the development of national regulatory requirements for such engagements.
- Enhance current standards to minimise the performance gap by making it absolutely clear as to the extent of work required by the auditor on fraud risks in ISA 240 and going concern in ISA 570. Whilst we consider that the standards are essentially fit for purpose, some enhancements could include:

- Revising requirements which may currently have the effect of reducing the auditor's professional scepticism, such as ISA 240 paragraph 14 which states: *Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine*.
- The risk of fraud is increased where the control environment is weak so further work in responding to fraud risks could be explicitly required when controls are not operating effectively. Currently the requirements focus on the response to the risk of management override of controls rather than more broadly on weak controls.

- Enhance the current standards to address the evolution gap with respect to technology by encouraging auditors to use technological tools, such as data analytics, process mining and visualisation. For example, data analytics tools can be used to analyse whole populations within high risk accounts to identify anomalies which may be indicative of fraud and can be the target of further procedures. Process mining can be used to identify internal control overrides, where standard processes are not applied, which can show controls weaknesses and high-risk transactions. We note that technological tools are not available yet to all auditors and cannot be applied to all clients or accounts, as software systems used by entities do not universally enable access to data in a form suitable for extraction and analysis. Nevertheless, we observe an acceleration in the uptake of technological tools by external auditors, as third-party providers proliferate and products become more viable, both economically and in terms of IT skills required in-house. As a consequence, our expectation is that external audit techniques will change significantly in coming years, with greater reliance on technological tools, which are typically more sophisticated than traditional sampling techniques and are more effective in identifying anomalous transactions and balances. We expect this foreshadows a greater role for external auditors in fraud detection in the future.
- Enhance current standards to address the knowledge gap by allowing communication of the auditor's work on going concern in Key Audit Matters (KAMs), even if a material uncertainty related to going concern (MURGC) is reported under an appropriately titled paragraph, as the KAM can provide greater detail regarding the matters which the auditor considered than would be the case in the MURGC paragraph. This could be informative for users.

Whilst further explanation could be included in the auditor's report on the work undertaken with respect to fraud or going concern, we don't see that this would provide significant value if it is always required, as it will become boilerplate unless it reflects additional requirements which the auditor needs to address.

Other stakeholders typically have scope to address fraud and monitor going concern more effectively and in a more timely manner than the external auditors. Prevention and detection of fraud and ensuring the entity remains a going concern is primarily the entity's responsibility and all parts of the reporting eco-system need to be working together to maximise the opportunity to effectively address fraud and the risk of unexpected corporate collapse, thereby reducing the expectation gap. Whistleblowers and effective internal controls systems have historically been the most effective means of fraud prevention and detection. External auditors' work is based on materiality and risk assessment, as a result only selected amounts and usually a sample of transactions and balances, are examined in detail. In contrast, an entity's system of internal controls should monitor and control every transaction and balance. Likewise, an entity's internal monitoring of cash flows and cash flow forecasts, and the viability of its business, is likely to be more effective and timely in identifying going concern issues than the auditor's periodic work after the fact, albeit management may be more optimistic about the likely business outcomes.

Fraud could be addressed by:

- Regulatory requirements for internal control assessments to be reported by management and externally assured, which may be limited to selected categories of entities, such as listed or public interest entities.
- Entities electing to obtain periodic fraud risk assessments from a suitable expert.
- A centralised register of fraud cases, including how they were perpetrated, how they could have been prevented, red flags which arose and how they were detected.
- Governments strengthening whistleblower protection.
- An increasing uptake by entities of data analytics and technological tools to monitor controls and activities within the entity, and identify anomalies, coupled with processes to follow up on the output of such techniques.

Going concern could be addressed by:

- Standard-setters and regulators mandating, or entities being encouraged to voluntarily make, enhancements to management commentary, such as an assessment and statement of future viability or resilience of the entity or the risk profile reported.
- Considering the need for assurance over the reasonableness of the underlying assumptions and data used as a basis for management commentary, beyond merely consideration, as is currently required by the standards for "other information".

Q 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?

As identified in response to question 1, requirements could be enhanced to include further work in responding to fraud risks when the control environment is weak or specific control weaknesses are identified. The current requirements focus on responses when control weakness creates opportunity for management override.

Enhancements could also be made regarding how data analytics and other technological tools can be utilised to help auditors identify fraud.

(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, not with respect to work effort in relation to fraud in the audit of financial statements. For such audits, we do not consider that fraud should be addressed differently for different entities, although clearly the fraud risks identified can vary widely between industries, locations and the size of an entity.

However, as raised in answer to question 1(b), we do see benefits in developing standards for other types of assurance engagements, such as assurance on controls over financial reporting, controls over fraud prevention and detection, management commentary and fraud and going concern risk assessments.

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

A "suspicious mindset" may well increase the likelihood of the auditor detecting fraud. However, that is not to say that it is the most efficient means of preventing or detecting fraud. Arguably, a suspicious mindset would increase the work effort considerably, which in turn would increase the cost of an audit. There are other engagements which can be more directly targeted at fraud, along with other strategies that entities can employ which may be more effective, including fraud risk assessments, cultural change, whistleblower policies and internal control assessments. In addition, not all fraud directly impacts the financial statements, and may fall outside of the auditor's fraud risk considerations. Consequently, the definition of fraud is important when understanding the impact of requirements to identify it.

(d) Should the IAASB enhance the auditor's considerations around fraud to include a "suspicious mindset"? If yes, for all audits or only in some circumstances?

We do not see the need to apply a suspicious mindset and consider that professional scepticism is an adequate benchmark for the level of scrutiny auditors should apply. However effective and appropriate exercise of professional scepticism is enhanced by the level of knowledge and experience of the audit team, coupled with factors such as adequate time and resources to conduct a quality audit. Suspicion is aroused when anomalies or evidence of fraud are identified, which is the appropriate time for further investigation or a "deep dive" to be undertaken.

(e) 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.)?

We do not consider that there is any need to communicate further information routinely in the auditor's report on the work conducted in relation to fraud, as we suggest it would become boilerplate and lose information value for stakeholders. This does not preclude reporting of a matter relating to fraud in KAMs where it is a matter of most significance in the audit. Communication with management or those changed with governance within the entity, and escalation to an appropriate authority, are already thoroughly addressed in ISA 240, so we do not see the need for further requirements in this regard.

Q3: 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?

No, we do not consider that further requirements are needed for auditors' assessment of going concern. However, further guidance may be helpful regarding the nature and extent of evidence required to support each type of modified opinion related to going concern.

(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

Any changes to the procedures required to be conducted by auditors should be driven by enhanced reporting requirements for management or those charged with governance of the entity, which can then be required to be audited or assured. Those charged with governance of the entity hold primary responsibility for assessing whether the entity remains a going concern, making appropriate disclosures where a material uncertainty arises or determining if it is no longer a going concern. Unless the reporting requirements are changed, we do not see a need for amendments to the ISAs. However, a standard on assurance engagements for an engagement on management commentary which addresses future viability beyond the 12 months required for the financial statements would be beneficial to underpin demand for assurance in the future.

(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?

We consider that there is sufficient transparency in relation to the auditor's work on going concern and further wording in the auditor's report would only become boilerplate.

We would support allowing KAMs to include going concern even if it is already raised in a MURGC paragraph, as KAMs typically provide more information than a MURGC paragraph. This may diminish the perceived importance of a MURGC, which should be of greater concern to users than a KAM.

The accounting standards need to be enhanced with respect to the going concern assessment. They need to provide the sort of details which are currently only contained within the auditing standards. We suggest that the IAASB urge the IASB to address this matter.

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?

With respect to going concern we recommend the inclusion of the diagrammatic representation of the going concern decision process, such as that contained in the Australian standard ASA 570 Appendix 1 and the New Zealand standard ISA (NZ) 570 (revised) Appendix 2, and which illustrates the audit opinions that flow from the auditor's going concern considerations.

ATTACHMENT 2

Responses to Perspectives Sought in IAASB Discussion Paper – *Fraud and Going Concern in an Audit of the Financial Statements: Expectation Gap*

The IAASB is interested in perspectives about/on:

1. **Page 15: the impact of corporate culture on fraudulent financial reporting and what, if any, additional audit procedures for the auditor should be considered by the IAASB in this regard.**

   Corporate culture, comprising such factors as the tone at the top, how that tone is reflected down through middle management, risk appetite, attitudes to compliance with legal and regulatory requirements and compliance with internal controls, is critical in managing the risk of fraudulent financial reporting. Whilst auditors need to be aware of these cultural influences within the entity and remain alert to red flags that indicate a poor culture, which may impact their risk assessment and reliance on controls, we would not advocate requirements to objectively evaluate culture as part of the financial statement audit. Nevertheless, a more comprehensive exploration of the influence of culture on the effective prevention and detection of fraud would be very beneficial in ISA 240, as it is currently touched on only briefly in that standard. We further note that ISA 300 does not mention culture in planning an audit, which could be addressed in future updates by the IAASB. In contrast, understanding the entity's culture and management's commitment to integrity and ethical values is covered in the recently revised ISA 315 *Identifying and Assessing the Risks of Material Misstatement.*

   If culture is to be meaningfully assured, we suggest that it would be more effectively addressed as part of a separate assurance engagement on internal controls, rather than specific additional procedures within the audit. Although it is not the role of the IAASB to mandate such an engagement, as noted in answer to question 1(b), a standard on assurance engagements specific to controls would be helpful.

2. **Page 18: 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.**

   Whilst there is much to be learnt from the experiences of forensic accountants and others engaged in investigating suspected or detected fraud, we do not support mandatory inclusion of such specialists in audit teams. Such specialists do have a place in raising awareness of fraud risks and sharing the modus operandi of fraudsters with auditors. However, usually the forensic accountant is engaged when a fraud is suspected or identified, and so they are tasked with determining whether a fraud has been perpetrated, determining the extent of the fraud, finding and preserving the evidence in a manner admissible in court, which is typically very targeted and involves intensive scrutiny. Whilst there are parallels, they are different disciplines with different scopes and parameters. As with the engagement of other experts, it should be left to the engagement partner's discretion as to when and whether a forensic accountant's expertise is required on any particular engagement.

   Nevertheless, we consider that understanding the fraud risks relevant to the industries and environments in which audited entities operate and methods by which frauds may be perpetrated are critical for external auditors. Such knowledge needs to be part of the education gained by auditors in university, through professional membership and on-going professional development, as well as experience gained in audits and from audit team leadership. This is certainly an area where there may be scope for enhancement and where the experience and observations of forensic accountants are most relevant.

In addition, we consider that there is a need for a more co-ordinated approach to collation of fraud cases to share with auditors and entities, so they can better understand the methods employed to perpetrate fraud. This would assist auditors by raising awareness of how frauds are being perpetrated and emerging fraud risks, which would be considered in planning their audit procedures. It would also be beneficial for entities, which are on the front line of fraud prevention and detection, to inform adjustments to internal controls and processes necessary to respond to evolving fraud risks and to better identify red flags. Such a role may be fulfilled by national regulators, government bodies or indeed the IAASB itself.

3. **Page 19: 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.**

We do not consider that auditors procedures should be extended to detecting non-material fraud per se, due to the likelihood that it would not pass a cost-benefit assessment. Not only are non-material frauds not easily identifiable without a significant increase in work effort and reduction in materiality thresholds, but the very nature of fraud, which can include concealment, collusion and deception, can mean it evades discovery. However, non-material fraud identified is still of interest and relevance to the auditor as it may impact their risk assessment if it is indicative of undetected fraud or systematic control weaknesses which may enable further fraud to be perpetuated and escalated in the future. Fraud which is quantitatively non-material may have qualitative impacts, such as reputational damage, loss of confidence in the entity or an undermining of corporate culture, which need to be considered. Further application material could be included in ISA 240 regarding these considerations.

We note that other types of engagements are likely to be more effective in preventing and detecting fraud. An assurance engagement on the effectiveness of the entity's internal controls over financial reporting is helpful in reducing fraud risks. However, more directly targeted at material and non-material fraud would be an assurance engagement on management's assessment of fraud risks and their response.

4. **Page 19: 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 severely negative impact on the entity (e.g., cybercrime attacks).**

There are many types of third party fraud which cannot reasonably be expected to be detected by the auditor. Therefore, it is important that the types of fraud that the auditor is expected to consider are clearly defined. Not all frauds impact the financial statements and third-party fraud such a cybercrime may not have an immediate or measurable financial impact, however, increased expertise in technology is necessary to understand the implications of such crimes. If such fraud is detected, the auditor will need to engage the relevant expertise to assess the impacts. Guidance for auditors in recognising when they require that expertise may be beneficial, although increasingly, audit teams are likely to need that IT expertise themselves.

Whilst broad third-party fraud risks can reasonably be expected to be considered by the auditor at a high level, we do not consider that the auditor can conduct an in-depth assessment of third party fraud risk. A more specific targeted engagement is required to address those risks.

5. **Page 20: 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.**

We consider that the engagement quality control review will already consider whether the auditor has met the requirements of the standards so there should be no need for further requirements for the EQCR specifically on fraud, beyond those already reflected in the ISAs.

6. **Page 23: 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.**

In Australia the auditor's going concern assessment extends for approximately twelve months from the date of the auditor's current report to the expected date of the next auditor's report, which is longer than the period required in ISA 570. The IAASB could consider similarly extending the period for going concern assessments to this extent. However, we would not recommend further extension beyond that time horizon. We consider that the going concern assessment per se becomes of dubious benefit beyond that period as there is increasing uncertainty regarding future outcomes the further into the future the assessment is required.

Nevertheless, a management statement regarding future viability of the entity could be subject to an assurance engagement to the extent of the assumptions and data underlying management's assessment of the future viability of the business and their risk assessment regarding the factors which will impact that viability. Regardless of the contents of any such assured statement, there are no guarantees that the outcomes expected will be achieved as the future is unpredictable.

7. **Page 24: whether changes are needed with regard to going concern and other concepts of resilience (within the purview of the IAASB's remit).**

Whilst we consider that going concern assessments are adequately addressed in the standards, there may be increasing appetite for assurance on resilience or viability of the entity. However, we suggest that any such assurance would need to be over the assumptions and data underpinning management's or TCWG's statement of resilience or viability. At a minimum, it would be considered as "other information" as part of the annual report. Changes in this regard could be led by the reporting framework or national legislation requiring such a statement, or encouragement that such statements be provided voluntarily and which may be assured.

8. **Page 25: 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.**

We query whether users understand the variety of different paragraphs which may be contained within the auditor's report. In particular, we understand that the difference between KAM and MURGC, and particularly their relative importance or severity, may not be well understood by users. We suggest that consideration be given to either combining KAM and MURGC so that if a MURGC exists it will always be a KAM or allowing both paragraphs to be used for the same matter with cross-references, as KAMs contain greater detail regarding the uncertainty.

9. Page 25: 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.

The international accounting (financial reporting) standards are not aligned to the auditing standards in this regard. We note that the NZASB is addressing this anomaly by amending their standards to align with the auditing standards, which are more fulsome. We suggest that the IASB be encouraged to do likewise, as the reporting framework defined by the accounting standards. should provide the criteria for the audit rather than the auditing standards addressing omissions in the reporting framework.

10. Page 27: whether more is needed related to professional skepticism when undertaking procedures with regard to fraud and going concern and what additional procedures, if any, may be appropriate.

The need for professional scepticism is raised adequately in ISA 240, although the requirement *"Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine"* suggests a lower threshold of scepticism than that which should be applied. Therefore, we suggest strengthening this requirement.

Professional scepticism is not raised in ISA 570, whereas the going concern assessment is an area where we would expect the auditor to explicitly exercise scepticism. Management and TCWG may be more optimistic about the entity's future prospects than an external party would be and so we suggest additional requirements be incorporated into ISA 570 regarding the need to exercise professional scepticism. This could be addressed, for example, by requiring consideration of the inherent bias which may influence management's and TCWG's judgements in assessing whether the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

11. Page 29: whether more information is needed in the auditor's report regarding fraud or going concern, and if so, further details about the transparency needed.

We do not see the need for additional wording in the auditor's report regarding the consideration of fraud or going concern where there is no impact to report. In this case the wording would become boilerplate and not provide much information value to users. However, where a MURGC is reported, we suggest that the MURGC paragraph in the auditor's report either reflect the same level of detail as would be contained in a KAM, or a KAM on the MURGC be permitted in addition to the MURGC paragraph to indicate the importance of the uncertainty.

12. Page 29: whether more transparency is needed with regard to communications with those charged with governance.

Not all communications between the auditor and TCWG need to be transparent to users as many matters will be resolved prior to the auditor's report being issued. Unresolved matters may be raised as a qualification in the auditor's report if needed. We are not aware of further need for requirements regarding transparency between the auditor and TCWG, as we believe this is adequately accommodated in the current standards.